

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

March 2010

The Ministry is keen to test some initial thinking on the detailed aspects ... that will flesh out the bare bones of the AML/CFT Act.

A long-awaited upgrade of New Zealand's Anti-Money Laundering (AML) law was finally passed by Parliament late last year. But although this is one of the most far-reaching pieces of law reform to hit the financial sector in recent years, it remains an over-arching framework only – it is not yet properly in force, and a lot of specific detail is still to be developed for particular sectors via subsidiary regulations and guidelines.

Now the 'rubber' is starting to hit the road, with the Ministry of Justice starting to develop those details in a consultation paper covering the specific AML regime likely to apply to regulated 'reporting entities'. The Ministry and the other supervising agencies are keen "to test some initial thinking with industry" on the matters that will find their way into the detailed aspects of the regime: the regulations, codes of practice and guidelines that will flesh out the bare bones of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (*AML/CFT Act*).

This article recaps the essentials of New Zealand's new AML framework, and then examines some key aspects of the Ministry's detailed proposals, which are available at www.justice.govt.nz. Submissions can be made by 19 March 2010.

Recap of New Zealand's AML essentials

The AML/CFT Act has been driven largely by 'international peer pressure', to ensure New Zealand's AML regime does not fall behind global best practice when it comes to combating financial crime and terrorist funding activities.

Global best practice is espoused by the internationally recognised 40+9 recommendations of the Financial Action Task Force (*FATF*). New Zealand's previous law, the Financial Transactions Reporting Act 1996 (*FTRA*), was not in full compliance with those recommendations, although it will be retained on a transitional basis. Significant changes were considered necessary to toughen up the obligations applying to regulated firms, to broaden the scope of industries covered, and to bring our AML regime up to a compliant state.

The new measures are also intended to operate alongside the Terrorism Suppression Act 2002, and the new Criminal Proceeds (Recovery) Act 2009, which enhances court action for forfeiture or recovery of the proceeds of crime. Together, these laws are part of a toughening stance by New Zealand on the use of the financial system to facilitate criminal activities, and on organised crime and drug-dealing more generally. It reflects a desire not just to ensure New Zealand is up to pace with leading international AML regimes, but also to recognise that there are domestic examples of money laundering which deserve attention as well.

The key AML/CFT obligations that will fall upon reporting entities include:

- Requirements to establish, implement, maintain and regularly audit an AML/CFT programme and risk assessment policies
- More onerous Customer Due Diligence (*CDD*) measures, especially when starting a business relationship or an occasional transaction



NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

No one could accuse the AML/CFT Act of being a rushed job ... and implementation of the bulk of the requirements is not expected until October 2011.

- Enhanced due diligence measures in some situations, transactions, business relationships or customer groups – such as for 'politically exposed persons' (*PEPS*) who are prominent foreign public individuals
- Ongoing account and transaction monitoring requirements
- Retaining details for account and transactions records for 5 years
- More systematic obligations to make Suspicious Transaction Reports (*STRs*) to the New Zealand Police Financial Intelligence Unit (*FIU*)
- Implement an AML/CFT compliance programme, with an appointed compliance officer, and vet and train staff.

Who is affected?	
Tranche 1 (about October 2011) Banks Casinos Finance companies, building societies, other deposit-takers Lenders and factoring and financial leasing firms Fund managers & trust companies Credit unions Credit/debit card companies Securities issue participants & exchanges Currency remitters & money changers Life & investment insurers Financial, currency, commodity traders and sharebrokers Collective investment schemes Other financial institutions & advisers	Tranche 2 (probably 2012 ?) Accountants Real estate agents Conveyancers & land brokers Lawyers TAB & racing/gaming activities Jewellers, bullion & precious metal dealers <i>Potentially</i> , retailers & auctioneers dealing in luxury cars, yachts, & artworks

Reforms will be phased in over time

No-one could accuse the AML/CFT Act of being a rushed job: government officials have been consulting on the topic since 2003, most of our leading trading partners already have a strict AML regime in place, and implementation of the bulk of the requirements is not expected for some 2 years after passage of the Act (ie approximately October 2011).

The detailed Ministry paper now released is the first serious step down the road to implementation, which will proceed in two phases for the different sectoral groups that will be covered by the new requirements:

- Phase 1: banks, casinos, life insurers and almost all types of financial institutions
- Phase 2: other sectors such as lawyers, accountants, real estate agents and luxury asset dealers.

Phase 1 businesses are covered by the new law, once the relevant parts of it come into force, and are the focus of the proposed regulations in the Ministry paper. After further consultation, coverage will be extended to Phase 2 businesses over the next couple of years.

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

Main aspects on which the Ministry is now seeking feedback

The Ministry document covers a range of areas that are highly relevant to firms who are (or should be) currently planning the necessary system and organisational changes needed to ensure compliance in 2011. As well as the implementation timeframes, noted above, the main areas highlighted here are:

- A possible extension of coverage
- Exemptions
- Threshold values
- Areas allowing reduced customer due diligence
- Identity verification as part of Know Your Customer (KYC) processes
- Enhanced due diligence or risk assessment for trusts, beneficial ownership structures, and private banking
- Reliance on third party relationships, and Institutional or Group arrangements, for due diligence.

Possible extension of coverage?

Tucked away in the middle of the 'Exemption' section is the suggestion of a potentially significant expansion of scope of the AML regime in Phase 2, outside of the core area of the banking, gambling and financial services sector. It has long been expected that dealers in some physical investment products such as bullion or precious metals and stones would be covered. Now comes confirmation that dealers, retailers and auctioneers of other high value luxury assets, works of art, cars and yachts) may be included in Phase 2.

On the one hand, this is a sensible closing of a gap, since money launderers and local drug barons may well have a penchant for luxury boats, motor vehicle and art investments. On the other hand, it could represent a major extension of the scope of coverage into pure retail businesses, which may prove controversial.

Exemptions

The very broad scope of AML/CFT Act means that a number of exemptions will be needed to ensure some low-risk or unintended activities are not caught. We could, over time, end up with a regime somewhat like the Securities Act, with ongoing ad hoc exemption notices being issued regularly.

Part of the difficulty for affected firms to date has been that the AML/CFT Act is in many places just a general skeleton of the regime, with the details that really impact on operations and implementation planning still being developed. For example, section 154 of the Act allows a general power for Regulations to be made giving exemptions for some transactions, products, services, or customer relationships (and s157 also allows a Minister of Cabinet to grant other ad hoc exemptions). Under that general umbrella, this discussion document is now a real opportunity for firms to examine the specific areas where Ministry officials are contemplating allowing exemptions.

An obvious, non-controversial exemption is for businesses that are not meant to be covered until Phase 2 (eg lawyers and accountants), where a small minority of their dealings may be caught already. A temporary or transitional exemption will apply until Phase 2 kicks in, and similar ones are proposed for pawnbrokers and market futures and derivatives trading in some commodities (electricity, climate change carbon credits, and fishing quota).

An ironic illustration of the breadth of the AML/CFT Act is that several government agencies will be caught due to some of their public banking,

There is suggestion of a potentially significant expansion of scope of the AML regime in Phase 2 ... to dealers, retailers, auctioneers of other high value luxury assets, works of art, cars and yachts.

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

treasury or funds activities – including the Reserve Bank of New Zealand itself. So, the regulators propose, quite sensibly, to exempt one of their own (the Reserve Bank) and other such agencies.

Other exemptions are being considered for occasional activities carried out on a very limited basis, and for low risk products and services. This could include some securities issues, such as employee shares schemes or government agency derivatives or options, and also pure risk-based life insurance. This will be pleasing for the life insurance industry, which lobbied unsuccessfully for an exemption in the AML/CFT Act. The reasoning is that a policy payable only on a specified risk occurring (eg death or disablement) is a much lower AML risk than other investment oriented or annuity income products. Pure life or funeral policies are likely to be exempt – although insurers will still be covered by the AML regime, where they offer bundled or 'universal' benefits products.

Threshold values where compliance or customer due diligence kicks in

In certain situations an occasional transaction outside of a normal business relationship will trigger Customer Due Diligence obligations, if it is over a dollar threshold value. Currently, under the FTRA this value is NZ\$10,000 (and has been for years); in Australia it is A\$10,000. The Ministry suggestion is to retain the status quo or to set a threshold of \$12,500, which is approximately the NZ currency equivalent of Australia. However, since the relevant FATF recommendation suggests it could be up to a maximum of €15,000 or US\$15,000, it is not immediately clear why a higher value of NZ\$15,000 (or even \$20,000) should not be acceptable at present exchange rates – this may reduce compliance costs, yet still be FATF-compliant.

Stored value cards and products are likely to be added to the scope of coverage, as 'bearer negotiable instruments', but subject to a sort of 'de minimis' threshold. This may be \$1,000 per transaction (or \$10,000 annually) for cards redeemable for cash; or higher at \$2,500 is suitable for cards where cash cannot be withdrawn, eg popular store gift cards for some retail chains.

Other thresholds are suggested for casino transactions, travellers cheques, money orders, postal orders and currency exchange operations.

Areas allowing reduced customer due diligence

The regulators recognise that it may be unduly onerous to subject certain types of business, or types of financial activity, to the full due diligence obligations of the AML/CFT Act. So partial exemptions are suggested to ease certain obligations, while ensuring that firms are still covered by the rest of the Act. The main proposals are that full CDD will not apply to:

- Debt collection activities, which often have limited 'customer' information and are usually chasing 'customers' who are not keen to provide any information voluntarily
- Low value life insurance products with premium payments under certain thresholds, or covering consumer credit default, until the point where they are to be cashed out
- Insurance policies that are now closed to new customers or premiums
- Non-bank deposit takers that are now in moratorium or being wound-up (what might be termed a 'failed finance company' exemption)
- Workplace superannuation schemes established under statute, with a New Zealand based manager who has good access to employee identity data, and with limits on transferability of the scheme benefits.
- Low value superannuation funds, perhaps less than \$1000, and certain overseas pension special bank accounts



An exemption for pure risk-based life insurance ... will be pleasing for the life insurance industry

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

- Special remittance card facilities, especially for low value money remittances to some Pacific Island nations
- Casinos, where customer address verification may not be necessary, given the huge number of tourist and transient visitors having an occasional one-off flutter at a casino
- Wire transfers under \$1000, or purely domestic transfers, at least in relation to some identity and originator information requirements.

Identity verification as part of Know Your Customer (KYC) processes

Could it be that use of the driver's licence as a time-honoured traditional Kiwi form of identification (*ID*), is on the way out? The discussion paper tackles the tricky subject of what amounts to appropriate identity verification, to ensure sufficient due diligence before commencing a customer relationship or occasional transaction.

Certain forms of ID are usually taken as being 'primary identification documents' under the Department of Internal Affairs' standard guidance document for such things. Those documents are a Passport, Citizenship Certificate or Certificate of Identity, Birth Certificate, Emergency or Refugee Travel document and a Firearms licence.

The humble driver licence only appears on the list of 'secondary documents' that meet some of the key verification objectives but are not as reliable in all respects. There are well-known issues with veracity of some driver licences, and it is proposed that it should not be the sole or primary form of ID for regulated entities, except in low to moderate risk conditions. Those conditions may be developed further in a code of practice, but eventually customers of reporting entities may have to get in the habit of carrying their passport more regularly for financial ID purposes.

Enhanced due diligence or scrutiny for trusts, beneficial ownership structures, and private banking?

The AML/CFT Act requires CDD not only on a customer, but on any beneficial owner of a customer (section 11). Further, section 22 requires 'Enhanced Due Diligence' for customers that are trusts or nominee companies. A particular concern in the financial community has been how these proposals will affect trusts? Kiwis sure love their family trusts and together with commercial, iwi and trading trusts New Zealand has a relatively high proportion of property ownership through trust structures.

FATF completed its member Mutual Evaluation of New Zealand in October 2009 and noted ongoing issues with lack of transparency around widespread use of trusts. Comment has been therefore keenly awaited from the regulators on the likely degree of checking that will be needed to ascertain the real beneficial owners of a trust – and in particular where the beneficiaries may be discretionary, or currently an indeterminate class of persons.

'Beneficial owner' means the individual who has effective control of the corporate customer, or owns at least a prescribed threshold amount of the customer. The discussion paper examines where that threshold amount should be set, and outlines a range of options from 20% to 25%, to 50% control. The Ministry appears to favour the 25% threshold, which is consistent with Australia and the UK, but it is open to submissions on the issue.

More helpfully, a regulation is likely to allow entities to stop at identifying, but not necessarily verifying, the name and date of birth of trust beneficiaries, and

Could it be that use of the driver's licence as a time-honoured traditional Kiwi form of identification, is on the way out?

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

for trusts with large numbers of beneficiaries, to identify the first 10 and then describe the rest by class or category of beneficiary instead.

On a related note, the discussion paper identifies private banking services, usually offered to high net-worth individuals on a very personalised and confidential basis, as an area that should be explicitly one that a reporting entity's risk-based AML assessment must pay close attention to.

The famously discrete Swiss banking services are probably the archetype of this form of customer service, and the increased scrutiny on such secret accounts that is currently being brought to bear by the USA is a major controversy in Swiss financial circles. Whether the same issues lurk behind the current Ministry proposal is hard to say, but it does seem likely that a code of practice dealing specifically with private banking confidentiality and anonymity issues will be a sensible development in due course.

Reliance on third party relationships, or a Group, for due diligence

Within any modern financial system there is usually a complex chain of entities managing a transaction, often only as intermediaries acting on behalf of a customer or another bank. There is the vexed question of to what extent they can rely on somebody else in the chain carrying out the full rigorous CDD, especially where there are pooled, omnibus or nominee accounts with little information about the underlying customer pool.

The main proposal is that firms seeking to rely on a third party intermediary must still carry out CDD on the intermediary itself, but may be able to rely on that intermediary to do CDD on the underlying customers (and be exempt from account monitoring and record keeping obligations) if certain conditions are met. The likely conditions would be that the intermediary must be itself regulated and supervised under the AML regime, and have adequate measures in place to ensure it complies with the AML/CFT Act, and may have to confirm in writing that it has done full CDD on the underlying customers.

On a similar theme to third-party reliance, it is common and efficient to find entities within a corporate group relying on each other for various information and compliance checking, especially within Australasia given the high degree of trans-Tasman integration in our financial sector. The AML/CFT Act allows (in section 32) reliance on other members of a Designated Business Group (as defined) for several shared functions. There is the ability to expand the definition of a Designated Business Group via regulations, and the Ministry is considering whether to include agents, sub-networks, and retail outlets of international wire transfer businesses (eg Western Union) as a 'group'.

Remaining loose ends

The enforcement model for New Zealand has been built around use of several existing regulatory agencies, rather than one specialist body (as with AUSTRAC in Australia). This was developed in the belief it would reduce costs to use bodies that already perform other regulatory functions for an industry group, and had established expertise and relationships with that sector.

However, the Select Committee in 2009 was highly critical of this decision, noting a preference for a single-regulator model, and the problem of much greater inter-agency liaison that might be required to ensure consistency of approach and avoid differing enforcement approaches developing between the regulated sectors. Nobody yet, at policy-making level, appears to have

The Ministry suggests private banking should be explicitly an area that a reporting entity's risk-based AML assessment must pay close attention to.

NEW ZEALAND'S ANTI-MONEY LAUNDERING LAW: NOW THE RUBBER HITS THE ROAD

clearly outlined how this will work, other than assurances that the supervisors will co-ordinate and liaise closely to ensure consistency.

A collaborative approach towards implementation, while still taking compliance seriously

At the time the AML/CFT Act was passed, Government agencies and regulators were urged by the Select Committee (and submitters) to adopt a collaborative approach to implementation. The Minister of Justice, Simon Power, said in Parliament then:

"In the first instance the bill obliges supervisors to engage in education, awareness raising, and guidance at the higher end. Supervisors may issue formal warnings and accept enforceable undertakings or inflate civil or criminal proceedings. The bill recognises that in extreme cases it may be necessary to take court actions against businesses that do not comply with their obligations."

Wilson Harle has legal expertise in a wide range of fraud, AML/CFT and white-collar crime issues.

We are the sole New Zealand law firm representative in the International Chamber of Commerce *Fraudnet* group. We have been active in advising on the new AML/CFT law, and in establishing a branch of the ACAMS (Association of Certified Anti-Money Laundering Specialists) group in New Zealand.

Contacts:

Gary Hughes
gary.hughes@wilsonharle.com
DDI: +64-9-915 9726
Mob: + 64-21-477 780

Chris Browne
chris.browne@wilsonharle.com
DDI: +64-9-915 5705
Mob: + 64-21-617 007

Pleasingly, the agencies have taken this on board, and there will be a series of further discussion and consultation work-streams over the detailed Regulations and Codes, as well as National and Sectoral risk assessments and typologies.

Collaborative or not, there is no way of avoiding a costly transition for New Zealand businesses, but on the other hand complacency about money-laundering or the increasing sophistication of criminal and terrorist elements would prove equally damaging in the long term. As an example, in January 2010 there was widespread media coverage of an Auckland address being used as a registered office for nearly 2500 shell or overseas companies via a 'virtual' office or address. The story was picked up by international media, who linked some of the companies to drug-money laundering and breach of international trading sanctions on weapons dealing. Prime Minister John Key was moved to express his concern about damage to our international financial reputation - as well he might; too many incidents like this could have real impact on perceptions of the credibility of our financial markets.

When finally operational, the AML/CFT Act will carry plenty of potential to bite reporting entities. There is a mix of civil liability provisions and criminal offences, with differing levels of potential penalties - in some instances up to NZ\$300,000 for individuals or NZ\$5 million for corporations. While reporting entities have the flexibility to apply a 'risk based approach', the lead time of 2 years for implementation is going to be necessary, to enable both reporting entities and the multiple regulators time to develop their approach and get the required systems and capabilities in order.

The Ministry document now helps fill in some of the details as to minimum levels of compliance expected within the broad rules - while still facilitating individual firm and sector discretion based on the prevailing level of risk of their customer base. Affected businesses should grasp this opportunity to engage with their new regulators on the detail.