NEW ZEALAND
BANKERS ASSOCIATION

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Dear Kirsty

Draft Factsheet on Managing Intermediaries

Thank you for the opportunity to comment on the draft Factsheet on Managing Intermediaries. Applying the AML/CFT Act to "managing intermediaries" that are also reporting entities is a challenge for banks, and the industry is grateful for the draft guidance. On behalf of the industry NZBA would like to raise a few matters in relation to the draft proposals.

Policy position

Generally, NZBA believes that as a matter of policy, where a managing intermediary is itself a reporting entity and conducts CDD, the other reporting entities involved in a business relationship with the intermediary should not have an obligation to separately conduct CDD. For example, where a bank has a managed fund as its customer, the duty to conduct CDD on investors in the managed fund should only fall on the fund.

This position makes sense for two reasons. The first is that the managing intermediary is separately supervised by an AML Supervisor. If the managing intermediary fails to comply with the legislation, it will have failed in its obligations as a reporting entity. Given the consequences of such a failure, and the fact that the managing intermediary is separately supervised, it is reasonable for other reporting entities involved in a business relationship with the intermediary to be relieved of duplicate compliance obligations.

Secondly, in such cases such as a managed fund who is a client of a bank, the managing intermediary (i.e. the fund) is in the best position to carry out CDD given they have a direct relationship with the investors. In many cases the reporting entity (i.e. the bank) will not have a direct relationship with the investor, making conducting CDD difficult.

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The proposed change would reduce unnecessary compliance cost while not diminishing the effect of the legislation and the objective of removing anonymity and mitigating risk of money laundering/financing terrorism. We understand that such a change may require legislative change or guidance from the AML Supervisors, but believe that it is an important matter which needs to be raised.

Beneficial ownership and duplication of CDD for banks dealing with managed funds

The Factsheet as currently drafted treats transactions conducted by a managed fund as being conducted "on behalf of" the underlying investors of the fund. Under this approach, from the point of view of a bank dealing with a managed fund, the fund manager will be treated as a "managing intermediary" and the investors are "beneficial owners".

Similarly, the Factsheet states that where the managed fund has an account or arrangement in their name the fund is considered to be a customer of the reporting entity. It is common practice for a fund to have a named arrangement however instructions will only be received from the fund manager.

Under both arrangements the implication is that the bank will have CDD obligations in respect of the underlying investors in the managed fund where they are customers of the fund under the AML/CFT Act. NZBA disagrees with the interpretation of beneficial ownership contained in the Factsheet and submits that there is no benefit, from a public policy perspective, in adopting this interpretation.

When a fund manager is carrying out transactions it is doing so on behalf of the fund for which it is appointed to manager, not on behalf of the individual investors into the fund. Under such an arrangement the fund/fund manager is in effect the bank's customer for AML/CFT compliance purposes, and not the underlying investors. Thus, NZBA submits that a bank should only be required to conduct CDD on those persons who have effective control or ownership of the fund/fund manager. There is no greater protection against money laundering from the bank undertaking CDD on the underlying investors as they have already been identified by the fund, and don't have any input into how the fund invests. As such, the individual investors should not be considered beneficial owners of the fund manager, and additional CDD requirements should not apply.

NZBA submits that the proposals in the Factsheet need to be amended. NZBA disagrees with the guidance that every reporting entity involved with managed funds' products will have CDD obligations. The Factsheet recognises that a reporting entity may appoint another person as agent to conduct CDD and contemplates that this may offer a practical method of achieving compliance (including through the use of a "chain" of agents). This is not, however, a practical solution due to the complexity that such a chain of agents creates. This creates a situation of conflict for banks. A bank would need to conduct thorough due diligence on a fund manager's AML/CFT compliance programme (on a regular basis) to ensure that the fund manager is managing the compliance obligations adequately on the bank's behalf. This will create unnecessary tension between the bank and the fund manager, and essentially turn the bank into a quasi-regulator. In putting in place agency agreements to meet AML/CFT Act obligations the banks are in effect "supervising" their customers as reporting entities. This should be the role of the supervisor.

To further illustrate why this agency model is flawed in practice, the fund manager (as agent for bank) will simply be carrying out CDD on investors to the standards contemplated by its own AML/CFT compliance procedures. The fund manager will have already conducted such CDD on the investor at the time of establishing a business relationship with the investor. As such, there will be nothing additional for the fund manager to do (on a bank's behalf) beyond the CDD it has already completed on investors in a fund. We therefore question the public benefit in having another reporting entity (e.g. a bank) having a duplicate responsibility to conduct CDD on investors in a managed fund, when no additional checks would in fact be completed. This is particularly unnecessary given the burden of entering into and monitoring agency agreements.

Fundamentally, in the case of managed funds, the fund manager is a reporting entity and has obligations to ensure CDD is conducted on investors where they are customers of the fund under the AML/CFT Act. It should be enough for the fund manager to have the obligation to carry out CDD on investors in a fund. NZBA submits that there is no benefit (i.e. no additional money laundering protections created) in imposing a duplicate set of CDD obligations on other reporting entities in a managed funds structure.

This position is supported by established precedent in the UK. The Joint Money Laundering Steering Group Guidance (Part II Sectoral Guidance at 20.28) states that where a reporting entity has a customer relationship with the fund manager and the fund manager is regulated, "there is no duty to identify the underlying customer (i.e. the fund and its relevant investors (if any))".

Furthermore, where "the firm [reporting entity] does not have a customer relationship with the Fund and receives instructions only from the investment manager [fund manager]. The firm [reporting entity] is able to perform simplified due diligence (CDD) on the investment manager [fund manager], subject to which it is not under any obligation to undertake CDD on the fund".

Based on the UK precedent, and the strong arguments for streamlining the requirements to reduce unnecessary duplication and compliance burden, NZBA supports a change (by regulation or guidance) that would allow banks to place reliance solely on the fund manager conducting CDD on investors, without any obligation to further verify this information.

Additional challenges for entities with Simplified CDD

An additional issue arises where a reporting entity is dealing with a managed fund that is operated by a government entity or an entity that otherwise qualifies for simplified customer CDD. Where a bank has such a customer, simplified CDD applies which means, amongst other things, that there is no need to look through to the beneficial owners. Under the draft guidance, where the fund is considered to be a customer of the bank, standard CDD (including the requirement to look through to the beneficial owners) applies.

This changes the CDD obligations for such customers, imposing a much higher burden on banks. NZBA believes that in cases where there has been a policy decision to apply simplified CDD to certain entities, they should similarly be excluded from the standard CDD obligations for funds that they operate.

Scope of the obligations

NZBA is of the view that the obligation to carry out CDD should be limited to "occasional transactions" and not all transactions. This position is based on FATF Recommendation 10 which clearly outlines when CDD should be conducted: establishing business relations, carrying out occasional transactions; suspicion of money laundering; doubts about adequacy of previously obtained customer ID information. Recommendation 10 does not refer to all transactions in general requiring CDD. FATF's intention was that the word "transaction" (in the context of defining a "beneficial owner") is limited to an "occasional transaction", and as such the obligations should be limited to these transactions.

In the context of managed funds, there are unlikely to ever be a large number of occasional transactions (if any) and thus under a narrower scope the burden of conducting CDD is likely to be minimal. Applying the CDD obligations to all transitions considerably increases the burden on reporting entities. This extension is not necessary, and goes beyond what the FATF report anticipated. As such, NZBA submits that the obligation should be reduced to only cover occasional transactions.

Next steps

NZBA requests that the Factsheet is amended to take into account the issues raised in this submission. Alternatively, if it is considered that further regulation is warranted to address the issues raised in this submission, NZBA would support such regulation. In addition, we would welcome the opportunity to meet with you and/or Officials to discuss our concerns with the draft Factsheet prior to final guidance/regulation being issued to the market.

If you have any questions regarding this submission please do not hesitate to contact me.

Yours sincerely

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