SUBMISSION TO

MINISTRY OF JUSTICE

ON

DRAFT ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM BILL

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SUBMISSION BY THE NEW ZEALAND BANKERS' ASSOCIATION TO THE MINISTRY OF JUSTICE ON DRAFT ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM BILL (Draft Bill)

INTRODUCTION

1. This submission on the Draft Bill is the collective view of the Association being the following eight member banks:

   - ANZ National Bank Limited
   - ASB Bank Limited
   - Bank of New Zealand
   - Citibank NA
   - The Hongkong and Shanghai Banking Corporation Limited
   - Kiwibank Limited
   - TSB Bank Limited
   - Westpac Banking Corporation (New Zealand division)

2. The Association welcomes this opportunity to comment on the Draft Bill and strongly supports the Ministry's statement[1] that the government is committed to working with industry to ensure that the [anti-money laundering ("AML") and countering the financing of terrorism ("CFT")] regime is:
   - effective in detecting and deterring money laundering at minimum cost to industry;
   - a best fit to New Zealand's institutional environment; and
   - to the greatest extent possible aligns with the Australian AML regime.

3. The Association is comfortable with the progress made in relation to the AML/CFT proposals. Several key Association concerns about earlier FATF IWG proposals appear to have been addressed in the Draft Bill including:
   - restricted application of customer due diligence CDD) to existing customers [paras 47-52];
   - removal of cheque deposits from the definition of occasional transactions [paras 18-20]; and
   - exclusion of domestic PEPs from enhanced due diligence duties [para 74].

[1] Letter from the Ministry of Justice to Stakeholders about the Bill dated 16 September 2008

4. Nevertheless the Association has identified several AML/CFT requirements in the Draft Bill that may be unworkable and disproportionate ie costly for member banks to implement and disruptive for the vast majority of law abiding customers but likely ineffective in detecting and deterring money laundering. The Association would like to work with officials over the next few months to fine-tune these proposed requirements before the Bill is introduced next year. In particular the Association would like to work with officials on the following suggestions in the following submission:

    - clarification of the meaning of beneficial owner [paras 8 - 14];
    - separate standard CDD for occasional transactions [paras 15-17];
    - elimination from the Draft Bill (or restriction) of the proposed duties to:
        - verify the identity and authority to act of those acting on behalf of a customer at 8(1)(c) [paras 23 -46]; and
        - conduct enhanced due diligence on PEPs conducting occasional transactions [paras 70 –73]; and
    - a new stand-alone clause on timing of CDD to accommodate normal banking business and FATF requirements [paras 53 –66].

5. Given the short time frame for response, this submission focuses on high level operational issues but the Association has not fully considered the:

    - implications of the penalties at Part 3;
    - balance in the Draft Bill between risk management and prescription and formed a single collective view (although some individual member's views are noted at para 6); or
    - detailed drafting including the definitions and their implications

    and the opportunity to provide further input on these points prior to the introduction of the Bill would be appreciated together with any other points that come to light after this submission is lodged.

RISK BASED APPROACH

6. At this stage members have differing views as to how the Draft Bill implements the risk based approach promoted by FATF. One member notes that while the Draft Bill is slightly more prescriptive than the equivalent Australian AML/CFT legislation, the Draft Bill generally establishes clear minimum standards and still provides reporting entities with sufficient flexibility to tailor their AML/CFT programme, without imposing overly prescriptive, unworkable requirements. On the other hand two members believe that the Draft Bill is overly prescriptive. A second member notes: "*While the draft AML/CFT Bill purports to adopt a risk based approach, it too frequently reverts to prescription in relation to a number of key issues. Accordingly, the draft Bill is closer to the US style legislation as opposed to the Australian legislation that allows for a more flexible approach in managing money laundering and terrorism financing risks."* A third member bank notes: "*Overseas experience and commonsense indicates a "risk-based" approach is paramount for any proposed AML/CFT legislation… and that an unthinking prescriptive approach (as encapsulated in the current Draft [Bill]) is inappropriate… The current proposal appears to be at variance with a very practical (and FATF sanctioned) risk-based approach."*

TRANSITION PERIOD

7. The Association supports:

- an implementation period of at least 2 years, so that the Act and *regulations* come into force 2 years after enactment. It is difficult to operationalise legislation where regulations have not been completed. This was the experience in Australia significantly increasing the costs of implementation. The shorter the implementation period the greater the cost burden on industry and (given the changes required to existing IT systems and the expected significant competition for resources) the less likely it will be that reporting entities, particularly smaller entities, will be able to obtain the necessary resources to undertake the necessary upgrades;

- phased commencement of the obligations – with some of the simpler obligations coming into force earlier than others; and

- no penalty free or assisted compliance period as applied in Australia because of the confusion, uncertainties, competitive issues and unnecessary compliance costs generated.

MEANING OF BENEFICIAL OWNER

Submission

8. The Association submits that the definition of 'beneficial owner' at clause 4 needs clarification to enable member banks to implement it efficiently and reduce disruption to normal banking business.

ULTIMATELY OWNS OR CONTROLS

9. Retention of the currently unrestricted reference to 'ultimately owns or controls' in the Draft Bill will not provide enough certainty for member banks implementing CDD requirements in relation to beneficial owners. The Association submits that the definition needs:

   - refinement to reflect the fact that the nature of beneficial ownership and control of different types of customer will vary for each type of customer; and

   - a materiality threshold in relation to ownership or control.

DIFFERENT TYPES OF CUSTOMER

10. Different types of customer will be owned or controlled in different ways and the 'beneficial owner' definition needs refinement to reflect this. Please see for example the UK Money Laundering Regulations 2007, reg 6, in the attached Schedule which clarifies the meaning of beneficial owner for different types of legal entities and arrangements as well as individuals (eg companies, partnerships and trusts).

11. In relation to (b) of the definition of beneficial owner in the Draft Bill concerning the conduct of transactions, - *the individual who ultimately owns or controls (b) the person on whose behalf a transaction is being conducted,* the person at (b) appears to be a legal person (as a legal person is more likely to be owned or controlled than an individual) rather than an individual. The definition needs refinement and clarification to also clearly capture beneficial owners who are individuals on whose *on whose behalf a transaction is being conducted* [2]

MATERIALITY THRESHOLD

12. Members are currently considering two different materiality thresholds – 50% and 25%. One member currently supports the 25% ownership or control threshold of the entity or arrangement (depending on the nature of the entity/arrangement/person) – as in Australia[3] and the United Kingdom[4] - since it is a fairly standard threshold worldwide.

13. The majority of members support a 50% materiality threshold for the following reasons:

    - the AML/CFT legislation applying in New Zealand needs to be in line with the wider regulatory framework New Zealand applies to the financial sector. A 50% threshold would mirror the definition of "controlling owner" in the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act). Wording with the following intent is suggested for the Draft Bill:

[2] UK Money Laundering Regulations, reg 6(9) and the EU Third Money Laundering Directive which provides 'beneficial owner' means the *natural person(s) who ultimately owns or controls the customer and/or the natural person on whose behalf a transaction or activity is being conducted*;
[3] chapter 1 par 1.2.1 definition of beneficial owner
[4] Money Laundering Regulations 2007, reg 6(1)(a)

"ultimately owns or controls" means an individual beneficially owning, or exercising control for that individual's benefit over, 50% or more of a legal person or arrangement (eg shares, voting rights, or property of an unlisted company, membership of an incorporated society, profits or property in a limited partnership or partnership, beneficiaries of an express trust, or beneficiaries of an arrangement that is in the nature of an implied trust), and where only a class of persons is required to be identified, only ascertain and name the scope of the class;

- a 50% threshold would satisfy the FATF's purpose being to capture those with "hands-on" ownership or control of the entity and prevent the true actor in relation to the entity/transaction from hiding behind others to mask the underlying illicit purpose, or to distance themselves from any illegality;

- the purpose of the 25% threshold, in company legislation at least, is to benefit groups of companies by reducing their financial reporting compliance costs. Application of the 25% threshold to AML/CFT legislation unnecessarily captures those with only an interest in the entity but not ultimate ownership or control;

- they understand that the Australian experience to date is that in the 4 years that banks have vetted customers, they have not had to make any terrorism reports on domestic beneficial owners. There is suggestion that Australia review the 25% threshold for beneficial owners, given the low risk presented (especially for domestic beneficial owners), the affordability and practicality of compliance and the interruption of normal banking business for ordinary Australians. The New Zealand regime should take this experience into account and lead the way by setting a different but more targeted and relevant standard, which other jurisdictions may chose to follow.

14. As the definition of beneficial owner has potentially very significant implications for the way banks do business, the Association wishes to work with the Ministry to develop the definition either in the Act, the regulations, or guidance notes in the light of the approaches and experience in other jurisdictions to provide certainty to member banks implementing the legislation and reduce unnecessary compliance costs.[5]

STANDARD CUSTOMER DUE DILIGENCE

OCCASIONAL TRANSACTIONS

Submission

15. The Association submits that:
    - the Draft Bill separates standard CDD for occasional transactions [paras 16 and 17]; and
    - the Ministry provide the Association with an opportunity to review omitted wording from the Draft Bill to accommodate the Interpretive Note to FATF SRVIIC, before the Bill is introduced to ensure that draft wording does not undermine the efficiency of the domestic payment system [paras 21 and 22].

[5] See also Association submission of 130906, paras 94 – 99.

SEPARATION OF STANDARD CDD REQUIREMENTS

16. The Association submits that the Ministry consider separating standard CDD requirements for 'occasional transactions' from the standard CDD requirements for establishing a business relationship with a new customer. Specifically, the Association submits that the Draft Bill explicitly restrict standard CDD for occasional transactions to the person actually conducting the transaction. Explicit application of the following duties to occasional transactions:

    - conducting full standard CDD on the beneficial owner including verification of identity – sub clause 8(1)(b);

    - conducting full standard CDD on the person who is acting on behalf of a customer and verification of their authority to act – sub clause 8(1)(c); and

    - obtaining information on the purpose and intended nature of the proposed business relationship – sub clause 8(1)(d)

    could create uncertainty for reporting entities implementing the legislation.

17. The practical implications of implementing clause 8 in relation to occasional transactions need considerable thought, however, and the opportunity to work through the issues with officials over the next few months would be appreciated. In the meantime, the Association notes the following points perhaps supporting the separation of standard CDD requirements in relation to occasional transactions and simplifying them:

    - the meaning of 'occasional transaction' under the Draft Bill is much wider than under the Financial Transactions Reporting Act 1996 (FTRA) including every transaction above the applicable threshold except cheque deposits. It appears to include:

        - not just face-to-face transactions such as cashing a cheque, depositing cash into another person's account, or cash withdrawal from an account; but also

        - electronic transactions though an ATM, EFT-POS, or Internet Banking eg a one-off payment via TradeMe;

    - the level of CDD for occasional transactions under the Draft Bill is, however, more onerous than under the FTRA ie sub-clauses 8(1)(b) – (d) – although the presence of cls 8(3) is strongly supported;

    - occasional transactions are immediate in nature and it is completely impractical for member banks in every case to, for example verify the authority to act of the person acting on behalf of a customer "on the basis of documents…obtained from a reliable and independent source" [see further paras]; and

    - sub-clause 8(1)(d) - purpose and intended nature of the proposed business relationship – may need some refinement in relation to occasional transactions.

In terms of how CDD is conducted for occasional transactions in relation to the person conducting the transaction, occasional transactions are a fraud and money laundering business risk for member banks and they face adequate **business** incentives to conduct adequate CDD on the person conducting the transaction. The overlay of prescriptive one-size-fits-all CDD duties under the AML/CFT legislation is unnecessary and, given the significant penalties for non-compliance, disproportionate to those business risks which are already adequately managed. Accordingly, the Association notes that the following appears to be adequate depending on the risk (and would not support prescription of any higher standard):

- for face-to-face transactions, collection of the name of the individual and sighting appropriate identification, eg ID such as a driver license, passport, or credit or debit card. The individual's name and the ID number are recorded on the transaction voucher; and

- for electronic transactions - electronic identification by recording the detail from the card or online account and individual identification either by a PIN (for cards), a personal logon username and password (for online banking). Also, there are transaction and daily limits imposed on certain electronic transactions, eg ATM withdrawals, EFT-POS payments.

SUPPORTS EXCLUSION OF CHEQUE DEPOSITS

18. The Association strongly supports the government's proposal to specifically exclude cheque deposits under the definition of 'occasional transaction' in the Draft Bill. This will reduce compliance costs and customer inconvenience as noted in previous Association submissions on the topic.6

19. This is because branch staff will not know by looking at a person whether that person is a customer (and accordingly ID verified) or not. In practice, **the trigger for occasional transaction CDD is the applicable threshold**, not whether a transaction is 'occasional' or not. Member banks have adopted this simple approach because it is easier:
    - to communicate to front line bank staff; and
    - for bank staff to apply and communicate to customers.

20. If cheque deposits were not excluded, a reporting entity would likely need to conduct CDD on all persons (including customers/non-account holders/non-customers) who conduct **all over the counter transactions** over the applicable threshold (not just those which are occasional transactions) to determine whether the person conducting the transaction is the account holder or not and, accordingly, whether the transaction is occasional or not.

OCCASIONAL TRANSACTIONS AND FATF SRVII

21. The Association notes that the Draft Bill omits reference to:
    - the FATF requirement to conduct CDD when carrying out occasional transactions that are wire transfers in the circumstances covered by Interpretive Note to SRVIIC; and

[6] Submissions dated 130906 on 2nd AML discussion document and 160707 on the 4th AML discussion document.

- the understanding reached between the Association and the Ministry in 2003 on how SRVII would be applied in NZ (particularly in relation to domestic electronic transactions) and formalised in a Cabinet Paper certified by the then Minister dated 13/10/04.

22. It is understood that work in underway within the Ministry to accommodate the above and the Association seeks an opportunity to review draft wording before the Bill is introduced to ensure that it does not undermine the efficiency of the domestic payment system.

INDIVIDUAL ACTING ON BEHALF OF A CUSTOMER Clause 8(c)(1)

Submission

23. The practical implications of implementing sub-clause 8(1)(c) in its current form also need considerable thought and at this stage the Association supports complete deletion of the sub-clause from the Draft Bill because:

    - implementation of the proposed requirement would be impractical and the costs would be disproportionate to the AML risks posed;
    - the policy intent is captured by CDD of beneficial owners at cls 8(1)(b); and
    - the UK Regulations[7] do not include a similar requirement.

    If the sub-clause is not deleted then significant amendment needs consideration to prevent wasted compliance costs – for example, to:
    - exclude authorised signatories appointed to merely operate an account or facility; or
    - allow reporting entities to accept certification from the customer (both natural person and non natural person) that they have carried out CDD on replacement authorised signatories appointed to operate an account or facility; and
    - soften the requirement to verify the individual's authority to act, on the basis of documents, data, or information obtained from a reliable and **independent** source.

    The opportunity to work through these practical issues with officials over the next few months would be appreciated.

24. The Association supports the principle that it is good business practice for reporting entities to take reasonable steps and subject to risk to:

    - understand the ownership and control structures of customers who are legal persons/arrangements;
    - be reasonably satisfied that the person purporting to control a customer legal person/arrangement is properly authorised to do so by the customer; and
    - identify signatories.

[7] Reg 5.

25. The problems with cls 8(1)(c) in the Draft Bill are that prescription of full CDD (including verification of ID and authority to act on the basis of documents, data, or information obtained from a reliable and **independent** source) appears to:

- extend to all those with signing authority and is not confined to those who have the power to control the customer eg open and close accounts. Given the large number and frequent changes of signatories of large organisations such as government departments, law partnerships and trustee companies such as Maori Land Trusts, this proposed requirement is unreasonable and disproportionate [see paras]; and

- apply in the case of occasional transactions which is unworkable given the immediate nature of occasional transactions eg it is impractical to verify the identity and authority to act of cash couriers using information from an independent source – the Association queries what independent information could reporting entities access efficiently to satisfy cls 8(1)(c) in this situation?

INDEPENDENT SOURCE

26. In relation to the use of documents, data, or information obtained from a reliable and independent source at cls 8(1)(c), in some situations a trust or a partnership can be established on an informal basis, and the information required to verify an individual's authority to act is simply not available from an independent source. There are also similar issues for "as trustee for" arrangements with children's bank accounts. At the very least, if clause 8(1)(c) is not deleted, the Association submits deletion of the word 'independent' from the clause.

PROVISION FOR SELF-DISCLOSURE REGIME?

27. The Association notes the Draft Bill excludes a multi-party facility holder exemption (currently at s 6(3) of the FTRA) as proposed in supporting FATF IWG discussion documents. In response to stakeholder concerns about requiring reporting entities to identify and verify the identity of all facility holders, irrespective of the number of facility holders or type of account, the FATF IWG had proposed there "should be provision for a self-disclosure verification regime that is consistent with the Australian AML/CTF "verification officer" approach for customers that are legal persons in low risk circumstances including those listed by the NZBA in its submission of 16 July 2007 at para 29."[8] The Association cannot, however, identify clear provision for the anticipated self-disclosure verification regime in the Draft Bill.

[8] Ministry of Justice *AML Compliance Costs: Background Information for NZBA Workshop Information* dated 130907 para 3(a)

EXTENSION TO ALL SIGNATORIES DISPROPORTIONATE/IMPRACTICAL

28. The wording of sub clause 8(1)(c) creates confusion because it appears to cover two types of individuals who are acting on behalf of the customer. They are:

    - First, an individual appointed under a power of attorney, such as a senior executive in a company, or a personal representative of an individual, to establish the business relationship on behalf of the customer; and
    - Second, an individual appointed only to operate an account or facility as an authorised signatory. That is, an individual authorised by the account owner under delegated authority to operate the account or facility on the customer's behalf.

29. Where a business relationship is established, if clause 8(1)(c) is retained, the full requirements could cover those in the first bullet point above only (subject to risk), ie individuals acting on behalf of a customer as the customer to establish the legal relationship (or make changes to the relationship) – not those with delegated authority to only operate an account or facility once established by the customer, ie those in the second bullet point above.

30. In banking terms, an "authorised signatory" is someone other than the customer that only "has authority to operate" on an account or facility. They are not the legal owner. The customer certifies that the individual is appointed to act on their behalf to operate, but not open or close or appoint other authorised signatories to operate, the account or facility. This is done in the account or facility establishment documents, which the customer enters into. Any replaced authorised signatories are normally also appointed by the customer using authorised signatory appointment forms.

31. Many financial institutions already apply rules around who they allow to establish the business relationship – normally it is only ever the customer, and attorneys are only accepted in limited circumstances. For instance, the signing protocols applied to many bank products require all persons and entities that make up the customer to sign, and attorneys are often limited to those appointed under certain statues. For example, for a:

    COMPANY (Companies Act 1993): two directors (or if one director, that director and a witness)
    PARTNERSHIP: all partners (to establish joint and several liability, rather than only joint liability through sections 9 and 12 of the Partnership Act 1908)
    TRUST: all trustees (to bind the trust assets in accordance with trust law and delegate as authorised for bank cheques and drafts only under section 81 of the Trustee Act 1956)
    INCORPORATED SOCIETY (Incorporated Societies Act 1908): authorised person
    LIMITED PARTNERSHIP (Limited Partnership Act 2008): authorised person
    INDIVIDUAL: that person
    JOINT OWNERS: all individuals and entities
    GOVERNMENT DEPARTMENT OR CROWN ENTITY: the Chief Executive (or equivalent) of the government department or Crown entity

UNDER A POWER OF ATTORNEY (Protection of Personal and Property Rights Act 1988, or Companies Act 1993, or Property Law Act 2007): the attorney and a completed certificate of non-revocation attached

32. In principle, there is no objection to, subject to risk, verifying the identity and authority to act of customers and beneficial owners who are individuals, bodies corporate or holders of powers of attorney. However, it would be unnecessarily onerous to verify the identity and authority to act using information **from an independent source of** all individuals authorised only to **operate** accounts and facilities.

33. It would be appropriate to delete clause 8(1)(c) from the Draft Bill for four compelling reasons.

- FATF compliance - FATF does not appear to require it under recommendation 5 [see paras 34 -37];
- FATF assessment – the FATF assessment of New Zealand in 2003 raised concerns that match the interpretation of recommendation 5 and the Methodology [see paras 38 and 39];
- Beneficial owner ID verification - the policy objectives are still met because individuals operating an account or facility for their own benefit or who are controlling the customer are already captured by the "beneficial owner" requirement [see paras 40 - 42];
- United Kingdom and Australian approach - the United Kingdom does not require it, and while Australian does, its application is very limited [paras 43 – 46].

FATF Compliance

34. FATF recommendation 5 does not appear to require application of CDD to "authorised signatories". Authorised signatories are individuals who are not the customer but have been authorised to only operate the account or facility.

35. Guidance on recommendation 5 provided at paragraph 5.4 of the Methodology also appears to confirm this. While at first blush 5.4 appears to require identification of authorised signatories, a closer reading shows that this is not the case. This is because paragraph 5.4 relates to identification of the customer, and only applies the "acting on behalf of" identification recommendation for legal persons (ie bodies corporate) or legal arrangements (ie trusts or partnerships).

36. This means 5.4 appears to recommend the identification of individuals acting on behalf of non-natural customers – which means directors, trustees, partners, senior executives acting under a power of attorney. This appears to be the first category of individuals noted above, (ie "First, an individual appointed under a power of attorney, such as a senior executive in a company, or a personal representative of an individual, to establish the business relationship on behalf of the customer")

37. It does not include the second category noted above, (ie "Second, an individual appointed only to operate an account or facility as an authorised signatory. That is, an individual authorised by the account owner under delegated authority to only operate the account or facility on the customer's behalf.") This is because, if authorised signatories on an account or facility had been intended to be identified and verified, then paragraph 5.4 would have referred to customers who are private individuals who appoint someone to act on their behalf. Private individuals also appoint authorised signatories, and yet 5.4 does not cover them. By comparison see paragraph 5.5.1 on identifying beneficial owners, which refers to it applying "for all customers".

FATF Assessment

38. The FATF assessment in 2003 raised concerns with New Zealand's FATF compliance, particularly, in relation to the effect of section 6(3) of the FTRA (see below). The FATF assessment report[9], states at paragraphs 35 and 36:

> "35 …*there are no explicit requirements [in the FTRA or otherwise] to identify the owners or controllers or legal persons such as companies. There are also a number of limitations and exceptions contained within the FTRA, such as:*
> *(a) if there are three or more facility holders, it is only necessary to verify the identity of the principal facility holder (term not defined);*
> *(b) term deposit accounts are exempted from the identification requirements of the FTRA; and*
> *(c) no requirement to identify the identity of a person when a transaction is conducted on that person's behalf in [their] capacity as beneficiary under a trust and if this person does not have a vested interest under the trust*.
>
> *Also, the FTRA only requires the financial institution to verify the identity of the real beneficiary of the transaction when the transaction involves an amount of cash exceeding NZ$9,999.99.*"
> "36 …*a significant weakness that needs to be addressed is the lack of adequate requirements to identify beneficial owners. The owners and controllers of legal persons such as companies should be required to be identified and verified, as should trustees and beneficiaries of trusts. Equally, if a permanent or occasional customer is suspected to be acting on behalf of another person, then there should be an obligation to identify that other person."*

39. The 2003 FATF compliance concern appears to relate to identification of all the persons and entities that make up the customer and the owners and controllers of legal persons or suspected owners and controllers of the customer, NOT whether individuals appointed to only operate the account or facility are identified. The FATF assessment does NOT recommend applying CDD to authorised signatories operating an account or facility.

[9] "*The New Zealand: Report on the Observance of Standards and Codes*", dated August 2005

Beneficial Owner Verification/Basle CDD Focus

40. From a policy perspective, reliance on customers to identify those individuals who only operate an account or facility is sufficient because operation of an account or facility is a "ministerial" task. That is, it is in the nature of administration rather than one allowing independent decision-making, beneficial control or ownership, because the operation of the account or facility is only ever allowed to be in accordance with the authority delegated to the individual.

41. If an individual is operating the account for their own benefit or they ultimately control the customer, then they would be captured by the "beneficial owner" CDD requirement at sub-clause 8(1)(b). The "beneficial owner" is an individual who ultimately owns or controls the customer or the person on whose behalf a transaction is being conducted.

42. The Basle Committee on Banking Supervision *General Guide to Account Opening and Customer Identification*[10] references signatories but in the context of those who have control over the business/assets and who manage accounts without requiring further authorisation. For example para 22 provides:

> *For corporations/partnerships, the principal guidance is to look behind the institution to identify those who have control over the business and the company's/partnership's assets, including those who have ultimate control. For corporations, particular attention should be paid to shareholders, signatories, or others who inject a significant proportion of the capital or financial support or otherwise exercise control. Where the owner is another corporate entity or trust, the objective is to undertake reasonable measures to look behind that company or entity and to verify the identity of the principals. What constitutes control for this purpose will depend on the nature of a company, and may rest in those who are mandated to manage funds, accounts or investments without requiring further authorisation, and who would be in a position to override internal procedures and control mechanisms.*

United Kingdom And Australian Approach

43. The UK Regulations do not explicitly require reporting entities to undertake the equivalent of the sub-clause 8(1)(c). The UK AML/CFT regime 'glosses over' the 'on behalf of' relationship, and leaves it to be dealt with on a risk basis in guidance notes. This is because in most cases involving a corporate customer, the individuals in this category are simply those with signing authority over customers' bank accounts. So long as the bank has verified the identity of the person who authorises the list in the first place (and changes to it) then the actual individuals who sign are merely carrying out administrative functions, rather than being anything approaching a 'customer' with the right to set up and terminate accounts. The JMLSG Guidance does underline the need for banks to be satisfied that those who purport to act have been properly authorised to do so - see, for example, in relation to private unlisted companies:

> *For operational purposes, the firm is likely to have a list of those authorised to give instruction for the movement of funds or assets along with an appropriate instrument authorising one or more directors (or equivalent) to give the firm such instructions. The identities of individual signatories need only be verified on a risk-based approach.*

[10] of February 2003

Similar statements could appear in New Zealand industry guidance notes for registered banks to clarify good practice for registered banks under the beneficial owner CDD requirement at 8(1)(b).

44. Australia has reduced the impact of the requirement by allowing customers to appoint a Verifying Officer who certifies, on behalf of the customer, that individuals (for example, employees of the customer who operate the account or facility) meet CDD. The Australian FTRA[11] verifying officer model allows a customer that is a non-natural person to identify its agents via the customer's appointed verifying officer. A verifying officer will be taken to have identified an agent if the officer has collected the following:
    - the full name of the agent;
    - the title of the position or role held by the agent with the customer;
    - a copy of the signature of the agent; and
    - evidence of the agent's authorisation to act on behalf of the customer.

45. The Association is considering whether a limited version of the verifying officer model applied in Australia would be appropriate for New Zealand. In New Zealand the verifying officer model would:

    - only be used for the appointment of replacement authorised signatories on an account or facility, not at the establishment of the business relationship; and
    - could be used by natural person customers (like individuals with joint accounts, trusts and partnerships), not just by non-natural customers.

46. This would be a more targeted version of the Australian model in that it would only apply on an ongoing basis (ie for replacement authorised signatories), but would be widened to accommodate customers who are individuals with joint accounts and other types of customer legal forms. This is efficient because at the time the business relationship is established, the customer would certify as to the identity of the initial authorised signatories appointed. The verifying officer would be appointed to certify any replacement authorised signatories

EXISTING CUSTOMERS – ALIGNMENT WITH AUSTRALIA

Submission

47. The Association:
    - strongly supports the significantly narrowed scope of proposals to re-verify the identity of existing customers; but
    - seeks deletion of clause 9(2)(e) (re-verification where doubt arises as to the adequacy of existing ID data) to ensure alignment with the Australian regime as discussed with officials in 2007 and because it covers similar ground to proposed clause 9(2)(d) but is not as clear.

48. The Association refers to its submissions on various FATF IWG proposals to re-verify the identity of existing customers and in particular the following extract from a note to the Associate Minister of Justice Hon Clayton Cosgrove dated 270807:

[11] at s 89 of the AML/CFT Act and Part 4.11 of the Rules

Retrospective Identification of Existing Customers[12]
[FATF IWG] Proposal

"…all reporting entities will need to adopt an approach which ultimately ensures that all existing customers have been properly identified. This means that the AML compliance programme would have to include a risk-based process for assessing the veracity or adequacy of the customer identification data held on existing customers. If a review of the data finds that it is adequate to meet the new requirements, the customer will not have to be subjected to re-verification. Where a review identifies inadequacies, the customer will have to be subject to re-verification."[13]

Practical Impact
This proposal may have high impact on banking operations and bank customers may be significantly inconvenienced. Even if this proposal is confined to high-risk customers only, where a trigger event occurs member banks would need to:-

a) review data held on each of their millions of customers to determine whether that data meets the new identity requirements; and
b) contact a number of those customers to re-verify their identity, with the exact number determined by the detail of the proposal.

Outcomes Sought

Financial institutions will not be required to undertake the action at 4(a) above.
Where a trigger event occurs, financial institutions to retrospectively re-verify the identity of an existing customer only where the bank has reasonable grounds to believe that the customer:-

- is not who they claim to be; or
- is or may be relevant to the investigation or prosecution of a money laundering or terrorist financing offence.

This is in line with the position under Australian AML reforms.

49. At a meeting between the Association and FATF Inter-agency Working Group representatives (Mr Gregor Allan and Ms Cindy O'Brien) on 240907, the following was noted:

> *Officials said that the Working Group had revised its view on CDD of existing customers and it now wished to simply follow the Australian approach. The Working Group agreed with the Association's analysis of the Australian approach. Officials confirmed that "triggers" would follow the Australian approach not those in the FATF Methodology. Pre-existing customers (i.e. prior to the proposed legislation not the FTRA) would be subject to the on going CDD that new customers are subject to through eg transaction monitoring. Officials confirmed that financial institutions could use a risk based approach to determine high risk customers*.

50. The Association wrote to the Working Group on 1 October 2007 noting its support for officials' view that the 'triggers' for re-verification of the identity of existing customers should follow the Australian approach. The Association subsequently sought written confirmation from the Ministry of this proposed approach. The Deloitte *Financial Industry Questionnaire* of April 2008 did not specify any ground for re-verification of the identity of existing customers including the circumstances at clause 9(2)(e) (where doubt arises as to the adequacy of existing ID data).

[12] See paragraphs 57 – 66 of the Association submission of 16 July 2007 on FATF Inter-Agency Working Group, *FATF-Compliance Review: Response to Stakeholder Comment on AML Proposals* of 21 June 2007.
[13] *FATF-Compliance Review: Response to Stakeholder Comment on AML Proposals,* paragraph 79.

51. Accordingly the Association queries why the Ministry has included clause 9(2)(e) in the Draft Bill when it was understood that the Bill would align with the Australian legislation[14] which:
    - restricts re-verification of the ID of existing customers to where a suspicious transaction reporting obligation arises;[15] and
    - does not include an equivalent of clause 9(2)(e) of the Draft Bill.

52. The Association notes that the proposed inclusion of the obligation at clause 9(2)(e) of the Draft Bill creates unnecessary uncertainty (for example over the meaning of 'doubt') and compliance may be disproportionate to the AML/CFT risks posed by existing customers. These risks are more efficiently targeted by reporting entities' obligation to conduct on going customer due diligence/transaction monitoring at clause 17 of the Draft Bill and the CDD obligations in the circumstances at clause 9(2)(c), (d) and (f). Clause 9(2)(d) effectively covers the same issue as cls 9(2)(e) but the wording is less ambiguous and provides more certainty to member banks implementing the CDD requirements.

NEW SECTION ON TIMING OF CDD NEEDED

Submission

53. The Association strongly supports the addition of a new provision about timing of CDD in the Draft Bill to reflect the intent of FATF Recommendation 5 and the Methodology (5.14) and reg 9(3) and (5) of the UK Regulations so that verification of the identity of the customer and beneficial owner following the establishment of the business relationship is permitted where:
    (a) This occurs as soon as reasonably practicable;
    (b) This is essential not to interrupt the normal conduct of business; and
    (c) The money laundering risks are effectively managed

    If the Ministry agrees with this general point, the Association would appreciate the opportunity to work with officials to fine tune the wording of the Draft Bill to accommodate it.

54. Member banks need the flexibility, with appropriate controls, to "commence" the provision of a product or service prior to completing CDD. This is and has been standard banking practice across New Zealand and Australia for many years. Flexibility in the development of appropriate rules/guidance in terms of "account opening" and "commence to provide" obligations will ensure that industry can continue to provide optimum service, with appropriate compliance controls.

55. The Association notes, however, that where a reporting entity is unable to carry out CDD, clause 22 of the Draft Bill (amongst other things) prohibits the establishment of a business relationship.

[14] Section 29 of the Act and part 6.3 of the Rules
[15] under section 41.

56. Without more flexibility around timing of verification of identity, the prohibition in its current form:

- appears to be more restrictive than FATF Recommendation 5 [see para] and the existing FTRA;
- would interrupt the normal conduct of banking business and poses reputational risk for banks [see paras]; and
- is out of step with other jurisdictions such as the UK [see para].

FATF RECOMMENDATION 5

57. The Association refers to FATF Recommendation 5/5.14 of the Methodology and notes that whilst Recommendation 5 does permit financial institutions to complete verification of identity after establishment of the business relationship (in defined circumstances), clause 22(a) of the Draft Bill does not appear to allow completion of this after the business relationship is established (depending on the meaning of establishing a business relationship).

FTRA

58. The existing FTRA provides greater flexibility to reporting entities than the Draft Bill around timing of CDD. For example, s 6(2) allow s a financial institutions to verify identity of a new facility holder as *soon as practicable after that person becomes a facility holder in relation to that facility in any case where (i) That person belongs to a class of persons with whom the financial institution does not normally have face to face dealings; and (ii) It is impracticable to undertake the verification before the person becomes a facility holder*

NORMAL CONDUCT OF BANKING BUSINESS

59. In certain circumstances, banking practice is to open an account and allow transfers in, but not transfers out. All outward transactions on the account are blocked until CDD is completed. This allows customers to be allocated an account number for administration purposes and to earn interest on funds immediately where they do not have sufficient identification etc to complete CDD at that time. The FATF Methodology notes that non face-to-face business is an example of the circumstances where it may be essential not to interrupt the normal conduct of business.

60. Banks typically open accounts in the normal course of business before conducting CDD, for example:

- when dealing with immigrants to New Zealand who must show the New Zealand Immigration Service that they have sufficient funds in New Zealand before their application for residency can be completed. That application is normally made while the person is not in New Zealand, so for many foreign customers (that is, those in countries where member banks does not have an office) CDD cannot be completed until the person arrives here. A bank would communicate with the immigrant before he or she arrives in New Zealand, open an account in advance of his/her arrival, send CDD documents to the immigrant for completion and verify the identify of the immigrant on arrival in the country and before any withdrawals are permitted on the account. Member banks often allow immigrants to remit funds up to a particular limit eg $1 million prior to completion of CDD and immigrant customers are permitted a certain time period say 3 months to complete CDD. During this period the customer is not to withdrawal or transfer money from the account;

- when setting up a credit card account in non face-to-face situations. When the bank accepts a credit card application it would typically open the account, issue the credit card and send it to a bank branch where CDD would be conducted before the customer can use the card; and

- on receipt of an application through third parties for the likes of lending and insurance products.

61. In these examples, if the meaning of 'establishing a business relationship' includes:

- capturing customer details;
- allocating customer/product numbers; and
- checking of names against independent lists to determine if the applicant is a PEP designated terrorist entity or a high risk customer requiring enhanced CDD (reporting entities may require new customers with a high risk rating to produce further information that they may not have readily available)

then clause 22 would prohibit these practices and accordingly interrupt the normal conduct of banking business.

62. These actions require a consistent application across business groups and can only reasonably be completed in large organisations, electronically and not done in "real time" by front line staff prior to the establishment of a 'business relationship" if the definition means the allocation of an account or product. This would also allow electronic verification for simplified CDD requirements under clauses 15 and 16 of the Draft Bill in relation to any low risk business relationships.

63. Also, one member bank notes that it is the account opening that triggers the issue of a customer number, which enables that bank to complete further checks for compliance with Terrorism Suppression Act obligations. This bank's system cannot match names without the customer record. A change to this approach would impose significant (and unnecessary) systems costs on this member bank and require real time monitoring to enable the enhanced CDD for politically exposed persons and compliance with Terrorism Suppression Act obligations.

64. The Association notes the statement in the FATF Methodology that:

> *5.14.1 Where a customer is permitted to utilise the business relationship prior to verification, financial institutions should be required to adopt risk management procedures concerning the conditions under which this may occur. These procedures should include a set of measures such as a limitation of the number, types and/or amount of transactions that can be performed and the monitoring of large or complex transactions being carried out outside of expected norms for that type of relationship.*

65. The Association maintains[16] its support for this general approach that financial institutions should be permitted to complete CDD as soon a practicable provided adequate risk management controls are adopted until verification is complete (e.g. restricting the facility to deposits only, a maximum balance set, no withdrawals until verification of identity is complete).

OTHER JURISDICTIONS

66. In the UK, the Money Laundering Regulations 2007 contain both a prohibition along the lines of that proposed at clause 22 of the Draft Bill at reg 11 plus a discreet section on timing of verification of identity at reg 9 an equivalent of which is absent in the Draft Bill. The Association refers the Ministry to regs 9(3) and 9(5) of the UK Money Laundering Regulations 2007 (below) which expressly provide for the flexibility anticipated in FATF Recommendation 5 as follows:

> *Timing of verification*
> *9 (2) Subject to paragraphs (3) to (5) and regulation 10, a relevant person must verify the identity of the customer (and any beneficial owner) before the establishment of a business relationship or the carrying out of an occasional transaction.*
> *(3) Such verification may be completed during the establishment of a business relationship if—*
> *(a) this is necessary not to interrupt the normal conduct of business; and*
> *(b) there is little risk of money laundering or terrorist financing occurring,*
> *provided that the verification is completed as soon as practicable after contact is first established.*
> *(5) The verification of the identity of a bank account holder may take place after the bank account has been opened provided that there are adequate safeguards in place to ensure that—*
> *(a) the account is not closed; and*
> *(b) transactions are not carried out by or on behalf of the account holder (including any payment from the account to the account holder),*
> *before verification has been completed.*

The Association strongly supports insertion of a similar section to reg 9 of the UK Regulations in the draft Bill.

[16] Submission 130906

ENHANCED CUSTOMER DUE DILIGENCE

WHEN ENHANCED DUE DILIGENCE APPLIES

67. The Association submits that clause 11 appears to be far too broad and prescriptive. It suggests that ALL customers or beneficial owners who are PEPs are high risk; and ALL cross border banking is high risk. The Draft Bill does not appear to allow any latitude and the Association would like to consult further with the Ministry on this point.

COUNTRIES THAT DO NOT OR INSUFFICIENTLY APPLY THE FATF RECOMMENDATIONS.

68. The Association strongly supports clause 121(e) of the Draft Bill obliging the Ministry of Justice to identify countries that do not, or insufficiently, apply the FATF Recommendations and notify reporting entities. The Ministry's list will enable reporting entities to target enhanced due diligence under clause 11(d). Without the ability to target investigative effort using such a list, the value and volume of international transactions would make implementation of the proposed clause a difficult and potentially an inefficient and wasteful activity.

POLITICALLY EXPOSED PERSONS (PEPS)

Submission

69. The Association submits that:

- enhanced due diligence measures should be restricted to a reporting entity establishing an ongoing business relationship with a PEP and not extended to 'occasional transactions' that involve a PEP ie reference to occasional transactions should be omitted at clauses 11(a) and 12 of the Draft Bill. This is because the costs of compliance would be disproportionate to the risks of PEPs conducting occasional transactions in New Zealand; and
- family and close associates of PEPs be excluded from the definition of PEP.

NO ENHANCED DUE DILIGENCE FOR PEPS RE OCCASIONAL TRANSACTIONS

70. The Association strongly supports application of enhanced due diligence in relation to PEPs using a risk based approach. Whilst clause 12 suggests a risk based approach applies, clause 11 appears to pre-determine PEPs as high risk requiring enhanced CDD in every case. If reporting entities do not have a clear right to apply a risk based approach under clause 12, for similar reasons to those noted at para 19 above, the Association would strongly submit that reporting entities should not be required to perform enhanced due diligence when conducting occasional transactions that involve a person who is a PEP. This is because branch staff will not know by looking at a person whether the person is a PEP or not. Often overseas individuals will open accounts and banks rely on the individuals to advise their correct occupation (politician/general/minister of government/public official). If the individual confirms their occupation as tourist, visitor or business executive this would not alert a front line staff member that the customer falls within the definition of a PEP. If a PEP discloses his or her name to a bank teller, there is a high risk that the teller will not realise that the person is a PEP.

71. It seems to the Association at this stage that the only way reporting entities can comply with the Draft Bill is, in relation to every person that conducts an occasional transaction over the counter (not just in relation to PEPs) front line staff are to:

- ask if the person is a PEP; and
- check every person against an independent real time electronic PEP list.

This would be a disproportionate expense (i.e. licensing Worldcom software to each frontline staff member), impractical and largely ineffective in detecting and deterring money laundering. In addition, customer inconvenience would increase for all of the vast majority of non-PEPs who would conduct occasional transactions over the counter with:

- significantly more queues in branches; and
- the likelihood of 'false positives' ie people with the same name as those on the PEP list being subjected to time consuming enhanced due diligence.

72. Even though it is highly unlikely that a PEP would conduct an occasional transaction in a branch, if it does happen, obtaining senior management approval for the transaction is unrealistic and impractical.

73. Whilst occasional transactions with PEPs could well be higher risk than establishing a business relationship with a PEP, without the right to apply a risk based approach under clause 12 or somehow limit the operational impact, the compliance costs and customer inconvenience would be disproportionate.

SUPPORTS EXCLUSION OF DOMESTIC PEPS

74. The Association strongly supports the exclusion of:

- 'domestic' PEPs from the definition of PEP in the Draft Bill and accordingly enhanced due diligence on domestic PEPs for the reasons outlined in previous Association submissions; and

- family and close associates of PEPs given the difficulty in monitoring and tracking them and the potential cost and impact.

CORRESPONDENT BANKING RELATIONSHIPS

Submission

75. The Association submits that:
- clause 13 should be clearly subject to a risk-based approach;
- the definition of 'correspondent banking relationship' should be clearly and explicitly restricted to banking services through nostro and vostro accounts as in Australia; and
- clause 13(4) definition referring to the provision of banking services by a 'financial Institution' should be limited to "foreign" financial institutions.

RESTRICTED TO NOSTRO VOSTRO ACCOUNTS

76. In relation to the enhanced due diligence requirements for correspondent banking relationships at clause 13 of the Draft Bill, the Association supports:
- the Ministry's proposal at 3(c) of the Information[17] that correspondent banking requirements should be limited to nostro and vostro accounts; and
- exclusion of methods of exchanging authentication of instructions (eg by exchanging SWIFT or telex test keys and/or authorised signatories) (Exchanges") from the enhanced due diligence requirements (i.e. where a nostro or vostro account is not involved).

77. The Association notes that the definition of 'correspondent banking relationship' at clause 13(4) of the Draft Bill partly mirrors the equivalent definition at clause 5 of the Australian AML CTF Act 2006. The NZ definition differs as the words '*of accounts (used for payment to or receipts from)*' are added. It is understood that these extra words are intended to cover nostro and vostro accounts so that the 'correspondent banking relationships' are limited to banking services through nostro and vostro accounts. If so, the definition needs fine tuning to remove ambiguity and the Association queries whether the definition it is meant to read along the lines of:

> "…means a relationship that involves the provision of banking services by a foreign financial institution (the **correspondent**) of accounts (used for payment to or receipts from) *to another financial institution (the respondent*…"

[17] Ministry of Justice *AML Compliance Costs: Background Information for NZBA Workshop Information* dated 130907

78. Either way some members believe that the wording is too broad and does not provide adequate certainty that transactions are limited to those through nostro and vostro accounts. The Association strongly supports alignment with the Australian requirements[18] which explicitly restricts the definition of correspondent banking relationship to those where banking services involve nostro and vostro accounts only, ie it excludes "all banking services that do not involve nostro or vostro accounts." To provide greater certainty, the Association supports a similar exclusion in the Draft Bill or regulations of banking services that do not involve nostro or vostro accounts from the definition of 'correspondent banking relationship'.

79. The reasons[19] for the Association's views are:

- anticipated legislation supporting FATF special recommendation VII (wire transfers) reduces AML/terrorist finance risk posed by "Exchanges" [see para 21];
- residual risk posed by Exchanges can be managed most efficiently and effectively in accordance with each bank's risk based approach – e.g. targeting Exchanges involving sending banks in high risk jurisdictions; and
- where an Exchange-only relationship exists (i.e. no account is involved), the sending bank must have an account relationship with a third party bank for the currency concerned to enable it to settle the payment. It is presumed that the sending bank's account correspondent has fulfilled its own enhanced due diligence requirements.

SUPPORTS PARENT VONDUCTING CDD ON BEHALF OF NZ REPORTING ENTITY

80. The Association strongly supports clause 18 of the Draft Bill as it would appear to allow, amongst other things, a parent company of a New Zealand reporting entity to undertake the enhanced correspondent banking CDD on behalf of the of the whole corporate group.

NEW OR DEVELOPING TECHNOLOGIES AND PRODUCTS THAT MIGHT FAVOUR ANONYMITY

81. In clause 14 reference to "new or developing technologies" needs to be defined. This clause could currently mean anything new or developing that related to technology would be high risk. A risk based approach should be adopted here.

[18] Anti-Money Laundering and Counter-Terrorism Financing Act 2006, s 5, definition of 'Correspondent Banking Relationship', paragraph (e) and *Anti-Money Laundering and Counter-Terrorism Financing Rules Instrument 2007 (No. 2) Schedule 1.*

[19] See letter from the Association to the FATF IWG dated 1/10/07

SIMPLIFIED CUSTOMER DUE DILIGENCE

82. The Association strongly supports simplified due diligence measures under clause 15 and 16 of the Draft Bill to accommodate:
    - in principle, those circumstances and examples outlined at para 5.9 of the FATF Methodology; and
    - the FATF IWG's proposal that in relation to the removal of the exemption "from identification requirements for …non-principal multi-party facility holders where there are three or more facility holders …that under a risk based approach, if the transactions are in fact low risk as posited by some submitters, simplified CDD measures may be applicable"[20]

83. For example, the UK Money Laundering Regulations 2007[21] allow simplified CDD in relation to certain customers and products - meaning not identifying the customer or verifying their identity or that of a beneficial owner and not having to obtain information on the purpose or intended nature of the business relationship. On going monitoring of the business relationship is still required. Exempt customers include: credit and financial institutions subject to AML regulation; companies listed on a regulated market; beneficial owners of pooled accounts held by notaries or independent legal professionals; UK public authorities and community institutions.

ONGOING CUSTOMER DUE DILIGENCE

84. Clause 17(3) is prescriptive as to what constitutes ongoing CDD. The Association submits that ongoing CDD should be risk based and determined by each reporting entity.

RELIANCE ON THIRD PARTIES

RELIANCE ON DESIGNATED BUSINESS GROUP Clause 18

85. The Association submits that the Draft Bill needs to support the following to ensure the efficient/proportionate implementation of the proposed regime:
    - as proposed by the FATF IWG "there should be provision for "businesses in related party relationships (e.g. A bank's insurance subsidiary or sister company)" to rely on the "CDD conducted by a related party (e.g. Bank to insurance company or vice versa) if either business could be the first customer contact for the individual and therefore the party that undertakes the initial CDD". An approach consistent with that provided for in the Australian AML/CFT designated business group concept is proposed.";
    - sufficient flexibility in terms of structure, membership, reporting obligations and sharing of information in relation to the concepts of "reporting entity" and members of a "designated business group". The 'designated business group' definition, therefore, needs to include "entities" of the group and commercial relationships not merely related companies (including members that are not reporting entities); and

[20] Response para 62
[21]

- a designated business group is able to implement a joint AML/CTF Programme that allows for management, and full reliance and sharing of information in respect of:
    - any relevant AML/CTF information;
    - centralised or other recording keeping (maintenance and access of records);
    - identification verification for customers and agents;
    - collection of additional "know your customer" information;
    - transaction monitoring;
    - ongoing customer due diligence;
    - making suspicious matter reports on behalf of each other;
    - exemption from funds transfer reporting obligations and originator information;
    - shared/joint compliance reports for the entire designated business group
    - a single AML/CTF compliance officer;
    - a single level of board oversight where appropriate;
    - agency arrangements; and
    - training.

This would reduce compliance costs without reducing the efficacy of the AML regime.

RELIANCE ON OTHER REPORTING ENTITIES

86. The Association strongly supports the proposal at clause 19 of the Draft Bill that that if a reporting entity wishes to rely on the customer due diligence of another reporting entity, then consent must be obtained from the reporting entity who has completed the due diligence. This will address a gap under the existing FTRA where a reporting entity only has to confirm the existence of a facility at another reporting entity to comply, irrespective of whether customer due diligence has been completed or not.

MULTI-PARTY RELATIONSHIPS

87. It is important that clauses 19 and 20 allow a number of entities to sign up an agreement that enables them to rely on each other to perform CDD on customers, especially for related companies. It is uncertain whether the wording achieves this. The issue is that frequently, a customer may have contact with two or more financial institutions or non-reporting entities in respect of the same transaction. This can be the case in both the retail market, where customers are routinely introduced by one firm to another, or deal with one through another, and in some wholesale markets, such as syndicated lending, where several firms may participate in a single loan to a customer.

88. Several financial institutions and firms requesting the same information not only creates a poor customer experience, but the duplication does not help in the fight against financial crime. The Association requests that the Draft Bill allows a multi-party agreement to be obtained to deal with multi-party business relationships of this nature, and between related parties (eg entities in the same group). The Association would like to work with the Ministry to fine tune the wording of the Draft Bill to achieve the above.

RELIANCE ON NON-REPORTING ENTITIES

89. The Association submits that a reporting entity should be able to rely upon a non-reporting entity to complete customer due diligence requirements on their behalf, providing consent is also obtained from the non-reporting entity. This is particularly relevant for overseas based customers wishing to open accounts with a reporting entity in New Zealand.

PROHIBITIONS IF CUSTOMER DUE DILIGENCE NOT CARRIED OUT

90. Please see paras 53 - 66 where the Association submits the Draft Bill needs a new clause about the timing of CDD to ensure workability.

CEASING TO PROVIDE A SERVICE AND TIPPING OFF

91. The Association requests that the Draft Bill clarify obligations in clause 22 (b) and (c) requiring reporting to terminate business relationships and not carry out transactions. There needs to be flexibility and application of practices that provide a degree of protection to the bank and employees with regard to tipping off obligations.

92. Clause 22 needs to be qualified so that the reporting entity can take "appropriate and reasonable steps or other appropriate action" under that clause while having regard to avoiding tipping off the customer.

SUSPICIOUS TRANSACTION REPORTS

93. The Association strongly supports prescription of standard form suspicious reporting form by the Ministry of Justice under clause 26(1)(a) to ensure that financial institutions can be certain about what they are required to report.

94. The Association would not support any requirement for reporting entities to disclose the name of the officer, employee or agent of the reporting entity who handled the transaction in a suspicious transaction report in accordance with past Association submissions on the FTRA and the resulting amendment to that Act to accommodate Association submissions.

RECORD KEEPING AND RETENTION

ACCOUNT FILES AND BUSINESS CORRESPONDENCE

95. The Association supports retention of sufficient information to provide an audit trail to enable the FIU to identify, investigate and prosecute money launderers and confiscate criminal funds. The Association anticipates that the customer's risk profile and the scale, nature and complexity of their business would all be material in determining how much information a financial institution is to retain. As a base, the Association supports:
    - retaining customer identification information for the life of the account plus five years; and
    - keeping transaction records for five years after they were generated.

96. Member banks of the Association do currently retain a narrow range of information that could be within the meaning of "account files and business correspondence" at clause 35(b) of the Draft Bill but would only support definition of the meaning of "account files and business correspondence' in industry guidance notes and would not like to see the terms defined in the Draft Bill or regulation.

97. This is because account files and business correspondence in relation to member banks at least will likely be different from those in relation to some other types of reporting entity. It unlikely that retention of widely defined business correspondence (which, in the case of banks, would include documentation with no forensic value) and account files will greatly assist the FIU with investigation and prosecution of money launderers or confiscation of the proceeds of crime. Patterns of money laundering or terrorist financing are tracked through transaction records, which are routinely destroyed after they lose their value as evidence (i.e. 7 years).

DESTRUCTION OF RECORDS

98. The Association requests that clause 38 be amended to include the qualification that reporting entities may continue to hold the records for as long as they are still used for commercial purposes; recognising that some of the information is collected by member banks for business purposes not just for AML compliance.

99. This would allow member banks to continue with the current practice of holding certain customer data for longer than 5 years, especially as it may relate to future proceedings relating to a deed (see the Limitation Act 1950). This is in line with Information Privacy Principle 9 of the Privacy Act 1993.

COMPLIANCE WITH AML REQUIREMENTS

100. As a general observation the Association notes that this subpart prescribes means of ensuring compliance with tick-the-box legislative AML requirements rather than providing incentives for reporting entities to effectively detect, assess, and manage money laundering risk (and monitor and improve the effective operation of those risk management controls) in ways that are proportionate to the nature, scale and complexity of their activities. The Association does not support some of the language of this subpart ie AML Compliance Programmes would read better along the lines of AML Risk Management Policies and Procedures.

AML COMPLIANCE PROGRAMME

101. The Association requests that clause 40(1) be amended to:

- delete the words "prevent activities"; and
- insert the words "manage and mitigate the possibility of money laundering and the financing of terrorism activities occurring through services the reporting entity provides".

102. Clause 40(1) requires reporting entities to have an AML compliance programme to "prevent activities related to money laundering and the financing of terrorism". While the common view of "prevent" is to "stop occurring", the Association considers that it would be optimistic to believe that reporting entities can prevent all of these activities occurring, and especially in relation to services other than the ones the reporting entity provides.

103. Reporting entities by the nature of their products will always be a target for those wishing to money launder and finance terrorism and legislative requirements to "manage and mitigate the possibility" of these occurrences would be a more appropriate standard than "prevent".

104. While senior executives in reporting entities can influence the management and mitigation of these types of activities through an AML compliance programme, they will not be in a position to prevent them. This point is especially relevant in relation to the enforcement and penalty provisions placed on senior executives under the Bill.

AUDIT OF AML COMPLIANCE PROGRAMME

Submission

105. Clause 42 needs clarification to allow registered banks to monitor their own AML risk management programmes internally (ie through their internal audit units) by confirming that "independent" includes an internal audit function. Clause 42 would also need amendment of the annual audit requirement – at this stage members are considering every three years may be adequate and align with Australian requirements. This would reduce compliance costs, without unduly limiting the effectiveness of the regime. AML compliance programmes will rarely change over time unless a change is made to the legislation, regulations, guidelines or rules.

106. The Association refers the Ministry to the UK's FSA Handbook which provides that a firm is required to carry out regular assessments of the adequacy of its systems and controls to ensure that they manage the money laundering risk effectively. Whilst at least annually the senior management of an FSA firm should commission a report from the equivalent of the AML compliance officer (which assesses the operation and effectiveness of the firms AML risk management controls), in practice senior management should determine the depth and frequency of information they feel necessary to discharge their responsibilities.

107. The Association supports the approach at the FSA's SYSC 3.2.6CR which provides that a firm will need to have some means of assessing that its risk mitigation procedures are working effectively, or, if they are not, where they need to be improved. Its policies and procedures will need to be kept under regular review. The focus is on the reporting entity itself auditing/monitoring to enhance the effectiveness of its own risk management policies and procedures not external parties ensuring compliance with tick-the-box prescription.

ENFORCEMENT

POWERS TO SEARCH, SEIZE, COMPEL PRODUCTION OF INFORMATION WITHOUT WARRANT OR COURT ORDER.

Submission

108. The Association submits that the Draft Bill require the powers of search and seizure at clauses 92 – 93 and 110 and 115 be subject to the production of a warrant or court order or at the very least a prescribed information request power and form. This places appropriate checks and balances on the use of these powers, and from a practical perspective, makes it easier for bank staff to ascertain when information can be released and to whom.

109. Whilst the Association notes current Government initiatives on this topic[22], in principle it opposes proposed clauses 92 – 93 and s 110 and 115 of the Draft Bill which provide powers to search, seize, compel production of information by the AML supervisor or the Police without warrant or court order which exceed the requirements set out by FATF.

110. It is noted that the FATF IWG originally proposed[23] a police power to compel production of information to "perform financial analysis functions and to follow up on suspicious transaction reports". The Association[24] opposed this noting:
    - the proposal goes beyond FATF requirements. The FATF Methodology in relation to recommendation 28 states at 28.1 *Competent authorities powers to be able to compel production of, search persons or premises for and seize and obtain records etc should be "exercised through lawful process (for example subpoenas, summonses, search and seizure warrants or court orders)*" There is no reference to search and seizure without warrant or court order;
    - concern about abuse of police powers – particularly police outside the FIU, who may abuse the power and use it as an alternative to obtaining search warrants;
    - the impact of section 21 of the New Zealand Bill of Rights Act, which protects citizens from unlawful or unreasonable search and seizure by the State;
    - opposition to provisions that would allow police to access bank records without the safeguards usually associated with search warrants;
    - the potential for a negative impact on banks' relationships with their customers if they were unable to ensure that they could maintain high levels of confidentiality;
    - any power to require records should be restricted to the FIU and not extend to every member of the New Zealand Police;
    - the FIU must have reasonable grounds to believe the information is relevant to a money laundering investigation; and
    - an information request form should be prescribed after consultation with financial institutions including the Association

[22] Law Commission *Search and Surveillance Powers* June 2007 Report 97 and the Search and Surveillance Powers Bill (2008)
[23] in the 1st AML CFT discussion document
[24] submission dated 7/11/05

111. The FATF IWG watered down the proposal in 2007[25] to a narrower production power proposed for "the purpose of enforcing statutory requirements for the filing of STRs and to ensure that STR reporting requirements are being complied with."[26] In response[27] the Association noted it would be helpful for all stakeholders, particularly customers if:-

- all requests were made in writing (not via an on-site visit as proposed) specifying the:-
    - o delegated authority of the requesting officer; and
    - o information required including the full name and address of the account holder, the account numbers and the period to which the information request relates; and
- financial institutions may provide electronic copies of records required.

As examples, the Association referred to limits placed on wide ranging information gathering powers possessed by the IRD[28] and the Ministry of Social Development.[29] But the topic has not been addressed since by the FATF IWG.

INSTITUTIONAL ARRANGEMENTS AND MISCELLANEOUS PROVISIONS

AML SUPERVISORS – FUNCTIONS Clause 109

112. Whilst existing s 25 of the FTRA about Police STR guidelines (which sets out an explicit consultation process with financial institutions) is replicated in the Draft Bill at clause 117 in relation to Police, there is no reference in the Draft Bill at all to an AML supervisor's obligation to consult with reporting entities and take their views into account in relation to supervisor guidelines for reporting entities under clause 109.

113. The Association requests that a process similar to s 117 is set out in the Act in relation to AML Supervisor Guidelines under clause 109 to ensure that reporting entities are consulted and that the guidelines accommodate changes in commercial practices, technology or typologies and do not undermine competition and innovation in the financial sector. The obligation to consult with reporting entities and take their views into account is an important check and balance on the powers of the AML Supervisors.

[25] 3rd AML CFT discussion document
[26] See also Law Commission *Entry, Search and Seizure* Preliminary Paper 50, April 2002.
[27] Submission dated 22/12/06
[28] Tax Administration Act 1994, s 17. See SPS 05/08 *Section 17 Notices* (July 2005) which is available on Inland Revenue's website at www.ird.govt.nz although aspects of this practice statement are currently under negotiation with the New Zealand Bankers' Association.
[29] Social Security Act 1964, s 11. Code of conduct under s 11B.

ROLE OF THE MINISTRY OF JUSTICE AND AML CO-ORDINATION COMMITTEE

REPORTING ENTITY EXPERTISE

114. The Draft Bill does not explicitly acknowledge the value that reporting entities (as AML experts) can add to the roles and functions of the Ministry of Justice and the AML co-ordination committee.

115. The Association submits that clause 121 requires the Ministry to consult with reporting entities as well as "other agencies with AML roles and functions when advising on the overall effectiveness of the AML regulatory system" if the agencies referred to the section are intended to be public sector agencies only.

116. The Association queries whether clause 124(f) contemplates that the forum (for examining any operational or policy issues that have implications for the effectiveness or efficiency of the AML regulatory system) would include industry representatives? Only one member of the Advisory Group, the Police, appears to have any practical AML expertise. Industry representatives should be included on the Advisory Group because:
    - industry is well placed to assist the Advisory Group with its objective by identifying barriers to effectiveness and efficiency of the regime;
    - it will assist the Advisory Group to form a more well-rounded view rather than rely on a synthesis of agencies' perspectives; and
    - it will likely improve communication and understanding between government and industry.

117. If this is not appropriate, then the Association submits that the Draft Bill or regulations explicitly provide for the establishment of a joint public/private sector forum managed by government similar to the Money Laundering Advisory Committee (MLAC) in the UK. The objectives for this group could be similar to those of the MLAC's which include:
    (a) enabling better co-ordination and coherence of the AML regime;
    (b) reviewing the efficiency and effectiveness of AML strategy, taking into account the potential costs and benefits;
    (c) providing a forum in which key stakeholders can comment and advise on the appropriate domestic response to international AML developments; and
    (d) examining industry produced guidance notes and making recommendations prior to submission for government approval.

118. The Association submits that the AML/CFT legislation establishes a formal relationship between this group and the AML/CFT Advisory Group including a requirement that the AML/CFT Advisory Group is to take the collective view of this group into account when formulating AML/CFT strategy.

119. The Association also submits that:

- the Advisory Group's performance will need to be measured against its objectives; and
- the Advisory Group must have clear lines of accountability. Supported subject to overriding point that it makes sense to provide industry with a formal opportunity to provide input on the effectiveness and efficiency of the AML regulatory system.

MINISTRY RETAINS POLICY ROLE

120. The Association is also concerned to ensure that, given the multi-supervisor approach taken by the Draft Bill, it is the Ministry of Justice that retains the policy role for the legislation and regulations under its administration of the Act. This would enable any discrepancies between regulations and rules developed by different AML Supervisors to be reviewed by the Ministry from a policy perspective – to ensure an even playing field, certainty, consistency of approach, and transparency of intended policy outcomes among the AML Supervisors. Accordingly, the Association supports clause 124(d) of the Draft Bill provided that the Ministry of Justice has overriding authority in relation to the substance of the guidance materials mentioned in the clause.

SCHEDULE

EXTRACT FROM UK MONEY LAUNDERING REGULATIONS 2007

Meaning of beneficial owner
6.—(1) In the case of a body corporate, "beneficial owner" means any individual who—

(a) as respects any body other than a company whose securities are listed on a regulated market, ultimately owns or controls (whether through direct or indirect ownership or control, including through bearer share holdings) more than 25% of the shares or voting rights in the body; or
(b) as respects any body corporate, otherwise exercises control over the management of the body.
(2) In the case of a partnership (other than a limited liability partnership), "beneficial owner" means any individual who—

(a) ultimately is entitled to or controls (whether the entitlement or control is direct or indirect) more than a 25% share of the capital or profits of the partnership or more than 25% of the voting rights in the partnership; or
(b) otherwise exercises control over the management of the partnership.
(3) In the case of a trust, "beneficial owner" means—

(a) any individual who is entitled to a specified interest in at least 25% of the capital of the trust property;
(b) as respects any trust other than one which is set up or operates entirely for the benefit of individuals falling within sub-paragraph (a), the class of persons in whose main interest the trust is set up or operates;
(c) any individual who has control over the trust.
(4) In paragraph (3)—

"specified interest" means a vested interest which is—
(a)in possession or in remainder or reversion (or, in Scotland, in fee); and
(b)defeasible or indefeasible;
"control" means a power (whether exercisable alone, jointly with another person or with the consent of another person) under the trust instrument or by law to—
(a)dispose of, advance, lend, invest, pay or apply trust property;
(b)vary the trust;
(c)add or remove a person as a beneficiary or to or from a class of beneficiaries;
(d)appoint or remove trustees;
(e)direct, withhold consent to or veto the exercise of a power such as is mentioned in sub-paragraph (a), (b), (c) or (d).
(5) For the purposes of paragraph (3)—

(a) where an individual is the beneficial owner of a body corporate which is entitled to a specified interest in the capital of the trust property or which has control over the trust, the individual is to be regarded as entitled to the interest or having control over the trust; and
(b) an individual does not have control solely as a result of—
(i) his consent being required in accordance with section 32(1)(c) of the Trustee Act 1925(39) (power of advancement);
(ii) any discretion delegated to him under section 34 of the Pensions Act 1995(40) (power of investment and delegation);
(iii) the power to give a direction conferred on him by section 19(2) of the Trusts of Land and Appointment of Trustees Act 1996(41) (appointment and retirement of trustee at instance of beneficiaries); or
(iv) the power exercisable collectively at common law to vary or extinguish a trust where the beneficiaries under the trust are of full age and capacity and (taken together) absolutely entitled to the property subject to the trust (or, in Scotland, have a full and unqualified right to the fee).
(6) In the case of a legal entity or legal arrangement which does not fall within paragraph (1), (2) or (3), "beneficial owner" means—

(a) where the individuals who benefit from the entity or arrangement have been determined, any individual who benefits from at least 25% of the property of the entity or arrangement;
(b) where the individuals who benefit from the entity or arrangement have yet to be determined, the class of persons in whose main interest the entity or arrangement is set up or operates;
(c) any individual who exercises control over at least 25% of the property of the entity or arrangement.

(7) For the purposes of paragraph (6), where an individual is the beneficial owner of a body corporate which benefits from or exercises control over the property of the entity or arrangement, the individual is to be regarded as benefiting from or exercising control over the property of the entity or arrangement.

(8) In the case of an estate of a deceased person in the course of administration, "beneficial owner" means—

(a) in England and Wales and Northern Ireland, the executor, original or by representation, or administrator for the time being of a deceased person;
(b) in Scotland, the executor for the purposes of the Executors (Scotland) Act 1900(42).
(9) In any other case, "beneficial owner" means the individual who ultimately owns or controls the customer or on whose behalf a transaction is being conducted.

(10) In this regulation—

"arrangement", "entity" and "trust" means an arrangement, entity or trust which administers and distributes funds;
"limited liability partnership" has the meaning given by the Limited Liability Partnerships Act 2000(43).