February 2010

Financial Services Update

Anti-Money Laundering Discussion Document

The Ministry of Justice last week released a discussion document (**Document**)concerning the Regulations and Codes of Practice to be issued under the new Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (**Act**). Responses from the industry are sought by Friday 19 March 2010.

While the Document is described on the Ministry's website as "informal", the Ministry has signalled that following responses it will develop a formal consultation document with "near-final" proposals to be released in May. The current round of consultation may therefore be the last opportunity to significantly influence the shape of the regime, and its impact on your business.

In a separate process, the supervisory agencies (the Reserve Bank, Securities Commission, and the Department of Internal Affairs), as well as the Financial Intelligence Unit of the New Zealand Police, are developing sectoral risk assessments and a national risk assessment. These are intended to provide context for the business level risk assessments each reporting entity will need to undertake in respect of their own business.

The discussion document on the Ministry's website. We have summarised its key features below. Please let us know if we can assist you further in understanding the implications for your business, to help ensure that you make the most of this opportunity to influence the regulatory environment.

Scope

The document presents a proposed approach (or in some cases a range of options) in relation to a range of regulations (binding obligations) and codes of practice (providing a "safe harbour" approach to meeting obligations) under the Act. It also seeks information from industry on a range of issues to inform further policy development.

Taken as a whole, the scope of the Ministry's proposed regulations seem well focussed on their points of key concern. Officials have so far been quite selective in the use of the very extensive regulatory powers under the Act.

Timeframe

In Appendix 1 of the document, the Ministry sets out its priorities for making the various regulations and codes contemplated. It lists those areas where it believes clarity will be required early, and those where it believes final details can follow later during the implementation period (though still prior to the end of 2010). Reporting entities will be pleased to note that the

vast majority of proposed regulations and codes are in the first category, and that the Ministry therefore proposes providing certainty in the near future. The only exceptions to this (where the Ministry proposes deferring development until later in the year) are:

- regulations clarifying the issues regarding the affiliation of corporations, within the definition of shell banks
- certain exemptions relating to Government agencies and the Lotteries Commission, specific case by case exemptions, and possible transitional exemptions for some groups from application of the two-yearly audit so as to provide for staggering of audits
- guidelines and/or Codes of Practice regarding the risk based approach generally
- guidance regarding records that are not required to be kept
- regulations regarding information to be contained in annual reports.

The Ministry anticipates putting final proposals to Ministers and Cabinet in July 2010. A decision will also be taken at that point regarding the commencement timeframe for obligations under the Act and regulations. The document seeks feedback from submitters regarding the implementation date.

Exemptions

A number of exemptions (for entities and classes of entities, and for transactions and classes of transactions) are proposed. The Ministry has signalled that, to be consistent with Financial Action Taskforce (**FATF**) standards a robust justification for any exemptions will be required. However, a number of exemptions are proposed, including:

- temporary exemptions for "phase two" entities (for example lawyers, accountants, and the New Zealand Racing Board) who are not intended to be subject to the regime at this stage. In many cases, these entities will fall within the broad definition of "financial institution" in the Act, so they must therefore be expressly excluded
- temporary exemptions for wholesale market instruments (including electricity, fishing quotas, and emissions trading) which will be considered for coverage during phase two of the reforms
- possible exemptions for government agencies that may fall within the definition of "financial institution".

Exemptions are also being considered for entities who only carry out financial activities on a very limited basis (for example many retailers). The document notes the contrasting approaches to this issue taken in the United Kingdon, where general exemptions exist for entities which meet stated conditions, and the approach in Australia where exemptions are given on a case by case basis. Submitters are asked to comment on these different approaches.

Exemptions for low risk products and services are also proposed, including:

- an exemption for life insurance products that are purely risk-based (with no investment component). We expect this proposal will be welcomed by many insurers who were concerned at the breadth of the definition of financial institution under the Act
- an exemption for funeral policies.

The document also seeks comment regarding the extent of money laundering risk in relation to the issuance of shares by a reporting entity to its employees, the issuance of securities or derivatives, or options for securities or derivatives in government agencies, and the treatment of share registries.

An exemption is also under consideration in relation to corporate treasury functions, and submitters' views are sought in relation to this proposal.

Exemptions are also being considered in relation to security guards and safety deposit boxes.

Inclusions

The Ministry considers that "stored value cards" represent a significant money laundering risk. These are not currently captured within the definition of bearer negotiable instruments, but the Ministry proposes adding them to the definition via regulation.

Thresholds

One of the key thresholds under the Act is the occasional transaction threshold – when a transaction with a non-customer is above this amount, customer due diligence (**CDD**) obligations will apply (see below). The Ministry proposes retaining the current threshold under the Financial Transactions Reporting Act 1996, which is NZ$10,000. However it is willing to consider a higher threshold closer to the Australian level of AUD$10,000. This would give New Zealand a threshold of approximately NZ$12,500. Submitters are asked to comment, and if possible quantify the impact of on their business, of setting the threshold at either of these two different levels.

The preferred level for the occasional transaction threshold for casinos is in the range NZ$5,000 to NZ$6,000, in line with FATF recommendations. Again, comment is sought from affected businesses regarding the impact of different threshold levels.

The document discusses at some length the risks associated with stored value cards, and seeks comment from submitters with regard to a possible threshold. A preferred approach is proposed involving two thresholds – one at NZ$2,500 for non-case redeemable cards, and one at NZ$1,000 for cash redeemable cards, subject to some conditions.

A threshold of NZ$5,000 is proposed for travellers' cheques, on the basis that this should allow non-reporting entities such as travel agents to continue to sell travellers cheques

without being captured under the Act. Thresholds of NZ$1,000 are proposed for money and postal orders, and for foreign currency exchange.

Beneficial Ownership

Another key threshold under the Act is in relation to the ownership threshold (in relation to a customer) beyond which a person will be deemed to be a beneficial owner of the customer. The document considers three options reflecting the different approaches taken in current legislation:

- option 1 (20%) would be consistent with the Reserve Bank of New Zealand Act 1989 definition of a "controlling interest"
- option 2 (25%) is the preferred option, and would be consistent with the Companies Act 1993. It would also be consistent with Australian and UK thresholds
- option 3 (50%) would be consistent with the Financial Service Providers (Registration and Disputes Resolution) Act 2008. While this option is floated, it seems unlikely such a high level will be ultimately acceptable to officials and Ministers.

Comment is sought from submitters regarding these options.

Partial Exemptions & Reduced Measures

A number of partial exemptions are proposed, exempting certain entities and transactions from some of the Act's requirements while retaining some obligations:

- it is proposed that debt collectors have a partial exemption in relation to all of the Act's requirements except suspicious transaction reporting
- views are sought on whether it is desirable to exclude low value investment-based life insurance products from CDD until cash-out, and whether insurance products that are closed to new customers should be exempt on the same basis
- it is proposed that non-bank deposit takers that are in the process of being wound up be exempted from AML requirements
- a preferred approach of allowing reduced measures in relation to workplace-based superannuation funds is put forward. This would exclude these products from the obligation to verify CDD information provided verification occurs at payout. It is proposed to fully exempt very low value superannuation funds. An exemption is also proposed in relation to overseas pension accounts for certain countries
- in the case of special remittance card facilities (which use two linked cards to remit funds from New Zealand to an overseas card holder), it is proposed to continue the current exemption under the Financial Transactions Reporting (Interpretation) Regulations 2008. This effectively exempts financial institutions from the requirement to verify the identity of the overseas card holder
- it is suggested that it may be appropriate for casinos to be exempted from the requirement to verify a customer's address, given the high proportion of tourists and spontaneous visitors to casinos. Comment is sought on this proposal, and also whether there are other situations where verification of address may be problematic.

Several partial exemptions are under consideration in relation to wire transfers, namely:

- that wire transfers below NZ$1,000 be exempted from CDD and originator information requirements, as permitted by FATF Special Recommendation VII
- that in the case of domestic wire transfers, the transaction itself be deemed to constitute sufficient identifying information
- that financial institutions, when acting as intermediaries in a wire transfer, be exempted from the obligation to pass on all originator information for the domestic leg of an incoming transfer.

Customer Due Diligence (CDD)

Although there is potential for a great deal of further prescription (beyond what is contained in the Act) in relation to CDD, officials are currently proposing regulations only in the following areas:

- basis for verification applying to a specified situation, customer, product, service, business relationship or transaction
- circumstances where standard due diligence applies
- entities or classes of entity to whom simplified due diligence can be applied
- enhanced customer due diligence identity requirements.

We discuss these proposals in more detail below.

Basis for Verification

The document discusses at some length the various policy issues surrounding verification of identity, including concerns about over-reliance on driver licences. It refers to the Department of Internal Affairs' Evidence of Identity (**EOI**) Standard which describes the five key objectives in establishing identity, as follows:

- determining that the identity exists (objective A)
- determining that the identity is living (objective B)
- determining that the presenting person links to the identity (objective C)
- providing confidence that the presenter is the sole claimant of the identity for the services requested (objective D)
- providing evidence of the presenter's use of identity in the community (objective E).

Different documents (including passports, driver licences, birth certificates, community services cards, and many others) are relevant to the achievement of different objectives. For example, an authoritative document which does not include photo ID, or other biometric data, is less likely to assist in objective C.

The Ministry's preference is to establish, by regulation, a clear minimum standard for documentary identity verification that will apply to all customers and sectors. However, officials acknowledge the possibility of a compromise solution, set out in a code of practice, which would allow reporting entities to rely on a driver licence as primary identification for low to moderate risk customers, subject to certain conditions. For customers assessed to be high risk, primary identification other than a driver licence (e.g. a passport) would be required. The code of practice will also contemplate a number of circumstances where standard identification cannot be provided for legitimate reasons (e.g. for children). Comment is sought regarding this overall approach.

The document also canvasses a range of electronic identity verification tools that are, or may be, available in the near future. It seeks further information from submitters regarding any such tools that are available, or under development. It also sets out a preferred approach in relation to non-face to face identification and verification procedures. That approach would require certification of documents by a trusted referee.

Standard Customer Due Diligence

It is proposed that the circumstances in which standard CDD must be applied be expanded by regulation to include existing anonymous accounts.

Simplified Customer Due Diligence

Officials are considering extending the list of types of entity which may be subjected to the lesser requirements of simplified CDD. Preliminary consideration is being given to the following classes of entities:

- Crown entities as defined by section 7(1) of the Crown Entities Act 2004
- Trustees and Statutory Supervisors as defined by section 48 of the Securities Act 1978
- trustee companies as defined the Trustee Companies Act 1967
- Crown research institutes
- organisations named in Schedule 4 of the Public Finance Act
- trusts established in Statute for the purposes of charitable distribution of funds (e.g.: Community Trusts).

Comments are sought regarding this proposal, including in relation to any possible competitive issues.

Enhanced Customer Due Diligence

Officials acknowledge the possible difficulties associated with identifying (and verifying) the beneficiaries of trusts, particularly where those trusts have large numbers of beneficiaries or (in the case of discretionary trusts) uncertain beneficiaries. The proposed response to this difficulty is to require reporting entities to identify, but not verify, the name and date of birth of beneficiaries of trusts who are their customers. Where the number of beneficiaries exceeds ten, reporting entities could merely describe the number and nature (or class) of the additional beneficiaries. The regulations would also require a reporting entity, where it is reasonable to do so, to require a discretionary trust to provide it with the identity of a beneficiary it is making a disbursement to.

Third Party Relationships

The document gives particular consideration to the issue of intermediaries who hold pooled, omnibus, or nominee accounts on behalf of customers. Officials' preferred approach is to exempt such arrangements from account monitoring and record keeping obligations provided the reporting entity is satisfied that the intermediary is regulated and has adequate measures in place to comply with the obligations of the Act, or in the case of an overseas person, broadly equivalent obligations. Provided certain conditions are met, the reporting entity would be able to rely on the intermediary to carry out CDD in respect of the underlying customer. Feedback is sought as to whether there are other situations involving intermediaries where compliance with AML/CFT obligations would be problematic.

Designated Business Groups (DGB)

The Ministry proposes extending eligibility for the formation of DGBs, which effectively share collective responsibility for AML obligations, to network agency and sub-agency relationships in the money remittance industry. Officials' seek views on whether there are other business relationships to which the DGB regime should be extended.

Factors in Risk Assessments: Private Banking

Officials propose (based on FATF recommendations) that a reporting entity would be required to explicitly consider the money laundering and financing of terrorism risks faced through the provision of private banking (if applicable). This would factor into the entity's risk assessment and would need to be accounted for in the entity's AML/CFT Programme. While we are not convinced that private banking imposes any particularly heightened risk in the New Zealand context, it is not clear whether this obligation will result in a significantly different approach or outcome to the risk assessment process.

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