Deloitte.

Ministry of Justice
Phase II Anti-money laundering reforms
Business Compliance Impacts

September 2016

Contents

1. Introduction

1.1. Background and context

New Zealand's AML/CFT regime is part of a suite of initiatives directed at combating transnational and organised crime. The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act), which came into force on 30 June 2013, implemented Phase I of the reforms and applied the AML/CFT regime to banks, casinos and financial institutions.

Phase II of the reforms would extend AML/CFT obligations on lawyers, conveyancers, accountants, real estate agents and high value dealers.

1.2. Objectives and scope

The purpose of this Study is twofold:

1. To estimate the additional business compliance costs for the proposed sectors from extending the coverage of the AML/CFT reforms to these sectors; and
2. To assess the potential benefits to these sectors from this proposed extension.

The proposed sectors ("in-scope sectors") are:

- Lawyers
- Accountants
- Real estate agents
- Conveyancers
- High value dealers – 'HVD' (including: dealers in precious metals and jewels, dealers in arts and antiquities, dealers in high value goods such as boats, luxury cars etc.). For the purpose of this report the Ministry of Justice ("the Ministry") has requested that the Study focus on motor vehicle dealers, jewellers and dealers in precious metals and jewels.

This Study was completed as agreed with the Ministry of Justice in the statement of work as signed on 4 July 2016.

This report should be read in conjunction with the Statement of Responsibility at the back of the report, limitation and caveats and disclaimers set out in 1.5 and 1.6.

1.3. Report structure

This report is structured as follows:

- **Section 2** describes, in an executive summary format, the Study's quantitative results and high-level overview of key qualitative factors and the overall study methodology applied.
- **Section 3** describes the detail of the study methodology, costing framework and model, and the key assumptions made.
- **Section 4** describes the detailed findings, comprising of both quantitative and qualitative assessments.

1.4. Acknowledgment

We would like to acknowledge the assistance received from the following:

- The Ministry of Justice as lead agency for the AML/CFT reforms;
- Respondents to our online survey;
- Interviewees we spoke to (including regulators); and

- Sector / industry bodies (individually referred to in the body of this report).

1.5. Limitations and caveats

Given the 'hidden' nature of money laundering and terrorism financing, the task of estimating costs and benefits associated with the extension of the AML/CFT regime in New Zealand faces significant evidential challenges, including the limited empirical evidence available on the scale of money laundering and terrorism financing ("ML/TF").

In light of these challenges, the analysis within this Study attempts to quantify impacts wherever possible, however, in many cases the analysis relies on adopting a large number of assumptions, applying qualitative feedback and professional judgement.

In addition the following caveats apply:

- A significant representative sample across all impacted industry groups was not possible due to time constraints and low online survey responses;
- Some entities declined the invitation to participate in the interviews for reasons of commercial sensitivity;
- Cost information, where supplied either in the online survey or in interviews, was not verified or validated but taken at face value.

Care should accordingly be exercised in interpreting the results as a basis for decision-making.

1.6. Disclaimer

This report is provided solely for the exclusive use of the Ministry of Justice and solely for the purpose of providing an estimate of the compliance costs and benefits of the proposed extension of the AML/CFT regime to affected industry groups covered by Phase II of the Reforms. Our report is not to be used for any other purpose, recited or referred to in any document, copied or made available (in whole or in part) to any other person without our prior written express consent. We accept or assume no duty, responsibility or liability to any other party in connection with the report or this engagement, including without limitation, liability for negligence in relation to the estimates of compliance costs and any industry feedback expressed or implied in this report.

The assumptions used within this report are based on the prevailing AML/CFT Act and regulations in force in New Zealand at the time of writing and the cost estimates have been provided following all reasonable endeavours to ensure the underlying assumptions are reasonable given the inherent limitations. We provide no assurances that the cost estimates will remain relevant beyond the date of this report and accept no accountability or responsibility for any changes to these estimates which might be occasioned when the final Phase II anti-money laundering regulatory requirements become available.

1.7. Report Clearance

The contents of this report have been discussed with the Ministry of Justice in a series of review meetings and cleared for publication in this final form on 21 September 2016.

2. Executive summary

2.1 Reform context

This Study seeks to analyse the costs to New Zealand business of complying with the extended AML/CFT regime. There are challenges in attempting to estimate these costs, largely due to the high degree of uncertainty around the number of likely reporting entities, their awareness and understanding of AML/CFT generally and their ability to implement fit-for-purpose solutions. Mindful of these challenges and Deloitte's experience with Phase I we have used a combination of online surveys, interviews and our own independent research to, as far as is reasonably practicable, estimate the costs of introducing Phase II.

2.2 Estimation approach

The estimated costs are presented below for each of the affected 'in-scope' sectors. All figures have been presented in NZD millions except where indicated otherwise in this report as, with all studies of this kind the analysis does not have the degree of detail and confidence indicated by a more precise number.

In each case costs are broken down into 'establishment' (initial set-up) and annual ongoing (operating) costs, for which a 'low-end' and 'high-end' estimate are provided. The former, sourced from the survey data, only captured the respondents' estimates of the (external) costs they expected to pay as few if any were in a position to provide any estimates of their internal costs (i.e. costs of employee time). In contrast the 'high-end' or best estimate provides a better approximation of the expected business compliance costs by using a combination of survey data, interview insights and independent research to determine the likely internal costs and challenge the 'low-end' external costs. While figures are shown on an annual basis it is worth noting that in practice there are more likely to be overlaps between years as reporting entities will take different implementation approaches.

In order to place costs in a more meaningful context these are translated into an annual effective cost per reporting entity and per transaction / client – whichever is the most relevant measure for the service provided e.g. clients in the professional services sector vs. transactions in the real estate sector.

2.3 Costs by sector

The impact on each sector varies primarily because of the number of estimated reporting entities in each sector (where reporting entities refers to an entity that is anticipated to become compliant with Phase II AML/CFT obligations), the number of transactions or clients served, and the compliance requirements (the key drivers).

The relative impact on each entity segment also varies as a function of entity size. Our modelling has shown that relative to the 'Large' entities the cost burden for 'Medium' and 'Small' entities can increase by a factor of approximately 50% (i.e. 1.5 times 'Larger Firm') and 70% respectively (i.e. 1.7 times 'Larger Firm') on a per transaction basis within each sector. We discuss this in more detail in Section 4: Detailed Findings.

Lawyers and conveyancers

The sector comprises approximately 7,115 lawyers in firms and 992 sole practitioners[1] giving a total of 1,919 businesses. Of the 1,919 businesses, we anticipate approximately 1,572 expected reporting entities. The figures do not include overseas based NZ lawyers, 'in-house' lawyers or barristers.

The size distribution of businesses is approximately: 'Small': 981 (51%); 'Medium': 904 (47%); 'Large': 34 (2%).

[1] New Zealand Law Society

Lawyers and Conveyancers	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (based on high end cost)[2]	Estimated number of business within the Sector[3]	Estimated number of reporting entities[4]
	low	high	low	high			
	$16.1 m	$80.9 m	$14.3 m	$59.6 m	$37.76	1,919	1,572

Accountants

The sector comprises approximately 2,000 'Approved Practice Entities'[5] (in various legal forms) and a further approximately 433 book-keepers and Certified Practising Accountants, giving a total of 2,433 businesses. Of these 2,433 businesses, we expect approximately 2,223 reporting entities to require compliance with the AML/CFT regime.

The size distribution of businesses is approximately: 'Small': 1,782 (73%); 'Medium': 549 (23%); 'Large': 102 (4%).

Accountants	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (based on high end cost)[6]	Estimated number of businesses within the Sector[7]	Estimated number of reporting entities[8]
	low	high	low	high			
	$25.4 m	$101.8 m	$22.7 m	$75.5 m	$64.40	2,433	2,223

Real estate agents

The sector comprises approximately 15,000 active registered real estate agents of which 871 are companies and 148 sole traders resulting in approximately 1,019 businesses.[9] The estimated number of reporting entities is 1006.

The size distribution of businesses is approximately: 'Small': 876 (86%); 'Medium': 92 (9%); 'Large': 51 (5%).

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2 Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers in this sector.
3 New Zealand Law society
4 Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
5 Chartered Accountants Australia and New Zealand
6 Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers in this sector.
7 Chartered Accountants Australia and New Zealand, Deloitte research and information provided to us directly by the Ministry of Justice
8 Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
9 Real Estate Agents Authority (REAA)

Real estate agents	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per transaction (based on high end cost)[10]	Estimated number of businesses within the Sector[11]	Estimated number of reporting entities[12]
	low	high	low	high			
	$13.3 m	$35.0 m	$11.8 m	$23.1 m	$355.88	1,019	1,006

High-value dealers

The high-value dealers sector is more diverse and fragmented than the other in-scope sectors. Industry body penetration in the sector is significantly less than for accountants, lawyers and real estate agents and online channels are also becoming increasingly popular and prominent. This on-line presence makes it significantly more difficult to gauge the size of the sector. For purposes of this Study, these online markets have been excluded and instead the reporting entities determined on industry membership, insights from interviews with industry bodies and participants and professional judgement.

Adjustments have been made to estimated reporting entities based on anticipated businesses not engaging in cash transactions (>$10k)[13] with their customers.

The size distribution of businesses is approximately as follows:

- Motor vehicle dealers (3,255 businesses): 'Small': 2,780 (85%); 'Medium': 378 (12%); 'Large': 97 (3%).
- Jewellers (640 businesses): 'Small': 524 (82%); 'Medium': 104 (16%); 'Large': 12 (2%).
- Others: Small': 467 (100%).

High Value Dealers	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (Jewellers) and transaction (Motor Vehicle Dealers) (based on high end cost)[14]	Estimated number of businesses within the Sector[15]	Estimated number of reporting entities[16]
	low	high	low	high			
Motor Vehicle dealers[17]	$13.9 m	$65.8m	$12.1 m	$45.7 m	$77.65	3,255	2,106

[10] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated transactions completed in this sector.
[11] Real Estate Agents Authority (REAA)
[12] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
[13] Approximation based on Deloitte calculations using survey data
[14] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated transactions completed or customers in this sector.
[15] Motor Trade Association (MTA) for motor vehicle dealers and for Jewellers - The Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand
[16] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
[17] Only captures retail sales and not private sales (latter accounting for 50% of the market) as indicated by the Ministry of Justice

Jewellers	$3.2 m	$10.7 m	$2.8 m	$7.1 m	$3.37	640	229
Other	n/a[18]	$18.8 m	n/a	$12.2 m	-	467	467
TOTAL	$17.1 m	$95.3 m	$14.9 m	$65.0 m	n/a	4,362	2802

In summary, across all 'in-scope' sectors, the establishment and ongoing costs are summarised as follows:

Total	**Establishment cost (Year 1)**		**Ongoing costs (per annum)**		**Average cost per client or transaction (based on high end cost)[19]**	**ated number of businesses within the Sector[20]**	**Estimated number of reporting entities[21]**
	low	high	low	high			
Lawyers and Conveyancers	$16.1 m	$80.9 m	$14.3 m	$59.6 m	$37.76 (per client)	1,919	1,572
Accountants	$25.4 m	$101.8 m	$22.7 m	$75.5 m	$64.40 (per client)	2,433	2,223
Real Estate	$13.3 m	$35.0 m	$11.8 m	$23.1 m	$355.88 (per transaction)	1,019	1,006
Motor Vehicle Dealers	$13.9 m	$65.8m	$12.1 m	$45.7 m	$77.65 (per transaction)	3,255	2,106
Jewellery	$3.2m	$10.7 m	$2.8 m	$7.1 m	$3.37 (per client)	640	229
Other	N/A[i22]	$18.8 m	N/A[23]	$12.2 m	-	467	467
Total	**$71.9 m**	**$313.0 m**	**$63.7 m**	**$223.2 m**		**9,733**	**7,603**

2.4 Costs by compliance requirement

The Study also looked at the cost of the more significant compliance requirements and associated costs. This was done to better understand where the more significant costs fell and accordingly help inform where costs

[18] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity

[19] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated transactions completed or customers in this sector.

[20] Motor Trade Association (MTA) for motor vehicle dealers and for Jewellers - The Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand

[21] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information

[22] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity

[23] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity

might be reduced for example through proportionally reduced (risk-based) obligations for part of a sector (akin to an 'AML Lite' solution).

Overall, compliance costs are summarised below by compliance requirement. The majority of the costs are internal and attributable to setting up and maintaining an AML/CFT programme year-to-year. Other external costs are more transactional (activity-based) and therefore variable in nature.

Compliance Requirement	Establishment costs (Year 1)			Ongoing costs (per annum)		
	Internal	External	Total	Internal	External	Total
Customer due diligence	-	-	-	$11.8 m	$1.8 m	$13.6 m
Account and transaction monitoring	-	-	-	$22.0 m	-	$22.0 m
Record keeping	-	-	-	$5.4 m	-	$5.4 m
AML Risk & Compliance Programme	$231.0 m	$82.0 m	$313.0 m	$136.1 m	$46.1 m	$182.2 m
Suspicious transaction reporting	-	-	-	$0.02	-	$0.02
TOTAL	$231.0 m	$82.0 m	$313.0 m	$175.3 m	$47.9 m	$223.2 m

2.5 Interviews

In addition to the online surveys, Deloitte interviewed 20 entities from across the 'in-scope' sectors. These interviews helped obtain industry insights, including: views on inherent exposure to ML/TF activities (as a proportional measure of AML/CFT investment), general levels of understanding of AML/CFT, likely implementation strategies and possible benefits (see below).

We would like to take this opportunity to thank all those interviewed.

2.6 Reform benefits

The interviews, in particular sought to elicit views about what, if any, benefits might realise from the reforms.

Sector and entity level

In the majority of cases, respondents saw no direct benefit to their businesses from the AML/CFT investments they expected to make. On the contrary, they viewed AML/CFT as a necessary 'compliance exercise' as part of doing business with very few interviewees venturing any convincing arguments as to why they would or could realise additional 'business benefits'.

There was nonetheless an appreciation, expressed in the interviews, of country-level benefits.

Country level

There was an appreciation from some entities interviewed that New Zealand needed to align itself with other countries in fighting transnational crime, where the benefits included New Zealand safeguarding its reputation. In this regard New Zealand's ranking in Transparency International's Corruption Perceptions Index; and FATF List of Uncooperative / AML/CTF Deficient Countries were mentioned.

Beyond the risk of failing to meet our international obligations there was also recognition that the deterrence of transnational and organised crime helps toward raising the wellbeing of all New Zealanders[24].

[24] http://www.treasury.govt.nz/abouttreasury/higherlivingstandards

3. Methodology

3.1 Accounting for costs

The policy objectives of AML/CFT regulations include taking account of and minimising as far as reasonably practicable private and social costs. 'Private costs' include costs to individual economic agents such as affected Phase II entities – the scope and focus of this Study and the basis for the costing framework and models referred to below. In contrast, 'social costs' refer to the costs to the system (ultimately society) as a whole from a proposed change and includes negative externalities. The 'social costs' are outside the scope of this Study.

In a situation such as New Zealand's progressive / tranched implementation of AML/CFT regulations, there is a natural presumption that lessons learned in the earlier phase can and will usefully inform Phase II, in the process effectively reducing uncertainty and any 'learning premium' implicit in Phase I. This Study has accordingly been informed by:

- Deloitte's own insights from supporting Phase I affected clients with their respective AML/CFT implementations. This includes our understanding of the make-up of the affected sectors and businesses (including business models), as well as costs.
- Information and insights from interviews with each of the New Zealand (joint) AML/CFT regulators. The purpose of these interviews was to better understand their 'lessons learned' and the extent to which these could impact the costs and benefits under Phase II. These responses have not been separately identified but incorporated with Deloitte's own professional experience and other qualitative feedback (from affected sectors) below.

3.2 Phase I lessons learned

All three New Zealand AML/CFT regulators were interviewed to better understand the lessons learned from experience in implementing Phase I of the AML/CFT reforms to date in New Zealand. This was for the sole purpose of understanding how costs and benefits played out in reality relative to what was expected initially and also to identify any unintended consequences or observed hidden costs that could better inform this Study. The following table combines Deloitte's own experience in enabling and support Phase I with regulatory perspectives that we considered relevant in the context of this (Phase II) Study.

Area / Topic	Phase I - Lessons learned	Implications for this Study
Consultation / Supervision	• Consultation should not be focussed purely on the main centres as a lot of value can be gained by extending this to the regions, where knowledge and understanding of AML/CFT is much lower and where ML/TF activity has a higher propensity to be displaced to. • Getting businesses to become compliant for Phase II will be a process. Some businesses still did not understand what needed to be done to become compliant two years after the legislation became effective. • Regulators have under Phase I provided some support to market participants that show commitment and willingness to 'get it right'. Regulators have also advised reporting entities to seek professional advice. • In Phase I regulators established their own policies and procedures – this work is now done and can be relied upon as an investment / 'sunk cost' with benefits for both regulators and market participants in Phase II.	• Conservative estimates of time and effort made on modelling costs. • Geographic dispersion of entities has not been used as a driver in the costing model. Instead segmentation into 'Small', 'Medium' and 'Large' entities is considered a more meaningful cost driver / discriminator. • No provision has been made in the costing

Area / Topic	Phase I - Lessons learned	Implications for this Study
	• The role of industry bodies was important in Phase I and become even more so under Phase II. There is an expectation from those surveyed that their respective industry bodies would be expected to deliver training and education programs and other support to their members. This represents a potential 'hidden cost' that could result in higher membership levies if industry bodies do assume the expected role and wish to recover costs. • Delays in issuing regulatory guidance under Phase I drove unnecessary costs as many reporting entities interpreted requirements differently from their supervisors and acted / invested accordingly, only to have to rework elements of their programs and processes. • Following the Phase I experience, including feedback from industry, regulators have been making some changes to the Act and / or Regulations to make these more workable. These cover: Policy matters as well as Technical matters • On the Annual Report, experience has shown it is better to err on the side of prescription, rather than leaving too much of the content 'free-form'. • The current definition of beneficial ownership and its somewhat 'narrow' interpretation has caused some significant issues for Phase I entities – banks' de-risking being one such manifestation. • Imposing requirements that could be considered ultra vires e.g. the current AML/CFT legislation requires reporting entities to obtain and verify customers' name date of birth and address using documents provided by reputable sources. Current practice appears to have narrowed this requirement by insistence upon documents that have the customers photograph as a primary document. This can significantly increase compliance costs.	model for seeking specific external legal advice. • Given what we understand as short time frames for Phase II legislative turnaround, a possible 2 year implementation for Phase II (vs 3 years for Phase I) and a higher number of reporting entities – collectively these could drive costs for both regulators and reporting entities higher than those estimated in this Study. We are unable to estimate the extent of this potential burden.
Proportionality	• The cost in Phase I was more strongly felt by smaller businesses. It is expected that the same will be the case with Phase II and it would be better if supervisors extend a helping hand to these entities to aid initial compliance. • Compliance costs could potentially be reduced by providing exemptions to lower risk businesses or areas e.g. reviews or audit exemptions. Increasing the compliance burden too much may result in businesses simply choosing not to be compliant at all. • The legislation and supervisors require affected entities to adopt a risk based approach, this is designed inter alia, to reduce the compliance burden. This risk based approach needs to be emphasised in consultations and guidance to avoid unnecessary costs – i.e. misallocated investment. • Many Phase I businesses did not have a sound grasp of where the 'real' risks were. They weren't identifying the 'right' areas and then focusing their energies on those (risky) areas. Phase II entities need to spend more time understanding their business and associated risks to ensure that the correct focus is in place for their AML/CFT activities. (Efficient allocation of	• The costing model segments each sector into 'Large', 'Medium' and 'Small' entities in each sector, so as to be able to highlight the relative cost burden across different size entities.

Area / Topic	Phase I - Lessons learned	Implications for this Study
	limited resources). • Where appropriate external professional support has been useful. However not all professionals have really 'engaged' with their clients and a number write 'standard reports' and / or simply repeat the Act etc. not all have consistently demonstrated that they understand the business(es). This can often result in rework. • The NZ market is maturing and becoming more familiar with 'risk-based' regulations like AML/CFT – there are still instances though where there is a capability mismatch between entity level of sophistication and what is required.	
Suspicious Transaction Reporting (STR)	• Reporting of STRs for Phase II will be more manual than for Phase I. This cost will be offset largely by the fewer STRs expected to be reported given the lower transactional volumes compared to Phase I businesses. • Suspicious transaction reporting by HVDs can put them potentially at increased risk of disclosure (to criminals) than is currently the case for Phase I entities or other Phase II entities. Protecting the identity of real estate agents or pawn brokers who may submit an STR that results in an investigation and prosecution may require other 'checks and balances' driving up costs.	• Lower STR reporting assumed for Phase II
Start-up vs. ongoing	• The most significant cost for businesses to become compliant is in the start-up costs (creation of a risk assessment and work programme and putting these processes and procedures in place for the first time.)	• The costing model reflects the internal costs with AML/CFT programme establishment and ongoing costs associated with programme maintenance
Industry organisation	• The absence of unified industry organisation / association has proved a problem for some sectors when trying to 'go it alone'.	• Cost amplifying for industries without organising / representative bodies
Benefits	• AML/CFT related practices are 'good business anyway' – many market participants 'do it' but don't put the AML/CFT label on what they do. • NZ slipping from the EU 'white list' in Phase I brought it home to many market participants the very real impacts of not being in a fully compliant jurisdiction e.g. NZ (as a country) became for a while subject to enhanced CDD • Some business have shared with us feedback such as: – We now have defined business processes – Some (e.g. lower end 'money transfer operators') have not 'stepped up to the mark' and have had to exit / been forced from the industry.	• The costing model has not explicitly factored in any benefits at the entity level as the majority of surveyed and interviewed entities indicated that they did not expect to realise any benefits from their investment in AML/CFT
Phase I vs. Phase II	• Phase I and Phase II have some very different characteristics : – Phase I included very 'high transaction' entities whereas Phase II includes only some sectors / entities considered as 'higher transaction'.	• The cost model makes provision for entity size segmentation (3 categories). • The number of 'businesses' in each

Area / Topic	Phase I - Lessons learned	Implications for this Study
	– Phase I tended to be focused on 'whole of business', whereas Phase II is likely to relate to only parts of a business (services / products, people and process) – Phase I had mainly 'Large' entities, whereas Phase II is mostly concerned with small and medium-size entities.	segment has been adjusted (in arriving at # reporting entities) to take account of survey feedback where some businesses indicated that they did not meet the specified activity definitions.

3.3 Costing framework

The Study's focus and scope is on entity-specific ('private') compliance costs, which are a function of both direct and indirect drivers. The cost drivers and assumptions that underpin them are summarised below.

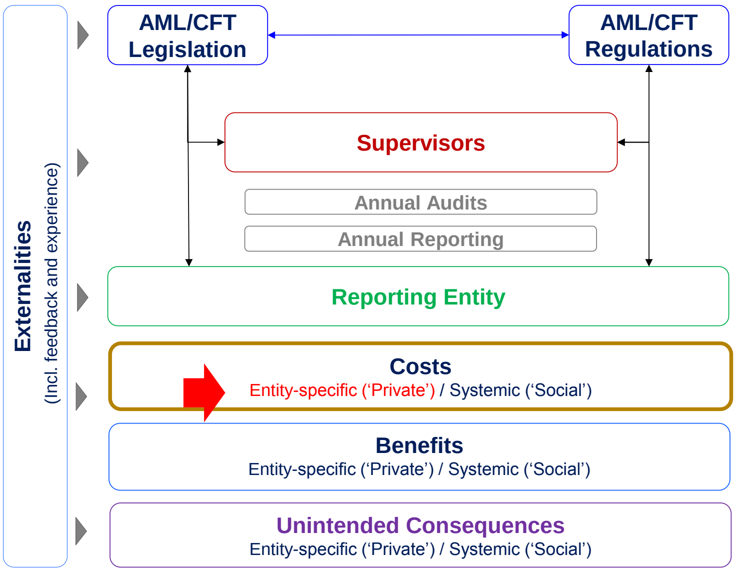

Figure 1: Cost and Benefit Drivers

3.4 Costing models

Two costing models were developed using different approaches in order to make maximum use of the limited data available from the surveys and interviews:

- **A 'top-down' approach ('low end estimate')** using data gathered from the more complete and comprehensive online survey responses we felt we could place some reliance on, and extrapolating the resulting costs across the respective sectors concerned. The primary shortcoming of this approach is that the survey results did not include any explicit or detailed account of internal (i.e. absorbed) costs as respondents were unable to supply any meaningful data in this regard. The outputs of this approach have been used as the 'low'-end estimates for purposes of the cost summaries in the executive summary and that follow.
- **A 'bottom-up' (activity-based) approach ('high end estimate')**, far more granular in detail and including internal 'absorbed' costs. Where possible data points were again used from the online survey, but the bulk were sourced from the industry bodies and other reputable sources including both

proprietary sources and publicly available sources. The outputs of this approach have been used as the 'high'-end estimates.

The results from each approach were used to cross-challenge the results of the other as a 'sense-check' across a range of model drivers and dimensions. We concluded that the results of the second ('bottom-up' approach, apart from being a more complete account of all costs (internal and external) are also more defendable from both a transparency and data quality perspective - given the combination of sources and the granularity and therefore 'challenge' and interrogation of the costs this afforded.

3.5 Cost drivers and assumptions

The primary cost drivers and assumptions in the 'bottom-up' (i.e. more detailed) costing model are as follows:

Cost Driver	Explanation
Number of 'Reporting Entities'	Reporting Entities are regulated. The number of reporting entities is calculated for each sector by identifying from reliable, authoritative sources (in most cases the Industry body concerned) the number of 'businesses' in the sector and reducing that by a % of entities claiming (via the online survey), that their activities were not captured by the regulations, applying an adjustment factor based on entity size.
Size of reporting entity	Reporting entities have been segmented into 'Small', 'Medium' and 'Large' using industry body supplied data where available. Where this data was not available Statistics New Zealand definitions and data was applied to the determined number of business in each sector to segment into 'Small', 'Medium' and 'Large' businesses.
Regulatory compliance requirement	The (5) core regulatory compliance outputs required of Reporting Entities drive the required establishment and ongoing activities needed to demonstrate compliance.

Assumption	Explanation
Sample Data representative of the population.	Certain information and data (e.g. price, volume) supplied through the surveys and interviews has been considered as representative of the relevant sectors – either where directly represented as such by respondents or where we have determined based on our own professional judgement.
Costs incurred as reported i.e. 'per annum' implied for establishment costs.	Implementation times and use of internal resourcing will vary to suit entity resource availability. While costs are reported on a 'per annum basis' it is worth noting that in practice there are more likely to be overlaps between years as reporting entities will take different implementation approaches To the extent that the additional resources cannot, for whatever reason (availability, price etc.) be sourced in the New Zealand market, these will effectively be resourced (substituted for) internally within Phase II entities themselves (through internal reallocations etc.). A number of interviewees indicated that this would be their implementation strategy.

4. Detailed Study Findings

The following section details the Study observations and assessments made in respect of each sector covering:

- Key distinctive features of the sector, including number and size of entities; sector segmentation. These indicia are considered important in reflecting the relative impact of the proposed changes on each sector;
- Cost estimates (both 'low' estimate (using 'top-down' model') and 'high' estimate (using 'bottom-up' model), as described in Section 3;
  - The impact on each sector varies primarily because of the number of reporting entities in each sector, the number of transactions or clients served, and the compliance requirements (together being the key drivers).
  - The relative impact on each entity segment also varies as a function of entity size. Our modelling has shown that relative to the 'Large' entities the cost burden for 'Medium' and 'Small' entities can increase by a factor of approximately 50% (i.e. 1.5 times 'Larger Firm') and 70% respectively (i.e. 1.7 times 'Larger Firm'). This applies to each of the sectors below where the size distribution is shown.
- Benefits cited by respondents (incorporated in the qualitative feedback); and
- Other observations and qualitative feedback from respondents relevant to the purpose and objectives of the Study.

4.1 Lawyers and conveyancers

Overview and costs

The sector comprises approximately 7,115 lawyers in firms and 992 sole practitioners[25] giving a total of 1,919 businesses. Of the 1,919 businesses, we anticipate approximately 1,570 expected reporting entities. The figures do not include overseas based NZ lawyers, 'in-house' lawyers or barristers.

The size distribution of businesses is approximately: 'Small': 981 (51%); 'Medium': 904 (47%); 'Large': 34 (2%).

Lawyers and Conveyancers Cost Estimates	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (based on high end cost)[26]	Estimated number of business within the Sector[27]	Estimated number of reporting entities[28]
	low	high	low	high			
	$16.1 m	$80.9 m	$14.3 m	$59.6 m	$37.76	1,919	1,572

The profession is already tightly regulated under the Lawyers and Conveyancers Act 2006 and through its governing body, the New Zealand Law Society "NZLS", is required to report to Parliament each year on the exercise of its regulatory functions and powers. This includes upholding the fundamental obligations imposed on lawyers of which the extension of the AML/CFT Act and Regulations will become a part.

[25] New Zealand Law Society
[26] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers in this sector.
[27] New Zealand Law society
[28] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information

Lawyers also provide conveyancing services and with conveyancers are regulated under the same Act. As at June 2015 the number of lawyers who had notified the NZLS of their intention to perform real estate services on a regular or systematic basis was 70[29]. For purposes of cost estimation we have dealt with lawyers and conveyancers together.

Surveys and interviews

The following table summarises the number of lawyers polled for the online survey, the responses received and the number of interviews conducted. Where survey respondents had partially completed the survey to a level of completion that could be utilised to help inform the business compliance costs these have been utilised. These additional survey responses have been included in the survey augmented figure in the table below.

	Surveys sent	Surveys completed	Surveys augmented	# Interviews Conducted
Lawyers	**1,400**	132 (9.4%)	191 (13.6%)	2
Conveyancers	**20**	1 (5.0%)	1 (5.0%)	3

Qualitative

Qualitative feedback from the interviews is summarised in a separate document.

Key high-level insights from these interviews relevant to and taken account of both explicitly and implicitly in the costing models are as follows:

Insight
AML/CFT Awareness Is generally quite high relative to other sectors as the Law Society has kept its members well briefed. Have benefited from AML/CFT awareness and training.
KYC Is high due to stable client base with significant repeat business. Allows for efficiency in CDD.
AML/CFT Compliance Officer Firms interviewed cited that their existing 'Trust Account supervisor' could become the natural default AML/CFT Officer due to the skills and experience being similar between the roles. Mitigates against additional costs of hiring specifically for the role.
Regulatory compliance experience and expertise Already high across the sector and therefore adapting to the AML/CFT regulations will be less onerous than for those sectors without similar experience.
Identity Verification Is already high for conveyancing transactions (required by Land-on-Line), so familiarity with the need and also the process.

[29] New Zealand Law Society - Report on the exercise of regulatory functions and powers for the year to 30 June 2015

4.2 Accountants

Overview and costs

The sector comprises approximately 2,000 'Approved Practice Entities'[30] (in various legal forms) and a further approximately 433 book-keepers and Certified Practising Accountants, giving a total of 2,433 businesses. Of these 2,433 businesses, we expect approximately 2,220 reporting entities to require compliance with the AML/CFT regime.

The size distribution of businesses is approximately: 'Small': 1,782 (73%); 'Medium': 549 (23%); 'Large': 102 (4%).

Accountants Cost Estimates	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (based on high end cost)[31]	Estimated number of businesses within the Sector[32]	Estimated number of reporting entities[33]
	low	high	low	high			
	$25.4 m	$101.8 m	$22.7 m	$75.5 m	$64.40	2,433	2,223

Surveys and interviews

The following table summarises the number of accountants polled for the online survey, the responses received and the number of interviews conducted. Where survey respondents had partially completed the survey to a level of completion that could be utilised to help inform the business compliance costs these have been utilised. These additional survey responses have been included in the survey augmented figure in the table below.

Surveys sent	Surveys completed	Surveys augmented	# Interviews Conducted
1,600	31 (1.9%)	49 (3.1%)	5

Qualitative

Qualitative feedback from the interviews is summarised in a separate document.

Key high-level insights from these interviews relevant to and taken account of both explicitly and implicitly in the costing models are as follows:

Insight

[30] Chartered Accountants Australia and New Zealand
[31] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers in this sector.
[32] Chartered Accountants Australia and New Zealand, Deloitte research and information provided to us directly by the Ministry of Justice
[33] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information

Insight
<u>AML/CFT Awareness</u> The level of maturity within the accounting sector is quite variable and the impact on accountants own businesses do not appear to be well understood or known in all cases. Investment in AML/CFT education and requirements will be needed.
<u>Customer Relationship Management</u> Strong likelihood that CRM is not as centralised as might be anticipated. Relationship Managers or Service Lines may need to collaborate even more closely in order to achieve efficiencies in CDD processes.
<u>Franchise models</u> As with real estate agents (where franchise models are more prevalent) the franchise model could present challenges with both AML/CFT costs (implementation and ongoing) as well as clarity of roles and responsibilities (Franchisor vs. franchisee).

4.3 Real Estate Agents

Overview and costs

The sector comprises approximately 15,000 active registered real estate agents of which 871 are companies and 148 sole traders resulting in approximately 1,019 businesses.[34] The estimated number of reporting entities is 1006.

The size distribution of businesses is approximately: 'Small': 876 (86%); 'Medium': 92 (9%); 'Large': 51 (5%).

Real estate agents Cost Estimates	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per transaction (based on high end cost)[35]	Estimated number of businesses within the Sector[36]	Estimated number of reporting entities[37]
	low	high	low	high			
	$13.3 m	$35.0 m	$11.8 m	$23.1 m	$355.88	1,019	1,006

Surveys and interviews

The following table summarises the number of real estate agents polled for the online survey, the responses received and the number of interviews conducted. Where survey respondents had partially completed the survey to a level of completion that could be utilised to help inform the business compliance costs these have been utilised. These additional survey responses have been included in the survey augmented figure in the table below.

[34] Real Estate Agents Authority (REAA)
[35] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated transactions completed in this sector.
[36] Real Estate Agents Authority (REAA)
[37] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information

Surveys sent	Surveys completed	Surveys augmented	# Interviews Conducted
Unknown	127	159	3

Qualitative

Qualitative feedback from the interviews is summarised in a separate document.

Key high-level insights from these interviews relevant to and taken account of both explicitly and implicitly in the costing models are as follows:

Insight
<u>Client vs. Transaction</u> Unlike many other businesses the final 'client' in a real estate transaction may not be 'clear-cut'. Through the lifecycle of a transaction e.g. multiple 'offers' can be received (incl. bids at auction), through the conveyancing process the proposed 'owner' can again change a number of times before 'title' is established in Land-on-line. This can present challenges for KYC and CDD.
<u>Foreign investors</u> The significant foreign investor base especially into the Auckland property market can present challenges with identity verification which may require more work and a longer timeframe to complete than for local resident New Zealanders.
<u>Franchise arrangements</u> As for Accountants - above
<u>Bank cleared funds</u> Nearly all real estate agents spoken to mentioned that they rely / would rely on all funds being 'bank-cleared' implying that regarding source of funds they could rely on this alone (i.e. seeing no need to make any further enquiries). This is unrealistic and in effect has the effect of arbitraging cost back to the banks.
<u>Commercial Real Estate</u> Levels of understanding of ML/TF risks posed by commercial real estate were particularly low with the entity spoken to in this market segment despite the firm being part of a global franchise.

4.4 High-Value Dealers (HVD)

Overview and costs

The high-value dealers sector is more diverse and fragmented than the other in-scope sectors. Industry body penetration in the sector is significantly less than for accountants, lawyers and real estate agents and online channels are also becoming increasingly popular and prominent. This on-line presence makes it significantly more difficult to gauge the size of the sector. For purposes of this Study, these online markets have been excluded and instead the reporting entities determined on industry membership, insights from interviews with industry experts and independent Deloitte research.

Adjustments have been made for anticipated cash transactions (>$10k)[38].

The size distribution of businesses is approximately as follows:

- Motor vehicle dealers (3,255 businesses): 'Small': 2,780 (85%); 'Medium': 378 (12%); 'Large': 97 (3%).
- Jewellers (640 businesses): 'Small': 524 (82%); 'Medium': 104 (16%); 'Large': 12 (2%).
- Others: Small': 467 (100%).

High Value Dealers Cost Estimates	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client (Jewellers) and transaction (Motor Vehicle Dealers) (based on high end cost)[39]	Estimated number of businesses within the Sector[40]	Estimated number of reporting entities[41]
	low	high	low	high			
Motor Vehicle dealers[42]	$13.9 m	$65.8m	$12.1 m	$45.7 m	$77.65	3,255	2,106
Jewellers	$3.2 m	$10.7 m	$2.8 m	$7.1 m	$3.37	640	229
Other	n/a[43]	$18.8 m	n/a	$12.2 m	-	467	467
TOTAL	$17.1 m	$95.3 m	$14.9 m	$65.0 m	n/a	4,362	2802

Surveys and interviews

The following table summarises the number of HVDs polled for the online survey, the responses received and the number of interviews conducted. Where survey respondents had partially completed the survey to a level of completion that could be utilised to help inform the business compliance costs these have been utilised. These additional survey responses have been included in the survey augmented figure in the table below.

Surveys sent	Surveys completed	Surveys augmented	# Interviews Conducted
600	35 (5.8%) (of which 24 MVDs and 11 Jewellers)	48 (8%)	8 (of which 5 MVDs and 3 Jewellers)

[38] Approximation based on Deloitte calculations using survey data
[39] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers or transactions completed in this sector.
[40] Motor Trade Association (MTA) for motor vehicle dealers and for Jewellers - The Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand
[41] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
[42] Only captures retail sales and not private sales (latter accounting for 50% of the market) as indicated by the Ministry of Justice
[43] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity

Surveys sent	Surveys completed	Surveys augmented	# Interviews Conducted

Qualitative

Qualitative feedback from the interviews is summarised in a separate document.

Key high-level insights from these interviews relevant to and taken account of both explicitly and implicitly in the costing models are as follows:

Insight – Motor vehicle dealers
<u>Bank cleared funds</u> As above for real estate agents
<u>Experience through financed deals</u> All those motor vehicle dealers spoken to had some experience of AML/CFT CDD requirements either through having to source identity verification information for finance purposes (own or third party financier).
<u>Private Sales</u> The size of the private sales market is significant and growing. These alternative markets by definition circumvent the need to deal through a dealership.
<u>Regulatory experience</u> A number of dealers referred to the already high level of regulatory requirements around: vehicle registration, CCCFA / Responsible lending among others, as indicative of their ability to adapt to AML/CFT.

Insight – Jewellers
<u>Wholesalers</u> Wholesalers were of the view that the risk (of ML/TF) lay more with their (raw gem / precious) metal suppliers (i.e. upstream) and with the retail jewellers (i.e. 'downstream'). Wholesalers saw the possibility of exemptions as being important for them.
<u>Online Businesses</u> As with motor vehicles sale there is a significant trend toward online businesses rather than 'bricks and mortar'.
<u>Size and nature of business</u> Outside of the main retailers, the bulk of jewellers are small businesses operating off low margins and with very limited capacity to absorb compliance costs. A number cited recent health and safety and factory regulations as already burdensome and hoped that the regulations would not adopt a 'one-size fits all' approach.
<u>AML/CFT Awareness</u> Is lowest relative to other sectors.

4.5 Aggregate costs

By Sector

In summary, across all 'in-scope' sectors, the establishment and ongoing costs are summarised as follows:

Total	Establishment cost (Year 1)		Ongoing costs (per annum)		Average cost per client or transaction (based on high end cost)[44]	Estimated number of businesses within the Sector[45]	Estimated number of reporting entities[46]
	low	high	low	high			
Lawyers and Conveyancers	$16.1 m	$80.9 m	$14.3 m	$59.6 m	$37.76 (per client)	1,919	1,572
Accountants	$25.4 m	$101.8 m	$22.7 m	$75.5 m	$64.40 (per client)	2,433	2,223
Real Estate	$13.3 m	$35.0 m	$11.8 m	$23.1 m	$355.88 (per transaction)	1,019	1,006
Motor Vehicle Dealers	$13.9 m	$65.8m	$12.1 m	$45.7 m	$77.65 (per transaction)	3,255	2,106
Jewellery	$3.2m	$10.7 m	$2.8 m	$7.1 m	$3.37 (per client)	640	229
Other	N/A[ii47]	$18.8 m	N/A[48]	$12.2 m	-	467	467
Total	**$71.9 m**	**$313.0 m**	**$63.7 m**	**$223.2 m**		**9,733**	**7,603**

By compliance requirement

The Study also looked at the cost of the more significant compliance requirements and associated costs. This was done to better understand where the more significant costs fell and accordingly help inform where costs might be reduced for example through proportionally reduced (risk-based) obligations for part of a sector (akin to an 'AML Lite' solution).

[44] Approximation based on Deloitte calculations using a combination of survey data, interview information and independent research. This figures is presented in NZD. The value represents the estimated total cost for this sector / total estimated customers or transactions completed in this sector.
[45] Motor Trade Association (MTA) for motor vehicle dealers and for Jewellers - The Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand
[46] Number of businesses adjusted for estimated 'non-reporting entities' from survey results and qualitative information
[47] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity
[48] As other high value dealers were not part of the survey population no low estimate is available for this category of potential reporting entity

Overall, compliance costs are summarised below by compliance requirement. The majority of the costs are internal and attributable to setting up and maintaining an AML/CFT programme year-to-year. Other costs, mainly external are more transactional (activity-based) and therefore variable in nature.

Compliance Requirement	Establishment costs			Ongoing costs		
	Internal	External	Total	Internal	External	Total
Customer due diligence	-	-	-	$11.8 m	$1.8 m	$13.6 m
Account and transaction monitoring	-	-	-	$22.0 m	-	$22.0 m
Record keeping	-	-	-	$5.4 m	-	$5.4 m
AML Risk & Compliance Programme	$231.0 m	$82.0 m	$313.0 m	$136.1 m	$46.1 m	$182.2 m
Suspicious transaction reporting	-	-	-	$0.02	-	$0.02
TOTAL	**$231.0 m**	**$82.0 m**	**$313.0 m**	**$175.3 m**	**$47.9 m**	**$223.2 m**

4.6 Benefits perspective

The interviews, in particular sought to elicit views about what, if any, benefits might realise from the reforms. These are summarised as follows:

Sector and entity level

The majority of cases respondents saw no direct benefit to their businesses from the AML/CFT investments they expected to make. On the contrary they viewed AML/CFT as a necessary 'compliance exercise' with very few venturing any convincing arguments as to why they would or could realise additional 'business benefits'.

At an entity level the potentially realisable benefits of AML/CFT benefits were presented to both online survey and interviewed respondents as outlined in the table below. The responses are those received from completed surveys:

Benefit Category / Benefit	Top 3 Benefit Statements Identified by Survey Respondents Per Category
Our financial and legal risks will reduce	
Decreased risk of breaching legal requirements	12.4%
Decreased risk of financial and/or reputational losses due to fraudulent activities both internal and external	19.7%
No perceived benefit	53.4%
Our business efficiency will improve	
Ability to make better business decisions due to improved systems, processes and reporting	8.3%
Ability to attract quality customers who enhance your brand and deter	8.3%

Benefit Category / Benefit	Top 3 Benefit Statements Identified by Survey Respondents Per Category
customers who could potentially damage your brand	
No perceived benefit	69.8%
Our governance and assurance processes will improve	
Senior management are better informed about business activities and practices because of improved systems, processes and governance structures	8.8%
Improved risk management practices and compliance capability	32.1%
No perceived benefit	59.1%
Our employee awareness and training will improve	
Enhanced employee engagement based on being part of a respected and ethical business	16.1%
Employees gain new technical skills in customer relationship management, risk management and evidence-based research	21.8%
No perceived benefit	61.7%
Our reputation and brand will be enhanced and/or protected	
Your reputation as a safe and ethical organisation to do business with is enhanced and/or maintained	22.9%
You and other businesses benefit from New Zealand's reputation as a safe and ethical place to conduct business in	17.7%
No perceived benefit	**54.2%**

Country level

There was an appreciation from some entities interviewed that New Zealand needed to align itself with other countries in fighting transnational crime, where the benefits included New Zealand safeguarding its reputation. In this regard New Zealand's ranking in Transparency International's Corruption Perceptions Index; and FATF List of Uncooperative / AML/CTF Deficient Countries were mentioned.

Beyond the risk of failing to meet our international obligations there was also recognition that the deterrence of transnational and organised crime helps toward raising the wellbeing of all New Zealanders[49].

[49] http://www.treasury.govt.nz/abouttreasury/higherlivingstandards

5. Statement of Responsibility

This engagement was performed in accordance with the terms contained in our Consulting Service Order dated 04 July 2016. Where Deloitte has provided advice or recommendations to the business compliance impacts for entities impacted by Phase II of AML/CFT regulations, we are not responsible for whether, or the manner in which, suggested improvements, recommendations, or opportunities are implemented. The management of Ministry of Justice, or their nominees, will need to consider carefully the full implications of each of these suggested improvements, recommendations, or opportunities, including any adverse effects and any financing requirements, and make such decisions, as they consider appropriate.

The work performed did not constitute an assurance engagement in accordance with the New Zealand Institute of Chartered Accountants.

The matters detailed in our report are only those which came to our attention during the course of performing our procedures and did not necessarily constitute a comprehensive statement of all the weaknesses or issues that exist or actions that might be taken. Accordingly, management should not rely on our report to identify all weaknesses and issues or actions that might be taken. The report should be read in the context of the scope of our work.

This report should not be relied upon as a substitute for actions that Ministry of Justice should take to assure itself of the business compliance impacts.

This report and all deliverables have been prepared solely for the use of Ministry of Justice, and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared, and is not intended, for any other purpose.