

# Regulatory Impact Statement: Second phase of reforms to the Anti-Money Laundering and Countering Financing of Terrorism regime

## Agency Disclosure Statement

1. This Regulatory Impact Statement (RIS) has been prepared by the Ministry of Justice. The RIS provides an analysis of options to enhance and extend New Zealand's anti-money laundering and countering financing of terrorism (AML/CFT) regime.

*Previous decisions have limited the scope of the options considered*

2. In June 2016, Cabinet agreed to progress the second phase of the reforms with a view of enacting the reforms by July 2017. In September 2016, Cabinet agreed to early policy decisions to progress the reforms. The key decisions were that:
  - 2.1. lawyers, accountants, real estate agents, conveyancers and some high value dealers will be covered in scope of the AML/CFT regime
  - 2.2. the commencement of the compliance obligations for the new sectors will be phased and conclude within two years of enacting the legislation; and
  - 2.3. the AML/CFT supervisory regime will be extended to the new sectors.
3. These early decisions limit the analysis to some extent, particularly in relation to retaining the status quo.

*The progress of the second phase of reforms was accelerated by Cabinet*

4. The progress of the reforms was accelerated following a Cabinet decision in June 2016. The truncated timeframe available to progress the reforms has limited the Ministry's ability to explore all possible options, including non-regulatory ones.

*The assessment of costs and benefits is subject to a number of uncertainties*

5. One of the key features of an AML/CFT regime is that while it imposes compliance costs on individual businesses, it produces wider benefits on the economy and society as a whole. To assess the balance between these costs and benefits, the Ministry has undertaken work to understand both the estimated level of compliance costs, and the estimated benefits of the reforms.
6. It is difficult to estimate the real costs of compliance for the new sectors. To assist in this, the Ministry commissioned Deloitte to conduct a Business Compliance Cost survey on the new sectors. Deloitte has noted that reliably identifying costs and benefits to businesses poses a unique challenge due to the inherently secretive nature of money laundering and terrorist financing. It is also difficult for the new sectors to reliably estimate the compliance costs as the new requirements are largely foreign to them. Deloitte has therefore made a number of assumptions and judgements to produce their conclusions.
7. The survey results include a range of estimated costs from a *low* estimate to a *high* estimate. The low estimate is based on the survey participants' self-assessment of the compliance costs,

and the high estimate combines this survey data with insights from interviews with businesses and independent research. The Ministry acknowledges that the range is broad, and due to the uncertainties in the estimations, has chosen not to present an adjusted figure within the range.

8. It should also be noted that the Business Compliance Cost survey was commissioned at a time when detailed policy decisions had not yet been made by Cabinet. The survey parameters were therefore set based on early predictions of the policy direction. This is particularly relevant for survey data on high value dealers, which only focuses on a narrow part of the wider sector, and only indicates costs based on full compliance obligations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act).
9. Some of the benefits of the reforms are by their nature unquantifiable. These include the benefits of detecting terrorist financing that may facilitate a terrorist attack, and the exact benefits of maintaining New Zealand's international and trade reputation. It is also very difficult to quantify other benefits such as the deterrent effect of a comprehensive AML/CFT regime, which extends to international criminals and terrorists who are seeking loopholes in the global system.
10. Taking into account these constraints, the Ministry has analysed the balance between the costs and benefits of the reforms. This analysis takes into account the high estimates for compliance costs, and conservative (i.e. low) estimates of the benefits. Benefits that are challenging to quantify – the deterrent effect, the reduction in social harm and the impact on New Zealand's international reputation – have been excluded from the equation. This is why the eventual benefits are likely to be more significant than what is indicated in the analysis.

*Further work is required to implement the Phase II reforms*

11. The current AML/CFT legislation consists of the AML/CFT Act and five sets of regulations. In general, the broad framework of the regime is set out in the AML/CFT Act, and specific details such as thresholds are set out in regulations. Subject to Cabinet's approval, this approach applies also to the second phase of reforms.
12. As a result, the RIS focuses on options relevant to items to be included in the AML/CFT Amendment Act. This does not include specific details about the coverage of new sectors in scope of the AML/CFT regime, for example. Additional regulatory impact analysis will be undertaken in due course to assess options relevant to amending or issuing regulations.



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## Executive summary

1. Some money laundering and terrorist financing is currently going undetected in New Zealand. In addition to domestic criminals taking advantage of the situation, New Zealand can be targeted by international criminal networks as a global weak link to inject the proceeds of crime into the international financial system.
2. New Zealand has an anti-money laundering and countering financing of terrorism (AML/CFT) regime – but the regime is not appropriate to the level of risk. High risk sectors such as lawyers, real estate agents, accountants and dealers in high value goods are not required to comply with the AML/CFT obligations. The sectors' current reporting and identity verification requirements are not sufficiently robust, and there is no supervision in place to monitor and enforce compliance.
3. The gaps in the regime reduce the availability of necessary information about financial activities, hindering the effective detection and deterrence of money laundering and terrorist financing. Undetected money laundering reduces the integrity of the financial system, distorts the economy and diminishes opportunities for legitimate activities. The Government loses tax revenue, while criminals get rewarded for their behaviour. Undetected terrorist financing can hinder the detection of terrorist activities, leading to potentially catastrophic consequences for society.
4. The Government has agreed to progress the second phase of reforms to the AML/CFT regime. This decision was made preliminarily in 2008 when the Government agreed to progress the first phase of the reforms (*Phase I*). In June 2016, the decision to progress the second phase (*Phase II*) was confirmed with a view of enacting the reforms by June 2017. In September 2016, Cabinet made preliminary decisions which included that lawyers, accountants, real estate agents, conveyancers and some high value dealers will be covered in scope of the AML/CFT regime.
5. This RIS analyses scope and timing options for including the following sectors in scope of the AML/CFT regime:
  - 5.1. lawyers and conveyancers
  - 5.2. accountants
  - 5.3. real estate agents
  - 5.4. dealers in high value goods; and
  - 5.5. gambling service providers.
6. The RIS also analyses options for the following:
  - 6.1. the AML/CFT supervisory model for the Phase II sectors
  - 6.2. improving information sharing within the AML/CFT regime
  - 6.3. expanding the suspicious transaction reporting requirements
  - 6.4. amending the provisions that allow reporting entities to rely on other entities
  - 6.5. expanding the ability to conduct simplified customer due diligence on new groups; and
  - 6.6. expanding the AML/CFT obligations for trust and company service providers

7. In addition to these more significant amendments, the RIS analyses a number of minor amendments to the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act). Very minor amendments with no significant regulatory impacts have not been analysed in the RIS.
8. The RIS presents estimates of the compliance costs for the new entities, which have been derived from a Business Compliance Cost survey conducted by Deloitte for the Ministry of Justice. The compliance costs have been estimated using a number of assumptions as presented in Part 4 of the RIS. Subject to Cabinet decisions particularly on including high value dealers in the regime, the Phase II reforms are estimated to result in the following compliance costs:

Sector	Totals by sector – \$ million				Average cost per client or transaction ( <i>high estimate</i> )	Estimated sector size	Estimated reporting entities
	Start-up total (year 1)		Ongoing (per annum)				
	Low	High	Low	High			
Lawyers and conveyancers	\$16.10	\$80.90	\$14.30	\$59.60	\$37.76	1,919	1,572
Accountants	\$25.40	\$101.80	\$22.70	\$75.50	\$64.40	2,433	2,223
Real estate agents	\$13.30	\$35.00	\$11.80	\$23.10	\$355.88	1,019	1,006
Motor vehicle dealers	\$13.9	\$65.80	\$12.10	\$45.70	\$77.65	3,255	2,106
Jewellers	\$3.2	\$10.70	\$2.80	\$7.10	\$3.37	640	229

Table 1. Summary of the estimated total sector-wide compliance costs. Source: Deloitte Business Compliance Cost survey.

9. In addition, the RIS includes estimates for the costs to Government arising from extending the AML/CFT supervisory model. The costs for the three options analysed can be summarised as follows:

Supervisory model	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	Total	Average per year	Year 1 set up costs
Status quo	The status quo does not incur costs for the government.							
Single supervisor	\$13.3	\$12.6	\$13.9	\$14.4	\$14.6	<b>\$68.8</b>	\$12.7	\$ 5.5
DIA	\$6.8	\$11.6	\$12.9	\$13.4	\$13.6	<b>\$58.3</b>	\$11.7	N/A
Government and self-regulatory bodies	\$9.4	\$16.1	\$16.6	\$17.1	\$17.4	<b>\$76.5</b>	\$15.3	N/A

Table 2. Summary of the estimated costs for the AML/CFT supervisory models. Costs expressed in \$ millions.

10. It should be noted that funding for Police will also be required to respond to projected increases in reporting and to ensure additional money laundering and terrorist financing investigations can be undertaken.
11. One of the key features of an AML/CFT regime is that while it incurs compliance costs on individual businesses, it produces wider benefits on the economy and society as a whole. Estimates of these benefits are therefore also presented. On balance, it is estimated that the ratio between the costs and the benefits is between 0.84 and 0.98. This range reflects different assumptions about the success of restraints and the rate at which restraints of assets are ultimately converted to forfeitures. It should, however, be noted that the estimated benefits considered in this ratio are conservative (i.e. low), while the compliance costs are based on the *high* estimates.
12. Further, a number of benefits that are challenging to quantify have been excluded from the ratio. Several potentially large non-quantifiable benefits include the reduction of social harm from reduced financial crime and underlying offending, the deterrent effect of the expanded measures, and the benefits derived from maintaining New Zealand's international and trade reputation.
13. The following table provides a summary of the Ministry's recommended options on each of the substantive issues.

Issue	MOJ recommendation
<b>Lawyers and conveyancers</b>	Require full compliance with AML/CFT obligations where high-risk services are provided. Require CDD when a business relationship is formed. Amend the existing provisions around legal professional privilege to align with the Evidence Act 2006 and the Search and Surveillance Act 2012.
<b>Accountants</b>	Require full compliance with AML/CFT obligations where high-risk services are provided. Require CDD when a business relationship is formed.
<b>Real estate agents and developers</b>	Require full compliance from real estate agents and property developers with AML/CFT obligations where high-risk services are provided. Require CDD on to be conducted only on the client and not the opposing party.
<b>High value dealers</b>	Two options are put forward for Cabinet decision. These are applying full compliance obligations on jewellers and motor vehicle dealers, and applying limited compliance obligations on jewellers and dealers in motor vehicles, boats, art and antiques, as well as second hand dealers and auctioneers.
<b>Gambling sector</b>	Expand AML/CFT obligations to the New Zealand Racing Board.
<b>Implementation period</b>	Phase the implementation over two years in the following way: lawyers and conveyancers after 6 months, accountants after 12 months, real estate sector and gambling providers after 18 months and high value dealers after 24 months.
<b>AML/CFT supervision</b>	The DIA as the supervisor for all Phase II sectors.
<b>Information sharing</b>	Create a new mechanism for 'structured flexibility' in information sharing.
<b>Suspicious activity reporting</b>	Include suspicious activity reporting in the AML/CFT regime.
<b>Reliance on third parties</b>	Amend the definition of <i>designated business group</i> and the circumstances for reliance (documents to be provided <i>upon request without delay</i> as opposed to within five days).
<b>Simplified CDD</b>	Expand simplified CDD requirements to New Zealand Owned Enterprises and majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions.
<b>Trust and company service providers</b>	Require full compliance when providing high risk services in the <i>ordinary course of business</i> .

Table 3. Summary of the Ministry's recommendations on each of the substantive issues in the RIS.

# 1. Status quo and problem definition

## 1.1 Money laundering and terrorist financing pose a threat to New Zealand

14. Money laundering and terrorist financing are serious global problems that pose a threat to New Zealand society and the economy. Money laundering is the process by which money obtained through crime is made legitimate to conceal its criminal origins. The financing of terrorism often uses similar methods as those used for money laundering.
15. New Zealand has an AML/CFT regime, but the regime is not appropriate to the level of risk. The lack of reporting and the poor availability of information prevent law enforcement from seeing the full picture of criminal operations. This, in turn, prevents the effective detection and prosecution of money laundering and its predicate offences such as fraud, tax evasion and drug offending. Similarly, the lack of detection of terrorist financing prevents law enforcement from following the funds to and from the originators, facilitators and recipients of funds used in financing terrorism.
16. Undetected money laundering has serious consequences for the legitimate economy. It diminishes the opportunities for legitimate businesses and activities<sup>1</sup>, and has the potential to distort the market by skewing prices and increasing the cost of borrowing, for example. When money laundering is not detected, criminals also get to enjoy the proceeds of their crimes – and may reinvest their funds in further criminal activities. In addition to domestic criminals taking advantage of the situation, New Zealand can be targeted by international criminal networks as a global weak link to inject the proceeds of crime into the international financial system.
17. While the exact scale of the illicit funds is hard to quantify, Police estimate that approximately \$1.35 billion of domestic proceeds of crime are laundered per annum as a result of economically motivated crimes defined under the Crimes Act 1961. This includes proceeds from some frauds and drug offences, but excludes illicit funds from other predicate offences such as tax evasion and any offences committed overseas<sup>2</sup>. This figure also does not include the cost of the social harm that results from money laundering and its predicate offences such as drug offending.
18. Undetected terrorist financing, on the other hand, can have potentially catastrophic consequences for the society. While New Zealand's current domestic terrorism threat level remains below that of its partner countries, the situation can change rapidly. In addition, gaps in the AML/CFT regime may invite overseas groups to use New Zealand as a conduit for funds to capitalise on New Zealand's current reputation as being low risk for terrorist financing.

## 1.2 The Government agreed to implement the AML/CFT reforms in two phases

19. In 2008, the Government decided to implement the AML/CFT regime in two phases. The first phase (*Phase I*) was implemented when the AML/CFT Act came into force on 30 June 2013.

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<sup>1</sup> For example, criminals operating a business as a money laundering front can keep their prices significantly lower than legitimate businesses. The illicit funds generated through criminal activity can then be co-mingled with legitimate revenue.

<sup>2</sup> This is therefore a conservative estimate of the total amount laundered in New Zealand as it excludes tax evasion, benefit, health and ACC fraud, serious fraud, environmental crimes such as illegal fishing, and illicit funds from overseas.

There was an agreement to progress the second phase of reforms (*Phase II*) at a later stage. The two-phase process was to stage the coverage of the AML/CFT compliance obligations as follows:

- 19.1. **Phase I** covered financial institutions such as banks and money remitters and casinos
  - 19.2. **Phase II** intends to cover non-financial businesses and professions such as lawyers, conveyancers, accountants, real estate agents and high value dealers.
20. In June 2016, Cabinet agreed to progress Phase II with a view of enacting the reforms by July 2017. In September 2016, Cabinet agreed to early policy decisions. The key decisions were the following:
- 20.1. lawyers, accountants, real estate agents, conveyancers and some high value dealers will be covered in scope of the AML/CFT regime
  - 20.2. the commencement of the compliance obligations for the new sectors will be phased over two years; and
  - 20.3. the AML/CFT supervisory regime will be extended to the new sectors.
21. To monitor reporting entities' compliance with the obligations, New Zealand has implemented a supervisory regime under the AML/CFT Act. The model has assigned an AML/CFT supervisory function to three Government departments: the Financial Markets Authority (FMA), the Reserve Bank of New Zealand (RBNZ) and the Department of Internal Affairs (DIA).
22. Where breaches of the AML/CFT Act are detected, the Act provides both a civil and a criminal penalty regime. The AML/CFT supervisors have sanctions at their disposal, ranging from formal warnings for minor breaches to applying to the court to impose fines for serious breaches. The Act also provides Police the authority to pursue criminal charges in certain situations, such as when reporting entities fail to report suspicious transactions or provide false or misleading information in connection with such reports.
23. The AML/CFT regime is informed by the international standards set by the Financial Action Task Force (FATF) – an intergovernmental forum of technical experts on money laundering and countering financing of terrorism. In addition to the FATF, New Zealand is a member of one of its regional bodies, the Asia / Pacific Group on Money Laundering (APG). As a member of these bodies, New Zealand has committed to the effective implementation of the international standards, which are known as the FATF Recommendations.

### **1.3 The Phase II sectors are considered to be a high risk**

24. The Phase II sectors are non-financial businesses that can often act as gatekeepers to the financial system. The New Zealand Police Financial Intelligence Unit (FIU) identified these sectors to be a high risk for money laundering and terrorist financing in its 2010 National Risk Assessment, and further typologies reports produced by the FIU confirm this risk. Generally, the benefits of using the gatekeeper professions can be summarised as follows:
- 24.1. the impression of respectability or legitimacy and normality especially in large transactions
  - 24.2. a further step in the money laundering chain which frustrates detection and investigation; and



- 24.3. allowing criminals to access services and techniques that they would not ordinarily have access to, which may be as simple as making introductions (such as opening an account) or facilitating setting up structures such as trusts and companies.
25. Recent Police investigations have exposed that abusing professional services, real estate and high value dealers is often closely linked to organised crime and drug offending. In a Police study of 57 asset recovery cases, misuse of professional services<sup>3</sup> was identified in 15 cases (26%) relating to over \$137 million – 62% of the assets in the sample. 46% of cases in the sample involved trusts, which were especially common in drugs cases. Company structures were misused in 29% of fraud cases in the sample which accounted for 71% of assets in fraud cases<sup>4</sup>.
26. The specific risks associated with the Phase II sectors are assessed in part three of this RIS.

*The risk associated with gatekeeper professions has been well established internationally*

27. In addition to domestic evidence, the money laundering and terrorist financing risk associated with the non-financial sectors has been well established internationally. As an example, the FATF published the *Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals* report in 2013. The report establishes a continuum of involvement of legal professionals in money laundering which applies equally well to other professionals and gatekeepers:

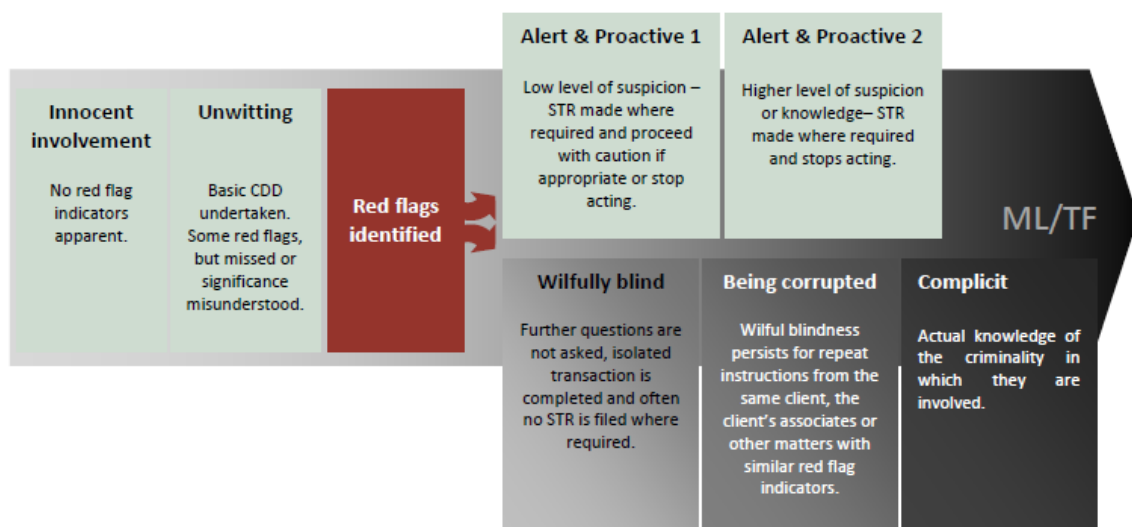


Figure 1. Continuum of involvement of legal professionals in money laundering. Source: *FATF Report Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals (2013)*. CDD = customer due diligence, STR = suspicious transaction report.

28. To reflect the risk associated with these sectors, the FATF Recommendations require the following measures to apply:

<sup>3</sup> The types of professional services included use of client accounts, purchase of real estate, creation and management of trusts, and transfer of ownership of assets to third parties.

<sup>4</sup> The types of assets recovered include property, shares, bonds and other monetary instruments, cars, boats, motorbikes, precious stones and metals, and art/antiquities.

Sector	The requirements apply...	Requirements in the Recommendations
<b>Lawyers and accountants<sup>5</sup></b>	When they prepare for or carry out transactions for their client concerning the following activities: <ul style="list-style-type: none"> <li>• buying and selling of real estate</li> <li>• managing of client money, securities or other assets</li> <li>• management of bank, savings or securities accounts</li> <li>• organisation of contributions for the creation, operation or management of companies</li> <li>• creation, operation or management of legal persons or arrangements, and buying and selling of business entities.</li> </ul>	Undertake customer due diligence (CDD) on their customers Keep CDD and transaction records Identify and manage risks associated with politically exposed persons and new technologies Implement programmes against money laundering and terrorist financing Apply enhanced CDD measures to business relationships and transactions from high risk countries identified by the FATF
<b>Real estate agents</b>	When they are involved in transactions for their client concerning the buying and selling of real estate.	Report suspicious transactions
<b>Dealers in precious metals and stones</b>	When they engage in any cash transaction with a customer equal to or above USD/EUR 15,000.	

Table 4. Summary of the FATF Recommendations on the Phase II sectors.

### *Government Inquiry into Foreign Trust Disclosure Rules*

29. In April 2016, there were widespread media reports on the content of the ‘Panama Papers’, a leak of confidential papers from the Panamanian law firm Mossack Fonseca. Some media reports indicated that the papers included references to New Zealand-based foreign trusts, which may have been used for tax evasion or other illicit purposes. As mentioned above, lawyers and accountants play a key role in facilitating the establishment of trusts for both domestic and foreign customers.
30. As a response, Cabinet announced the Government Inquiry into Foreign Trust Disclosure Rules, which was conducted by tax expert John Shewan and was published in June 2016. The following recommendations from the Inquiry relate to AML/CFT:
- 30.1. early revocation of current exemption for lawyers and accountants from AML/CFT reporting requirements<sup>6</sup>
  - 30.2. mandatory requirement to verify in all cases the underlying source of funds or wealth settled on a foreign trust
  - 30.3. expand the guidelines on the scope of customer due diligence required in establishing and verifying beneficial ownership, effective control and source of funds in complex multi-layered trust structures; and
  - 30.4. revise the suspicious transaction reporting requirements to facilitate the reporting of actual or proposed transactions that have not or will not necessarily go through a New Zealand bank.

<sup>5</sup> The exact definition is *lawyers, notaries, other independent legal professionals and accountants – this refers to sole practitioners, partners or employed professionals within professional firms. It is not meant to refer to ‘internal’ professionals that are employees of other types of businesses, nor to professionals working for government agencies, who may already be subject to AML/CFT measures.*

<sup>6</sup> Regulation 20 of the AML/CFT (Definitions) Regulations 2011 explicitly excludes a set of entities including lawyers, conveyancers, accountants and real estate agents from the scope of the AML/CFT Act.

31. In addition, the Inquiry recommended undertaking a review of the current legislative arrangements for the sharing of information between New Zealand Government agencies (specifically Inland Revenue, FIU and the Department of Internal Affairs). While this review is intended to be separate from the Phase II policy process, there is an opportunity to address some information sharing issues as part of Phase II.

*The Shewan recommendations align with the risk associated with trusts*

32. The findings and recommendations from the Inquiry align with the established risk associated with complex legal arrangements such as trusts. Each year, the FIU receives a significant number of enquiries from international counterparts about New Zealand legal arrangements that are suspected of effecting a range of financially-motivated crime, including tax evasion, people, drugs and arms trafficking, fraud and corruption. This reduces New Zealand’s reputational capital and ties up scarce local investigative resource.
33. A high proportion of current suspicious transaction reports also relate to domestic trusts<sup>7</sup> and companies, and this indicates that New Zealand criminals are known to be using these structures for illicit purposes. Criminal beneficial owners of trusts and companies can use the structures in a similar way than other, legitimate individuals. For example, several drug operations have used family trusts to launder illicit funds.

#### **1.4 The current obligations on Phase II sectors are insufficient to deter and detect money laundering and terrorist financing**

34. The Financial Transactions Reporting Act 1996 (FTRA) currently requires lawyers, conveyancers, real estate agents, accountants and the New Zealand Racing Board to comply with some identity verification, record-keeping and suspicious transaction reporting requirements. However, these obligations only apply in limited circumstances and are not as comprehensive as those under the AML/CFT Act. Some Phase II sectors are also required to comply with existing professional standards set by their industry bodies. In general, however, the professional standards differ or are less detailed than what is required under the AML/CFT Act.
35. The compliance obligations under the AML/CFT Act form a comprehensive set of measures to detect and deter money laundering and terrorist financing. The measures contribute to a heightened awareness of money laundering and terrorist financing, and establish mechanisms to gather, report and retain the relevant information. The AML/CFT Act provides for supervision and tools to monitor and enforce compliance.
36. The following table compares the summarised requirements under the FTRA with those currently required from Phase I reporting entities under the AML/CFT Act:

	FTRA	AML/CFT Act
<b>Customer due diligence (CDD)</b>	Identity verification is required in limited circumstances (when financial institutions (FIs) receive cash payments over \$10,000 for the purposes of deposit or investment or settling real estate	CDD is required when a reporting entity (RE) establishes a business relationship with a new customer or when a customer seeks to conduct an occasional transaction through the RE. CDD must be ongoing to ensure that the business relationship and associated transactions are consistent with the RE’s knowledge about the customer

<sup>7</sup> The FIU has identified 504 suspicious transaction reports between 1 January 2008 and 31 December 2014 relating to around 200 trusts. The reports included around 600 transactions amounting to over \$200 million.

	transactions. If the FI has reasonable grounds to believe the customer is conducting the transaction on behalf of another person, the identity of the other person needs to be verified. There are no requirements to verify the identity of beneficial owners of customers.	and the customer's risk profile. The CDD requirements include verifying the identity of the customer, any beneficial owner of a customer, and any person acting on behalf of a customer.
<b>Enhanced CDD</b>	No requirements.	CDD can be enhanced, standard or simplified according to the level of risk. REs must be able to identify and manage risks associated with high risk customers such as trusts, customers from high risk jurisdictions and politically exposed persons.
<b>Account monitoring</b>	No requirements.	REs must proactively monitor customers' accounts to identify suspicious activity.
<b>Suspicious transaction reporting</b>	FIs must report to the FIU when they have reasonable grounds to suspect that the transaction involves money laundering, terrorist financing or the proceeds of crime.	REs must report to the FIU when they have reasonable grounds to suspect that a transaction is related to <i>any</i> offence <sup>8</sup> .
<b>Record keeping</b>	Relevant records must be kept for a period of at least five years after the transaction has been completed or the business relationship has ended.	Relevant records must be kept for a period of at least five years after the transaction has been completed or the business relationship has ended.
<b>Staff requirements</b>	No requirements.	REs must have an AML/CFT compliance officer. Staff involved in AML/CFT and senior managers must be vetted and trained appropriately.
<b>Risk assessment</b>	No requirements.	REs must undertake an assessment of the ML/TF risk associated with their business. This must include an assessment of the types of the RE's customers, the products and services it offers, the methods it uses to deliver the products and services, and the countries and institutions it deals with.
<b>Reporting and audit</b>	No requirements.	REs must prepare an annual report on their risk assessments and AML/CFT programmes. The risk assessment and AML/CFT programme must be audited every two years.
<b>Supervision</b>	No supervision.	REs' compliance is supervised by the AML/CFT supervisors. There are sanctions for non-compliance.

Table 5. Comparison of compliance obligations under the FTRA and the AML/CFT Act.

*Effectiveness of the FTRA regime is estimated to be low*

37. At the strategic level, it is difficult to assess how effective the FTRA measures and professional standards are at deterring and detecting money laundering and terrorist financing. This is

<sup>8</sup> The AML/CFT Amendment Act 2015 changed the reporting requirement to apply to any offence. This Act will come into force on 1 July 2017.

particularly difficult because there is no supervisory agency to monitor and enforce compliance with the obligations. The AML/CFT regime, in contrast, has a supervisory regime as explained above.

38. The number of suspicious transaction reports from the Phase II sectors under the FTRA can be used to provide an indication of the level of compliance. The limited suspicious transaction reporting requirements have resulted in poor intelligence from the Phase II sectors. To summarise, the FIU has received the following numbers of suspicious transactions reports from the Phase II sectors:

	Average STRs per annum before the commencement of the AML/CFT Act	Average STRs per annum after commencement of the AML/CFT Act	Total STRs between 1996 and 2016
Lawyers	9.7	7	186
Accountants	0.36	0	6
Real estate agents	4.7	1.3	60
NZ Racing Board	17.4	2	267

Table 6. Summary of suspicious transaction reports received by the FIU from the Phase II sectors. Source: FIU.

39. The reporting numbers indicate that the reporting of suspicious transactions from the Phase II sectors has always been low. However, the number decreased even further after the commencement of the AML/CFT Act in 2013. The New Zealand Racing Board was granted a Ministerial exemption from the Act in September 2013.
40. This provided specific exclusions from the AML/CFT Act (and the relevant reporting requirements) for lawyers, accountants and real estate agents.
41. To provide context, the total number of STRs received by the FIU in the 2014—2015 year was 11,692. The implementation of Phase I of the AML/CFT regime increased the Phase I entities' reporting of suspicious transactions by 350% over the two-year period after implementation.

## 1.5 Gaps in the AML/CFT regime prevent the effective detection of crime

42. As the Phase II sectors are currently not covered by the AML/CFT Act, there is insufficient reporting of suspicious transactions from these sectors to the FIU. In most cases, transactions made through the Phase II sectors are not traceable back to their origins and the customers' identities may be unknown. As mentioned above, undetected money laundering harms legitimate businesses and also translates to lost Government revenue both from unpaid taxes and missed opportunities to confiscate criminal assets – and undetected terrorist financing can potentially compromise New Zealand's national security and cost human lives.
43. In addition to the detection of criminal activity, the AML/CFT regime focuses heavily on proactive prevention and deterrence. Reporting entities are required to assess and understand the money laundering and terrorist financing risks facing their business and train their staff appropriately. The insufficient AML/CFT controls within the Phase II sectors contribute to a poor preventative and deterrent effect, and send a message that criminal activity can be profitable.
44. The insufficient AML/CFT controls can also contribute to New Zealand being considered a global weak link from two perspectives:

- 44.1. international criminal networks can target New Zealand to inject the proceeds of crime into the international financial system; and
  - 44.2. the poor availability of intelligence can undermine New Zealand's responsibilities as part of the global law enforcement community, and particularly the Five Eyes intelligence alliance with the United States, United Kingdom and Australia.
45. Further, money laundering and terrorist financing are evolving, dynamic threats. The methods develop in parallel with the regulatory developments – where one avenue is closed off, another unregulated one will attract more financial flows. It is therefore critical to close the existing loopholes in the system by extending the AML/CFT obligations to non-financial businesses and professions. The dynamism also means that a further phase of reforms to the AML/CFT regime can be expected in the future.
46. The dynamism applies particularly to the threat of terrorist financing and terrorism more generally. Globally, this threat has changed significantly over the past few years. Efforts are also being made to understand the regional threat of terrorist financing, as evidenced by the recently published *Regional Risk Assessment on Terrorism Financing 2016* developed by the Australian and Indonesian FIUs. It is critical for New Zealand to respond to the evolving threats both domestically, regionally and internationally and revise its legislation where appropriate.

## 1.6 New Zealand's international reputation could be compromised

47. As a member of the FATF and the APG, New Zealand has made a commitment to effectively implement the FATF Recommendations. The current AML/CFT regime for the Phase II sectors is, however, out of step with the Recommendations and international best practice.
48. New Zealand's AML/CFT regime, or any perceived gaps in it, directly affects New Zealand's international and trade reputation<sup>9</sup>. New Zealand is due to be evaluated on its compliance with the FATF Recommendations in 2020. A finding of continued non-compliance with the Recommendations carries the following potential risks:
- 48.1. possible increased cost of borrowing overseas for both the Government and private sector, as overseas lenders perceive New Zealand as a greater financial risk and demand a bigger margin to compensate;
  - 48.2. difficulties (in the form of increased costs or lost business opportunities) for New Zealand companies in doing business overseas, as other countries may have laws that discriminate against non-compliant countries; and
  - 48.3. overseas investment in New Zealand may be reduced because of investors' perception of increased risks, or legal restrictions in the investors' home jurisdictions.
49. New Zealand also plays a leading role in the Asia-Pacific region and as an example, recently concluded its two-year term as the co-chair of the APG. New Zealand has also provided technical assistance to the Pacific countries in particular to improve the effectiveness of their AML/CFT regimes. The weaknesses in New Zealand's own AML/CFT regime create a risk of losing credibility and influence in the region.

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<sup>9</sup> This has been demonstrated in the past when New Zealand was removed from the European Union's (EU) banking and corporate "white list" status in 2012 to the tangible detriment of New Zealand businesses. The removal was a consequence of FATF finding deficiencies in NZ's AML/CFT measures.

## **1.7 Phase II offers an opportunity to reform parts of the existing system**

50. The current AML/CFT regime has been in place for three years. During this time, a number of issues have arisen that warrant improvements to the existing regime. In addition, the international standards on AML/CFT have developed further since the policy consideration on Phase I. Phase II offers an opportunity to fix any identified gaps in the existing regime.

## 2. Objectives

51. The purpose of the RIS is to analyse and identify the status quo, and different options for Phase II of reforms to New Zealand's AML/CFT regime.
52. The objectives of the reforms can be grouped to primary and subsidiary objectives. The primary objectives correspond to the purposes of the existing AML/CFT Act, as follows:
  - 52.1. *Primary: Detect and deter money laundering and the financing of terrorism*

Subsidiary: The non-financial sectors posing a risk of money laundering and terrorist financing are complying with appropriate AML/CFT measures, and contributing to the wider effort to detect and deter money laundering and terrorist financing.
  - 52.2. *Primary: Maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the FATF*

Subsidiary: New Zealand's AML/CFT regime is more closely aligned with the FATF recommendations, contributing to New Zealand's international reputation.
  - 52.3. *Primary: Contribute to public confidence in the financial system*

Subsidiary: Public confidence in the financial system is enhanced by closing loopholes that criminals can use to launder money or finance terrorism. As the Phase II sectors are not strictly part of the financial system, the objective also encompasses public confidence in the professional services system.

### 2.1 Criteria to assess the options

53. In considering the objectives, we have used the following criteria for assessing the options:
  - 53.1. **Effectiveness at detecting and deterring money laundering and terrorist financing:** The option is effective at deterring and detecting money laundering and the financing of terrorism, and aligns with New Zealand's existing AML/CFT regime. The regime delivers intelligence to detect and deter all other economically motivated crime.
  - 53.2. **Proportionality:** The compliance burden associated with the option is proportionate to the money laundering and terrorist financing risk. The option does not impose undue compliance burden on reporting entities or supervisors, businesses or customers attempting to undertake legitimate transactions.
  - 53.3. **Practicality:** The option is likely to be easy for reporting entities and supervisors to understand, implement, and monitor. The option will contribute to reporting entities' level of compliance.
  - 53.4. **International standards:** The option is in line with the FATF recommendations on AML/CFT, and contributes to the effectiveness of New Zealand's AML/CFT regime which will be assessed by the FATF in 2020.



### 3. Options and impact analysis

#### 3.1 Categorisation of the amendments

54. The amendments have been categorised as follows:

54.1. **Significant:** amendments that significantly change or expand the legislation in practice. These amendments expand the AML/CFT regime to new sectors, amend the AML/CFT supervisory framework, and make other changes to the existing AML/CFT regime.

54.2. **Minor:** amendments that are important because the legislation is changed or expanded, but have only a minor impact in practice. These amendments mainly relate to fixing issues with the existing AML/CFT regime.

55. The analysis on the amendments is included in the following:

55.1. Significant amendments are included in Part A; and

55.2. Minor amendments are included in Part B.

#### 3.2 Options analysed

56. The analysis covers the options of:

56.1. the status quo (where applicable); and

56.2. depending on the proposal, a number of options. The options analysis includes an assessment of the option *compared* to the status quo, and the difference the option would make. The difference has been assessed using the following symbols:

- worse than status quo
- 0 equivalent to status quo
- + better than status quo
- ++ much better than status quo

56.3. Where the status quo is inapplicable, the following symbols have been used:

- ✓ the option meets the criterion
- ~ the option meets the criterion to some extent
- ✗ the option does not meet the criterion

56.4. Where applicable, the Ministry's preferred option has been identified at the end of the analysis.

## Part A – Analysis of significant amendments

### Amendments to include new sectors in scope of the AML/CFT Act

57. These amendments expand the scope of the entities covered by the AML/CFT Act.

### Lawyers and conveyancers

58. Some legal services are considered to be high risk by the FIU. Lawyers and conveyancers often act as gatekeepers to the financial system, and using their services can give the impression of legitimacy, creates a further step in the money laundering chain, and allows criminals to access services and techniques they would not ordinarily have access to. After the implementation of Phase I of the AML/CFT regime, it has also been increasingly difficult to launder illicit funds through banks, which has motivated criminals to seek the advice and services of the legal sector.
59. The attractiveness of legal services has led to the misuse of legal services by money launderers and terrorist financiers to be well established in both international and domestic typology studies. The FATF has identified the following vulnerabilities in the legal profession:
- 59.1. use of client accounts
  - 59.2. purchase of real estate (this would also apply to other purchases of large assets and businesses)
  - 59.3. creation and management of trusts and companies
  - 59.4. setting up and managing charities; and
  - 59.5. managing client affairs.
60. FIU has analysed 47 properties worth \$27,032,500 which were subject to criminal proceeds recovery action in 20 Asset Recover Unit cases. In these cases, hiding the ownership of the property (for example, by placing it in a trust) is the most common money laundering method and occurred in all the cases that were analysed. The second most common method was transferring the criminal proceeds to a lawyer or real estate agent by electronic transfer.
61. Lawyers and conveyancers are vulnerable to misuse by money launderers, terrorist financiers and other criminals even when they act appropriately. This may be either because there are no red flag indicators, or because lack of awareness or systems lead to red flags being missed despite genuine intentions to not facilitate crime.
62. The services provided by lawyers are widely available in New Zealand. Currently there are approximately 13,000 practicing lawyers and 1,919 law firms. There are currently 17 conveyancers in New Zealand. In addition, there is a high degree of international exposure for professional services offered by New Zealand lawyers. Many services can be provided online and are actively marketed to offshore customers. In many instances, the privacy and even secrecy of services is actively promoted.

### Options analysis for addressing the problem

*Status quo – Obligations under the FTRA and professional obligations*

63. Lawyers and conveyancers would continue to be exempt from the AML/CFT Act but would continue to have obligations under the FTRA, and their professional obligations under the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008. Lawyers and conveyancers would continue to be unsupervised for AML/CFT purposes.

*Option one – Lawyers and conveyancers providing certain services have obligations under the AML/CFT Act*

64. Lawyers and conveyancers who prepare for or carry out transactions for their client concerning the following activities would have compliance obligations under the AML/CFT Act:

- 64.1. buying and selling of real estate
- 64.2. managing of client money, securities or other assets
- 64.3. management of bank, savings or securities accounts
- 64.4. organisation of contributions for the creation, operation or management of companies; and
- 64.5. creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

65. This list of activities is adopted from the FATF Recommendations, and due to its broad scope can include a variety of different activities. Under this option, the intention is to refine the scope of the services and obligations in ensuing regulations. The regulations would be accompanied by a separate RIS to analyse the impact of the specific services covered.

66. This group excludes ‘internal’ legal professionals such as in-house lawyers working for government agencies. In practice, all conveyancers would have compliance obligations under this option as all conveyancers provide at least one of the high-risk services. Some lawyers such as family or criminal lawyers would not have compliance obligations.

*Option two – Lawyers and conveyancers providing any services have obligations under the AML/CFT Act*

67. Lawyers and conveyancers providing any services, regardless of the risk associated with them, would have compliance obligations under the AML/CFT Act. As with Option one, this group excludes ‘internal’ legal professionals.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The current obligations under the FTRA are not effective at detecting and deterring ML/TF or their predicate offences. As an example, there have been less than 10 annual suspicious transaction reports from the sector since the FTRA came into force in 1996. The lack of supervision means that compliance with the FTRA is not enforced	The current obligations under the FTRA and the professional obligations are insufficient to mitigate the risk associated with the services provided by the sector. While maintaining the status quo would incur no further costs for the sector, the current measures are not proportionate to the ML/TF risk.	The current obligations have not been easy to implement for the sector, as evidenced by the low level of compliance. The lack of supervision also translates to a lack of guidance and education, contributing to a poor level of compliance.	The status quo does not comply with the FATF Recommendations. The limited obligations are likely to attract significant criticism during New Zealand’s mutual evaluation in 2020, and have a negative impact on the assessment result.

	appropriately.			
<b>Option 1</b> Some services provided by lawyers and conveyancers	<b>++</b> Targeting the application of the AML/CFT obligations to higher risk activities would improve the availability of relevant information with regard to the covered high risk services. Combined with appropriate AML/CFT supervision, this option is likely to result in a higher level of compliance than under the status quo. Further, the deterrent effect is likely to extend to overseas customers seeking to launder funds using New Zealand structures such as foreign trusts.	<b>++</b> The AML/CFT obligations and associated costs would only be applied to those lawyers and conveyancers who provide the high risk services. This would be proportionate to the risk associated with these services. Supervisory resources could also be targeted towards the higher risk activities.	<b>++</b> It would be easier for the reporting entities to understand and implement the obligations as there would be a clear rationale for applying them to only the high risk services. This would also apply to the customers, who would only be asked for identity verification in higher risk situations. Targeted application of the AML/CFT obligations would reduce the population of reporting entities, enabling the supervisor to focus on the higher risk entities. It should be noted that the ease of implementation can be increased through refined definitions of the covered services in ensuing regulations.	<b>++</b> The option is likely to be consistent with the FATF Recommendations. This will increase the overall effectiveness of the regime assessed by the FATF in 2020.
<b>Option 2</b> All services provided by lawyers and conveyancers	<b>++</b> The option would be effective at detecting and deterring ML/TF as it would impose compliance obligations on all lawyers and conveyancers, regardless of the services they provide. Provided that all reporting entities would comply with the obligations, there would be a broad scope of reporting and effective deterrence.	<b>-</b> Many legal services (such as those provided by criminal barristers) have very low ML/TF risk. Including these entities in the regime would incur undue compliance costs with little added benefits for the AML/CFT regime. Further, supervising all lawyers and conveyancers even where there is very low risk of ML/TF could divert supervisory resources from higher risk activities. Undue compliance burden would also fall on a large number of legitimate customers. While the status quo is not proportionate to the risk, this option would impose too many compliance obligations and, on balance, be equally disproportionate to the risk as the status quo.	<b>-</b> Where an entity has a very low ML/TF risk profile, it may be difficult for it to understand and implement the obligations. Further, it would not be practical for the supervisors to supervise a large population of lawyers and conveyancers that do not necessarily carry any ML/TF risk.	<b>+</b> The option is likely to go beyond the FATF Recommendations, possibly resulting in a poor application of the risk-based approach. Comparatively, it would be better to cover the whole sector than not cover any of it, however.

Table 7. Options analysis for coverage of the legal and conveyancing sector in scope of AML/CFT legislation.

**Ministry’s preferred option: including a part of the legal and conveyancing sector in the AML/CFT regime (Option one)**

68. The Ministry’s preferred option is to include those lawyers and conveyancers in scope of the regime who provide any of the designated high risk services in the ordinary course of their business.

69. The following sections analyse further issues related to the coverage of lawyers and conveyancers.

***Which compliance obligations should lawyers and conveyancers have?***

70. Currently all Phase I reporting entities have the same AML/CFT compliance obligations (these are explained in detail in part 1.4. of this RIS). There are two main options for the compliance obligations of the legal and conveyancing sector:

*Option one – apply limited compliance obligations to lawyers and conveyancers*

71. Under this option, lawyers and conveyancers included in scope of the reforms would only need to comply with the requirements to conduct CDD on their customers, and report suspicious transactions to the FIU. They would be supervised for compliance to the extent possible. The other compliance obligations, such as conducting an AML/CFT risk assessment, maintaining an AML/CFT programme or training staff would not apply.

*Option two – apply the existing compliance obligations under the AML/CFT Act on lawyers and conveyancers*

72. This option would require the lawyers and conveyancers in scope of the reforms to comply with the existing obligations under the AML/CFT Act, consistent with those imposed on the Phase I reporting entities.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The status quo has been analysed in the previous section on coverage of the legal and conveyancing sector.			
<b>Option 1</b> Limited obligations	<b>0</b> Limited requirements would not improve the ineffective status quo under the FTRA significantly. Without a risk assessment and training, for example, the sectors may not have a sufficient understanding of the risks to adjust the level of CDD to the risk or identify what is suspicious. Further, it would be difficult to monitor and enforce compliance with the AML/CFT Act if the sectors are only supervised for their CDD and reporting obligations.	<b>0</b> The compliance burden under this option would not differ much from that associated with the FTRA obligations. The limited measures would be insufficient to mitigate the risk, and therefore out of proportion compared to the risk.	<b>-</b> This option may be even harder to implement than the obligations under the FTRA. This is mainly due to the difficulty in identifying entities for more targeted and active supervision. The supervisors would have limited information about the risk facing the entities, and the entities would not be fully equipped with the tools and knowledge to identify suspicious activities or conduct CDD on high risk customers. This would also create an uneven playing field between the Phase I sectors and the Phase II sectors. A number of Phase I entities may seek to get Ministerial exemptions from the AML/CFT Act to comply with the lighter compliance obligations to balance the inequality between Phase I and Phase II sectors.	<b>0</b> This option is inconsistent with the FATF Recommendations, and would not improve compliance compared to status quo. It is likely to have a negative impact on the effectiveness of the regime which will be assessed by the FATF in 2020.
<b>Option 2</b> Full set of obligations	<b>++</b> The full set of obligations would contribute to the provision of valuable intelligence to the FIU,	<b>+</b> As the risk associated with the services provided by the sector is high, the full set of compliance	<b>++</b> The current obligations under the AML/CFT Act complement one another, and form a comprehensive package of measures. The measures assist	<b>++</b> This option is consistent with the FATF Recommendations. If implemented

	and provide a sufficient deterrent effect for criminals.	obligations is a proportionate response to mitigate the risk.	reporting entities to direct their efforts to the higher risk situations. As the ML/TF methods associated with the legal and conveyancing sector can be very complex, the full set of obligations would be necessary to ensure the reporting entities are well aware of these methods and able to mitigate them effectively. This option would also maintain internal consistency within the AML/CFT regime.	appropriately, the full set of obligations is likely to contribute to the overall effectiveness of the regime.
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Table 8. Options analysis for compliance obligations for the legal and conveyancing sector.

73. The Ministry’s preferred option is to apply the existing compliance obligations under the AML/CFT Act to lawyers and conveyancers (Option two).

**What are the estimated compliance costs for lawyers and conveyancers?**

74. The compliance costs for lawyers and conveyancers have been estimated based on the Business Compliance Cost survey conducted by Deloitte. The estimates apply for a scenario where lawyers and conveyancers providing high risk services (as outlined above) are included in the AML/CFT regime, and have full compliance obligations. The *low* estimate is based on the survey data alone and the *high* estimate combines this data with interview insights and independent research.

75. Further details of the compliance costs are included in Part 4 of the RIS. This includes a comparison of the costs with the estimated benefits of the Phase II reforms.

Type of cost	Start-up total (year 1)		Ongoing (per annum)	
	Low	High	Low	High
All reporting entities	\$ 16.10 million	\$ 80.90 million	\$ 14.30 million	\$ 59.60 million
One entity	\$ 10.25 thousand	\$ 51.53 thousand	\$ 9.11 thousand	\$ 37.96 thousand
One client	\$ 37.76 (based on <i>high</i> estimate)			

Table 9. Estimated compliance costs for lawyers and conveyancers. Source: Deloitte Business Compliance Cost survey.

**How to appropriately protect legal professional privilege?**

76. Legal professional privilege plays an important role in the New Zealand legal system. It is therefore important to consider how it can be protected in the implementation of the Phase II reforms without unduly compromising the effectiveness of the regime. Potential tension between the AML/CFT Act’s obligations and legal professional privilege may occur in the following circumstances:

- 76.1. when a lawyer is required to file a suspicious transaction report under the AML/CFT Act but information relating to the transaction may be privileged; or

- 76.2. when a sector supervisor requests information from a lawyer under the AML/CFT Act but information relating to the request may be privileged.
77. The AML/CFT Act currently provides protection from criminal, civil and disciplinary proceedings for a person who supplies information about a suspicious transaction if the information is provided in good faith.
78. The AML/CFT Act (section 40(3)) states that the requirement to report suspicious transactions does not require lawyers to disclose any *privileged communication*. The definition of privileged communication came from the FTRA, and predates the definition as codified in the Evidence Act 2006. This definition was subsequently confirmed in the Search and Surveillance Act 2012.

*Status quo – retain the current definition of privileged communication*

79. This option would not amend the current definition of privileged communication as defined in section 42 of the AML/CFT Act.

*Option one – align the current definition with other relevant Acts*

80. This option would align the provisions relating to legal professional privilege in the AML/CFT Act to those in the Evidence Act 2006 and the Search and Surveillance Act 2012. This would expand the circumstances in which the suspicious transaction reporting requirements do not apply, to the following:
- 80.1. privilege for communications with legal advisers
  - 80.2. privilege for preparatory materials for proceedings; and
  - 80.3. privilege for settlement negotiations or mediation.
81. In addition, the provisions would be amended so that privilege does not apply if there is a *prima facie* case that the communication or information is made for a dishonest purpose or to enable the committing of an offence.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The current definition does not have an impact on detecting and deterring ML/TF.	There is an insignificant compliance burden associated with the current definition of LPP.	Amending the existing model is a practical solution and easier to implement than a whole new regime around privilege. Aligning the definition with other legislation would also be a logical solution.	The FATF Recommendations note that it is for each country to determine the matters that would fall under LPP.
<b>Option 1</b> Align the definition with other Acts	<b>0</b> Amending the definition in this way would not significantly hamper the detection or deterrence of ML/TF.	<b>0</b> Compared to the status quo, expanding the definition of LPP would have a negligible impact on the compliance obligations.	<b>+</b> Aligning the definition with other legislation would be a logical solution. As lawyers may already be familiar with the way LPP is protected under other Acts, this may contribute to the ease of implementation.	<b>0</b> The FATF Recommendations note that it is for each country to determine the matters that would fall under LPP.

Table 10. Options analysis for legal professional privilege.

82. The Ministry's preferred option is to amend the definition of legal professional privilege to align with the definitions in the Evidence Act 2006 and the Search and Surveillance Act 2012 (Option one).

## **Accountants**

83. Some services provided by accountants are considered high risk for money laundering by the FIU. The professional services provided by accountants are attractive to criminals as many of the services such as trust accounts and establishing and managing companies can obscure the beneficial ownership of the funds. The risks and vulnerabilities associated with services provided by accountants are to a large extent similar to those associated with the legal sector as explained in the section above.
84. The accountancy industry in New Zealand is large and the services are widely available. There are approximately 33,000 chartered accountants in New Zealand, 2,000 certified practicing accountants and 400 bookkeepers. As not all people providing accountancy services are registered with NZICA or CAANZ, and there is some overlap with CPA, the sector size has been estimated at approximately 2,433. As with the legal sector, there is a high degree of international exposure for professional services offered by New Zealand accountants.

### **Options analysis for addressing the problem**

#### *Status quo – Obligations under the FTRA and professional obligations*

85. Accountants would continue to be exempt from the AML/CFT Act but would continue to have obligations under the FTRA and their professional obligations. Accountants would continue to be unsupervised for AML/CFT purposes.

#### *Option one – Accountants providing certain services have obligations under the AML/CFT Act*

86. Similarly to lawyers and conveyancers, accountants who prepare for or carry out transactions for their client concerning the following activities would have compliance obligations under the AML/CFT Act:
- 86.1. buying and selling of real estate
  - 86.2. managing of client money, securities or other assets
  - 86.3. management of bank, savings or securities accounts
  - 86.4. organisation of contributions for the creation, operation or management of companies; and
  - 86.5. creation, operation or management of legal persons or arrangements, and buying and selling of business entities.
87. This list of activities is adopted from the FATF Recommendations, and due to its broad scope can include a variety of different activities. Under this option, the intention is to refine the scope of the services and obligations in ensuing regulations. The regulations would be accompanied by a separate RIS to analyse the impact of the specific services covered.
88. This group excludes 'internal' professionals such as in-house accountants working for entities other than professional accounting firms.



*Option two – Accountants providing any services have compliance obligations under the AML/CFT Act*

89. Accountants providing any services, regardless of the risk associated with them, would have compliance obligations under the AML/CFT Act. This option would extend AML/CFT obligations to accountants who provide assurance and advisory services such as tax advice, auditing and bookkeeping services as a business. As with Option one, this would exclude ‘internal’ professionals, however.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The current obligations under the FTRA are not effective at detecting and deterring ML/TF. For example, there have been only 7 suspicious transaction reports from the whole sector since the FTRA came into force in 1996. There is no supervision to enforce compliance with the FTRA.	The current obligations under the FTRA and the professional obligations are insufficient to mitigate the risk associated with the services provided by the sector. While maintaining the status quo would incur no further costs for the sector, the current measures are not proportionate to the high ML/TF risk.	The current obligations have not been easy to implement for the sector, as evidenced by the low level of compliance. The lack of supervision also translates to a lack of guidance and education, contributing to a poor level of compliance.	The status quo does not comply with the FATF Recommendations. The limited obligations are likely to attract significant criticism during New Zealand’s mutual evaluation in 2020, and have a negative impact on the assessment result.
<b>Option 1</b>  Some services provided by accountants	<b>+</b> Targeting the application of the AML/CFT obligations to higher risk activities would improve the availability of relevant information with regard to the covered high risk services. Combined with appropriate AML/CFT supervision, this option is likely to result in a higher level of compliance than under the status quo. Further, the deterrent effect is likely to extend to overseas customers seeking to launder funds using New Zealand structures such as foreign trusts.	<b>++</b> The AML/CFT obligations and associated costs would only be applied to those accountants who provide the high risk activities. This would be proportionate to the risk associated with these services. Supervisory resources would be targeted towards the higher risk activities.	<b>++</b> Targeted application of the AML/CFT obligations would be a practical solution. This would reduce the population of reporting entities, and enable the supervisors to focus on the higher risk entities.	<b>+</b> The option is likely to align with the FATF Recommendations, although the Recommendations do strongly encourage non-financial activities of accountants to be covered.
<b>Option 2</b>  All services provided by accountants	<b>++</b> The option would be the most effective at detecting and deterring ML/TF as it would extend the compliance obligations to all accountants. In addition to the high-risk services that are mainly related to financial transactions, this option would extend the coverage to	<b>0</b> The compliance burden goes beyond what is strictly necessary to mitigate the risk arising from the designated high risk services. Where the status quo is insufficient to mitigate the risk and therefore disproportionate, this option is equally	<b>-</b> Where an entity has a very low ML/TF risk profile and may not engage in financial transactions with the client, it may be difficult for it to understand and implement the obligations. Further, it would not be practical for the supervisors to supervise a large population of accountants that do not necessarily	<b>++</b> This option is likely to be fully compliant with the FATF Recommendations. Under Recommendation 23, countries are strongly encouraged to extend the reporting requirements to non-

	situations where accountants provide tax advice for example, and may have visibility over illicit activities related to tax evasion.	disproportionate in that it goes beyond what is necessary to mitigate the highest risk in the sector.	carry any ML/TF risk.	financial activities such as auditing.
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Table 11. Options analysis for coverage of the accounting sector in scope of AML/CFT legislation.

**Ministry’s preferred option: including parts of the accounting sector in the AML/CFT regime (Option one)**

90. The Ministry’s preferred option is to include accountants that provide any of the high risk services above in scope of the AML/CFT legislation. The analysis for the level of compliance obligations is identical to that included for lawyers and conveyancers in the section above, and has not been duplicated in this section.

***What are the estimated compliance costs for accountants?***

91. The compliance costs for accountants have been estimated based on the Business Compliance Cost survey conducted by Deloitte. The estimates apply for a scenario where accountants providing high risk services (as outlined above) are included in the AML/CFT regime, and have full compliance obligations. The *low* estimate is based on the survey data alone and the *high* estimate combines this data with interview insights and independent research.

92. Further details of the compliance costs are included in Part 4 of the RIS. This includes a comparison of the costs with the estimated benefits of the Phase II reforms.

Type of cost	Start-up total (year 1)		Ongoing (per annum)	
	Low	High	Low	High
All reporting entities	\$ 25.40 million	\$ 101.80 million	\$ 22.70 million	\$ 75.50 million
One entity	\$ 11.43 thousand	\$ 45.79 thousand	\$ 10.21 thousand	\$ 33.96 thousand
One client	\$ 64.40 (based on <i>high</i> estimate)			

Table 12. Estimated compliance costs for accountants. Source: Deloitte Business Compliance Cost survey.

**Real estate agents**

93. The FIU considers the real estate sector to be highly vulnerable to money laundering. As with the other Phase II sectors, the risk associated with the real estate sector has also been well established internationally<sup>10</sup>. The primary risks associated with the real estate sector include the following:

- 93.1. the sale and purchase of real estate, which provides an opportunity to launder large sums through a single transaction

<sup>10</sup> Some examples of international reports related to the risk include the FATF’s *Money Laundering and Terrorist Financing through the Real Estate Sector* (2007) and *Guidance on the Risk-Based Approach for Real Estate Agents* (2008), and the Australian AML/CFT supervisor AUSTRAC’s Strategic analysis brief: *Money laundering through real estate* (2015).

- 93.2. purchasing commercial or rental properties or farms, which may provide a legitimate income with which illicit proceeds can be co-mingled
  - 93.3. cash laundering (deposits, settlements payments, mortgage repayments, renovations, rentals)
  - 93.4. structured payments (cash, cheque or electronic) for deposit and towards settlement
  - 93.5. 'loans' from unrelated associates, non-bank entities, trusts or companies, or from offshore to make the loan appear legitimate and pay it off with illicit funds; and
  - 93.6. hiding ownership and control of the property by using false identity, associates, third parties, trust or companies.
94. Despite the current controls under the FTRA and real estate agents' professional standards, layering techniques may make detection of involvement of money launderers in a real estate transaction difficult. Layering refers to transactions that happen once the proceeds of crime are already in the financial system with the aim of distancing them from their criminal origin.
95. Real estate agents are also in a unique position in the real estate – or potentially money laundering – transaction. They are often the client-facing participant in a property deal and can see information that other participants may not. For example, they may know how many other properties the vendor holds, how long the property has been owned before selling, whether the price is negotiated, and whether the property is over- or undervalued. This type of information is valuable when determining whether a real estate transaction should raise suspicions of illicit activity.
96. Real estate is readily available in New Zealand and is considered as a reliable and profitable investment strategy. There are approximately 18,500 real estate licenses, 871 real estate companies and 148 sole traders. The total value of transactions facilitated by real estate agents is high. Real Estate Institute of New Zealand (REINZ) and QV data indicates that around \$60 billion worth of real estate is transacted per annum.

### **Options analysis for addressing the problem**

#### *Status quo – Obligations under the FTRA and professional obligations*

- 97. Real estate agents would continue to be exempt from the AML/CFT Act, but would continue to have obligations under the FTRA and the Land Transfer Act 1952 and their professional obligations. Real estate agents must also be licensed and are regulated by the Real Estate Agents Authority (REAA). Real estate agents would continue to be unsupervised for AML/CFT purposes.
- 98. Trust accounts operated by real estate agents must be audited annually and submitted to REAA. Real estate agents who hold settlement funds in trust accounts pending settlement have audit commitments under the Real Estate Agents Act 2008. However, such obligations only apply in limited circumstances and are not currently subject to strict oversight.

#### *Option one – Include licensed real estate agents in scope of the AML/CFT regime*

- 99. This option would apply compliance obligations to all real estate agents licensed by REAA under the Real Estate Agents Act 2008 when they conduct transactions for the sale or purchase of real estate for a client. Based on the analysis of the appropriate level of compliance obligations included in the section on lawyers and conveyancers, this option analyses the coverage of real estate agents based on the full set of compliance obligations.

*Option two – Include real estate agents and property developers in scope of the AML/CFT regime when acting on behalf of clients*

100. In addition to licensed real estate agents, this option would expand AML/CFT obligations to anyone conducting transactions for the purchase or sale of real estate for a client. In practice, this option would cover property developers that act on behalf of a client in the sale or purchase of real estate. As part of the real estate sector, property developers may also unwittingly facilitate money laundering. This option would ensure consistency with the coverage of real estate agents.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The status quo is not effective at detecting and deterring ML/TF. Compliance with the FTRA obligations has been low, and there is no supervision to enforce compliance.	The current limited obligations under the FTRA and professional standards are not proportionate to the high risk associated with the real estate sector.	The current obligations have not been easy to implement for the sector, as evidenced by the low level of compliance. The lack of supervision also translates to a lack of guidance and education, contributing to a poor level of compliance.	The status quo does not comply with the FATF Recommendations. The limited obligations are likely to attract significant criticism during New Zealand’s mutual evaluation in 2020, and have a negative impact on the assessment result.
<b>Option 1</b>  Licensed real estate agents	<b>+</b> Based on the currently available evidence, this option would be effective at detecting and deterring ML/TF. Real estate agents would be required to implement more comprehensive measures to detect and report suspicious activities. However, there could be a displacement effect towards property development as criminals seek other ways to purchase real estate while avoiding controls. For example, criminals may seek to make payments in cash or by international transfer directly to a property developer for real estate to circumvent the AML/CFT controls and customer due diligence conducted by real estate agents or New Zealand banks.	<b>++</b> This option would apply compliance obligations that are the minimum required to mitigate the risk in the real estate sector.	<b>++</b> Provided that there is a sufficient implementation period and the appropriate guidance and education, real estate agents should be able to comply with the obligations relatively easily. Identification of reporting entities would be easy based on the current licensing requirements.	<b>+</b> This option is in line with the FATF Recommendations. It is also consistent with the approaches adopted internationally (UK, EU).
<b>Option 2</b>  Real estate agents and property	<b>++</b> This option would ensure the full scope of the real estate sector is included in scope of the regime. It would prevent any displacement effect from real estate agents to property	<b>+</b> While this option would encompass compliance obligations on a larger group of entities, it would mitigate the specific displacement risk in the real estate	<b>+</b> While real estate agents are licensed and easily identifiable, there is no such mechanism for property developers. It may be difficult to	<b>++</b> The FATF Recommendations do not explicitly require property developers to be covered. Covering a wider spectrum

developers	developers.	sector. The additional compliance burden on property developers can therefore be considered to be proportionate to the risk.	identify the reporting entities and enforce their compliance with the obligations. Property developers may also have a low level of awareness of AML/CFT which may make it more difficult to comply with the obligations.	would, however, improve the effectiveness of the regime and therefore contribute to a favourable evaluation in 2020. International practice is mixed as some countries have placed obligations on property developers (e.g. Canada, Spain) and others have not (e.g. UK, EU countries).
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Table 13. Options analysis for coverage of the real estate sector in scope of AML/CFT legislation.

**Ministry’s preferred option: expanding AML/CFT obligations to real estate agents and property developers when acting on behalf of clients**

101. The Ministry’s preferred option is to expand the AML/CFT obligations to real estate agents and property developers when they act on behalf of clients. This would be a comprehensive response to the risk associated with the real estate sector, and reduce the risk of a displacement effect from real estate agents to property developers.
102. The following section analyses options for the scope of real estate agents’ CDD obligations towards the vendors and purchasers of property. Further issues about the scope of the obligations will be determined through regulations, and analysed in a separate RIS accompanying the regulations.

***What are the estimated compliance costs for real estate agents?***

103. The compliance costs for real estate agents have been estimated based on the Business Compliance Cost survey conducted by Deloitte. The estimates apply for a scenario where real estate agents have full compliance obligations. The *low* estimate is based on the survey data alone and the *high* estimate combines this data with interview insights and independent research.
104. Further details of the compliance costs are included in Part 4 of the RIS. This includes a comparison of the costs with the estimated benefits of the Phase II reforms.

Type of cost	Start-up total (year 1)		Ongoing (per annum)	
	Low	High	Low	High
All reporting entities	\$ 13.30 million	\$ 35 million	\$ 11.80 million	\$ 23.10 million
One entity	\$ 13.22 thousand	\$ 34.79 thousand	\$ 11.73 thousand	\$ 22.96 thousand
One transaction	\$ 355.88 (based on <i>high</i> estimate)			

Table 14. Estimated compliance costs for the real estate sector. Source: Deloitte Business Compliance Cost survey.

**Who would real estate agents need to conduct CDD on?**

105. A key matter related to the coverage of real estate agents in scope of AML/CFT legislation is the types of customers they would need to conduct CDD on. The scope of the requirements have an impact on the information available to law enforcement on property transactions – but also on the compliance obligations on both real estate agents and anyone selling or purchasing property.

*Option one – Require real estate agents to apply AML/CFT obligations to their customer only*

106. Real estate agents would be required to carry out CDD on their customer but not the opposing party in the transaction. For example, a real estate agent representing the vendor would not be required to conduct CDD on the purchaser. Conversely, a real estate agent representing the purchaser would not be required to conduct CDD on the vendor.

*Option two – Require real estate agents to conduct CDD on their customer, and only on the seller/purchaser where they have not been subject to CDD by any other reporting entity*

107. Real estate agents would be required to carry out CDD on their customer. They would also need to conduct CDD on the other party to the transaction where that person is *unrepresented* by another reporting entity. For example, a real estate agent representing the vendor would be required to conduct CDD on a purchaser when the purchaser is not represented by another agent, lawyer or conveyancer.

*Option three – Require real estate agents to apply AML/CFT compliance requirements on both sellers and purchasers of real estate*

108. Real estate agents would need to conduct CDD on both the vendor and purchaser of property.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The status quo is inapplicable as this is a new issue arising from the coverage of the real estate sector in scope of the AML/CFT regime.			
<b>Option 1</b>  Customer (vendor or purchaser ) only	<p>~ Out of the three options, this option may leave some gaps in the detection of ML/TF. In the majority of cases, however, both parties to the transaction would be represented by a real estate agent or another party such as a lawyer or a conveyancer and CDD would be conducted. This would bridge the potential gap in the information. The residual risk of cash payments being made by unrepresented purchasers would still be addressed to some extent as they would be considered occasional transactions, and the agent would be required to conduct CDD and file a prescribed transaction report when accepting more than \$10,000</p>	<p>✓ Although some CDD information may not be captured under this option, the compliance burden would generally be proportionate to the risk.</p>	<p>✓ This option would be practical and reasonably easy to implement by real estate agents. In most cases, the real estate agent’s client is the vendor, and this option would align with the agent’s general duties towards his or her client.</p>	<p>✗ The FATF Recommendations require CDD to be conducted on both the vendor and purchaser of property.</p>

	in cash.			
<b>Option 2</b> Customer, and the opposing party in limited circumstances	✓ This option would be effective in detecting and deterring ML/TF. The CDD information of both parties to the transaction would be captured.	✓ This option would be proportionate to the risk associated with real estate transactions. The ability to rely on another party's CDD information would reduce the compliance burden. When purchasing property, customers would not need to present CDD information to the vendor's real estate agent if they have already provided this information to their own lawyer or conveyancer for example.	✗ This option would require the real estate agent to know whether another party such as another agent or a lawyer has already conducted CDD on the purchaser. This may present practical challenges, and cause delays in the transaction. Further, a potential conflict of interest may arise in cases where the real estate agent conducts CDD on the opposing party, forms a suspicion and has to suspend the sale they are attempting to complete for their own customer.	~ The FATF Recommendations require CDD to be conducted on both the vendor and purchaser of property.
<b>Option 3</b> Both vendor and purchaser of real estate	✓ This option would be effective in detecting and deterring ML/TF. The CDD information of both parties to the transaction would be captured.	✗ Under the proposed new requirements, lawyers and conveyancers acting for purchasers would be required to conduct CDD on their clients. Requiring a real estate agent to then also conduct CDD on the same client could lead to duplication of effort and cost. The compliance burden would be exacerbated in situations where the purchaser is also represented by a real estate agent.	✗ It is likely that it would be difficult for real estate agents to comply with the obligation. As mentioned under 'proportionality', this option may result in duplication of effort. Customers would need to provide their CDD information to multiple reporting entities. Further, a potential conflict of interest may arise in cases where the real estate agent conducts CDD on the opposing party, forms a suspicion and has to suspend the sale they are attempting to complete for their own customer.	✓ The FATF Recommendations require CDD to be conducted on both the vendor and purchaser of property.

Table 15. Options analysis for the customer due diligence requirements for the real estate sector.

**Ministry's preferred option: requiring CDD on the customer (vendor or purchaser) only (Option one)**

109. The residual risk associated with only conducting CDD on the real estate agent's customer (the vendor) could be further mitigated by the following measures:

109.1. a purchaser would be subject to CDD in most instances where a lawyer or conveyancer is used (which would be subject to the AML/CFT Act); and

109.2. the risk of cash payments being made by purchasers would still be addressed to some extent as they would be considered occasional transactions and the agent



would be required to conduct CDD and file a prescribed transaction report when accepting more than \$10,000 in cash.

110. In addition, to purchase property in New Zealand there is a requirement to have a New Zealand bank account. While this is insufficient in itself to verify the customer's identity, it may contribute to the controls in place.

### High value dealers

111. Buying and selling high-value assets is attractive for criminals because such transactions can avoid interaction with the financial sector. The purchase of high value goods is a critical 'placement' stage for criminals – the stage at which criminal proceeds are first inserted into the legitimate economy. Once purchased, high value goods:
- 111.1. can be recapitalised through uncontrolled trading markets
  - 111.2. are easy to transport (both domestically and internationally, especially in the case of small, discrete and easily disguisable goods such as precious metals and gems)
  - 111.3. are easy to disguise and conceal; and
  - 111.4. maintain their value for long periods.
112. Buying high value goods are an obvious and simple avenue for the placement of ill-gotten cash. Police experience case studies show that New Zealand's organised criminal gangs and drug offenders often operate in a cash environment, which makes high value goods particularly attractive for these groups.
113. The FATF definition of high value dealers is *dealers in precious metals and dealers in precious stones*. However, both domestic and international typology studies confirm this group can include dealers in a wide variety of goods such as art, gold, silver, jewellery, watches, gems, diamonds, vehicles such as cars and boats, and household items such as appliances. In addition to dealers in goods, the group can include auctioneers<sup>11</sup> and brokers for example, and both retail and second-hand trade of goods. Currently, high value dealers do not have any AML/CFT or reporting obligations<sup>12</sup>.
114. Given this potentially wide definition, New Zealand has a high number of high value dealers and they are readily available throughout the country. High value goods can be purchased at any retailer or second-hand (private or public markets) and can be sold in private markets, exchanged 'in kind' or traded in second hand or auctioneering markets. An estimated \$2 billion in vehicles and jewellery alone is sold through retail annually in New Zealand.
115. The scope of the sector that can reasonably be regulated under the AML/CFT regime does not extend to the private market. While a large number of high value goods are bought and sold privately, regulating the private market under the AML/CFT regime is neither practicable nor desirable. This would entail private individuals buying or selling goods unrelated to a business operation having obligations under the AML/CFT Act. It should therefore be noted that all of the options analysed below exclude any activities in the private market.

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<sup>11</sup> It should be noted that licensed or registered auctioneers and providers of internet auctions are currently exempt from the AML/CFT under regulation 21A of the AML/CFT (Definitions) Regulations 2011. Should auctioneers be included as high value dealers, it would be necessary to consider whether the exemption remains.

<sup>12</sup> The Secondhand Dealers and Pawnbrokers Act 2004 requires dealers to be licensed and includes obligations to report and hold stolen goods, and identification and verification requirements for the 'pledger'. Dealers registered as companies are also required to retain financial records and submit annual returns.



116. The current lack of controls represents a high risk for New Zealand. The FIU considers high value goods to be particularly attractive for small to medium sized domestic criminal operations that commit financially motivated, cash-generating crimes. FIU research indicates 219 instances where high value goods have been identified within the description of a suspicious transaction report submitted by a reporting entity. The instances can be categorised as follows:

Type of item	Instances
Motor vehicles (cars, trailers)	72
Boats	86
Precious metals and stones	80
Jewellery and watches	32
Art	75
Other (bonds, deposit boxes)	10

Table 16. Breakdown of high value goods that have been identified in suspicious transaction reports. Source: FIU.

### Options analysis for addressing the problem

#### *Status quo – high value dealers have no AML/CFT obligations*

117. High value dealers would continue to have no obligations under the AML/CFT Act. The limited obligations on second hand dealers and pawnbrokers as described above would continue to apply, and the sector would continue to be unsupervised for AML/CFT or any other purposes.

#### *Option one – full AML/CFT obligations are extended to dealers in precious metals and stones where they accept cash payments over a threshold*

118. AML/CFT obligations would be extended to dealers in precious metals and stones who accept cash payments over a certain threshold (options for the threshold are analysed further in the next section). This group includes jewellers, bullion and precious stone dealers, and the sector is estimated to include 600 businesses. It is estimated that fewer than half of these businesses would continue to accept large cash payments if doing so triggered AML/CFT obligations.<sup>13</sup>

119. This category of high value dealers has been chosen on the basis that the FATF Recommendations specifically require countries to include these businesses in their AML/CFT regimes.

#### *Option two – full AML/CFT obligations are extended to dealers in precious metals and stones and dealers in motor vehicles and boats where they accept cash payments over a threshold*

120. AML/CFT obligations would be extended to dealers in precious metals and stones, and dealers in motor vehicles and boats who accept cash payments over a certain threshold. It is estimated that there are 3,000 motor vehicle dealers in New Zealand, and approximately 2,500 of these would continue to accept large cash payments and therefore ‘opt in’ to the AML/CFT regime.<sup>14</sup>

<sup>13</sup> Deloitte: *Phase II AML Reforms: Business Compliance Impacts*

<sup>14</sup> Deloitte: *Phase II AML Reforms: Business Compliance Impacts*

121. The reasoning above for including dealers in precious metals and stones applies to this option. Motor vehicle dealers and boats have been chosen for this option because in New Zealand both have been identified as attractive commodities for criminals investing their illicit funds<sup>15</sup>.

*Option three – limited AML/CFT obligations are extended to dealers in precious metals and stones, motor vehicles, boats, arts and antiques, including auctioneers and second hand dealers where they accept cash payments over a threshold*

122. AML/CFT obligations would be extended to a larger group: dealers in precious metals and stones, motor vehicles, boats, arts and antiques. This group would include auctioneers and second hand dealers. The compliance obligations would be lighter than those required from Phase I entities, as follows:

- 122.1. checking and verifying customers' identities when their cash payment exceeds a threshold to be determined by regulations
- 122.2. reporting all cash transactions over a threshold to the FIU
- 122.3. record keeping; and
- 122.4. optional reporting of suspicious transactions that fall below the cash threshold.

123. This option would include targeted supervision for compliance with the reporting obligations. The supervision would be based on criminal cases revealing that the dealer has not reported cash, risk identified by the supervisor or the FIU, or requesting documents to enable matching between cash turnover and expected reporting.

*Option four – limited AML/CFT obligations are extended to all businesses where they accept cash payments over a threshold*

124. All retailers accepting cash payments over a certain threshold would have the limited obligations as described above under the AML/CFT Act. They would also be subject to limited supervision.

*Option five – full AML/CFT obligations extended to all businesses where they accept cash payments over a threshold*

125. All retailers accepting cash payments over a certain threshold would be required to comply with AML/CFT obligations as currently set out in the AML/CFT Act.

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<sup>15</sup> For example, in a total of 1,073 asset recovery cases, cars/vans/four wheel drives were identified in 218 in cases and boats in 41 cases.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	Some high value dealers have been associated with ML/TF. The non-coverage of the sector may compromise efforts to detect and deter ML/TF.	The lack of compliance obligations is not proportionate to the risk associated with the high value dealers sector.	There are currently no compliance obligations.	The status quo does not comply with the FATF Recommendations.
<b>Option 1</b>  Precious metals and stones, full obligations	<b>0</b> This option would not improve the regime's ability to detect and deter ML/TF significantly. Choosing to cover this narrow segment of the wider sector does not reflect the risk associated with different high value goods in New Zealand. The major risk associated with this option is the displacement of ML/TF activities from this sector to the other unregulated high value dealers.	- Applying full compliance obligations on one part of the sector while leaving other dealers in high risk high value goods unregulated would be a disproportionate response to the risk. The affected businesses are likely to consider that there is an uneven playing field between different high value dealers, and that there is an undue compliance burden. Businesses do, however, have an option of opting out of the regime by not accepting large cash payments.	<b>0</b> Some reporting entities may find the obligations difficult to comply with. The sector is unaccustomed to AML/CFT and regulatory oversight, and some businesses are small with limited resources. Identification of dealers in precious metals and stones would, however, be reasonably practical when compared to the whole high value dealer sector. Supervisors would need to identify which businesses wish to opt in and out of the regime and not accept large cash payments.	<b>+++</b> The FATF Recommendations require dealers in precious metals and stones to have AML/CFT obligations. This option would bring the regime fully in line with the FATF Recommendations.
<b>Option 2</b>  Precious metals and stones, motor vehicles, boats, full obligations	<b>+</b> This option would improve the regime's ability to detect and deter ML/TF. Due to the relatively wide coverage of the highest risk sectors, the displacement effect would be lessened but not minimised – criminals could still launder funds by buying arts and antiques for example. The quality of reporting (suspicious and prescribed transaction reports) is likely to be higher than under the lighter compliance obligations, as businesses would have a better understanding of risks and potentially suspicious activities. This is due to the broad range of obligations to enhance compliance (e.g. training, oversight, monitoring and audit).	<b>+</b> While the full compliance obligations are more costly to implement than the lighter obligations, they apply to a smaller population of reporting entities. They would also more effectively mitigate the risk associated with the sector. Businesses could opt out of the regime if they decide not to accept large cash payments.	<b>+</b> Some reporting entities may find the obligations difficult to comply with. The sector is unaccustomed to AML/CFT and regulatory oversight, and some businesses are small with limited resources. Many businesses may wish to opt out of the regime by not accepting large cash payments if they consider the obligations to be overly difficult to implement. Supervisors would need to identify which businesses wish to opt out of the regime and not accept large cash payments, which is likely to be slightly more difficult than under Option 1 but easier than under Options 3, 4 and 5.	<b>+++</b> The FATF Recommendations require dealers in precious metals and stones to have AML/CFT obligations. This option would bring the regime fully in line with the FATF Recommendations.
<b>Option 3</b>  Precious metals, stones, motor vehicles, boats, art, limited	<b>+</b> This option would increase the sources of reporting to the FIU, but may decrease the quality of the reports (cash/prescribed transaction reports and optional suspicious activity reports). The reporting entities may not have the capacity to submit high-quality cash reports in the absence of AML/CFT programmes and mandatory staff training. Compliance with the reporting	<b>+</b> While the overall compliance burden per entity would be lower than in options 1 and 2, the burden would be spread over a wider scope of businesses. Businesses could, however, opt out of the regime if they decide not to accept large cash payments.	<b>+</b> The cash reporting requirement would not require risk-based decisions from the reporting entity. For example, they would not need to judge whether a cash transaction is suspicious or not but it would be reported to the FIU in any case. Overall, the lighter compliance obligations would be easier for the reporting entities to implement. It may, however, be difficult to ensure that all retailers of	<b>+</b> The lighter compliance obligations would not be fully compliant with the FATF Recommendations. They would, however, be an improvement to status quo and enhance compliance to

obligations	obligations could also be low in the absence of comprehensive supervision. There could still be displacement to unregulated sectors such as dealers in whiteware and other appliances.		high value goods in the various sectors are aware of the requirements when dealing in large amounts of cash. It may be challenging for supervision to identify and meaningfully supervise the affected businesses which would be caught.	some extent.
<b>Option 4</b> All high value dealers, limited obligations	<b>+</b> This option would further expand the sectors the FIU would receive some intelligence from. However, as with option 3, quality of reporting and compliance with the reporting obligations could be low in the absence of comprehensive supervision. The displacement effect would be minimised.	<b>0</b> This option would require all businesses accepting cash payments over a threshold to comply with the cash reporting and CDD obligations. Depending on the cash threshold, this may be a compliance burden that is not proportionate to the risk associated with the wider sector of dealers in any goods over a certain threshold.	<b>+</b> The cash reporting requirement would not require risk-based decisions from the reporting entity. For example, they would not need to judge whether a cash transaction is suspicious or not but it would be reported to the FIU in any case. In addition, it would be challenging for the relevant supervisor to identify and educate the entire spectrum of businesses willing to accept cash payments over a certain threshold.	<b>+</b> This option is not fully compliant with the FATF Recommendations. It would, however, be an improvement to status quo and enhance compliance to some extent.
<b>Option 5</b> All high value dealers, full obligations	<b>++</b> This option, if implemented appropriately by the sector, would improve the detection of ML/TF significantly. Law enforcement would receive information from a wide scope of businesses, and there would be no displacement effect from one part of the sector to another.	<b>-</b> The compliance burden on the sector is likely to be disproportionate to the proven risk associated with the sector. The AML/CFT supervisor would need to dedicate resources to identify and educate a wide population of reporting entities. Customers are likely to be impacted as many businesses may wish to opt out of the regime and no longer accept large cash payments.	<b>-</b> The businesses are likely to find the full set of obligations difficult to comply with, particularly where the reporting entities are small or unfamiliar with AML/CFT. It is likely to be difficult to identify and educate the wide scope of businesses accepting cash payments over a certain threshold.	<b>+++</b> This option goes beyond what is strictly required by the FATF Recommendations. Given the risk associated with the high value goods sector, this would most likely be considered a positive development, however. The option is also aligned with the approach adopted in the UK and the EU countries.

Table 17. Options analysis for the coverage of the high value dealers sector in scope of AML/CFT legislation.

### Ministry's preferred option: Put Options 2 and 3 forward for Cabinet decision

126. The Ministry's preferred option is to put Options 2 and 3 forward for Cabinet decision.

#### **What are the compliance costs for high value dealers?**

127. The overall assessment of the compliance costs for the Phase II sectors is included in Part 4 of the RIS. Due to the different feasible options for regulating high value dealers, however, this section compares the estimated costs of Options 2 and 3 as explained above. Both options have been estimated on the basis that the cash threshold is set at \$10,000.

128. The costs for Option 2 have been calculated based on the Business Compliance Cost survey conducted by Deloitte. The proportion of businesses that wish to opt out of the regime and not accept large cash transactions is estimated to be 64 % for jewellers and 35 % for motor dealers. The costs are based on the *high* estimate. Without the supporting survey data, it is difficult to estimate how many businesses would opt out of the regime under Option 3, but estimations have been provided in the table below.

129. To provide context, the costs were translated into an annual cost per reporting entity and a unit cost by the Deloitte Business Compliance Cost survey. The per unit cost reflects the cost per client for jewellers, auctioneers and dealers in antiques and arts, whereas for motor and marine vehicles the cost per unit reflects the cost per transaction. Similar unit costing per sector have been calculated for Option 3 using the same assumptions for comparative purposes.

HVD	Option 2				Option 3			
	Number of REs	Total compliance cost	Cost per entity	Unit cost	Number of REs	Total compliance cost	Cost per entity	Unit cost
Jewellers <sup>16</sup>	229	\$ 17,8 million	\$77,729.26	\$3.37	512	\$0.35 million	\$683.59	\$0.03
Motor vehicles <sup>17</sup>	2,106	\$111,4 million	\$52,896.49	\$77.65	2,357	\$3.2 million	\$1,357.66	\$1.99
Marine vehicles <sup>18</sup>	208	\$10,2 million	\$49,038.46	\$71.99	208	\$0.22 million	\$1,057.69	\$1.55
Auctioneers					886	\$0.70 million	\$ 790.07	\$0.03
Antiques and arts					744	\$0.51 million	\$685.48	\$1.01
<b>Total</b>	2543	\$139,4 million			4,707	\$6.51 million		

Table 18. Estimates for the compliance costs under Options 2 and 3. Source: Deloitte Business Compliance Cost survey.

<sup>16</sup> Under Option 2, jewellers are defined as members of the Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand. Under Option 3, the group includes anyone retailing watches or jewellery.

<sup>17</sup> Under Option 2, motor vehicles are defined as dealers in motor vehicles who are members of the Motor Trade Association (following the definition used in the Deloitte Business Compliance Cost survey). Under Option 3, a wider group of commodities have been captured. This group includes anyone retailing motor vehicles including cars, motor cycles, trailers, motor homes and caravans, industrial vehicles such as diggers and tractors etc.

<sup>18</sup> Under Option 2, marine vehicles were not included in the Deloitte Business Compliance Cost survey. Instead, the figures for motor vehicle dealers and data points gathered for costing of Option 3 have been used to provide an estimate. This is a high end estimate only and reflects assumptions made by the Ministry of Justice. It does not reflect industry feedback as marine vehicle dealers were not included in the survey population. Under Option 3, Marine Vehicles includes anyone retailing marine vehicles including boats, yachts and jet skis.

**Cash threshold for capturing high value dealers**

- 130. Another matter related to the coverage of high value dealers under AML/CFT legislation is the applicable cash threshold for triggering CDD requirements. The analysis of this sub-option is applicable to all options under the preceding section except for the status quo.
- 131. To provide context, the following table presents a percentage distribution of assets seized by the Asset Recovery Unit by value range. It should be noted that it does not indicate whether the goods were purchased with cash or by other means such as EFTPOS or credit cards.

Category	≥\$1,000	\$1-2,000	\$2-5,000	\$5-10,000	≥\$10,000
<b>Total</b>	6%	4%	11%	16%	63%
<b>Artwork</b>	0%	0%	10%	5%	86%
<b>Boats</b>	0%	0%	3%	21%	76%
<b>Bonus bonds/shares</b>	9%	9%	9%	5%	67%
<b>Cars/vans/four wheel drives</b>	2%	2%	9%	13%	73%
<b>Furniture and effects</b>	4%	8%	23%	15%	50%
<b>Jewellery (inc. precious metals)</b>	41%	9%	15%	10%	24%
<b>Motorcycles</b>	3%	6%	15%	25%	51%

Table 19. Distribution of high value goods seized by the Asset Recovery Unit by value. Source: FIU.

- 132. While there is some variation in value ranges between different types of goods, generally the majority of assets seized have been valued at over \$10,000. The only category where the majority of the assets fall in the ‘less than \$1,000’ value range is jewellery and precious metals.
- 133. The table below assesses three options for the threshold: **\$5,000, \$10,000 and \$15,000.**

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The status quo on this option is inapplicable as the cash threshold is a new issue to be considered.			
<b>Option 1</b> \$5,000	<p>✔ This option would address additional ML/TF risk, and capture transactions between \$5,000 and \$10,000.</p>	<p>✘ This option may impose an undue and disproportionate compliance burden on the reporting entities. Customers would also need to produce CDD information at each purchase over \$5,000.</p>	<p>⚡ This option is not aligned with the existing thresholds under the AML/CFT Act. For example, the new requirement to report prescribed transactions is triggered at \$10,000 domestic cash transactions, but CDD (and cash reports under Options 3 and 4) would be required for transactions at or above \$5,000. This may complicate the implementation of the requirements.</p>	<p>⚡ This option may go beyond the FATF Recommendations and result in poor application of the risk-based approach.</p>

<b>Option 2</b> \$10,000	✓ This option would contribute to the detection and deterrence of ML/TF as it would capture most of the higher risk, higher volume transactions.	✓ Capturing transactions over \$10,000 is reasonable, and would not be overly onerous for reporting entities or legitimate customers.	✓ This option would align with the thresholds in the AML/CFT Act. The threshold for conducting CDD on occasional transactions and for reporting domestic cash transactions to the FIU is currently \$10,000.	✓ The FATF Recommendations' threshold for dealers in precious metals and stones is EUR/USD 15,000 (approximately \$20,000 to \$23,000)
<b>Option 3</b> \$15,000	~ This option would not capture transactions that are significant but under \$15,000. It may miss valuable intelligence about illicit transactions.	~ The compliance burden may be lower than with the lower thresholds, but is out of proportion with the risk associated with large cash transactions.	✗ This option would be misaligned with the existing thresholds in the AML/CFT Act. For example, the new requirement to report prescribed transactions is triggered at \$10,000 but CDD would only be conducted at \$15,000.	✓ The FATF Recommendations' threshold for dealers in precious metals and stones is EUR/USD 15,000 (approximately \$20,000 to \$23,000)

Table 20. Options analysis for the appropriate cash threshold for the high value dealers sector.

**Ministry’s preferred option: set the threshold for \$10,000 (Option two)**

134. The Ministry’s preferred option is to set the threshold at \$10,000. This option strikes a balance between detecting illicit activity and the compliance burden on businesses while maintaining internal consistency in the AML/CFT regime.

**Gambling sector**

135. Some parts of the gambling sector are known to be at high risk of being misused by criminals for money laundering and terrorist financing. For this reason, the highest-risk part of the sector, casinos, were included under Phase I of the AML/CFT regime.

136. The two main money laundering risks associated with gambling services are the following:

- 136.1. where gambling operators provide accounts for gambling or betting purposes that can be used to deposit, move and withdraw funds, making them appear as legitimate winnings in the process; and
- 136.2. an ability to launder illicit funds via large, anonymous cash bets.

**Options analysis for addressing the problem**

*Status quo – Only casinos have AML/CFT obligations*

137. The gambling sector, apart from casinos, would continue to have no compliance obligations under the AML/CFT Act. The New Zealand Racing Board (NZRB) would continue to have some limited obligations under the FTRA, but they would not be supervised for AML/CFT purposes.

*Option one – AML/CFT obligations extended to certain gambling providers*

138. The NZRB and New Zealand Lotteries Commission (NZLC) are currently covered by the AML/CFT legislation but they have been granted Ministerial exemptions from the AML/CFT Act. This option would revoke the Ministerial exemptions and extend AML/CFT compliance obligations in the following way:

- 138.1. NZRB would be covered when it operates accounts on behalf of its customers or accepts cash transactions over a threshold to be determined in regulations; and
- 138.2. NZLC would not be covered explicitly. Instead, it would be covered under the existing definition of financial institution under the AML/CFT Act because it accepts deposits from the public. It would have the opportunity to reapply for a Ministerial exemption.

*Option two – AML/CFT obligations extended to additional parts of the gambling sector*

139. In addition to the NZRB, additional gambling providers would have AML/CFT compliance obligations. This would be achieved by including the following activities in scope of the legislation:

- 139.1. accepting a bet on behalf of a person
- 139.2. making a bet on behalf of another person
- 139.3. providing accounts for the purpose of gambling or betting.

140. The additional gambling providers under this option could include junket operators and online casinos providing services for New Zealand customers. It should be noted that this option is not intended to cover pokies in clubs and pubs because they are considered to be a low-risk activity<sup>19</sup>.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	Some gambling providers have been associated with ML/TF. The non-coverage of the sector may compromise efforts to detect and deter ML/TF. The NZRB has limited existing obligations under the FTRA, but these have not contributed meaningfully to the detection of ML/TF.	The lack of AML/CFT obligations is disproportionate to the risk associated with gambling services.	This option imposes no further obligations.	The FATF Recommendations do not specify which gambling providers beyond casinos should have AML/CFT obligations. They do, however, require a risk-based approach whereby any sectors considered to be a ML/TF risk should be covered.
<b>Option 1</b> NZRB has AML/CFT compliance obligations.	+ Coverage of NZRB would improve the detection and deterrence of ML/TF.	+ Applying the current compliance obligations under the AML/CFT Act on NZRB would be a proportionate response to the risk presented by its services.	+ NZRB is currently a reporting entity under the AML/CFT Act, but it has been granted a Ministerial exemption. By virtue of its current capture, they are likely to have an understanding of the requirements under the AML/CFT which facilitates implementation.	++ This option would apply the risk-based approach as required by the FATF Recommendations.

<sup>19</sup> The Gambling (Harm Prevention and Minimisation) Regulations 2004 set maximum stake and prize limits at relatively low levels for Class 4 gambling as defined in section 30 of the Gambling Act 2003. This limits the ability to launder via large cash bets.



<p><b>Option 2</b></p> <p>All gambling providers providing accounts or accepting bets have AML/CFT compliance obligations</p>	<p>++ Coverage of further gambling providers would enhance the detection and deterrence of ML/TF.</p>	<p>- Imposing compliance obligations on additional gambling providers will have compliance costs, some of which may be disproportionate to the risk involved.</p>	<p>- The main risk associated with this option is the uncertainty about which gambling providers are included in scope of AML/CFT legislation. Specifically, overseas entities providing accounts for gambling or betting purposes to New Zealand customers may inadvertently be captured – but it would be difficult for the AML/CFT supervisors to supervise these providers as they fall outside the territorial scope of the AML/CFT Act.</p>	<p>+ This option may, however, go beyond the FATF Recommendations, and result in poor application of the risk-based approach. On balance, there would be a positive impact compared to the status quo.</p>
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Table 21. Options analysis for the coverage of the gambling sector in scope of AML/CFT legislation.

**Ministry’s preferred option: expanding AML/CFT obligations to the NZRB and the NZLC (Option one)**

141. The Ministry’s preferred option is to revoke the Ministerial exemptions provided to the NZRB and NZLC and include them in scope of the AML/CFT regime.

**Implementation period**

142. When the AML/CFT Act was enacted in 2009, the compliance obligations for reporting entities did not commence until 2013. The four-year period was to ensure that the reporting entities and AML/CFT supervisors had sufficient time to prepare for the commencement of the regime. To align with this approach, it is appropriate to consider what the implementation period for different Phase II sectors should be.

143. The phased implementation period also allows for the development of the necessary regulations to support the AML/CFT Act, and the appropriate guidance materials both for the affected sectors and the wider public.

**Options analysis for addressing the problem**

*Status quo – All compliance obligations come into force after enactment*

144. If there is no explicit decision to phase the compliance obligations for different Phase II sectors, the obligations will commence on the day when the Amendment Act comes into force.

*Option one – Implementation period with more variability between sectors*

145. This option would phase the implementation in the following way:

- 145.1. 6-month implementation period for lawyers
- 145.2. 12-month implementation period for accountants
- 145.3. 18-month implementation period for real estate and gambling sector
- 145.4. 24-month implementation period for high value dealers.

146. This phasing is done based on the Ministry’s perceived readiness of the sectors to comply with the requirements. This perception has been formed through consultation and discussions with the sectors and their representative bodies.

*Option one – Implementation period with less variability between sectors*

147. This option would phase the implementation in the following way:

147.1. 12-month implementation period for lawyers and accountants

147.2. 24-month implementation period for all other sectors.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b> Immediate enactment	While the sectors would be required to comply with the obligations from enactment, it is unlikely that most sectors would be able to comply fully. Without a sufficient implementation period to develop supervisory capability for the new sectors, supervision is also unlikely to monitor and enforce compliance immediately after enactment.	Despite the high risk associated with the new sectors, it is not justified to require immediate implementation. The rapid implementation is likely to significantly increase the compliance burden and costs because reporting entities would need to rely extensively on external assistance to establish their systems.	This option would be highly impractical both for the new sectors and their AML/CFT supervisors.	While this option would be theoretically the most compliant with the technical component of the FATF Recommendations, it is unlikely to contribute to the effectiveness of the regime in the longer term.
<b>Option 1</b> 6-24 month period	<b>++</b> This option would be the most aligned with the Shewan Inquiry recommendation to bring the legal and accounting sectors in scope of the regime as soon as possible. Phasing in this manner would allow the relevant supervisor time to progressively build up capacity to effectively supervise the highest risk sectors.	<b>+</b> The implementation periods have been determined based on the risk associated with the sectors and the readiness of the sectors to comply with the obligations. While the legal sector would especially need to comply within a very short period of time, overall the compliance burden is proportionate to the risk.	<b>0</b> It is likely that the sectors with a short implementation period would find difficulties becoming fully compliant within the implementation period. However, the option is practical for the relevant supervisor that can progressively build capacity to supervise the new sectors.	<b>+</b> This option is likely to result in a favourable FATF evaluation in 2020 as the highest risk sectors (lawyers, accountants and real estate sector) would have been subject to the AML/CFT Act for a relatively sufficient period to demonstrate effectiveness.
<b>Option 2</b> 12-24 month period	<b>0</b> This option may hinder the effective detection and deterrence of ML/TF as some of the high risk sectors would only be required to comply from 2019 onwards. This may also cause displacement from the legal and accounting sectors to the unregulated sectors.	<b>+</b> This option would divide the sectors to two categories: higher and lower risk and readiness. Diving the implementation this way would be proportionate to the risk associated with the sectors.	<b>++</b> This option would allow more time for the legal sector to become compliant, and would therefore be easier to implement from the sector’s perspective. This option is practical for the relevant supervisor that can progressively build capacity to supervise the new sectors.	<b>0</b> This option may result in criticism during the FATF evaluation particularly because the real estate sector would have only been required to comply with the obligations for less than a year at the time of the evaluation (February 2020).

Table 22. Options analysis for the length of the implementation period for the Phase II sectors.

### **Ministry's preferred option: phasing the implementation over two years with more variability between sectors (Option one)**

148. The Ministry's preferred option is to phase the implementation so that sectors are required to comply with the obligations between 6 and 24 months after the Amendment Act comes into force. Compared to Option 2, this option is more closely aligned with the recommendation from the Shewan Inquiry, which recommended lawyers and accountants to be included in the regime as soon as possible (more specifically, prior to 31 December 2016).

### **Amendments to make changes to the AML/CFT supervisory regime**

149. The following options are intended to expand New Zealand's AML/CFT supervisory regime, and designate a supervisor for the new sectors to be covered under Phase II.

### **Supervisory model for Phase II sectors**

#### **Status quo and problem definition**

150. While the current AML/CFT supervisory framework is working well for the existing sectors, including additional sectors under Phase II requires the framework to be extended. Not designating a supervisor for the new sectors to be covered under the AML/CFT Act would compromise the enforcement of the Act and likely limit the level of compliance with the obligations.

151. New Zealand currently operates a multi-agency supervisory model. The supervisory function for reporting entities is divided as follows:

- 151.1. the Reserve Bank of New Zealand (RBNZ) supervised registered banks, life insurers and non-bank deposit takers;
- 151.2. the Financial Markets Authority (FMA) supervises financial entities such as issuers of securities, licensed supervisors and statutory supervisors, derivatives issues and dealers, managed investment schemes, brokers and custodians, financial advisors, equity crowd funding service providers and peer to peer lending service providers;
- 151.3. the Department of Internal Affairs (DIA) supervises casinos, non-deposit-taking lenders, money changers and other reporting entities not supervised by the other two supervisors.

#### **There are three main AML/CFT supervisory models**

152. While there is variation among countries, most countries operate a version of one of the following AML/CFT supervisory models:

- 152.1. single supervisor, where all supervisory functions are grouped under a single agency
- 152.2. multi-agency supervisor, where multiple Government agencies supervise their designated sectors (which is the current New Zealand model); and
- 152.3. agency supervision with self-regulatory bodies, where one or several agency supervisors share the supervisory function with bodies such as professional associations.

## Options analysis for addressing the problem

### *Status quo – the Phase II sectors are not supervised for compliance with the AML/CFT Act*

153. There is currently no supervisory framework in place for the Phase II sectors. Continuing the status quo would mean that even if the Phase II sectors would have AML/CFT obligations, they would not be supervised or monitored for compliance.

### *Option one – a single supervisor supervises all reporting entities*

154. A new agency would be established to supervise both Phase I and Phase II reporting entities. The current supervisory responsibilities of the DIA, the RBNZ and the FMA would be merged into the new agency.

### *Option two – the Department of Internal Affairs supervises Phase II entities*

155. The DIA would be the supervisor for all Phase II entities. This option would build on the DIA's current AML/CFT supervisory role for entities such as casinos, money changers and money remitters. The FMA's and RBNZ's supervisory responsibilities would remain unchanged.

### *Option three – Government departments and self-regulatory bodies as supervisors for Phase II sectors*

156. The supervision of Phase II sectors would be divided to Government departments and self-regulatory bodies as follows:

- 156.1. New Zealand Law Society for lawyers
- 156.2. New Zealand Institute of Chartered Accountants and CPA Australia for accountants
- 156.3. Real Estate Agents Authority for real estate agents
- 156.4. DIA for others (conveyancers, high value dealers, gambling providers); and
- 156.5. FMA and RBNZ for the reporting entities they supervise currently.

157. In analysing this option, the criterion of proportionality has been modified to analyse the resources required from the Government. The specific costs associated with each option are included and explained later in this section.

	Deterring and detecting ML/TF	Resources	Practicality	Int. standards
<b>Status quo</b>	The status quo with no supervision would be ineffective at detecting and deterring ML/TF. This would likely result in very low levels of compliance from the Phase II sectors. Further, there would be no consistency between the Phase I and Phase II sectors, possibly resulting in displacement of illicit activities to the unsupervised sectors.	Continuing the status quo would incur no further costs on the Government, but would also be ineffective and not mitigate the risk associated with the Phase II sectors.	Leaving the Phase II sectors unsupervised would make it difficult for the entities to comply with their obligations. The role of the supervisors is not only monitoring and enforcement of compliance, but also education and raising awareness about AML/CFT.	Continuing the status quo would not be compliant with the FATF Recommendations, and would compromise the effectiveness of the AML/CFT regime.

<p><b>Option 1</b></p> <p>Single supervisor for all reporting entities</p>	<p>++ A single Government agency would have the capacity and capability to establish effective supervisory structures. This would also ensure that AML/CFT supervision is consistent for all sectors and that there is sufficient focus and quality of supervision. However, this option would not leverage AML/CFT existing sector-relationships that the Sector Supervisors currently have with their supervised sectors. This option may also undermine the existing supervision of reporting entities.</p>	<p>+ The cost of this option will likely be higher than the other options – largely because of the one-off cost of establishment. There will likely be additional corporate overhead costs which are balanced against the benefits of reduced duplication of effort and co-ordination.</p>	<p>- A new agency would take significant time to build the expertise, systems and structures required for effective supervision. It would be difficult to establish a new agency before the proposed commencement of Phase II.</p>	<p>+ The FATF Recommendation 28 provides two options for supervising DNFBPs: supervisors and SRBs. The single supervisor would be consistent with this Recommendation.</p>
<p><b>Option 2</b></p> <p>The DIA supervises all Phase II sectors.</p>	<p>++ Other than the gambling sector, the DIA does not have established relationships with Phase II sectors and would need to build expertise and knowledge<sup>20</sup>. However, as an existing supervisor, the DIA has experience in AML/CFT supervision and has established a risk-based approach across all supervisory activities. The DIA has established structures, systems and mechanisms or an effective AML/CFT supervision capability which could be extended to the Phase II sectors. This model would support consistency in supervision by limiting the number of supervisors and ensuring one supervisor for businesses that provide similar services (e.g. lawyers, conveyancers accountants and trust and company service providers).</p>	<p>++ The resources required for this model are lower than those for the other models. This is largely due to the ability to leverage some of the existing structures and systems.</p>	<p>++ The DIA has existing supervisory structures and systems in place which could be extended to establish an effective AML/CFT supervisory regime for Phase II sectors. Limited legislative changes would be needed, although preparation time would be required to understand and assess sector risks, build the compliance team and extend systems to Phase II entities. It should also be noted that some elements such as DIA’s current IT system would need to be replaced to accommodate supervising the new reporting entities.</p>	<p>+ The FATF Recommendation 28 provides two options for supervising DNFBPs: supervisors and SRBs. DIA as the supervisor for all Phase II entities would be consistent with this Recommendation.</p>
<p><b>Option 3</b></p> <p>Government departments supervise Phase II sectors together with self-regulatory bodies (SRBs).</p>	<p>+ The SRBs do not have experience in AML/CFT supervision and would need to build capability to ensure effective risk-based proactive monitoring and enforcement. Establishing a wider range of supervisors also increases the potential for inconsistent supervision. To ensure effective supervision under this model, an appropriate oversight mechanism from a Government body would also be required. It would take longer to establish effective monitoring as some bodies do not have the structural basis for</p>	<p>+ The cost of this option is likely to be higher than that of Option 2. This is because there will be additional costs as the new organisations learn how to be an AML/CFT supervisor, there will be a cost associated with Government oversight/monitoring of performance, and if several new entities the cost of</p>	<p>- This option could leverage the SRBs’ existing activities on education, communication, licensing and monitoring for AML/CFT supervision. It may be easier for some of the Phase II sectors to be regulated by only one body for both AML/CFT and other purposes. However, the need for establishing appropriate Government oversight for the SRBs would add a layer of complexity that may decrease the practicality of this option. Further, not all businesses</p>	<p>+ The FATF Recommendation 28 allows SRBs to supervise DNFBPs, provided that the body can ensure that its members comply with their obligations to combat ML/TF.</p>

<sup>20</sup> It should be noted that before the implementation of Phase I, the DIA also did not have established relationships with the Phase I sectors apart from casinos. It has, however, built the necessary knowledge base and relationships with its current reporting entities and is likely to be able to do this with the Phase II sectors as well.

	monitoring and enforcement. This option would also require the existing coordination mechanisms between the supervisors to be amended to facilitate cooperation with non-Government supervisors. Finally, the SRBs also representing the interests of their members may have a conflict of interest that could lead to insufficient supervision.	duplicating systems. This is balanced against the ability to more readily integrate AML/CFT activities with the other regulatory roles of the entities.	providing the captured services are members of NZLS, NZICA or CPA Australia and as a result, another Government agency would be required to supervise accountants that are not members of these bodies.	
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Table 23. Options analysis for the AML/CFT supervisory model for the Phase II sectors.

### Cost implications of the supervisory models

158. Establishing and maintaining an AML/CFT supervisory model requires resources from the Government. Without the appropriate resources, AML/CFT supervision is unlikely to be effective. This contributes to low levels of compliance and can defeat the purpose of establishing an AML/CFT regime in the first place.
159. The cost of supervision is directly linked to the number of reporting entities in the sector. The following table includes the estimated numbers of reporting entities in each sector, which have been used as a basis for the costings. The estimates are based on the Business Compliance Cost survey Deloitte conducted on behalf of the Ministry of Justice. The costs are estimated at each reporting entity having full compliance obligations in line with the Phase I entities.
160. The numbers of reporting entities in the motor vehicle dealers and jewellers sectors have been estimated on the basis that 64% of jewellers and 35% of motor vehicle dealers decide to opt out of the regime. This estimate is also based on the results of the Deloitte Business Compliance Cost survey.

Sector	Estimated sector size	Estimated reporting entities
Lawyers and conveyancers	1,919	1,572
Accountants	2,433	2,223
Real estate agents	1,019	1,006
Motor vehicle dealers	3,255	2,106
Jewellers	640	229
<b>Total</b>	<b>9,299</b>	<b>7,136</b>

Table 24. Estimated numbers of Phase II reporting entities to be supervised. Source: Deloitte Business Compliance Cost survey.

161. The supervision costs for the DIA model (Option 2) have been estimated by using a combination of three costing methods. All three methods are based on the estimated reporting entity numbers as explained above. The methods are:
- 161.1. A risk-based model that assumes that a certain percentage of each sector will require active supervision activities including onsite visits and desk-based reviews. A range of supervision days was calculated based on proxies provided by the current AML/CFT supervisors. The number of days required for onsite visits and desk-based reviews

was then extrapolated to include all the other supervisory activities such as guidance and enforcement.

- 161.2. An extrapolation of the number of FTEs required from current supervision levels with estimated efficiencies of 5%, 10% and 15% due to greater economies of scope.
- 161.3. A second risk-based model that assumes 75% of supervision time is spent on the 30% of the highest risk reporting entities in the sector. Application of a distribution where 75% of supervision activities are spent on the highest 30% of risk to establish the estimated number of non-compliant entities requiring active supervision. The same level of risk was applied to desk-based and on-site review levels to determine number of supervision days for *minimum*, *intermediate* and *maximum* levels of effort. The number of FTEs for each calculation for each sector was aggregated together to determine an average number of FTEs needed.
162. An average full time equivalent (FTE) number and associated cost were obtained based on these three models. Additional FTEs were added for operational support staff and management structures. Using these numbers, the costs for the other two models were calculated to account for duplication of supervisory efforts, savings based on the existing knowledge of the sectors, entity start up costs and additional corporate overheads.
163. It should be noted that the estimates include operational expenditure only. They do not include capital costs or the ongoing operational costs related to the capital, such as those required for establishing and maintaining an appropriate IT infrastructure. Additional capital funding will be necessary for each of the options to implement an effective and responsive supervisory regime.
164. Taking into account the parameters as explained, the following table summarises the estimated costs for each of the models analysed above.

Supervisory model	2017/2018	2018/2019	2019/2020	2020/2021	2021/2022	Total	Average per year	Year 1 set up costs
<b>Status quo</b>	The status quo does not incur costs for the government.							
<b>Option 1</b>	\$ 13.3	\$ 12.6	\$ 13.9	\$ 14.4	\$ 14.6	<b>\$ 68.8</b>	\$ 12.7	\$ 5.5
<b>Option 2</b>	\$ 6.8	\$ 11.6	\$ 12.9	\$ 13.4	\$ 13.6	<b>\$ 58.3</b>	\$ 11.7	N/A
<b>Option 3</b>	\$ 9.4	\$ 16.1	\$ 16.6	\$ 17.1	\$ 17.4	<b>\$ 76.5</b>	\$ 15.3	N/A

Table 25. Estimated costs for AML/CFT supervisory models for Phase II entities. Costs expressed as \$ million.

165. The cost estimates show that the DIA as the supervisor for all Phase II entities would be the least costly option across the five-year period. The model would incur lower establishment costs compared to the two alternative models. After establishment, the ongoing costs are also estimated to be at a lower level compared to the other models.

**Ministry’s preferred option: DIA as the supervisor for all Phase II entities (Option 2)**

166. The Ministry’s preferred option is to maintain the existing supervisory model and establish DIA as the supervisor for all Phase II sectors. The DIA’s existing supervisory systems could be leveraged and extended to the Phase II sectors. This would support consistent supervision across sectors, and would require limited legislative and structural changes. With appropriate

resources and time, the DIA would be well-placed to establish an effective supervisory regime for Phase II.

167. Another factor in favour of the DIA model is the timeliness of establishing the supervisory structure for the Phase II entities. Out of the three proposed models, the DIA model would require the least amount of time to become fully operational and effective.



## Significant amendments to the existing AML/CFT regime

### Information sharing

168. The AML/CFT Act provides a prescriptive regime for sharing information. In general, Police and the FIU, Customs and the AML/CFT supervisors (the AML/CFT agencies) are able to share information, but the process for sharing is highly prescribed. The AML/CFT agencies can share information with other agencies only in limited circumstances:
- 168.1. where the information shared is not personal information; and
  - 168.2. where the information is shared for law enforcement purposes.
169. This regime has proven unworkable because of the following reasons:
- 169.1. the restriction to non-personal information for agencies other than AML agencies greatly restricts the information that can be shared and therefore the value of the sharing; agencies with a clear interest in AML (e.g. Inland Revenue) are excluded
  - 169.2. some information can only be shared in one direction or requires a production order, rather than permitting proactive release
  - 169.3. limiting the purpose to law enforcement purposes has constrained the flow of information and excludes, for instance, information that is relevant to supervision or other regulatory management, but not a crime; and
  - 169.4. there is uncertainty in the regime about what information is permitted to be shared, leading to risk aversion.
170. Expanding the regime to the Phase II sectors also creates new challenges to share information effectively in an environment with a large number of new reporting entities.
171. The recent Government Inquiry into Foreign Trust Disclosure Rules highlighted information sharing as a key gap in the current AML/CFT regime and an area where improvements are required. Improving the information sharing regime in the AML/CFT Act is also consistent with the broader Government goal of ensuring that information sharing is efficient and effective and enables better enforcement of our key regulatory regimes.

### Options analysis for addressing the problem

*Status quo – Information sharing provisions remain the same*

172. There are no legislative changes to the information sharing regime.

*Option one – Technical amendments to existing information sharing provisions*

173. The prescriptive approach in the current AML/CFT Act is maintained. The language of the Act is, however, amended to enable new agencies such as Inland Revenue to share information.

*Option two – Create a new mechanism for ‘structured flexibility’ in information sharing*

174. The more flexible regime can be summarised as follows:

- 174.1. the purpose of information sharing is expanded to *effective administration of the AML/CFT regime*. This would include law enforcement purposes, supervisory

purposes, intelligence and enforcement of a specified list of pieces of legislation, including the Inland Revenue Acts.

- 174.2. a ‘future-proofing’ mechanism is created to enable decision makers to create new information sharing arrangements provided certain safeguards are in place. This mechanism can include memoranda of understanding or sharing arrangements specified in regulations, for example.

*Option three – Insert a broad enabling provision in the legislation*

175. A broad enabling information sharing provision is inserted in the legislation, supported by non-binding guidance on appropriate sharing. This would enable all agencies to share any information obtained in their regulatory capacity.

176. For the purposes of analysing the set of options, the criteria of practicality has been modified to include privacy considerations. Instead of compliance burden to the sector, the criterion of proportionality encompasses the effort required by agencies to share information.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The lack of ability to share relevant information is hampering the detection of ML/TF.	Information that is not shared appropriately leads to duplication of effort by agencies and suboptimal regulatory and law enforcement outcomes.	The current information sharing provisions are not fit for purpose, and agencies cannot share information effectively.	The FATF Recommendations require information to be shared between Government agencies, and with the private sector. The current arrangements are unlikely to meet the Recommendations.
<b>Option 1</b> Technical amendments	<b>+</b> This option would improve information sharing and therefore the effectiveness of the regime in the short term. It would, however, not provide for revisions in the future.	<b>+</b> The option would alleviate some of the burden to obtain information for the agencies. New agencies would be able to share information, thereby reducing the effort required to either obtain the information or operate with less information available.	<b>0</b> The prescriptive approach may need frequent revisions, which may not be practical given that the current provisions are included in primary legislation. This option would be satisfactory from the privacy perspective.	<b>0</b> This option may be too restrictive to align with the FATF Recommendations.
<b>Option 2</b> Structured flexibility	<b>++</b> This option would improve the effectiveness of the regime. Agencies would be able to share information more freely, contributing to better law enforcement and regulatory outcomes.	<b>++</b> The approach could be amended as necessary to reduce the burden on agencies.	<b>++</b> This is a practical option that works both in the short and the long term. Safeguards would be embedded in the future-proofing mechanism, ensuring that the privacy of individuals is not compromised.	<b>+</b> This option is likely to contribute to the effectiveness of the regime and therefore align with the FATF Recommendations.

<p><b>Option 3</b></p> <p>Broad enabling provision</p>	<p><b>0</b> If the information sharing provisions are used fully, efficiencies can be gained and the detection of ML/TF could be improved. However, the broad provision may lead to risk aversion to share information which would not contribute to effectiveness.</p>	<p><b>+</b> In theory, agencies would be able to eliminate the duplication of effort when collecting and using information.</p>	<p><b>-</b> This option is likely to attract criticism for being too liberal with individuals' personal information. In addition, past experience suggests that enabling provisions that are either too broad or too vague lead to risk aversion and do not result in the desired efficiencies.</p>	<p><b>0</b> This option would be compliant with the FATF Recommendations from the law enforcement perspective, but may attract criticism if the information is not protected adequately.</p>
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Table 26. Options analysis for improving information sharing in the AML/CFT regime.

**Ministry's preferred option: A more flexible regime for sharing information within Government (Option 2)**

177. The Ministry's preferred option is to create a new, flexible regime for sharing information. This strikes a balance between the current prescriptive regime and a wide open enabling provision while safeguarding privacy principles.

**Suspicious activity reporting**

178. The AML/CFT Act currently requires reporting entities to report suspicious *transactions* to the Police Financial Intelligence Unit (FIU) where there are reasonable grounds to suspect a transaction may be related to a criminal offence.

179. Limitations in this reporting regime have been identified in the Shewan Inquiry on Foreign Trusts and by the FIU, as suspicious *activity* is not reported when it is identified outside of a specific transaction. For example, suspicious activity is not reported when:

- 179.1. a trust and company service provider identifies suspicious transactions involving New Zealand entities that do not go through a New Zealand bank
- 179.2. suspicious behaviour is identified when a customer seeks information from reporting entities to understand how to avoid detection; or
- 179.3. suspicious activity is identified when a customer establishes complex legal structures without an underlying transaction.

180. As a result of the limitations, valuable intelligence is not being reported to the FIU by reporting entities when they identify suspicious activity.

**Options analysis for addressing the problem**

*Status quo – only suspicious transactions are reported*

181. The reporting entities would only need to report their suspicion to the FIU when their suspicion is linked to a transaction a customer conducts or seeks to conduct through the reporting entity.

*Option one – reporting entities are required to report suspicious activities to the FIU*

182. An additional category of reporting would be added to the AML/CFT regime. This would see reporting entities report to the FIU when they form a suspicion on reasonable grounds in the following circumstances:
- 182.1. the reporting entity provides or proposes to provide a service to a customer related to the activity the basis on which they are a reporting entity; or
  - 182.2. a customer requests the reporting entity to provide such a service or enquires about a service.
183. While the requirement to report would be included in the AML/CFT Act, supporting regulations with details of the reporting requirements would be issued at a later date. These regulations would also determine the commencement date of the new requirement. The requirements to report suspicious transactions would remain unchanged.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	Reporting entities are currently not able or required to report their suspicions in situations where there has been no actual or attempted transaction. As a result, the FIU is not receiving valuable information about potential ML/TF or predicate offending.	While this option would not incur additional costs on reporting entities or the FIU, it also compromises the effectiveness of the reporting regime.	The suspicious transaction reporting requirement is reasonably easy for reporting entities to implement. However, impracticalities arise where suspicion has been formed without a link to a transaction. For example, the FIU's reporting regime rejects suspicious transaction reports that do not specify the amount of the transaction.	The FATF Recommendations only require suspicious transactions to be reported to the FIU.
<b>Option 1</b> Suspicious activity reporting	<b>++</b> The option enhances the detection and deterrence of ML/TF because it enables reporting entities to report their suspicions without a link to a transaction.	<b>+</b> This proposal will have an impact on reporting entities which would be required to revise their monitoring and reporting systems and train staff on the changes. However, with sufficient lead-in time, reporting entities could implement changes through planned updates and training mechanisms to minimise the cost impact. Investment to FIU capability (IT systems and personnel) would be required to ensure that it can receive and analyse the additional reports.	<b>0</b> The requirement to report suspicious activities, if not defined appropriately, may be difficult for reporting entities to implement. This is because defining suspicious activity can be subjective. This risk can be mitigated by defining suspicious activity in either the supporting regulations, or ensuing guidance.	<b>0</b> While this proposal extends beyond the international standards set by the FATF, the US, the UK and Australia require reporting entities to report suspicious activity beyond a specified transaction. Their experience has demonstrated the value of the additional financial intelligence.

Table 27. Options analysis for extending the reporting of suspicious transactions.

**Ministry's preferred option: include suspicious activity reporting in the AML/CFT regime (Option one)**

184. The Ministry's preferred option would be to extend the current reporting requirements to suspicious activities. This option enhances the detection of money laundering and terrorist financing, and is aligned with the measures in Australia, the UK and the US. This option would

also fulfil the Shewan Inquiry recommendation on expanding the reporting of suspicious transactions.

### **Reliance on third parties**

185. A customer may come into contact with more than one reporting entity in a single transaction or service. The AML/CFT Act allows reporting entities to share controls and rely on other reporting entities in certain circumstances to reduce duplication of compliance effort. Given the increase in the number of small businesses, partnerships and franchise businesses in the Phase II sectors, the circumstances when reliance is permitted could be expanded.
186. Currently, the AML/CFT Act includes provisions for the reliance on third parties to allow reporting entities to share AML/CFT obligations and the associated costs of implementation. The Act provides three mechanisms for the reliance on third parties for AML/CFT obligations:
- 186.1. reliance on a member of a designated business group (DBG)
  - 186.2. reliance on other reporting entities or persons in another country; and
  - 186.3. reliance on agents.
187. In all circumstances, the reporting entity retains responsibility for compliance with AML/CFT requirements. These provisions were developed to align with the international standards set by FATF on the reliance for CDD purposes.

### **Options analysis for addressing the problem**

#### *Status quo – Reliance provisions remain the same*

188. There would be no change to the existing reliance provisions.

#### *Option one – Amend the definition of designated business group*

189. This option would expand the definition of DBG to allow reporting entities to form a DBG where:
- 189.1. each member is a related law firm, or a subsidiary of a law firm, that is a reporting entity in NZ (or foreign equivalent)
  - 189.2. each member is a related accounting practice, or a subsidiary of an accounting practice, that is a reporting entity in NZ (or foreign equivalent)
  - 189.3. each member is a related trust and company service provider (TCSP), or a subsidiary of a TCSP, that is a reporting entity in NZ (or foreign equivalent)
  - 189.4. each member is a related real estate agent.
190. Related entities would refer to being part of the same franchise, providing products or services under a common-brand name, or having common strategies, processes and controls.

#### *Option two – Amend the circumstances for reliance*

191. This option would amend the circumstances under which reliance on another reporting entity is permitted for CDD to require verification documents to be provided *upon request without delay* rather than *within five days*.
192. It should be noted that options one and two are *not* mutually exclusive. Instead, both options can be adopted to enhance the existing provisions on reliance.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	Retaining the current regime on reliance would not compromise the regime's effectiveness of detecting ML/TF.	Reporting entities, particularly in the Phase II sectors, may face a disproportionate compliance burden if they are not able to rely on relevant entities for some compliance obligations.	The lack of appropriate reliance provisions may lead to duplication of effort, and reduce the overall compliance of the Phase II sectors.	The current provisions are in line with the FATF Recommendations.
<b>Option 1</b> DBG amendment	<b>0</b> This option would not compromise the regime's effectiveness of detecting ML/TF.	<b>++</b> This option would reduce the overall compliance burden on the entities able to rely on others. This would improve the proportionality of the option.	<b>++</b> Specifying the new types of DBG that are allowed would be reasonably easy for reporting entities to understand.	<b>0</b> This option would not be inconsistent with the FATF Recommendations.
<b>Option 2</b> Amend circumstances for reliance	<b>0</b> This option would not compromise the regime's effectiveness of detecting ML/TF.	<b>++</b> This option would reduce the overall compliance burden on the entities able to rely on others. This would improve the proportionality of the option.	<b>++</b> This is a practical solution that would make it easier for reporting entities to comply with their obligations.	<b>0</b> The FATF Recommendations do not specify a time limit for the relevant documents to be produced.

Table 28. Options analysis for extending the provisions on reliance under the AML/CFT Act.

### Ministry's preferred option: amend the definition of DBG and the circumstances for reliance (Options 1 and 2)

193. The Ministry's preferred option is to amend both the definition of designated business group and the circumstances for reliance. When combined, these amendments will alleviate some of the compliance burden on the Phase II sectors while not compromising the effectiveness of the regime or New Zealand's compliance with the FATF Recommendations.

### Customer due diligence

194. The current AML/CFT Act allows for simplified customer due diligence (CDD) to be performed on specific low risk entities as defined by the Act. Simplified CDD allows reporting entities to check and verify fewer details about their customers than when they are conducting standard or enhanced CDD. Feedback has been received from market participants that the current definitions are not in line with the relative risk rating, creating an unnecessary compliance burden.

195. More specifically, conducting simplified CDD requires the reporting entity to obtain the following information in relation to a person acting on behalf of the customer: the person's name and date of birth, and the person's relationship to the customer. The information must be verified according to the level of risk involved to the extent where the reporting entity is satisfied it knows who the person is and that the person has authority to act on behalf of the customer.

## Options analysis for addressing the problem

*Status quo – Simplified CDD is not extended to further entities*

196. The list of entities that the simplified CDD requirements apply to remains the same.

*Option one – Simplified due diligence is extended to two new groups of entities*

197. The ability to conduct simplified CDD would be extended to New Zealand Owned Enterprises (as defined by Schedule 1 of the State Owned Enterprises Act 1986) and majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions. It should be noted that simplified CDD can be extended to further entities through regulations.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b>	The status quo is not hampering the ability to detect and deter ML/TF.	Conducting more comprehensive CDD on very low risk entities is not cost-effective.	Conducting more comprehensive CDD on very low risk entities is imposing an unnecessary compliance burden.	The status quo complies with the FATF Recommendations.
<b>Option 1</b>  Extend simplified due diligence to two new groups of entities	<b>0</b> Due to the low risk of the proposed new entities, this option would not reduce the ability to detect and deter ML/TF.	<b>++</b> The option would reduce the compliance costs on industry.	<b>++</b> The option would simplify the compliance obligations on industry.	<b>0</b> The option would not be against the FATF Recommendations.

Table 29. Options analysis for extending the ability to conduct simplified customer due diligence to new groups of entities.

### Ministry's preferred option: extend the ability to conduct simplified CDD on two new groups of entities (Option one)

198. The Ministry's preferred option is to extend the ability to conduct simplified CDD to New Zealand Owned Enterprises (as defined by Schedule 1 of the State Owned Enterprises Act 1986) and majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions. This option implements the risk-based approach by relieving the compliance burden of conducting a higher level of CDD on these groups while not hampering the regime's ability to detect money laundering and terrorist financing.

### Trust and company service providers

199. Using legal structures such as trusts and shell companies can be attractive to money launderers seeking to hide the beneficial ownership of criminal assets. To mitigate the risk, the AML/CFT Act places compliance obligations on some trust and company service providers (TCSPs) providing the following high risk services:

199.1. acting as a formation agent of legal persons or arrangements

199.2. arranging for a person to act as a nominee director or nominee shareholder or trustee in relation to legal persons or arrangements; or

- 199.3. providing a registered office, a business address, a correspondence address, or an administrative address for a company, a partnership, or any other legal person or arrangement.
200. TCSPs currently need to comply with the AML/CFT Act where they provide these services as the *only or principal part of their business*. However, obligations under the AML/CFT Act generally arise when an entity provides a service in the *ordinary course of business*.
201. The reason for the different approach is that TCSPs were initially intended to be covered through Phase II of the reforms. Their coverage was, however, brought forward because of the risk associated with their services and they were included as reporting entities through the AML/CFT (Definitions) Regulations 2011. At that stage, the scope of their coverage was limited.

### Options analysis for addressing the problem

#### *Status quo – Only or principal part of business*

202. Continuing the status quo would continue to impose AML/CFT compliance obligations on TCSPs only where they provide certain high risk services as the only or principal part of their business. In practice, only some TCSPs would be captured by the AML/CFT Act.

#### *Option one – Ordinary course of business*

203. This option would bring TCSPs' compliance obligations in line with other reporting entities. The alignment would be particularly relevant to ensure TCSP's obligations correspond to those of other professions such as lawyers and accountants that provide trust and company services.

	Deterring and detecting ML/TF	Proportionality	Practicality	Int. standards
<b>Status quo</b> Only or principal part of business	The status quo does not cover all TCSPs which may compromise the detection and deterrence of ML/TF in this high risk sector. TCSPs can also structure their business to avoid being captured by the AML/CFT Act by making sure the captured services are not the only or principal part of their business.	The status quo would incur no further costs to Government or industry, but is not effective at detecting and deterring ML/TF.	The compliance obligations would not be aligned with those of other professionals providing trust and company services. Further, there is no agreed definition of 'only or principal part of business'.	Not requiring all TCSPs providing high risk services to comply with the AML/CFT Act does not meet the FATF Recommendations.
<b>Option 1</b> Ordinary course of business	<b>++</b> The TCSP sector has been identified as providing high risk services. This option would expand the coverage of the sector, increasing the regime's effectiveness at detecting and	<b>+</b> Entities that provide trust and company services in the <i>ordinary course of their business</i> , but not as the <i>only or principal part of their business</i> , would be captured under the AML/CFT Act under this option. Most of these entities are, however, lawyers and accountants that are intended	<b>++</b> This option would align the way compliance obligations arise for TCSPs with other reporting entities. As there is guidance available on what 'ordinary course of business' means, it	<b>+</b> The FATF Recommendations require TCSPs to verify their clients' identities and report suspicious transactions where they provide high risk services.



	<p>detering ML/TF. This option would remove the ability to structure a TCSP's to avoid capture.</p>	<p>to be captured under the Phase II reforms. The additional compliance burden on TCSPs that would otherwise not be covered as lawyers or accountants is proportionate to the risk associated with the sector.</p>	<p>would be easier for reporting entities to understand in what circumstances their compliance obligations would arise.</p>	
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Table 30. Options analysis for extending the coverage of trust and company service providers under the AML/CFT Act.

**Ministry's preferred option: ordinary course of business (Option one)**

204. The Ministry's preferred option is to bring TCSP's compliance obligations in line with those of other reporting entities. This would improve the AML/CFT regime's coverage in the sector, and ensure a level playing field among entities such as lawyers and accountants providing similar services.

## Part B – Analysis of minor amendments

205. This section analyses minor and technical amendments to the AML/CFT regime.

Option	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Review period</b>					
<p><u>Status quo</u></p> <p>There is currently no set review period for the AML/CFT Act or regime.</p>	<p>Not having a set review period may lead to a situation where there is insufficient appetite to amend the AML/CFT regime even if this was necessary to enable effective detection and deterrence of ML/TF.</p>	<p>This option would not offer an opportunity to tailor the obligations – and ensuing compliance burden – to the future risk associated with particular sectors.</p>	<p>This option may lead to a situation where the current regime is not workable for the reporting entities or supervisors, but it would not be possible to initiate a review of the regime due to competing priorities, for example.</p>	<p>The status quo does not offer an avenue for further amendments to the regime based on any revisions of the FATF Recommendations.</p>	<p>The status quo could compromise the effectiveness of the AML/CFT regime overall in the medium to long term.</p>
<p><u>Proposed amendment</u></p> <p>It is proposed to include a requirement to review the AML/CFT Act immediately after the FATF mutual evaluation report is complete. This will provide an opportunity to respond to the findings of the report, and assist in ensuring that the AML/CFT regime maintains an appropriate balance between addressing criminal risks and the impact on affected businesses.</p>	<p><b>++</b> Reviewing the legislation would offer an opportunity to adjust the regime and, if applicable, extend it to further entities. It would allow for mitigating the potential displacement effect of the Phase II reforms to unregulated sectors.</p>	<p><b>+</b> The review would offer an opportunity to revise the compliance obligations. This includes targeting efforts towards higher risk activities and reducing the compliance burden where risks are lower.</p>	<p><b>++</b> Review after the mutual evaluation is a logical option. There would be no need for an explicit decision to revise the AML/CFT regime in the future, as the review period would be pre-determined.</p>	<p><b>+</b> The FATF Recommendations do not specify when AML/CFT regimes need to be reviewed or revised, but they do require the regime to be effective. Periodic reviews would contribute to effectiveness, and enable revisions to the FATF Recommendations to be incorporated to the legislation. Further, a review after the completion of the report would allow for amendments to the regime based on the report's findings.</p>	<p><b>Preferred Option</b></p> <p><b>+</b> This option would ensure that the AML/CFT stays fit for purpose and aligned with the domestic risk profile and the FATF Recommendations over time.</p>

Option	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Regulation-making powers under the AML/CFT Act</b>					
<p><u>Status quo</u></p> <p>There are currently a number of issues with the regulation making powers under the AML/CFT Act. In particular, some sections of the Act provide for amendments through regulations, but there is no corresponding regulation making power under the Act.</p>	<p>The missing regulation-making powers are reducing the AML/CFT Act's ability to deter and detect ML/TF.</p>	<p>The missing regulation-making powers inhibit the ability to tailor the regime where necessary, which may lead to undue costs on both supervisors and reporting entities.</p>	<p>The missing regulation-making powers are making the AML/CFT Act internally inconsistent, and more difficult to comply with.</p>	<p>While the FATF Recommendations do not have requirements for <i>how</i> countries implement the Recommendations, the missing regulation-making powers are not contributing to the effectiveness of the AML/CFT regime.</p>	<p>The status quo is unsatisfactory. It does not provide for the regulation-making powers envisaged in the AML/CFT Act, and do not allow for the regime to be tailored where necessary.</p>
<p><u>Proposed amendment</u></p> <p>It is proposed that the current regulation making powers are amended to clarify their nature to ensure implementation of the original policy intent, and to provide greater flexibility to issue regulations. The proposed new regulation making powers are the following:</p> <ul style="list-style-type: none"> <li>allow for inclusions and exclusions from the definition of financial institution (s 5)</li> <li>allow for amendments to conditions for reliance on third parties (s 33 and 34)</li> <li>allow for exemptions to be made to any of the financial activities listed under the definition of financial institution (s 5)</li> <li>allow for prescribing the steps or actions that must be taken to verify identity information (s 13(b))</li> <li>allow for thresholds in the AML/CFT Act to be set at or above the thresholds to allow greater flexibility.</li> </ul>	<p>++ The added clarity and flexibility contributes to the effectiveness of the AML/CFT regime.</p>	<p>++ The option improves the effectiveness of the regime without incurring additional costs on Government or reporting entities.</p>	<p>++ The option improves the practicality of the regime by allowing changes to be made through the less time-consuming regulation-making process as opposed to changing the primary legislation.</p>	<p>0 While the FATF Recommendations do not have requirements for <i>how</i> countries implement the Recommendations, the added clarity and flexibility may contribute to the effectiveness of the regime.</p>	<p><b>Preferred Option</b></p> <p>++ The preferred option would improve the ability to tailor the AML/CFT where necessary.</p>

Option	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Ministerial exemptions</b>					
<p><u>Status quo</u></p> <p>The power to grant exemptions from the AML/CFT Act lies with the Minister of Justice.</p> <p>The current process is inefficient and time-consuming, with the average exemption taking 13 months to process, some applications taking up to 3 years to reach a final decision.</p> <p>With the addition of the new sectors and increased reporting entities, the volume of applications is expected to rise to between 300 and 500 more applications (Phase I resulted in 140 applications to date).</p>	<p>The long processing times for Ministerial exemptions mean that reporting entities may not have certainty over their compliance obligations while their application is processed. This can compromise the effectiveness of the regime.</p>	<p>The current process is resource-intensive for multiple Government agencies. Further, exemption applicants may have to engage the services of a lawyer for the whole duration of the processing period.</p>	<p>The current process is not practical. The processing delays can be lengthy, and the process can be difficult for reporting entities to understand.</p>	<p>The status quo complies with the FATF Recommendations that allow for exemptions to be granted in situations where there is a proven low risk of ML/TF.</p>	<p>The status quo is not satisfactory. The process is resource-intensive and does not provide certainty to reporting entities.</p>
<p><u>Proposed amendment</u></p> <p>The proposed amendment is to improve the operational efficiency of the Ministerial exemption process by:</p> <ul style="list-style-type: none"> <li>delegating the exemption power from the Minister of Justice to the Secretary for Justice</li> <li>improving the considerations for granting Ministerial exemptions under the AML/CFT Act to better reflect the primacy of ML/TF over other considerations (such as regulatory burden); and</li> <li>making operational improvements to streamline the exemption process and reconsider the resources allocated to it.</li> </ul>	<p><b>++</b> Improving the effectiveness of the exemptions regime would ensure that proven low risk entities are granted exemptions, and supervision can be targeted towards higher risk entities.</p>	<p><b>++</b>A streamlined process would save costs for both the Government and the exemption applicants.</p>	<p><b>++</b> Delegating the decision making power to the Secretary for Justice would be a practical solution that would not have an impact on the quality of the exemption decisions. The operational improvements would further enhance the practicality of the process.</p>	<p><b>+</b> Prioritising low risk as the primary consideration for granting exemptions would improve compliance with the FATF Recommendations.</p>	<p><b>Preferred Option</b></p> <p><b>++</b> The preferred option would accelerate the decision making process and thereby tailor the AML/CFT regime to exclude very low risk entities more efficiently.</p>

Table 31. Options analysis for minor amendments.

## 4. Costs and benefits of the Phase II reforms

206. This section presents the estimated compliance costs and estimated benefits associated with the Phase II reforms. On balance, it is estimated that the benefits are comparable to the costs by the following ratio calculated using the CBAX tool:

Indicator	Discount rate	
	7% real (default)	3% real (sensitivity)
<b>Main scenario</b>		
Net Present Value	(25)	41
Benefit Cost Ratio	0.98	1.03
Return on Investment – Societal total	0.8	1.4
Return on Investment – Government	0.9	0.9
<b>Scenario testing</b>		
Net Present Value	(281)	(262)
Benefit Cost Ratio	0.84	0.87
Return on Investment – Societal total	- 1.6	- 1.0
Return on Investment – Government	0.5	0.5

Table 32. Summary of monetised results from the CBAX analysis.

207. The Ministry considers that the benefit cost ratio is conservative in that it overestimates the costs and underestimates the benefits. This is because the high estimates have been used for the compliance costs (which may not be experienced in practice), whereas the assessment of the benefits has been deliberately conservative (i.e. towards the low end). There are also a number of benefits that are challenging to quantify and therefore have been excluded from the formal cost benefit analysis. These are explained in further detail below.

### 4.1. Compliance costs for the Phase II sectors

208. This section analyses the compliance costs on the Phase II sectors. The costs to Government mainly arise from the need to establish an effective AML/CFT supervisory regime for the Phase II sectors. The costs associated with this are analysed in part three of this RIS. It should be noted that funding for Police will also be required to respond to projected increases in reporting and to ensure additional money laundering and terrorist financing investigations can be undertaken.

209. To assess the impact on the sectors, the Ministry of Justice commissioned Deloitte to conduct a Business Compliance Cost survey in July – September 2016. In addition to the online survey, Deloitte interviewed 20 entities from across the Phase II sectors.

#### ***Which businesses were included in the survey?***

210. The survey covers all the Phase II sectors except for gambling service providers. The following definitions have been used for the different sectors:

210.1. Lawyers and conveyancers that provide any of the high-risk services identified by the FATF (as explained earlier in this RIS), excluding overseas-based New Zealand lawyers, 'in-house' lawyers or barristers.

210.2. Accountants that provide any of the high-risk services identified by the FATF.

- 210.3. Real estate agents that are involved in transactions for their client concerning the buying and selling of real estate.
- 210.4. High value dealers are defined as motor vehicle dealers, jewellers<sup>21</sup> and ‘others’. The ‘others’ category was not included in the survey population and the numbers associated to them have been estimated based on available data.<sup>22</sup>
- 210.5. The definition only captures retail sales, and excludes private sales.
211. The compliance costs have been estimated on the basis that all the reporting entities have ‘full’ compliance obligations in line with those of the Phase I sectors.
212. The survey does not assess the potential compliance costs on the New Zealand Racing Board or other gambling providers. Figures from this sector have therefore not been included in the analysis below.

***The number of reporting entities is likely to change based on policy decisions yet to be made***

213. The number of reporting entities is one of the most significant drivers for the overall cost of compliance for the Phase II sectors. However, policy decisions that have not been made yet have an impact on the final population of reporting entities. This leads to a high degree of uncertainty about the estimates used in the survey.
214. For the high value dealers sector, it should be noted that due to the diversity and fragmentation of the sector and the prominence of online trading (which is excluded from the survey), it is difficult to gauge the real size of the sector. In addition, the number of reporting entities in this sector is heavily dependent on how many businesses choose to accept large cash payments and thus ‘opt in’ to the AML/CFT regime.
215. The following estimations have been used for the sectors:

Sector	Total size of sector	Estimated reporting entities
Lawyers and conveyancers	1,919 <sup>23</sup>	1,572
Accountants	2,433	2,220
Real estate agents	1,019 <sup>24</sup>	1,006
Motor vehicle dealers	3,255	2,106
Jewellers	640	229
High value dealers (other)	467	467
High value dealers (total)	4,362	2,802

Table 33. Estimates of Phase II sector sizes and the estimated numbers of reporting entities. Source: Deloitte Business Compliance Cost survey.

<sup>21</sup> Motor vehicle dealers include members of the Motor Trade Association. Jewellers include members of the Jewellers Association of New Zealand and the Jewellers and Watchmakers Association of New Zealand.

<sup>22</sup> This definition corresponds to Option 2 of covering high value dealers as analysed in this RIS. The costs associated with this option are compared to the costs of Option 3 in Part 3 of the RIS.

<sup>23</sup> This estimate is based on 7,115 lawyers in firms and 992 sole practitioners, giving a total of 1,919 businesses.

<sup>24</sup> This estimate is based on 15,000 active registered real estate agents of which 871 are companies and 148 sole traders, giving a total of 1,019 businesses.

216. The following estimations have been made about the sizes of the reporting entities per sector:

Sector	Small (fewer than 10 employees)	Medium (10-20 employees)	Large (more than 20 employees)
Lawyers and conveyancers	51%	47%	2%
Accountants	73%	23%	4%
Real estate agents	86%	9%	5%
Motor vehicle dealers	85%	12%	3%
Jewellers	82%	16%	2%
Other high value dealers	100%	0%	0%

Table 34. Estimates of the numbers of small, medium and large businesses in the Phase II sectors. Source: Deloitte Business Compliance Cost survey.

***There are a number of uncertainties around the compliance costs***

217. It should be noted that the cost estimates are largely based on the Phase II sector entities' self-assessment of the resources required to comply with the AML/CFT Act. Some of these entities may not, however, have a comprehensive understanding of AML/CFT risks or obligations. This is largely due to the lack of existing AML/CFT controls. To mitigate this, the pure survey data has been supplemented by interviews with entities and independent research done by Deloitte.

***What is the estimated total cost of compliance for the sectors?***

218. The following table summarises the estimated total costs of compliance for the Phase II sectors. The parameters as explained above apply to the estimates. In addition, the following applies:

- 218.1. in each case costs are broken down into start-up costs and annual ongoing costs, for which a *low* and *high* estimate are provided
- 218.2. the *low* estimate is sourced from the survey data and is therefore based on the entities' self-assessment of the compliance costs
- 218.3. there is no *low* estimate available for high value dealers other than jewellers and motor vehicle dealers, as this group was not included in the survey population
- 218.4. the *high* estimate provides an approximation of the expected compliance costs by using a combination of survey data, interview insights and independent research
- 218.5. while the 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; and
- 218.6. the figures have been rounded to millions.

Sector	Totals by sector – \$ million			
	Start-up total (year 1)		Ongoing (per annum)	
	Low	High	Low	High
Lawyers and conveyancers	\$ 16.10	\$ 80.90	\$ 14.30	\$ 59.60
Accountants	\$ 25.40	\$ 101.80	\$ 22.70	\$ 75.50
Real estate agents	\$ 13.30	\$ 35.00	\$ 11.80	\$ 23.10
Motor vehicle dealers	\$ 13.9	\$ 65.80	\$ 12.10	\$ 45.70
Jewellers	\$ 3.2	\$ 10.70	\$ 2.80	\$ 7.10
High value dealers (other)	N/A	\$ 18.8	N/A	\$ 12.20
<b>Total</b>	<b>\$ 71.90</b>	<b>\$ 313.0</b>	<b>\$ 63.70</b>	<b>\$ 223.20</b>

Table 35. Estimates of total compliance costs per Phase II sector. Costs expressed in \$ millions. Source: Deloitte Business Compliance Cost survey.

### ***What is the estimated cost of compliance for one entity?***

219. The following table summarises the estimated costs of compliance *by entity* for the Phase II sectors. To provide more meaningful figures, the costs are expressed in \$ thousands as opposed to \$ millions. The same parameters as explained above apply to these estimates. In addition, no per entity costs are available for high value dealers other than jewellers and motor vehicle dealers as this group was not included in the survey population.

Sector	Average by entity by sector			
	Start-up total (year 1)		Ongoing (per annum)	
	Low	High	Low	High
Lawyers and conveyancers	\$ 10.25	\$ 51.53	\$ 9.11	\$ 37.96
Accountants	\$ 11.43	\$ 45.79	\$ 10.21	\$ 33.96
Real estate agents	\$ 13.22	\$ 34.79	\$ 11.73	\$ 22.96
Motor vehicle dealers	\$ 10.89	\$ 60.70	\$ 9.49	\$ 41.40
Jewellers	\$ 1.44	\$ 4.81	\$ 1.26	\$ 3.19

Table 36. Estimates of compliance costs per entity in the Phase II sectors. Costs expressed in \$ thousands. Source: Deloitte Business Compliance Cost survey.

### ***What is the estimated cost of compliance for one client?***

220. The following table summarises the estimated costs per transaction or per customer. The costs are based on the *high* estimates as explained above.



Sector	Cost per client	Cost per transaction
Lawyers and conveyancers	\$ 37.76	
Accountants	\$ 64.40	
Real estate agents		\$ 355.88
Motor vehicle dealers		\$ 77.65
Jewellers	\$ 3.37	

Table 37. Estimates of compliance costs per client or transaction in the Phase II sectors. Costs expressed in real \$ values. Source: Deloitte Business Compliance Cost survey.

## 4.2 Benefits of the Phase II reforms

221. While the compliance costs of the Phase II reforms are borne mainly by individual businesses, the reforms will have wider economic and societal benefits. Some of these are direct benefits from increased detection and deterrence of money laundering and terrorist financing, while others take into account the wider flow-on impacts such as the expected impacts of reduced predicate offending.

### *Increased financial intelligence supports investigations and prosecutions*

222. The increased reporting requirements will produce additional financial intelligence, which will increase the law enforcement agencies' ability to detect, investigate and prosecute money laundering, terrorist financing and the underlying offending. It should be noted that realising these benefits is dependent on the law enforcement agencies having sufficient resources to utilise the improved intelligence for investigations and prosecutions.
223. It is anticipated that the number of suspicious transaction reports from the Phase II sectors will increase from the current levels of reporting under the FTRA. If New Zealand experiences similar growth in reporting as other countries operating a comprehensive AML/CFT regime, the Phase II sectors are estimated to produce approximately 5% of the total suspicious transaction reports received by the FIU per annum. Bringing the new sectors in scope of the regime will also expand the applicability of the upcoming requirements to report prescribed transactions to the FIU. These will include domestic cash transactions over \$10,000 and international wire transfers over \$1,000.
224. Expanding the CDD and record keeping requirements to the new sectors will increase the transparency of financial transactions, and enables law enforcement agencies to follow the money trail created by the records. This will further support investigations and prosecutions.
225. The benefits of increased financial intelligence do not stop at New Zealand's borders. Better intelligence will improve New Zealand's ability to cooperate with partner agencies overseas, and particularly with the members of the Five Eyes intelligence alliance. This can help disrupt the activities of international networks of criminals and terrorists.

### *Enhanced asset recovery will produce revenue to the Crown and have wider impacts on preventing crime*

226. Bringing the Phase II sectors in scope of the AML/CFT regime will enhance the Police's ability to forfeit assets obtained with proceeds of crime. In addition to producing direct revenue to the Crown, the increased forfeitures are expected to disrupt and frustrate the flow of illicit funds. To summarise:

Estimated value	Description
<b>\$57 to \$97 million</b>	<p><b>Revenue to the Crown from additional forfeitures</b></p> <p>The estimated revenue to the Crown in net present value over 10 years. This reflects the same proportion of revenue returned to the Crown from current asset forfeitures and assumes a proportional increase in forfeitures from Phase II.</p>
<b>\$1.4 to \$1.7 billion</b>	<p><b>Disruption impact</b></p> <p>The estimated value of the financial flows the reforms are expected to frustrate and disrupt over 10 years in net present value terms.</p> <p>This includes domestic predicate criminal activity and associated money laundering efforts. This figure has been calculated by multiplying the projected value of restrained assets by 3.3. The multiplier is based on the Proceeds of Crime Disruption Index (McFadden, 2015).</p>

Table 38. Estimates of the value of additional forfeitures and the associated disruption impact.

*The enhanced deterrent effect will reduce the incentive to commit financially motivated crimes*

227. One of the benefits of the Phase II reforms is the increased deterrent effect. As money laundering and terrorist financing is made more difficult, committing profit-generating crimes can be expected to lose some of its attraction. The proceeds of crime cannot be enjoyed as easily, and attempting to launder them through the regulated sectors will risk detection. This will reduce the incentives for criminals to commit financially motivated crimes.
228. It is difficult to estimate or quantify the impact of the deterrent effect. To provide context, the Ministry anticipates it would not be unreasonable to assume that three times as much money laundering is deterred relative to capture<sup>25</sup>. This estimate does not include the deterrent effect internationally. The impact of the international effect is, however, extremely difficult to quantify.

*The legitimate economy will benefit from enhanced detection and deterrence*

229. Improved detection and deterrence of money laundering is beneficial for the legitimate economy. The competitive advantage illicit businesses may enjoy through keeping their prices disproportionately low or not paying taxes is reduced, and there is an increasingly equal playing field for all businesses.
230. Deterring and detecting money laundering is expected to have a flow-on impact on detecting and deterring tax evasion, which is one of the most prevalent predicate offences. This would improve the Government's ability to collect tax revenue.

*Decreased predicate offending is likely to result in reduced social harm*

231. Money laundering, terrorist financing and their predicate offences such as drug offending, fraud and tax evasion cause social harm that can be reduced by increased detection and deterrence. Laundering the proceeds of drug offending, for example, fuels further offending and has the potential of increasing the supply and usage of illegal drugs in New Zealand. Reducing the opportunities to reinvest funds in further offending is expected to have similar impacts on other predicate offences.

232. The Ministry has arrived at a very indicative figure of \$800 million in social harm avoided by the restraint and seizure of funds from money laundering. Due to the number of assumptions<sup>26</sup> used to reach this figure, it has not been used in the CBAX analysis as explained below.

*Improved compliance with international standards is likely to maintain New Zealand's reputation*

233. The Phase II reforms will contribute to New Zealand's compliance with the FATF Recommendations ahead of the Mutual Evaluation in 2020. Achieving a satisfactory level of compliance will maintain New Zealand's international and trade reputation – but also avoid the onerous, costly and resource-intensive follow-up reporting requirements that result from a report indicating poor compliance and effectiveness.

234. Improving the effectiveness of the regime is expected to reduce New Zealand's attractiveness as a target for international money launderers and terrorist financiers. In addition to the reputational benefit for New Zealand, this can benefit domestic investigations. For example, the FIU currently receives a significant number of enquiries from international counterparts about New Zealand legal arrangements such as trusts that are suspected of effecting financially motivated crime. Responding to the enquiries ties up scarce local investigative resources.

235. Maintaining New Zealand's international and trade reputation can also have direct benefits for New Zealand businesses. The international perception of New Zealand's risk profile can influence the cost of borrowing and the level of overseas investment in New Zealand, for example. Increased compliance with the FATF Recommendations may also increase the ease of doing business overseas, as other jurisdictions may have laws that discriminate against non-compliant countries.

*The benefits of increased detection of terrorist financing are very difficult to quantify*

236. Some of the benefits of the reforms are, by their nature, very difficult to quantify. This includes particularly the benefits gained from increased deterrence, detection and disruption of terrorist financing. These benefits are, however, likely to be significant. These include the increased detection of international financial flows that are being passed through New Zealand to obscure the money trail and frustrate detection.

### **4.3 The quantifiable benefits are expected to be comparable to the costs**

237. The Ministry has conducted a cost benefit analysis using the CBAX tool. The benefits are almost certainly larger than this what analysis estimates, as the total benefits include ones that have not been quantified. Further, the *high* estimates have been used for the compliance costs, which may not be experienced in practice, whereas the assessment of the benefits has been deliberately conservative (i.e. towards the low end).

238. The CBAX analysis incorporated the *high* estimates of compliance costs, and only incorporates those benefits that have monetary values calculated for them. The following benefits, which have been explained in more detail above, have not been included in the analysis due to their intangible nature:

- 238.1. the deterrent effect as a direct result of increased monitoring, and consequent benefits from a reduction in predicate offending

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<sup>26</sup> These assumptions are explained in the full CBAX analysis.

- 238.2. decrease in social harm resulting from the decrease in crime (including predicate offending); and
  - 238.3. an improved international reputation leading to better trade terms and an increased perception as a 'safe' country with which to do business.
239. With very conservative benefits calculations, the partial regulation of the highest risk portion of the high-risk sectors generates a benefit cost ratio that is close to 1.0 (0.98 at 7% discount rate, 1.03 at 3% discount rate). Using a different range of assumptions about the success of restraints and the rate at which restraints of assets are ultimately converted to forfeitures, the benefit cost ratio has been calculated at 0.84 at 7% discount rate and 0.87 at 3% discount rate.

## 5. Consultation

240. The Ministry of Justice has consulted on the Phase II reforms with both the public and private sectors.

### 5.1 Private sector consultation

241. The consultation document *Improving New Zealand’s ability to tackle money laundering and terrorist financing: Ministry of Justice Consultation Paper on Phase Two of the AML/CFT Act* was published on the Ministry of Justice website on 17 August 2016. The month-long consultation closed on 16 September 2016, and the Ministry received almost 60 submissions from the Phase II sector participants, members of the public, industry bodies and consultants with an expertise in AML/CFT.

242. In addition to the formal consultation, the Ministry of Justice met with a number of industry groups to discuss the Phase II reforms. The most significant feedback from the formal consultation has been summarised and responded to in the sections below.

#### Coverage of Phase II sectors

243. The key input by sector has been summarised in the table below.

Sector	Input from sector concerned	Input from other sectors	MOJ response
Lawyers and conveyancers	<p>Submissions generally supported the coverage of the sector. However, there were concerns that some AML/CFT obligations are inconsistent with the traditional solicitor-client relationship of trust and confidence.</p> <p>It was considered important to refine and clearly define the services captured in the legislation to avoid inadvertent capture. Further, the scope of the covered services needs to be consistent for all entities providing similar services.</p> <p>In terms of legal professional privilege, it was considered that the provisions should align with the evidence and search laws and should include litigation privilege.</p>	<p>Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of lawyers into the regime to enhance NZ’s AML/CFT regime and NZ’s reputation.</p> <p>Some submissions expressed a concern that the exemption for privileged communication in the AML/CFT Act is too wide and would allow the claiming of privilege in circumstances that are too broad.</p>	<p>The submissions have been taken into account when analysing which specific activities should be included. These will be determined further in regulations.</p> <p>The input on legal professional privilege has been taken into account when developing the policy options.</p>
Accountants	<p>Submissions from accountants agreed in principle with the coverage of accountants providing certain services under the AML/CFT regime as part of Phase II given the risks associated with misuse of the sector. However, they considered that there needed to be greater clarity over the captured services that would an accountant within the scope of the AML/CFT regime and wanted to ensure that the regime was in proportion to the risks identified.</p>	<p>Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of accountants into the regime to enhance NZ’s AML/CFT regime and NZ’s reputation.</p>	<p>The submissions have been taken into account when analysing which specific activities should be included. These will be determined further in regulations.</p>

<p><b>Real estate agents</b></p>	<p>The Real Estate Institute of NZ submitted that the services must be specific to avoid inadvertent capture of real estate agents. The REINZ considered that the real estate agent should be required to conduct customer due diligence on the vendor (their customer) rather than the purchaser. It considered that AML/CFT obligations should not apply unless an agent received funds from a vendor into their trust account.</p> <p>The Real Estate Agents Authority supported the inclusion of real estate agents in the AML/CFT regime due to the risks of misuse by the sector. It submitted that AML/CF obligations should commence in a real estate transaction when an agent establishes a relationship with a client, when receiving funds from a vendor, or when receiving funds from a purchaser. The REAA also submitted that other parts of the property sector should be included in the AML/CFT regime including property traders and finders, and commercial real estate service providers.</p>	<p>Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of real estate agents into the regime to enhance NZ's AML/CFT regime and NZ's reputation.</p>	<p>The submissions have been taken into account when analysing which specific activities should be included. These will be determined further in regulations.</p>
<p><b>High value dealers</b></p>	<p>Submissions by motor vehicle dealers noted that most transactions in the sector are private sales (around 70%) which would remain outside of the AML/CFT regime. It was noted that all businesses could be targeted, although it recognised the significant challenges of this approach.</p> <p>Submissions by jewellers indicated that applying the compliance obligations would be a burden to the businesses, and only dealers which are not members of a recognised jewellery industry or trade organisation should be covered.</p>	<p>A limited number of submissions were received from other sectors.</p>	<p>The sector's concerns about the compliance costs have been taken into account in the analysis by incorporating a wider range of options, some of which encompass lighter compliance obligations.</p>
<p><b>Gambling sector</b></p>	<p>The entities considered for inclusion (the New Zealand Racing Board (NZRB) and New Zealand Lotteries Commission (NZLC)) agreed with the need to consider their coverage as part of the reforms.</p> <p>The NZRB noted it is important to craft the legislation in a way that allows them to focus on the areas of highest risk as opposed to low-risk, routine transactions. The NZLC considered their activities to be sufficiently low risk to warrant the continuation of the current exemption from the AML/CFT Act.</p>	<p>Other sectors, and particularly casinos, were supportive of including NZRB and NZLC in scope of the reforms.</p>	<p>The submissions have been taken into account when analysing which specific activities should be included. These will be determined further during the drafting process.</p>

<b>Implementation period</b>	<p>Many submissions, including those from law and accountancy firms, stated that they would require a minimum of 12 months to enable them to meet their compliance requirements.</p> <p>A few indicated a 6 month period while others indicated 24 months or longer.</p>	<p>The Phase I entities recognised the need for an implementation period, but expressed mixed views about the appropriate length.</p>	<p>The Ministry's recommended option would bring lawyers in scope of the regime within 6 months from enactment of the amending legislation. While this is shorter than what was desired by some submitters, the Ministry considers that, on balance, the earlier enactment would mitigate the risk associated with the sector. If the Ministry's recommended supervisory model (DIA as the single supervisor for Phase II sectors) is chosen, this option would allow for staggered implementation of the supervisory regime.</p>
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Table 39. Summary of feedback on the coverage of Phase II sectors.

#### *AML/CFT supervisory model*

244. In general, submissions identified the need for effective and efficient supervision of Phase II entities to ensure an effective regime and a level playing field among affected businesses. There was, however, no consensus on the most appropriate supervisory model for the Phase II sectors or the AML/CFT regime as a whole. Submissions were received both supporting and expressing concerns about each of the models proposed in the consultation document. These models included a single supervisor, continuation of the current multi-agency model, and delegating some of the supervisory responsibilities to self-regulatory industry bodies.
245. The submitters' views have been taken into account in the analysis where applicable. As there was, however, no consensus on any of the proposed models, the Ministry's preferred option has been determined based on the analysis against the assessment criteria.

#### *Other amendments*

246. The key submissions on other issues have been summarised in the table below.

Issue	Input from Phase II sectors	Input from Phase I sectors	MOJ response
<b>Information sharing</b>	<p>Feedback on the information sharing proposals was mixed, with vocal minorities at both extremes (e.g. share nothing vs. share everything). On the whole, the submissions were tentatively supportive of greater information sharing, provided that appropriate constraints are in place to ensure that private information is not mistreated.</p>		<p>The feedback on the privacy impact of the information sharing proposals resulted in the Ministry placing added weight to the privacy considerations in the analysis of the information sharing options.</p>

<p><b>Simplified CDD</b></p>	<p>Submissions were generally in agreement that simplified CDD should be extended to the entities proposed in the consultation paper.</p> <p>Submissions suggested simplified CDD to be extended to further groups including:</p> <ul style="list-style-type: none"> <li>▪ Businesses licensed and supervised by recognised regulatory authorities (lawyers, financial institutions, accountants)</li> <li>▪ New Zealand registered charities</li> <li>▪ Foreign financial institutions in low-risk overseas jurisdictions with sufficient AML/CFT regimes</li> <li>▪ Majority-owned subsidiaries that are themselves subject to simplified due diligence</li> <li>▪ Workplace Savings Schemes registered under the FMCA.</li> </ul>		<p>The proposals to extend simplified CDD to further entities can be considered for inclusion in regulations. This decision needs to be based on the ML/TF risk profile of the various groups.</p>
<p><b>SARs</b></p>	<p>There was some variation amongst the submissions, but on balance submitters supported the proposal provided that the definition of ‘suspicious activity’ is sufficiently clear in the legislation or guidance.</p>	<p>The majority of these submissions supported the proposal. There were, however, concerns about the potential additional compliance costs.</p>	<p>Provided that the proposal is adopted, the submitters’ request for clarity around the definition of ‘suspicious activity’ will be taken into account in the drafting.</p>

Table 40. Summary of feedback on other issues related to the Phase II reforms.

## 5.2 Public sector consultation

247. The Ministry of Justice has consulted on the development of the Phase II reforms with the relevant Government agencies involved in AML/CFT. These include:

- 247.1. AML/CFT supervisors Financial Markets Authority, Reserve Bank of New Zealand and the Department of Internal Affairs;
- 247.2. the New Zealand Police Financial Intelligence Unit;
- 247.3. the New Zealand Police;
- 247.4. Customs;
- 247.5. Inland Revenue;
- 247.6. Ministry of Foreign Affairs and Trade; and
- 247.7. Ministry of Business, Innovation and Employment.



## 6. Implementation plan

248. Most of the proposed amendments will be given effect when the relevant sections of the AML/CFT Amendment Act come into force, or when the supporting regulations are made. The options for the implementation period for different Phase II sectors are included in Part 3 of this RIS.
249. Subject to Cabinet's approval, the supporting regulations will include the more refined details of how and when the new sectors will need to comply with their AML/CFT obligations. These regulations will be passed as early as practicable after the passage of the Amendment Act to allow the sectors to prepare for implementing the requirements.
250. In addition, implementation of some amendments will require amendment to other Acts and Regulations:
- 250.1. Anti-Money Laundering and Countering Financing of Terrorism (Definitions) Regulations 2011, which contain specific exemptions from the AML/CFT Act for lawyers, conveyancers, real estate agents and accountants
  - 250.2. depending on the policy decisions, other sets of AML/CFT Regulations; and
  - 250.3. Financial Transactions Reporting Act 1996, which will be repealed upon enactment of the AML/CFT Amendment Act.

### 6.1 Compliance costs minimisation strategies

*The AML/CFT regime operates on a risk-based approach*

251. The AML/CFT regime operates on the basis of a risk-based approach. This means that more comprehensive AML/CFT controls are required in higher risk situations, whereas these may not be necessary in lower risk situations. The AML/CFT risk assessment sets the parameters of which parts of the entity's business carry a higher money laundering and terrorist financing risk, and the ensuing AML/CFT programme should be adjusted to the level of risk.
252. The risk-based approach also applies to AML/CFT supervision. Regardless of the choice of supervisory model, the supervisor is expected to assess the risks in the supervised sector, and target efforts and resources to where risks are the highest.
253. Subject to Cabinet's agreement, the phased implementation will also allow less prepared sectors more time to prepare for compliance. This is likely to reduce some of the costs associated with preparing for compliance and establishing the appropriate systems. The proposal is consistent with the need to implement the regime on a risk-based approach.
254. The risk-based approach also allows for reporting entities to rely on other reporting entities in certain circumstances to reduce duplication of compliance effort. One of the proposals presented in the RIS is expanding the circumstances for reliance to better cater for the new sectors.

*The exemptions process can be used to reduce the compliance burden on low-risk entities*

255. The current AML/CFT regime includes a process to provide Ministerial and regulatory exemptions for low-risk businesses, transactions, products, services or customers. The exemptions can be either full or partial, and may be subject to conditions. The intention is to

continue providing exemptions from the AML/CFT Act for Phase II reporting entities to tailor the regime and adjust the compliance burden in low-risk situations.

*High value dealers will have the option of opting out of the regime*

256. Regardless of the policy decision on including high value dealers in scope of the regime, individual high value dealers will have an option of 'opting out' of the regime by deciding not to accept cash payments over the applicable threshold. The trade-off of not accepting large cash payments is not expected to be overly restrictive for the businesses in the sector who wish to opt out.

*Leveraging the existing supervisory model will allow for further savings*

257. The Ministry's preferred AML/CFT supervisory model would reduce the costs to the Crown when compared to the alternative models. This would allow leveraging the existing supervisory structures within the Department of Internal Affairs. The estimated costs associated with the different models are included in Part 3 of the RIS.

## **6.2 Implementation risks**

258. The main implementation risks associated with the reforms can be summarised as follows:

- 258.1. the implementation periods are not sufficient for the reporting entities to build their systems and become compliant on time
- 258.2. the compliance obligations are not fit for purpose or well understood, contributing to low levels of compliance; and
- 258.3. the supervisory framework is not effective and the relevant supervisors do not have the capacity to monitor and enforce compliance with the AML/CFT obligations.

259. These risks can be mitigated by choosing reasonable implementation periods for the new sectors, and providing the necessary guidance and education ahead of implementation. The supporting regulations containing the specific details of coverage need to be sufficiently clear and, where necessary, supported by clarifying guidance. The relevant supervisor needs to be provided appropriate resources to effectively supervise the new sectors.

## **6.3 Information that regulated parties will require to comply with the obligations**

260. When the Phase I reforms were implemented, the AML/CFT supervisors focused heavily on providing guidance and education particularly to the less sophisticated reporting entities. It is expected that a similar or higher level of guidance and education will be required for the Phase II sectors to comply with their new obligations. This may include a campaign to raise awareness amongst the wider public.

## **6.4 The AML/CFT supervisory framework is designed to enforce compliance with the AML/CFT Act**

261. The primary method for enforcing compliance with the AML/CFT obligations is AML/CFT supervision. The supervision is risk-based, which means that more supervisory attention will be directed towards higher risk entities.

262. During the period between the passage of the legislation and the commencement of the compliance obligations, the relevant supervisor will need to go through a process of identifying relevant reporting entities and providing guidance to them to prepare them to comply with their obligations.
263. The AML/CFT supervisors have a number of tools at their disposal to identify non-compliance with the AML/CFT Act and enforce compliance where needed. These include:
- 263.1. on-site visits to verify whether and how reporting entities are complying with their obligations
  - 263.2. desk-based reviews of the reporting entities' compliance documents such as the AML/CFT programme
  - 263.3. requiring reporting entities to submit an annual report on their AML/CFT risk assessment and programme; and
  - 263.4. requiring the AML/CFT risk assessment and programme to be audited every two years.
264. Consistent with the current AML/CFT regime, there will be both civil and criminal penalties for non-compliance. This can be seen as a continuum ranging from supervisory recommendations to prosecution for civil or criminal penalties. Supervisory actions include formal warnings, performance injunctions, restraining injunctions, enforceable undertakings, civil penalties and criminal prosecutions.

## **7. Monitoring, evaluation and review**

265. The Ministry will monitor the effectiveness of the Phase II reforms through its established monitoring and reporting mechanisms such as the Ministry's Five Year Strategic Plan, environmental scanning, and the annual regulatory scan.

### **7.1 New Zealand's AML/CFT regime will be evaluated in 2020**

266. As a member of the FATF, New Zealand will be evaluated on the effectiveness of its AML/CFT regime in 2020. The evaluations – commonly referred to as Mutual Evaluations – take place approximately every ten years and are conducted by an international team of experts from different FATF member countries and international bodies.

267. The evaluation is two-fold, and assesses:

267.1. technical compliance against the FATF's 40 Recommendations; and

267.2. effectiveness against the FATF's 11 Immediate Outcomes.

268. The Recommendations on technical compliance form the basis of an effective AML/CFT regime. Many of these Recommendations relate to how the AML/CFT legislation sets out the relevant requirements. For example, Recommendations 22 and 23 set out the legislative requirements that should apply to non-financial businesses and professions such as the Phase II sectors.

269. Technical compliance in itself is not a guarantee of an effective system, however. This is why the Immediate Outcomes assess how effectively different parts of the AML/CFT regime function in practice. Some of the areas assessed are the country's understanding of risks, the effectiveness of the supervisory framework, to what extent reporting entities comply with their obligations, and how effectively money laundering and terrorist financing cases are investigated and prosecuted.

270. Following New Zealand's evaluation, a Mutual Evaluation Report will be presented to FATF's decision-making body, the FATF Plenary. The Plenary consists of representatives from the FATF member jurisdictions, associate members and observers. Once the Plenary has decided on the result of the evaluation and the ensuing ratings, the report will be made public. If the report determines there are gaps in the evaluated country's AML/CFT regime, suggestions for improvements are included.

271. Depending on the severity of the shortcomings in the regime, the country will be placed on one of the follow-up processes which differ in terms of the intensity and frequency of reporting requirements. Progress will be re-evaluated at following FATF meetings. Once the country has remedied the gaps in the regime, it will be able to exit the follow-up process and discontinue reporting back to FATF on changes to its AML/CFT regime.

### **7.2 A review of the regime can be expected**

272. One of the minor amendments discussed in this RIS proposes a statutory review of the AML/CFT regime to occur after the FATF mutual evaluation. This would provide an opportunity to review and amend the regime after the Phase II reforms have been in place for a number of years, and remedy any shortcomings identified in the Mutual Evaluation report.

## **Appendix 1: Changes to the AML/CFT Amendment Bill**

### **1.1 Consultation on exposure draft of the AML/CFT Amendment Bill**

1. This appendix to the RIS on the second phase of reforms to the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regime sets out the key changes to the AML/CFT Amendment Bill following public consultation on an exposure draft of the Bill.

*A second round of consultation took place in December 2016 and January 2017*

2. In October 2016, Cabinet agreed to consult on an exposure draft of the Bill with the aim of reducing the compliance burden on businesses and avoiding unintended consequences. The three key issues the consultation sought views on were:
  - 2.1. whether the exposure draft was clear and whether it accurately reflected the initial proposals outlined in the accompanying information paper;
  - 2.2. whether businesses could use provisions in the Bill to reduce compliance costs associated with the reforms; and
  - 2.3. what else could be done to help businesses reduce compliance costs associated with implementation of the reforms.
3. The Ministry received 32 submissions on the Bill before the consultation period closed on 27 January 2017. Two further submissions were received after the consultation was closed.

*The consultation informed further changes to the AML/CFT Amendment Bill*

4. The Ministry proposes further changes to the Bill as a result of the consultation process. In addition, minor changes to the drafting are proposed to clarify the policy intent behind the drafting.
5. The changes are outlined in the table below.

## 1.2 Proposed changes to the AML/CFT Amendment Bill

Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Detering and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Implementation periods for Phase II sectors</b>					
<p>Most submissions commented on the implementation period for the Phase II sectors, mainly proposing extensions. Collectively, the reasons behind the extension requests were that the sectors need more time to become compliant with their AML/CFT obligations.</p> <p>The proposed implementation periods are as follows:</p> <ul style="list-style-type: none"> <li>• Lawyers and conveyancers by Order in Council but no later than 1 July 2018</li> <li>• Accountants by Order in Council but no later than 1 October 2018</li> <li>• Real estate agents by Order in Council but no later than 1 January 2019</li> <li>• New Zealand Racing Board and high-value dealers by Order in Council but no later than 1 August 2019.</li> </ul>	<p><b>0</b> While extending the implementation timeframe has a negative impact on deterring and detecting ML/TF in the short term, in the longer term the extended lead-in period will allow the Phase II sectors to better prepare for compliance with their new obligations.</p>	<p><b>+</b> Allowing for a longer implementation period can contribute to reducing the cost of compliance. For example, businesses may not need to hire outside</p>	<p><b>++</b> A longer implementation period gives the sectors more time and therefore flexibility to implement the compliance obligations. This is particularly relevant for the legal and conveyancing sector, whose implementation period is proposed to be extended from 6 months to 12 months.</p>	<p><b>0</b> While it may be preferable to require compliance well ahead of the FATF mutual evaluation in 2020, the longer implementation period is also expected to contribute to higher levels of compliance from the Phase II sectors.</p>	<p><b>+</b> The extended implementation period for some Phase II sectors is a practical solution that is expected to help the businesses in these sectors implement their new AML/CFT compliance obligations.</p>

Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Definition of designated non-financial business and profession</b>					
<p>Some submissions commented on the way the Phase II sectors are captured in the Bill. The comments related mainly to how the sectors were defined and the captured activities. The proposed changes are the following:</p> <ul style="list-style-type: none"> <li>• Minor changes to the definition of law firm and accounting practice</li> <li>• Removing the activities of <i>arranging</i> client funds, and managing client funds that have been paid as fees</li> <li>• Including the activity of transferring the title in, or the beneficial ownership of, real estate or legal persons or arrangements</li> <li>• Limiting the activity of providing a registered office, a business address, a correspondence address, or an administrative address to situations where these services are not provided as ancillary services to lower risk activities</li> <li>• Where the activities relate to companies, changing the wording to refer to both legal persons and arrangements.</li> </ul>	<p><b>0</b> The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.</p>	<p><b>+</b> Refining the definitions and activities is likely to increase the proportionality of the obligations, as some wording in the exposure draft of the Bill could create unintended consequences and require compliance with AML/CFT obligations in situations where there is a very low level of ML/TF risk.</p>	<p><b>++</b> The proposed amendments clarify the provisions and remove unintended consequences (such as capturing managing funds that have been received as fees for professional services which are not intended to be captured).</p>	<p><b>0</b> The proposed changes are unlikely to have major impacts on New Zealand's compliance with the FATF Recommendations.</p>	<p><b>+</b> Refining the definitions and activities is likely to make it easier for the Phase II sectors to comply with their new AML/CFT obligations.</p> <p>It should be noted that the wording in the Bill will be supplemented with further guidance to clarify any outstanding issues.</p>

Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Real estate agents will conduct customer due diligence as prescribed in regulations</b>					
The exposure draft did not specify at what point in a real estate transaction real estate agents should conduct customer due diligence (CDD). Following consultation, it is proposed that the timing be prescribed in regulations.	0 No impact.	+ Prescribing the timing of CDD in regulations can increase the proportionality of the compliance obligations by adjusting the timing to the specific characteristics of real estate transactions.	+ Regulations allow for greater flexibility than setting out the timing of CDD in the primary Act.	0 No impact.	+ Regulations allow for greater flexibility than setting out the timing of CDD in the primary Act.
<b>Amendments related to reliance on third parties</b>					
Allowing conveyancers to form designated business groups to reduce their compliance burden. Allowing for a more flexible timeframe for obtaining identity verification documents within a designated business group.	0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.	+ The proposed changes can reduce the compliance burden on reporting entities.	+ The proposed changes make it easier for reporting entities to comply with their obligations.	0 The proposed changes are not contrary to the FATF Recommendations.	+ The proposed changes can make it easier for reporting entities to comply with their obligations and reduce the costs of compliance.



Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Legal professional privilege</b>					
<p>Following consultation, the following changes are proposed:</p> <ul style="list-style-type: none"> <li>• Requiring there is a prima facie case that the privileged communication was made for a dishonest purpose or to enable or aid the commission of an offence</li> <li>• Refinements to the definition of confidential communication to align with the existing AML/CFT Act</li> <li>• Alignment with the Search and Surveillance Act to recognise legal professional privilege when issuing and executing search warrants</li> <li>• Amendment to include section 56(2) of the Evidence Act in the definition of privileged communication</li> <li>• Legal professional privilege should apply to prescribed transaction reporting.</li> </ul>	<p>0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.</p>	<p>0 No impact.</p>	<p>+ Aligning the provisions with the Evidence Act and the Search and Surveillance Act is a practical solution that is likely to make it easier for the legal sector to deal with legal professional privilege in the AML/CFT context.</p>	<p>0 The proposed changes are not contrary to the FATF Recommendations.</p>	<p>+ The proposed changes make it easier for the legal sector to deal with legal professional privilege in the AML/CFT context.</p>
<b>Coverage of the New Zealand Racing Board</b>					
<p>Changes are proposed to revise the definition of transaction to include placing a bet and gambling with respect to the New Zealand Racing Board (NZRB). In addition, it is proposed to refine the coverage of NZRB to include the conduct of betting under section 50 of the Racing Act 2003 and the operation of accounts or provision of vouchers.</p>	<p>0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.</p>	<p>0 No impact.</p>	<p>+ The proposed changes make it easier for the New Zealand Racing Board to comply with the AML/CFT Act as they clarify how the Act applies.</p> <p>It should be noted that further details about the coverage can be included in regulations.</p>	<p>0 No impact.</p>	<p>+ The proposed changes clarify when the New Zealand Racing Board is required to comply with the Act.</p>

Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Information sharing</b>					
<p>The proposed amendments clarify the original policy intent of allowing for more flexible information sharing for both law enforcement and regulatory purposes:</p> <ul style="list-style-type: none"> <li>Revising the definition of law enforcement purposes and adding a new definition of regulatory purposes which can be used for allowing the sharing of information</li> <li>Revising the drafting to clarify that personal information can be shared without regulations or information sharing agreements.</li> </ul>	<p>+ The proposed changes allow for more information sharing, which can facilitate deterring and detecting ML/TF.</p>	<p>0 No impact.</p>	<p>+ The proposed changes provide more flexibility for the government to share information for law enforcement and regulatory purposes.</p>	<p>+ The proposed changes are likely to improve the effectiveness of the AML/CFT regime, which can contribute to the results of New Zealand's FATF mutual evaluation in 2020.</p>	<p>+ The proposed changes clarify the original policy intent and allow for more flexible information sharing, including the sharing of personal information.</p>
<b>Simplified customer due diligence</b>					
<p>The proposed amendments are:</p> <ul style="list-style-type: none"> <li>Revising the draft to ensure that simplified due diligence may be applied to majority-owned subsidiaries of publicly traded NZ entities, NZ government bodies and state owned enterprises in low-risk countries</li> <li>Revising the draft to delete the requirement that a government body is "regulated for AML/CFT purposes".</li> </ul>	<p>0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.</p>	<p>+ The proposed changes can reduce the compliance burden on reporting entities.</p>	<p>+ The proposed changes make it easier for reporting entities to comply with their obligations.</p>	<p>0 The proposed changes are not contrary to the FATF Recommendations.</p>	<p>+ The proposed changes can make it easier for reporting entities to comply with their obligations and reduce the costs of compliance.</p>
<b>Application of the Act</b>					
<p>Submissions indicated that the wording of section 6 in the exposure draft was ambiguous and difficult to apply. It is proposed to amend the wording to be more aligned with the existing AML/CFT Act.</p>	<p>0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.</p>	<p>0 No impact.</p>	<p>+ The proposed change clarifies the policy intent and is easier for reporting entities to understand and apply.</p>	<p>0 No impact.</p>	<p>+ The proposed change clarifies when reporting entities need to comply with the AML/CFT Act.</p>

Proposed amendment	Criteria for assessment of options				Conclusions/net outcomes
	Deterring and detecting ML/TF	Proportionality	Practicality	International standards	
<b>Other changes</b>					
It is proposed that the timing of AML/CFT audits can be set in regulations.	0 The proposed changes are unlikely to have major impacts on deterring and detecting ML/TF.	+ The proposed change can reduce the compliance burden on reporting entities.	+ The proposed change can make it easier for reporting entities to comply with their obligations.	0 The proposed change is not contrary to the FATF Recommendations.	+ The proposed change can make it easier for reporting entities to comply with their obligations and reduce the costs of compliance.