

ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM REFORMS: PHASE II

Proposal

1. To progress the second phase of reforms to New Zealand's anti-money laundering and countering financing of terrorism (AML/CFT) regime, I seek Cabinet's agreement to:
 - 1.1. the early policy decisions outlined in this paper;
 - 1.2. grant me a limited Power to Act to make some further decisions to progress the early decisions;
 - 1.3. issue drafting instructions to the Parliamentary Counsel Office (PCO) firstly on the early policy decisions, and secondly on the further decisions made under the Power to Act; and
 - 1.4. introduce an Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill (Amendment Bill) in the House before the end of 2016.
2. I will seek Cabinet's agreement to final policy decisions in October 2016.

Executive summary

3. Cabinet agreed in June 2016 to pass legislation to implement the second phase of the AML/CFT reforms (Phase II) by July 2017 [CAB-16-Min-0251 refers]. To enable the Amendment Bill to be enacted by July 2017 it will need to be introduced to the House before the end of 2016.
4. I also seek Cabinet's agreement to the inclusion of an Amendment Bill in the 2016 Legislation Programme, with a priority of 5 (to be referred to a Select Committee within the year). Along with the above, introduction of the Amendment Bill in November 2016 will allow it to be passed by July 2017.
5. My goal is to introduce a Bill to the house that provides appropriate oversight of the agreed further sectors while ensuring compliance costs are minimised. To progress this in the agreed timeframe, it is necessary to progress the work through three streams at the same time.
6. Therefore, I seek Cabinet's agreement to early policy decisions to:
 - 5.1. include new sectors in scope of the AML/CFT regime;
 - 5.2. improve information sharing;

- 5.3. extend the AML/CFT supervisory regime to the new sectors;
 - 5.4. extend the ability to conduct simplified customer due diligence to new groups of entities; and
 - 5.5. extend the regulation-making powers to the new sectors.
7. In addition, I seek a limited Power to Act to make further, limited decisions, to continue to progress the drafting of early decisions so that a Bill can be introduced this year. The decisions made under the Power to Act would be contained to progressing early policy decisions that are not contentious, and do not have a direct financial impact on other portfolios, to enable drafting of these areas to advance.
 8. I therefore seek Cabinet's agreement to issue drafting instructions firstly on the early policy decisions, and secondly on the further decisions made under the Power to Act on the limited basis contained herein.
 9. I will also come back to Cabinet in October 2016 for decision on final policy settings, and to confirm decisions made under the Power to Act in October 2016 through Cabinet's Economic Growth and Infrastructure Committee (EGI).

Background

What is the AML/CFT regime?

10. New Zealand has implemented a robust regime to detect and deter financial crime. The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) commenced in 2013. This established a regulatory regime for businesses that offer products or services that may be misused by criminals to launder the proceeds of crime or finance terrorism.
11. The Act implemented Phase I of the AML/CFT reforms and applies to banks, financial institutions and casinos (collectively referred to as reporting entities). These businesses are required to establish controls to deter and detect criminal activity, including carrying out risk assessments, identifying their customers to know who they are dealing with, and reporting suspicious transactions to the Police's Financial Intelligence Unit.
12. Phase II of the AML/CFT reforms will extend the laws to more businesses and professions which offer services that may be misused. Criminals try to use certain services provided by lawyers, accountants, real estate agents, conveyancers, and high value dealers to move their funds in and out of the financial system while avoiding detection. Phase II will improve the coverage of the AML/CFT regime and reduce the 'displacement' effect¹ of criminals targeting unregulated sectors.
13. The AML/CFT regime is an effective tool to combat crime in New Zealand and it will be enhanced by Phase II. All profit-motivated crimes such as drug trafficking, fraud

¹ The displacement effect refers to situation where some sectors of the economy are covered by AML/CFT legislation, and criminals redirect their financial flows to unregulated sectors to avoid detection.

and tax evasion require the movement of funds. The AML/CFT regime prevents criminals from moving funds anonymously, and generates valuable financial intelligence for law enforcement to 'follow the money' in investigations.

14. The AML/CFT legislation protects New Zealand businesses from being misused and enhances financial integrity across the economy. It protects New Zealand's reputation by implementing international standards on AML/CFT and ensures that we are not considered a 'soft target' by international criminals.
15. In addition, Phase II helps New Zealand implement the international standards set by the Financial Action Task Force (FATF) – an inter-governmental forum of technical experts on AML/CFT. Our AML/CFT regime will be assessed for effectiveness by the FATF in 2020, and the results of the assessment are likely to have an impact on New Zealand's international and trade reputation.

What we have already decided

16. In 2008, the Government decided to implement the AML/CFT regime in two phases [CAB (POL) MIN [08] 17/3 refers]. Phase I was implemented when the AML/CFT Act came into force on 30 June 2013. There was an agreement to progress Phase II of the reforms at a later stage.
17. In June 2016, Cabinet agreed to progress Phase II of the reforms, with a view of enacting the reforms by July 2017 [CAB-16-MIN-0251 refers]. This decision has been announced.
18. In July 2016, Cabinet also agreed that certain recommendations made in the foreign trust inquiry be considered as part of the AML/CFT Phase II reforms [CAB-16-Min-0342 refers]. Such recommendations included considering possible changes to the suspicious transaction reporting regime.

Comment

19. To enable the Amendment Bill to be enacted by July 2017, it will need to be introduced to the House before the end of 2016. As indicated in the June Cabinet paper, this timeframe is extremely tight. However, the timeframe is necessary because:
 - 19.1. gaps in the coverage of the AML/CFT regime result in lost opportunities to detect and disrupt money laundering and terrorist financing, and the serious predicate offences such as drug offending, fraud and tax evasion;
 - 19.2. a longer timeframe would mean that the uncovered sectors continue to remain exposed to abuse by criminals, and remain unsupported for a longer period of time; and
 - 19.3. a longer period of coverage gaps increases the threat to New Zealand being targeted by international criminals and terrorists as a global "weak link" that can be exploited to inject proceeds of crime into the financial system.

20. While necessary, the timeframe does not allow sufficient time to sequentially develop policy, test its workability with affected sectors, and then prepare draft legislation. Instead, it is necessary to progress these three activities at the same time.
21. We have already begun to design components of the overall policy and have had early engagement with a range of sector representatives to help do this. Much of this early work has been included in a consultation document that was released by the Ministry of Justice on 17 August 2016.
22. At this stage, if we are to meet our timeline, it is necessary to begin the drafting of the legislation now. I therefore seek Cabinet's approval to take an iterative approach to making policy decisions and drafting legislation. More specifically, I propose to seek:
 - 22.1. Cabinet's agreement to a number of early policy decisions as outlined in this paper;
 - 22.2. Cabinet's authorisation for me to have a limited Power to Act on the basis set out in this paper so that I can continue the process of issuing drafting instructions from early policy decisions; and
 - 22.3. Cabinet's final policy decisions in October 2016 reporting through EGI.
23. As noted above, this iterative approach is necessary to ensure that the Amendment Bill can be introduced by the end of 2016, and that we can engage with the affected sectors on the workability of our proposed approach.
24. I also seek Cabinet's agreement to the inclusion of an Amendment Bill in the 2016 Legislation Programme, with a priority of 5 (to be referred to a Select Committee within the year). Introduction of the Amendment Bill in November 2016 will allow it to be passed by July 2017.

Early policy decisions

New sectors to be covered by AML/CFT legislation

25. I seek Cabinet's early agreement to include lawyers, accountants, real estate agents, conveyancers and some high value dealers in scope of the AML/CFT regime.
26. When Cabinet decided in 2008 to implement the AML/CFT regime in two phases, it was agreed that non-financial sectors such as lawyers, accountants and real estate agents would be brought under the regime at a later date [CAB (POL) MIN [08] 17/3 refers].
27. These sectors were identified as high-risk sectors in New Zealand's 2010 National Risk Assessment on AML/CFT. According to analysis by the Financial Intelligence Unit within Police, these sectors are also at risk of being increasingly targeted by

criminals seeking new ways to launder proceeds of crime now that more traditional methods are less available.

28. In addition, officials have engaged with the representative bodies of the currently unregulated sectors after the June Cabinet decision to progress the Phase II reforms. These discussions have confirmed officials' views of the identified risks associated with these sectors.

Phasing the commencement of AML/CFT compliance obligations

29. I seek Cabinet's early agreement to phase the commencement across the Phase II sectors with lawyers to be the first to come under the regime, with a view of having all Phase II sectors complying with the AML/CFT Act within two years of the Amendment Bill's enactment.

30. The sectors to be covered by the Phase II reforms have varying levels of readiness to implement AML/CFT compliance obligations. To ensure less prepared sectors have a sufficient lead-in period before the commencement of their obligations, it is appropriate to phase the commencement of the Amendment Bill. Phasing may also be necessary to ensure that the prospective AML/CFT supervisors are ready to supervise the new sectors. More specifically:

- 30.1. members of the legal sector are likely to be the most prepared for the commencement of their AML/CFT obligations², and it would therefore be appropriate for their obligations to commence earlier; and

- 30.2. high value dealers may require a longer lead-in period before they comply with their respective obligations.

31. The final decision on phasing will take into account a number of factors including operational readiness of the sectors and of the supervisor, risk, and cost.

Revoking the current exemptions from the AML/CFT Act 2009

32. I seek Cabinet's approval to revoke the regulatory exemptions for some of the Phase II sectors. Revoking the exemptions would coincide with the commencement of the sectors' AML/CFT obligations.

33. Lawyers, incorporated law firms, conveyancers, incorporated conveyancing firms, accountants and real estate agents are currently specifically exempted from obligations under the AML/CFT Act. This exemption is by regulation (regulation 20 of the AML/CFT (Definitions) Regulations 2011). Revoking this exemption is a necessary first step to enable the sectors to be covered.

34. In this context, it should be noted that the New Zealand Racing Board and the New Zealand Lotteries Commission have been granted Ministerial exemptions from the AML/CFT Act. These transitional exemptions were granted on the condition that

² The legal sector already has some identity verification, record-keeping and suspicious transaction reporting requirements under the Financial Transactions Reporting Act 1996.

they expire automatically when the Phase II reforms come into force. Once the exemptions expire, these two entities will automatically have compliance obligations under the AML/CFT Act.

- 35.** I understand that the Lotteries Commission has already undertaken a review of its business, identified its areas of vulnerability, and is taking steps to remove those vulnerabilities. They may at some stage seek a further Ministerial exemption on that basis.

Improving information sharing

- 36.** I seek Cabinet's early agreement to the initial scope of information-sharing proposals within the framework of the Phase II reforms.
- 37.** One of the recommendations from the Government Inquiry into Foreign Trust Disclosure Rules conducted by John Shewan was to undertake a review of the current legislative arrangements for the sharing of information between New Zealand Government agencies. There is an opportunity to address some information sharing issues as part of the Phase II reforms.
- 38.** Some of the considerations related to information sharing include the nature, purpose, timing and availability of the information to be shared. The reason for improvement is two-fold:
- 38.1. it is necessary to consider how the AML/CFT Act allows information to be shared in principle; and
 - 38.2. the inclusion of new sectors increases the number and type of reporting entities, therefore increasing the need for effective information sharing.
- 39.** The Ministry is currently consulting on potential changes to existing information sharing arrangements to enhance the operation of the AML/CFT Act 2009.
- 40.** Consistent with that consultation, I recommend the initial scope of information-sharing proposals, within the framework of AML/CFT Phase II reforms, include considering improved information-sharing arrangements between:
- 40.1. Police and AML/CFT supervisors (Reserve Bank, Department of Internal Affairs and the Financial Markets Authority);
 - 40.2. Police and other relevant AML/CFT agencies, law enforcement, defence and intelligence agencies;
 - 40.3. AML/CFT supervisors;
 - 40.4. AML/CFT supervisors and other relevant agencies; and
 - 40.5. reporting entities.
- 41.** Ministry of Justice officials are working closely with Police and other relevant agencies to develop final policy proposals. Cabinet will be asked to consider the

scope of the information-sharing arrangements and agree to final proposals in October through EGI.

Supervision of the new sectors

- 42. I seek Cabinet's early agreement to extend the AML/CFT supervisory regime to the new sectors to be covered by the AML/CFT legislation.
- 43. The AML/CFT Act requires reporting entities to be supervised by AML/CFT supervisors. Currently, there are three AML/CFT supervisors for the Phase I sectors: the Financial Markets Authority, the Reserve Bank of New Zealand and the Department of Internal Affairs.
- 44. The Phase II sectors must also be supervised appropriately to ensure they maintain appropriate AML/CFT controls, and that no sector is disadvantaged by complying with the obligations of the AML/CFT Act.
- 45. No Power to Act is being sought at this stage on who the supervisory agency/agencies will be. Cabinet will be asked to make decisions on this in the October Cabinet paper.

Simplified customer due diligence

- 46. I seek Cabinet's agreement to extend the ability to conduct simplified customer due diligence with regard to new groups of entities where there is a proven low risk of money laundering and terrorist financing. Initially I propose that this be extended to include:
 - 46.1. State Owned Enterprises as set out in the State Owned Enterprises Act 1986; and
 - 46.2. majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions.
- 47. The AML/CFT Act currently allows for simplified customer due diligence to be conducted in certain situations where there is a lower risk of money laundering and terrorist financing. Conducting simplified customer due diligence means that reporting entities are required to obtain less information about the customer. These situations include, for example, where a reporting entity establishes a business relationship with a government department or a Crown entity.

Regulation making power

- 48. I seek Cabinet's agreement to extend the current regulation-making powers in the AML/CFT Act where it is necessary to ensure that new regulations also apply to the new sectors being brought in scope of the AML/CFT legislation through Phase II.
- 49. In summary, the early decisions sought are the following:

Issue	Early decision
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New sectors	Lawyers, accountants, real estate agents, conveyancers and some high value dealers will be included in the coverage of the AML/CFT legislation.
Commencement	Implementation will be phased across the Phase II sectors with lawyers to be the first to come under the regime. Implementation for all sectors will occur within two years from the Amendment Act coming into force.
Current regulatory exemptions for sectors	The current regulatory exemptions for lawyers, accountants, real estate agents and conveyancers will be revoked.
Information sharing	The initial scope of proposed information-sharing improvements.
Supervision	The new sectors will be supervised for compliance with their AML/CFT obligations but no decision is sought at this time on who the supervisor(s) will be.
Simplified customer due diligence	Simplified customer due diligence will be extended to State Owned Enterprises and majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions.
Regulation-making power	The current regulation-making powers in the AML/CFT Act 2009 will be extended to the new sectors.

Power to Act

50. To maintain momentum, I seek Cabinet's authorisation for me to make a limited number of decisions under a Power to Act. These decisions would be contained to progressing early policy decisions that are not contentious, and do not have a direct financial impact on other portfolios. Where appropriate, decisions would be informed by ongoing consultation.
51. This proposal is consistent with the iterative approach outlined earlier in this paper. Cabinet's agreement would enable me to issue drafting instructions and thus introduce a Bill by the end of this year.
52. The scope of the decisions I seek to make under the Power to Act are set out in the table below. I intend to submit decisions made under this Power to Act to Cabinet in October 2016 for confirmation through EGI.

Issue	Early decision	Power to Act
New sectors	Lawyers, accountants, real estate agents, conveyancers and some high value dealers will be included in the coverage of the AML/CFT legislation.	No power to act sought.
Commencement	Implementation will be phased across the Phase II sectors with lawyers to be the first to come under the regime. Implementation for all sectors will	The dates when the different sectors are expected to comply and any conditions associated with

	occur within two years from the Amendment Act coming into force.	those requirements.
Current regulatory exemptions for sectors	The current regulatory exemptions for lawyers, accountants, real estate agents and conveyancers will be revoked.	The timing and conditions of revoking the exemptions under regulations.
Information sharing	The initial scope of information sharing proposals	The details of the information sharing proposals between law enforcement agencies, AML/CFT supervisors other relevant agencies and reporting entities, taking into consideration privacy principles.
Supervision	The new sectors will be supervised for compliance with their AML/CFT obligations.	No power to act sought.
Simplified customer due diligence	Simplified customer due diligence will be extended to State Owned Enterprises and majority-owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions.	Any additional situations to which simplified customer due diligence will apply.
Regulation-making power	The current regulation-making powers in the AML/CFT Act 2009 will be extended to the new sectors.	No power to act sought.

Consequential amendments

53. In addition, consequential amendments to the AML/CFT Act and other pieces of legislation are likely to be necessary to align them with the changes related to Phase II. One group of consequential amendments will include aligning the definitions between the Financial Transactions Reporting Act 1996 and the AML/CFT Act 2009. I seek Cabinet's approval to use the Power to Act to also make these consequential amendments.

Final Cabinet decisions in October

54. I intend to seek Cabinet's final decisions on the Phase II policy in October 2016. In addition, I intend to seek Cabinet's confirmation of decisions made under the proposed Power to Act. I would issue final drafting instructions to PCO after Cabinet's final decisions.

55. In advance of final decisions in October 2016, I will provide Cabinet with a verbal update in early October on the key matters arising from the formal consultation process with the sectors. I will also provide an update on any key decisions that have been made under the Power to Act.

56. The key decisions I will bring to Cabinet in October are set out in the table below.

Issue	Early decision	Final decision
New sectors	Lawyers, accountants, real estate agents, conveyancers, and some high value dealers will be included in the coverage of the AML/CFT legislation.	Details of what services provided by the new sectors will be included, and at what stage in the service the AML/CFT obligations apply Details of the extent to which AML/CFT obligations will apply to high value dealers ³
Information sharing	The initial scope of information sharing proposals.	The scope of information-sharing arrangements and final information sharing proposals.
Supervision	The new sectors will be supervised for compliance with their AML/CFT obligations.	Details of the supervisory model, including who will supervise the Phase II sectors, what powers the prospective supervisor(s) will be given, and the funding of the supervisory model.
Regulation-making power	The current regulation-making powers in the AML/CFT Act 2009 will be extended to the new sectors.	Decision on any further regulation-making powers.
Other decisions	No early decision sought.	Any other decisions needed to give effect to Phase II within the agreed timeframe.

57. I have asked officials to provide further advice on all these matters. The proposals brought to Cabinet in October 2016 will also be informed by the ongoing consultation with the affected sectors.

Consultation

58. The Department of Internal Affairs, the Financial Markets Authority, the Reserve Bank of New Zealand (AML/CFT supervisors), New Zealand Police, the New Zealand Customs Service, the Ministry of Foreign Affairs and Trade and the

³ The two approaches included in consultation are either to cover specific businesses such as jewellers or car dealers, or to cover any business within the wider sector that accepts cash payments over a certain threshold.

Treasury have been consulted. The Department of the Prime Minister and Cabinet has been informed.

Financial implications

59. The early policy decisions set out in this paper do not have any further financial implications beyond the decisions already made. Cabinet will be informed of the financial implications of the Phase II reforms in more detail in October 2016.

Human rights

60. The reforms are not expected to raise issues with the New Zealand Bill of Rights Act 1990.

Legislative implications

61. An Amendment Bill will be required to implement the AML/CFT Phase II reforms. The Amendment Bill is necessary to give effect to Government's commitment to extend the AML/CFT obligations to additional entities not currently covered under the AML/CFT regime.

Compliance

62. The Amendment Bill is expected to comply with each of the following:
- 62.1. principles of the Treaty of Waitangi;
 - 62.2. rights and freedoms contained in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993;
 - 62.3. principles and guidelines set out in the Privacy Act 1993 (if the legislation raises privacy issues, indicate whether the Privacy Commissioner agrees that it complies with all relevant principles);
 - 62.4. relevant international standards and obligations;
 - 62.5. LAC Guidelines: Guidelines on Process and Content of Legislation, a publication by the Legislation Advisory Committee.

Binding on the Crown

63. The changes arising from the Amendment Bill will be binding on the Crown.

Associated Regulations

64. Amendments to current Regulations will be required to give effect to the provisions of the Bill. The amendments will be substantive and of medium complexity.

Regulatory impact analysis

65. The Treasury notes that the Regulatory Impact Analysis (RIA) requirements apply to the early policy decisions sought in this paper but a regulatory impact statement

(RIS) has not been prepared. Therefore, the RIA requirements have not been met. A RIS will be prepared for the October 2016 Cabinet paper seeking final policy decisions.

66. The Ministry of Justice is in the process of preparing a RIS for the wider Phase II reforms. As the early policy decisions in this paper are only setting out the framework for the more detailed decisions to be made in October 2016, the Ministry has decided to address the issues collectively in the wider RIS.

Gender implications

67. The reforms will not have any gender implications.

Disability perspective

68. The reforms will not have any disability implications.

Publicity

69. No public announcement is planned at this stage.

Recommendations

The Minister of Justice recommends that the Committee:

1. **Note** that in September 2008, the Government agreed that the anti-money laundering and countering financing of terrorism (AML/CFT) reforms would apply in a first phase to financial institutions and the casino sector and in a second phase, to non-financial businesses and professions with the types of organisations and the nature of their obligations for inclusion in the provisions to be subject to further policy development [CAB Min (08) 36/3 refers];
2. **Note** that the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the AML/CFT Act) implemented the first phase of the reforms;
3. **Note** that in June 2016, Cabinet agreed to progress the second phase of AML/CFT reforms, with a view of enacting the reforms by July 2017 [CAB-16-Min-0251 refers];
4. **Agree** that:
 - 4.1. lawyers, accountants, real estate agents, conveyancers, and some high value dealers will be covered in scope of the AML/CFT regime;
 - 4.2. the commencement of the AML/CFT compliance obligations for the new sectors will be phased and conclude within two years of the Act coming into force;
 - 4.3. the current regulatory exemptions for the new sectors will be revoked;
 - 4.4. the initial scope of information-sharing proposals;
 - 4.5. the AML/CFT supervisory regime will be extended to the new sectors;

- 4.6. the ability to conduct simplified customer due diligence with regard to new groups of entities where there is a proven low risk of money laundering and terrorist financing will be extended to include State Owned Enterprises under the State Owned Enterprises Act 1986 and majority owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions; and
 - 4.7. the regulation-making powers in the AML/CFT Act will be extended to ensure they apply to the new sectors.
- 5. Agree** that the Minister of Justice can make limited decisions under a Power to Act to enable further drafting to occur, and that these limited decisions will be focused on:
- 5.1. the dates that the different sectors are expected to comply and any conditions associated with those requirements;
 - 5.2. the timing and conditions of revoking exemptions;
 - 5.3. the details of the information sharing proposals between law enforcement agencies, AML/CFT supervisors, other relevant agencies and reporting entities, taking into consideration privacy principles;
 - 5.4. any additional situations to which simplified customer due diligence will apply to;
 - 5.5. consequential amendments to the AML/CFT Act and associated Acts (e.g. the Financial Transactions Reporting Act);
- 6. Invite** the Minister of Justice to issue drafting instructions to PCO to progress legislative changes needed to progress the decisions in this paper and further items specified under the Power to Act;
- 7. Agree** that the Minister of Justice will seek Cabinet's final agreement in October 2016 to:
- 7.1. details of what services provided by the new sectors will be included, and at what stage in the service the AML/CFT obligations will apply;
 - 7.2. details of the extent to which AML/CFT obligations will apply to high value dealers;
 - 7.3. the scope of information-sharing arrangements and final improving information sharing proposals;
 - 7.4. details of the supervision model which will include who will supervise the Phase II sectors, what powers the prospective supervisor(s) will be given, and the funding of the supervisory model;
 - 7.5. details of any further proposals to extend the regulation-making powers in the AML/CFT Act; and

- 7.6. any other decision needed to give effect to Phase II within the agreed timeframe.
8. **Note** that the Amendment Bill should be introduced by November 2016 and passed by July 2017;
9. **Approve** the inclusion of the Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill in the 2016 Legislation Programme, with a priority of 5 (to be referred to a Select Committee in the year);

Authorised for lodgement

Hon Amy Adams
Minister of Justice

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