

## Regulatory Impact Statement

### Implementation of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 – Proposed Regulations

#### Agency Disclosure Statement

This Regulatory Impact Statement has been prepared by the Ministry of Justice.

It provides an analysis of options to regulate to ensure the Anti-Money Laundering and Countering Financing of Terrorism Act (the AML/CFT Act) implements the internationally accepted Financial Action Task Force (FATF) anti-money laundering and countering financing of terrorism standards in a way which is efficient and proportionate to money laundering and terrorism financing risks within the New Zealand context. The proposals relate specifically to:

- the AML/CFT Act's coverage of business sectors and products – certain sectors and products identified as important to the efficient and effective functioning of the AML/CFT Act are currently not covered by the Act, whereas other sectors and products covered by the Act have been identified as unnecessarily included (at this point in time).
- the determination of beneficial ownership as part of the due diligence obligations relating to customers that are legal persons, and the application of due diligence to trusts – currently the Act's provisions do not conform to the FATF standard;
- the expenditure value at which customer due diligence obligations relating to various types of one-off (occasional) cash transactions take effect – currently the Financial Transactions Reporting Act requires customer due diligence measures for occasional cash transactions over \$10,000. No thresholds are currently established under the AML/CFT Act, and therefore upon commencement of the Act all such transactions regardless of value would be subject to obligations
- certain limitations on the ability for businesses to participate and form designated business groups which facilitate the sharing of certain AML/CFT obligations across entities.

The proposals have been extensively consulted with industry. In February 2010 the Ministry of Justice released a discussion document presenting options for regulation and seeking information from industry. In August 2010 the Ministry released a consultation document containing refined proposals and invited comment from industry. Relevant feedback from industry is reflected in comments on these proposals.

Key considerations have been to comply with the FATF standards, ensure the response is proportionate, ensure costs to industry are minimised, and harmonise New Zealand's AML/CFT regime with Australia's wherever possible and appropriate.

The development and analysis of the proposals, as well as drawing from the FATF standard, has considered AML/CFT laws of New Zealand's key financial trading partners, in particular Australia, the United States, Canada and the United Kingdom. The Financial Intelligence Unit of the New Zealand Police and a range of regulatory agencies have

been closely involved in developing the proposals in this paper. Some specific aspects of proposals have been discussed with the Australian Transactions Analysis Centre (AUSTRAC).

The cost analysis predominantly relies on an assessment of business compliance costs of the indicative anti-money laundering regulatory requirements undertaken in 2008 by Deloitte on behalf of the Ministry of Justice, analysis from the 2009 Regulatory Impact Analysis of the AML/CFT legislation, and to a small degree cost estimates provided by industry during consultation on the proposals. The following caveats should be noted in considering the cost estimates where these are provided:

- 2008 cost assessment limitations – representativeness of sample across impacted industry groups was not possible due to budget and time constraints, and in some cases non-participation, however, the impact on final cost estimates was not considered significant and cost information supplied by interviewees was not verified or validated.
- Some changes between the assumptions of the 2008 assessment and proposals (eg. the \$6000 threshold for occasional transactions undertaken through casinos).

The costs of certain proposals are unable to be assessed for cost impacts as the detail of the proposals were either not considered as part of the 2008 costing exercise, and officials have received no specific cost information from affected industry concerning the proposals (eg. the coverage of additional sectors and products) or the costing exercise did not extend to the level of detail at which the proposal is located.

Some of the proposed regulations are expected to effectively reduce compliance costs to businesses, whereas some of the proposed regulations are expected to impose additional costs on businesses, but are considered justified according to the Act's crime intelligence and deterrence objectives, and are important to New Zealand's international reputation.

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28/10/10

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## Status quo and problem definition

While New Zealand is internationally recognised as being low risk for terrorism financing, money laundering related to domestic as well as international profit-generating crime occurs within and via New Zealand's financial and broader market system. The amount of money laundered within and through New Zealand is difficult to quantify, but is thought to be significant given the scope of what can constitute money laundering. Money laundering involves activity undertaken for the purpose of concealing, or facilitating the concealing of, any property known or believed to be, or having reckless disregard for it being, in all or part, the proceeds of any serious offence (ie. attracting a maximum term of imprisonment of five years or more) (refer section 243, Crimes Act) or a certain specified drug offence (refer section 12B, Misuse of Drugs Act) committed either in or outside New Zealand. For example, the New Zealand Police estimate the 'street' level proceeds generated by the methamphetamine market alone to be approximately NZ\$1.2 billion per annum.

Money laundering and the financing of terrorism are global problems and there is a strong international expectation New Zealand will implement appropriate anti-money laundering and countering financing of terrorism (AML/CFT) measures. The Financial Action Task Force (FATF), of which New Zealand is a member, has established AML/CFT Recommendations, which while not legally binding are widely accepted as the international benchmark for country-level AML/CFT measures. Member countries' compliance with the FATF Recommendations is routinely evaluated (for background on the FATF mandate, refer to the June 2009 Regulatory Impact Statement concerning the AML/CFT Regime Reform [linked here](#)). The most recent FATF Mutual Evaluation of New Zealand undertaken and published during 2009 ([summary linked here](#)) found New Zealand to be partially or non-compliant with 24 of the 49 Recommendations.

New Zealand's current AML/CFT measures are implemented primarily through the Financial Transactions Reporting Act 1996 (FTRA), which responded to the original 1990 FATF Recommendations placing obligations on financial institutions, casinos and other businesses (eg. accountants, lawyers) to carry out due diligence on their customers and report any suspicious transactions to the New Zealand Police Financial Intelligence Unit (the "FIU").

The Anti-Money Laundering and Countering the Financing of Terrorism Act 2009 (AML/CFT Act), passed in October 2009 (but yet to be commenced by Order in Council), builds on the FTRA, introducing enhanced AML/CFT risk management obligations on financial institutions and casinos ("reporting entities"), along with a supervision framework. Once the Act's provisions are commenced, the most substantial deficiencies in New Zealand's current AML/CFT measures (eg. substandard customer due diligence practices, limited sector coverage, and lack of supervision of entities in carrying out their AML/CFT obligations) will be remedied, and New Zealand's AML/CFT measures will better align with the measures already implemented by Australia, United Kingdom, Canada and the United States (among others).

To ensure the AML/CFT Act is focused and proportionate, a number of regulations are proposed; some of which would effectively reduce compliance costs to businesses, and others which are expected to have compliance impacts, but are justified according to the Act's crime intelligence and deterrence objectives. This Regulatory Impact Statement discusses the impacts associated with proposals relating to the following issues:

- inclusion of business sectors and products within the AML/CFT Act's coverage – regulations are proposed to include Trust and Company Service Providers, Authorised

Financial Advisers, and Stored Value Instruments within the Act's coverage, attaching to these sectors and products the Act's obligations as are relevant;

- exemptions of business sectors and activities from some or all of the AML/CFT Act obligations – regulations are proposed to exempt sectors intended for coverage in a planned second phase of reform, along with sectors involving low risk of money laundering and terrorism financing, and activities undertaken within certain sectors which already have similar obligations across related businesses for common customers;
- determination of beneficial ownership – regulations are proposed to establish a threshold of ownership to which beneficial ownership obligations apply, clarify the application of the due diligence as it relates to trusts, and exempt, in relation to certain entities and products, the collection of beneficial ownership information;
- application of customer due diligence (CDD) obligations relating to specific types of financial transaction activities above certain values – regulations are proposed to establish various occasional transaction product-specific expenditure thresholds above which entities will be required to undertake AML/CFT obligations; and
- scope of business relationships required for participation in a designated business group (DBG), which facilitates the sharing of AML/CFT obligations.

## **Objectives**

The outcomes sought are those established by the purpose of the AML/CFT Act, which are to:

- detect and deter money laundering and the financing of terrorism;
- maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the FATF; and
- contribute to public confidence in the financial system.

The Act is designed to achieve these purposes by facilitating co-operation between reporting entities, law enforcement and regulatory agencies.

Importantly, the proposal aims to achieve the purposes of the Act effectively with minimum cost to industry.

## **Regulatory impact analysis**

### **Inclusion of business sectors and products within the AML/CFT Act's coverage**

#### *Overview*

The AML/CFT Act upon commencement will apply to businesses that come within the definition of a 'reporting entity', which includes casinos and 'financial institutions' (for interpretation refer section 5 of the AML/CFT Act), along with particular financial products insofar as they are relevant to the objectives of the Act. The AML/CFT Act can include within its coverage, via regulations, additional sectors and products relevant to the objectives and functioning of the Act (subject to a five year sunset clause to ensure regular evaluation).

Given the complexity of arrangements within the financial system, sectors and products to which the AML/CFT Act is relevant and important can inadvertently escape the Act's coverage. This section discusses proposals to include within the coverage of the Act upon its commencement Trust and Company Service Providers, authorised financial advisers, and stored value instruments (eg. cash passports).

### *Proposed inclusion of Trust and Company Service Providers*

#### Status quo

Trust and Company Service Providers (TCSPs), otherwise known as company formation agents - provide services supporting the establishment and maintenance of companies and trusts on behalf of third parties. The sector was to be considered for coverage in a planned second phase of AML/CFT reform, given the sector is recommended by the FATF for AML/CFT coverage based on the role they play within the international financial system. A number of countries currently place AML/CFT obligations on the sector (eg. USA, UK and Canada).

Amendments to the Companies Act have been agreed to require all New Zealand registered companies to involve a New Zealand-resident company formation agent (where they do not have a New Zealand-resident director). In principle agreement has been given to extending similarly applicable measures to limited partnerships, under the Limited Partnerships Act.

#### Problem

The sector has been of increasing concern to New Zealand authorities, being involved (whether intentionally or inadvertently) in the establishment of New Zealand legal entities with no economic purpose within New Zealand but used for serious criminal offending in overseas jurisdictions. New Zealand authorities have been formally approached over the past five years in respect of 150 serious crime and tax evasion cases in overseas jurisdictions, and recently a serious contravention of UN Security Council Resolutions involving New Zealand registered legal entities. Additionally around 1000 New Zealand registered companies and Limited Partnerships have been identified as potentially operating financial frauds in overseas jurisdictions.

The sector is not specifically regulated to maintain information, critical to law enforcement needs.

While the cost of crime related to New Zealand legal entities, facilitated by the sector, predominantly falls on jurisdictions beyond New Zealand's borders, this is nonetheless a significant negative externality associated with New Zealand's legal and regulatory arrangements, and overtime is expected to detriment New Zealand's international reputation.

As noted in the FATF New Zealand Mutual Evaluation Report (paragraph 557 - 558 refers [linked here](#)), "The company registration mechanism is based on fragile processes hence, the opportunity for criminals and money launderers to exploit shell banks occur. Indeed, the New Zealand authorities acknowledge that some such entities are incorporated in New Zealand, but have no physical presence in terms of activities and management in the country. Instead, they conduct their deposit taking activity through the internet and are focused on customers living outside of New Zealand."

## Alternative Option

An option, to require all New Zealand companies to have an ordinarily resident director, such as the approach taken by Australia and Singapore, has been considered, but is not preferred at this time. It was considered such an approach would result in unjustified cost and duties to non-residents establishing New Zealand companies and potentially risk foreign direct investment in New Zealand.

## Preferred option

The preferred option is to include, via regulation, TCSPs as reporting entities subject to AML/CFT obligations upon commencement of the Act.

It is estimated that there are currently 40 – 50 small TCSPs operating in New Zealand, but significant volumes of New Zealand legal entity formations are undertaken outside of New Zealand, and therefore with the agreed changes to the Companies Act (and Limited Partnerships Act) the domestic sector is expected to increase its volume of activity. It is assumed that the sector has limited AML/CFT measures in place, and therefore the start-up investment and ongoing costs to entities are likely to be at the significant end of the spectrum. An assessment of the costs that would be borne by the sector has not been undertaken, and therefore it is uncertain.

The preferred approach is however considered proportionate and necessary, given the role company structures and the sector has been observed to have played in a number of serious criminal cases brought to the attention of New Zealand authorities in recent years, and in light of FATF criticism of New Zealand and what other countries are doing in this area. It complements the agreed changes to the Companies and Limited Partnerships Acts. Local agents would be obligated to undertake due diligence on individuals and legal entities on which behalf they formed and maintained companies and limited partnerships (including taking steps to determine underlying beneficial involvement), and report any suspicious transactions they become aware of (although mostly they will not be dealing with the individuals or entities in a transactional manner).

While the proposal will not prevent overseas persons setting up companies here directly on the internet without any checks on identity or whether they have a legitimate interest in doing so, the proposal will help to deter some use of New Zealand legal entities in, and better enable New Zealand to assist investigation of, serious crime, tax evasion and terrorism in other jurisdictions. It would be consistent with the approach taken by the USA, UK and Canada. Overall it will help to protect New Zealand's international reputation.

## *Inclusion of authorised financial advisers*

### Status quo

Many authorised financial advisers (ie. those required to be authorised under the Financial Advisers Act 2008) undertake activities that see their inclusion in the definition of a financial institution, and therefore will be subject to AML/CFT obligations upon commencement of the AML/CFT Act. However, a proportion of the authorised financial advisor sector is not covered by the definition but currently undertake customer interface services on behalf of financial service providers (particularly the securities and insurance sectors), which will be subject to AML/CFT obligations. Upon commencement of the Act, financial service providers

will only be able to rely on other reporting entities, or authorised agents to carry out customer due diligence obligations at the customer interface on their behalf.

#### Problem

Maintaining the status quo, at a minimum, has potential to result in duplication of some AML/CFT obligations between financial advisers and affected financial service sectors, or at the extreme, crowd out financial advisers, and necessitate affected financial service providers to invest in customer interface procedures.

#### Preferred Option

The preferred option is to include, via regulation, financial advisers as reporting entities. The objective is to ensure the Act works effectively with minimum cost to industry as a whole, by essentially allowing for the continuation of current business practices undertaken in the financial service sectors (particularly the securities and insurance sectors).

The financial advisor sector is estimated to comprise mainly individuals and small firms, however, as some within the sector are already covered by the Act because of activities undertaken, it is not possible to determine what proportion of the sector would be additionally included as a result of the proposed regulation and therefore the extent of the impact from the proposal on the sector. However, it is likely that the benefits to the financial service providers would outweigh the costs to affected authorised financial advisers.

#### *Inclusion of stored value instruments*

#### Status quo

It is ambiguous as to whether stored value instruments are included within coverage of the AML/CFT Act as a 'facility' (ie. an arrangement provided by a reporting entity through which a facility holder conducts two or more transactions – refer section 5 of the AML/CFT Act) and therefore attract the full obligations attached to the establishment of a ongoing business relationship, or are inadvertently not covered and would potentially not attract obligations upon commencement of the Act.

#### Problem

In either case, this is not desirable. The money laundering and terrorism financing risks of the instruments are well documented. 'Open system' cards (those that allow cash withdrawals) in particular are increasingly noted as being used to illicitly transfer cash across borders and circumvent AML/CFT measures based on their compactness, ease of transport, transferability and anonymity they offer. Their exclusion from AML/CFT measures is clearly not preferred. However, neither is their inclusion as a customer facility, of which the implication is that each purchase of a stored value instrument would constitute the establishment of a business relationship and entail the full suite of AML/CFT obligations on the provider of the product in relation to each customer.

#### Preferred Option

The preferred approach is that stored value instruments, via regulation, be included in the definition of bearer negotiable instrument (BNI), which are included in the definition of cash in

the AML/CFT Act, and are subject to the lesser occasional transaction obligations. This is appropriate both in that, conceptually, stored value instruments are most comparable to BNI (eg. travellers cheques), and proportionately, the obligations satisfy the intelligence objectives with minimum compliance cost impact.

### Exemption of sectors and products from AML/CFT Act coverage

#### Status Quo

Given the broad definition of financial institution in the Act, an array of sectors and products will be subject to the obligations of the Act upon its commencement. Based on the FATF standard, the AML/CFT Act's definition of a 'financial institution' is broad enabling it to cover a wide breadth of transactional settings potentially abused by criminals. The AML/CFT Act, via regulation, can exempt from its coverage business sectors and products to ensure the Act's obligations are applied efficiently and proportionately to vulnerabilities (subject to a five year sunset clause to ensure regular evaluation).

#### Problem

The breadth of definition can see the inclusion of sectors and products that may not be justified as included based on the risk they present within the financial system. The following categories of sectors and products have been identified as being currently included within the scope of coverage of the Act, but:

- are intended for coverage in a planned second phase of reform instead due to a consideration that they present relatively lesser risk and priority for coverage;
- have been assessed as currently involving low risk of money laundering and terrorism financing due to their basic nature or protections in place; and
- in undertaking AML/CFT obligations, they will duplicate obligations across related businesses in respect of common customers.

#### Preferred Option

The preferred option is to exempt, via regulation, a number of financial industry sectors and financial products from the full suite or discrete AML/CFT obligations as set out in the following table:

Table one: Exemption of sectors and products

| Proposal   | Entities and products  | Analysis   |
|--|--|--|
| Total exemption from the AML/CFT Act upon commencement for sectors and entities to be considered for AML/CFT | <ul style="list-style-type: none"> <li>• <i>NZ Lotteries Commission;</i></li> <li>• <i>New Zealand Racing Board;</i></li> <li>• <i>Sectors including Pawnbrokers; Retailers providing short term self-funded credit to customers</i></li> <li>• <i>Government departments</i></li> </ul> | <p><b>Costs</b></p> <p>Potential cost to intelligence and law enforcement objectives in exempting the New Zealand Racing Board, but this is mitigated to some extent by existing coverage by the lesser provisions of the FTRA.</p> <p><b>Benefits</b></p> <p>Neither Retailers providing self funded credit to customers, pawnbrokers, Lotteries Commission, nor Government departments</p> |

|  |  |  |
|--|--|--|
| <p>obligations as a part of the second phase of AML/CFT reforms.</p>   | <p><i>listed under Schedule 1 of the State Sector Act 1988 (ie. does not apply to Crown Entities) and Reserve Bank of New Zealand</i></p>  | <p>were assessed for likely compliance costs with the AML/CFT Act, but the proposed clarification of their exclusion has compliance benefits for the sectors. Pawnbrokers are regulated and licensed under the Second-Hand Dealers and Pawnbrokers Act, mitigating some risks. The Racing Board was estimated to incur start-up and ongoing costs of respectively \$140k and \$60k, which the proposal sees deferred until the possible inclusion of the entity.</p> <p><b>Net impact: negligible, but positive to industry</b></p>  |
| <p>Total exemptions for sectors and products based on assessed low risk of money laundering and terrorism financing</p>  | <ul style="list-style-type: none"> <li>• <i>General Insurance</i></li> <li>• <i>Certain life insurance products, including pure risk-based life insurance, Funeral insurance policies, and policies closed to new customers</i></li> <li>• <i>Overseas pension accounts</i></li> <li>• <i>Corporate treasury functions</i></li> <li>• <i>Safety deposit boxes in the accommodation industry</i></li> </ul>   | <p><b>Costs</b></p> <p>Negligible impact to intelligence and law enforcement.</p> <p><b>Benefits</b></p> <p>Neither general insurance, overseas pension accounts, corporate treasury functions, nor safety deposit boxes in the accommodation industry were assessed for likely compliance costs with the AML/CFT Act, but the proposed clarification of their exclusion has compliance benefits for entities in these sectors. The life insurance sector was estimated to face substantial start-up and ongoing costs of respectively \$3.3 million and \$0.9 million per year (mainly for account monitoring), which will be reduced in proportion to the activity exempted.</p> <p><b>Net impact: positive insofar as it reduces compliance costs to affected sectors.</b></p>  |
| <p>Partial exemptions for activities undertaken within sectors, which involve unnecessary duplication of the obligations across related businesses in respect of common customers.</p> | <ul style="list-style-type: none"> <li>• <i>Low value life insurance products (exemption of identity verification until final pay-out)</i></li> <li>• <i>Insurance premium funded products (CDD exemption)</i></li> <li>• <i>Workplace-based, Kiwisaver-based and low-value superannuation funds (CDD exemption at relationship establishment)</i></li> <li>• <i>domestic wire transfers (Originator information exempted)</i></li> <li>• <i>Special remittance card facility (CDD on second customer exempted)</i></li> <li>• <i>Debt collectors and Securities Registries (all obligations exempted apart from suspicious reporting and related record keeping)</i></li> </ul> | <p><b>Costs</b></p> <p>No/Negligible impact to intelligence and law enforcement.</p> <p><b>Benefits</b></p> <p>The proposed exemptions relating to the life insurance and superannuation sectors improves clarity and better ensures a level interpretation of obligations, which in turn supports competition within the sectors. The superannuation sector was not costed in the original compliance exercise, but the AML/CFT obligations are assumed similar to the life insurance sector, and in some cases affect the same entities. The life insurance sector is estimated to face negligible AML/CFT CDD related costs, as customer volumes are relatively low and Industry practice is broadly consistent the new obligations, however, the exemption will help to focus industry AML/CFT activity.</p> <p>While not costed, submissions by Industry suggest the exemption of originator information for domestic wire transfers will save substantial systems changes and some ongoing costs, and therefore significantly reduces industry compliance costs.</p> <p>The proposal relating to the special remittance card facility maintains the status quo, as the product is currently subject to comparably reduced obligations under the FTRA.</p> <p>Debt collectors and Securities Registries were not costed, but the proposal is expected to reduce costs to the industry.</p> <p><b>Net impact: positive</b></p> |

## Determination of beneficial ownership of legal entities

### *Applicable threshold for beneficial ownership*

#### Status Quo

As discussed in the above section, legal entities are instrumentally used by criminals to maintain anonymity in relation to assets and activities. Knowing who holds beneficial ownership, insofar as they are able to exercise some effective control of a legal entity, is critical to judging the legitimacy of activities undertaken by a legal entity. The determination of beneficial ownership as part of customer due diligence relating to legal entities is therefore among the core FATF Recommendations, and is critical to the purposes of the AML/CFT Act.

Upon commencement, the AML/CFT Act will require reporting entities as part of customer due diligence of legal entities to identify and take reasonable steps (according to the level of risk) to verify the identity of beneficial owners. The AML/CFT Act can establish, via regulations, a threshold clarifying what level of beneficial ownership constitutes effective control of an entity for the purposes of the Act.

#### Problem

The status quo would see the effective control threshold interpreted anywhere up to 49% given this is the point of differentiation from the threshold for absolute control of a legal entity. This is not preferred as, should such an interpretation be widely implemented by industry, individuals exercising substantial levels of effective control within legal entities (potentially 48%) would remain unidentified and the Act's detection and deterrence objectives would not be realised. The approach is inconsistent with comparable jurisdictions (eg. Australia, Ireland and England have adopted a 25% threshold). It would also be inconsistent with the approach taken to the issue by other New Zealand legislation (eg. the Reserve Bank of New Zealand Act 1989 and the Takeovers Act 1993 recognise an ownership threshold of 20% of a company as significant to control, and the Companies Act 1993 recognises a threshold of 25% as significant). Most importantly, given the well documented risk associated with the use of legal entities to maintain anonymity and separation from illicit activity, the status quo is deficient in terms of the level of scrutiny it obligates in respect of customers that are legal entities.

#### Alternative Option

An alternative approach suggested by one submitter would see the application of dual beneficial ownership thresholds. For example, low to medium risk customers would be subject to a 50% threshold and high risk customers a 25% threshold to which natural person beneficial ownership would need to be determined.

The AML/CFT Act already places a risk-based approach at the centre of beneficial ownership checks. Reporting entities are only required to take steps to verify the identity of the beneficial owner(s) of a customer that they consider are reasonable according to level of the risk (section 16(1)(b)). Under the legislated provision, reporting entities can apply different levels of effort in verifying ownership arrangements according to their assessment of risk of different situations. In fact, certain low risk situations are proposed to be exempted from the obligation altogether (as part of the proposed nomination of entities for simplified due diligence). The alternative approach would provide for negligible reduction in beneficial

ownership determination activity, and also add additional unnecessary inflexibility and complexity to the obligation, and is therefore not preferred.

#### Preferred Option

The preferred approach is to set in regulation a beneficial ownership threshold of 25%, meaning that an individual who owns 25% or more of a customer that is a legal entity would be subject to the AML/CFT Act's customer due diligence requirements; an approach and threshold consistent with other jurisdictions, and the Companies Act 1993, and one which appropriately satisfies law enforcement objectives.

The beneficial ownership requirement is a substantial dimension to the additional start-up and ongoing costs of customer due diligence obligations assessed as part of the June 2009 Regulatory Impact Statement concerning the AML/CFT Regime Reform ([linked here](#)), particularly for the banking sector. In that analysis, the impact the additional customer due diligence obligations from current industry practice predominantly falls on the registered banks (start-up costs to the banking sector as a whole were estimated as being just over \$4 million spread across the implementation period, and ongoing annual costs were estimated at \$0.8 million spread across the sector falling on entities roughly in proportion to the volume of activity undertaken).

#### *Trust beneficiary information for inclusion*

#### Status Quo

Upon commencement of the Act, reporting entities will be obligated to undertake enhanced due diligence (which in addition to standard requirements, entails determination of the customer's source of funds) on customers that are trusts. Essentially, obligations relate to the trustee (as the customer), and settler (as the source of funds or wealth), however, there is no obligation to identify beneficiaries of the trust. Given the widely documented money laundering and terrorism financing risk of trusts, and that FATF explicitly recommends due diligence measures be extended to beneficiaries, the status quo is not preferred.

#### Alternative Option

An alternative approach, as suggested by submitters, is that, rather than both name and date of birth information being collected, that only name information be collected (as per the approach in Australia). This approach is not preferred as name only information is fundamentally ambiguous.

#### Preferred Option

The preferred approach is to require as part of enhanced due diligence obligations relating to trusts, via regulation, the collection (but not the verification) of the name and date of birth of any beneficiaries of a trust. However, recognising the logistical difficulty in obtaining a complete set of information in the case of discretionary trusts and trusts with large numbers of beneficiaries, it is proposed that reporting entities collect information concerning the nature (or class) of beneficiaries, and where practicable, the number of beneficiaries within each class.

The impact of the collection of this information was included in the costing of the AML/CFT reform (as part of the standard due diligence obligation), and is therefore incorporated in the original June 2009 Regulatory Impact Statement concerning the AML/CFT Regime Reform. It is not possible to disaggregate the specific cost from the overall costing, and therefore determine the net difference in cost of the preferred approach.

### *Beneficial ownership information exempted*

#### Status Quo

Currently, upon commencement of the Act, there are a number of situations where reporting entities will be required to obtain and maintain beneficial ownership information that can be reliably obtained from other sources if the need arises, or is anticipated as being unnecessary due to the assessed low risk. The AML/CFT Act can, via regulations, scope out situations for which determination of beneficial ownership is required.

#### Problem

A general aim of the Act is that obligations be undertaken in proportion to assessed risk (the risk based approach). Related to this objective is that collection of the same information does not need to be duplicated. A number of situations are identified where the status quo would see the collection and maintenance of information relating to customers and activities of lower risk, or is already collected according to other legislated measures, which is clearly inefficient and an unnecessary cost to reporting entities.

#### Preferred Option

The following categories of customers and activities are proposed not to require beneficial ownership checks:

- customers proposed for simplified due diligence;
- certain accounts held in trust by a person subject to the FTRA or AML/CFT Act (eg. an account held by a law firm for holding customer funds on trust);
- specified financial activities below certain values (discussed below).

This will minimise unnecessary duplication and costs for reporting entities in dealing with such customers and products, with negligible detriment to law enforcement objectives.

### **Application of obligations in respect of specified financial products below value thresholds**

#### Status Quo

The status quo under the FTRA requires financial institutions and other businesses to verify the identity of people not in a business relationship with the institution when they undertake a one-off transaction ("occasional transaction") in cash above a regulated threshold of \$10,000 and maintain records of such transactions.

The AML/CFT Act upon commencement will obligate reporting entities to undertake customer due diligence and keep records in relation to all occasional cash transactions

(defined in the AML/CFT Act to include a slightly broader range of exchange instruments as compared to the FTRA). However, the AML/CFT Act provides for the setting of different regulated value thresholds relating to different specified financial products above which obligations are required. Proposals are discussed below to regulate:

- General occasional cash transaction threshold
- Transaction threshold relating to casinos
- Other specific transaction thresholds for specified financial products and activities (eg. Stored value instruments, Travellers cheques, Money orders and postal orders, Currency exchange).

Offsetting the costs to industry, verification of customer addresses are exempted for all occasional transactions.

#### *General cash transaction threshold*

#### Problem

Maintaining the status quo in the sense of not enacting a regulation setting a basic occasional transaction would see, upon commencement of the Act, financial institutions subject to AML/CFT obligations relating to every occasional transaction undertaken, which is not preferred because the cost to businesses would substantially outweigh the benefits to law enforcement.

#### Alternative Option One

An alternative approach, suggested by some submitters, would see an increase from the current FTRA threshold of \$10,000 to some greater amount, such as the FATF recommendation of either US\$15,000 or €15,000 (between approximately \$NZ20,000 and \$NZ27,000). Such an increase would not be detrimental to New Zealand's international reputation. However, neither would it necessarily result in substantial compliance cost saving to industry. While a lesser proportion of transactions would be subject to the obligations associated with a higher threshold, given this would be largely a systems issue, and submitters indications there are substantial business compliance costs associated with changing this threshold, the benefits to business of this option are thought to be negligible. Most importantly, such a change would potentially have a detrimental impact on the deterrence and detection of suspicious activity. In the last year alone, FIU data suggests almost 5% transactions identified as suspicious, involved indications of having been structured to avoid application of the FTRA (most predominantly wire transfers identified by banks and money remitters).

#### Alternative Option Two

A second alternative would be to require the reporting of all transactions above \$10,000 directly to a national transactions database operated by the FIU (such as the approach taken in Australia). The benefit of such an option to reporting entities is that some obligations concerning such threshold transactions can be relaxed (eg. record keeping). Such an option has certain benefits in deterring and detecting suspicious transactions, through enabling the identification of suspicious transactional activity undertaken across multiple financial institutions that would otherwise not be identified and reported as suspicious as well as high

value transactional activity associated with persons and entities of interest. The costs to government and industry associated with the implementation of such a measure are unknown, and therefore the option is not preferred, but is part of work being undertaken in a second phase of reform.

#### Preferred Option

The preferred option is to regulate a general occasional cash transaction threshold at \$10,000. This is consistent with the status quo under the FTRA. There are no impacts from the proposal in addition to those already agreed as part of the Act.

#### *Transaction thresholds for casinos*

##### Status Quo

Assuming a general occasional cash transaction threshold is adopted (as per the above discussion), the status quo would see, upon commencement of the Act, casinos subject to obligations comparable to those currently set out in the FTRA.

##### Problem

Casinos are a well documented money laundering risk ([see link](#)), as they are cash-intensive, processing high volumes of low to high value transactions. As noted in the FATF New Zealand Mutual Evaluation Report (paragraph 71 refers [linked here](#)), "of the 25,219 suspicious transaction reports submitted to the FIU from 2004 to 2008, only 638 (2.5%) were provided by casinos or gaming operators. Known Asian organised crime group members have been identified as frequenting New Zealand's main casinos and yet are often designated as high rollers' or VIPs' (very important persons) due to the large amounts they gamble." While money laundering activity is often arranged to circumvent AML/CFT systems, for example by 'structuring' transactions to fall below value thresholds. A lower transaction threshold necessitates a greater level of structuring, and therefore can aid in highlighting suspicious activity.

Recognising the relatively high risk of the sector, the FATF recommends a casino specific transaction threshold equivalent to \$US3000 or €3000 (between \$NZ4000 and \$NZ5500). Apart from Australia (which applies its general cash reporting threshold of \$10,000), jurisdictions with which New Zealand compares itself have implemented a casino specific threshold of \$3,000 in their respective currencies (ie. USA and United Kingdom).

##### Alternative Option

Similar alternative options, and implications to those discussed above in respect of the general transaction threshold apply to the consideration of an applicable threshold for cash transactions undertaken through casinos.

##### Preferred Option

Given the well documented exposure of casinos to money laundering risk ([see link](#)), the preferred approach is to establish a threshold of \$6,000 above which AML/CFT obligations are applicable.

The implication of reducing the transaction threshold from \$10,000 to \$6,000 for the six casinos is expected to be an increase in the number of customers needing to have their identity verified and increased volumes of information recorded and kept. This is not expected to substantially alter the assessed start-up cost (costed at \$1.5 million across the industry), but based on the expected increased volume of customers subject to the obligations (submitters suggest this to be potentially almost 50%) is expected to increase the annual cost impact by almost \$0.5 million to just over \$1.4 million spread across the six casinos falling on individual entities roughly in proportion to the volume of relevant activity undertaken. It is expected that lowering the threshold would have both a deterrence and detection effect, by requiring criminals to structure transactions to a greater extent to avoid the lower threshold. Offsetting the additional compliance impacts are proposed exemptions for casinos in relation to address verification and record keeping requirements.

*Transaction thresholds for other specified financial products and activities*

Status Quo

Assuming a general occasional transaction threshold is adopted (as per the above discussion), the status quo would see, upon commencement of the Act, the issuance of stored value instruments (subject to their regulated inclusion within the definition of BNI discussed above), travellers cheques, and undertaking of money and postal orders and currency exchange, in most cases, subject to AML/CFT obligations.

Problem

Each of these financial activities have been documented as being utilised for illicit cross border transfer of cash for the purposes money laundering and terrorism financing. For example, in the past year, around 9% of suspicious transactions reported to the FIU involved various forms of foreign currency conversion (this figure excludes international wire transfers). Accordingly, the preferred approach is to adopt, via regulation, lower transaction thresholds specifically applicable to the various activities, as set out in the below table.

Table two: threshold options for specified financial products and activities

| <i>Product</i>                  | <i>Alternative options (if any)</i>  | <i>Preferred threshold</i>   |
|---------------------------------|--|--|
| <i>Stored Value instruments</i> | <p>Set maximum withdrawal thresholds, or maximum annual value thresholds.</p> <p><i>Costs</i></p> <p>Approach would impact consumer demand, and therefore reduce volume of business for providers.</p> <p><i>Benefits</i></p> <p>The proposal is simple and easy to understand and implement, and the approach would ensure the products had limited instrumental use to criminals, which would effectively deter criminal activity associated with the instruments.</p> | <p>Two thresholds: \$5000 for stored value instruments that do not permit withdrawal of cash ('closed system'), and \$1000 for stored value instruments that permit cash withdrawals ('open system')</p> <p><i>Costs</i></p> <p>Compliance costs are expected but these have not been specifically assessed, but approach is consistent with Australia, supporting the trans-Tasman harmonisation objectives. The proposal is also simple and easy to understand and implement, thereby minimising associated compliance costs.</p> <p><i>Benefits</i></p> <p>The approach is considered to accord proportionate treatment to the products according to their respective risks, ensuring</p> |

|                                  |   |   |
|----------------------------------|---|---|
|                                  | <p><b>Net impact: negative - while providing for deterrence, approach would reduce legitimate use within NZ disproportionately to the assessed risks.</b></p>   | <p>that higher value, and higher risk, products are subject to obligations under the AML/CFT Act. Products well documented emerging risk, and therefore lower threshold against which obligations take effect expected to improve deterrence and detection of suspicious activity.</p> <p><b>Net Impact: Positive, predominantly based on expected deterrence and detection of suspicious activities.</b></p>   |
| <i>Travellers Cheques</i>        | <p>Adopt the Australian threshold of \$1000</p> <p><b>Costs</b></p> <p>Compliance costs to business not assessed, but would have some potentially significant impact on some sectors not subject to AML/CFT obligations (ie. travel agents).</p> <p><b>Benefits</b></p> <p>Benefit to law enforcement objectives, but product not considered to be as higher risk as other products due to signature requirement.</p> <p><b>Net impact: uncertain, as positive to law enforcement objectives, but minor negative impact to additional businesses.</b></p>   | <p>Adopt threshold of \$5000 at which AML/CFT obligations apply</p> <p><b>Costs</b></p> <p>Compliance costs to business not assessed, and while expected to be negligible, will impact some sectors not subject to AML/CFT obligations (ie. travel agents). Reduced volumes of transactions applicable compared to the alternative option</p> <p><b>Benefits</b></p> <p>Minor benefit to law enforcement objectives</p> <p><b>Net impact: uncertain, as positive to law enforcement objectives, but minor negative impact to additional businesses.</b></p> |
| <i>Money and Postal Orders</i>   | <p>Preclude postal orders above specified maximum (eg. the UK the maximum for a postal order is £250)</p> <p><b>Costs</b></p> <p>Compliance costs to business not assessed, but approach would reduce volume of business for providers given threshold is 25% of predominant industry practice.</p> <p><b>Benefits</b></p> <p>The proposal is simple and easy to understand and implement, and the approach would ensure the products had limited instrumental use to criminals, which would effectively deter criminal activity associated with the instruments.</p> <p><b>Net Impact: negative - while providing for deterrence, approach would reduce legitimate use within NZ disproportionately to the assessed risks.</b></p> | <p>Adopt threshold of \$1000 at which AML/CFT obligations apply</p> <p><b>Costs</b></p> <p>Compliance costs to business not assessed, but expected to be negligible, given threshold exceeds predominant industry practice.</p> <p><b>Benefits</b></p> <p>Negligible, as comparable to status quo industry practice but provides regulatory clarity.</p> <p><b>Net Impact: neutral</b></p>  |
| <i>Foreign currency Exchange</i> | <p>No alternative assessed</p>  | <p>Adopt threshold of \$1000 at which AML/CFT obligations apply, in conjunction with exemption for the address verification requirement for non-New Zealand residents</p>   |

|  |  |   |
|--|--|---|
|  |  | <p><i>Costs</i></p> <p>Costs have not been assessed, but Industry has submitted that compliance costs, particularly of the address verification requirement are significant because a large proportion of people who use currency exchange services are tourists. However, proposed exemption will reduce this particular compliance cost substantially mitigating the cost impact. Also, the approach is consistent with Australia</p> <p><i>Benefits</i></p> <p>Given documented risks, a low threshold is justified and is expected to deter and assist detection of suspicious activity.</p> <p><b>Net Impact: Positive</b></p> |
|--|--|---|

### **Scope of business relationship required for participation in a designated business group**

#### Status Quo

The AML/CFT Act provides for the formation of designated business groups (DGB), which involves a group of related businesses agreeing to commonly develop their risk assessment, and AML/CFT programme of measures to identify and manage risks across their collective business functions. The AML/CFT Act sets out certain parameters governing what degree of business relationship is required as a basis to form such an arrangement. Recognising the complexity and extent of change within the financial sector, the Act, via regulations, can extend the scope of basis for establishing such an arrangement.

Formal money remittance organisations predominantly provide their services through sub-agents such as Post Shops and corner dairies.

#### Problem

The status quo would see, upon commencement of the Act, in excess of 600 sub-agents of remittance service providers being individually subject to the full suite of AML/CFT obligations. This is neither efficient, nor the most effective way of monitoring and detecting suspicious activity.

#### Preferred Option

The preferred approach is to allow, through regulation, remittance agents and sub-agents resident in New Zealand to join together in a DBG. This approach is expected to:

- Reduce compliance costs to individual agents;
- enhance (on top of much improved) financial intelligence coming from the sector through enabling the observation of patterns of transactions and assessment of suspicious activity across a wider transaction base; and
- improve engagement between the sector and government.

## Consultation

The Ministry of Justice, in consultation with the Reserve Bank of New Zealand, the Securities Commission, Department of Internal Affairs, New Zealand Customs and New Zealand Police, has consulted the public on the specific proposals on three separate occasions:

- In July 2009 via a public information document released during the Select Committee consideration of the AML/CFT legislation
- a draft suite of proposals was publically consulted on in February 2010;
- Based on submissions and workshops with industry bodies and affected businesses responding to the February 2010 consultation, a final suite of proposals was issued for public comment in August 2010. 35 submissions were received, and further meetings with businesses and industry bodies were held to refine the proposals.

Key points raised by submitters on the most recent consultation include the following:

- proposed casino transaction threshold too low – the proposed threshold responds to the sector being identified as a particular money laundering vulnerability, both on the basis of international exposure and experience of the sector, and the low level of suspicious activity reported by casinos, but picked up elsewhere. While Australia has adopted the higher threshold of \$10,000, the preferred approach is consistent with other countries, including the US and UK
- address verification related to occasional transactions is too difficult – it is proposed to exempt this obligation
- workplace superannuation exemption criteria too narrow – the proposal has been broadened to address issues raised by industry on this issue.

## Summary and conclusions

The combined suite of proposals, while not impact and cost free, is considered to provide a net benefit to industry, public and New Zealand over the status quo. The benefits and costs of each of the proposals are summarised in the below table.

Table three: Summary of proposals

| <i>Proposal</i>   | <i>Detect and deter ML/TF</i>  | <i>New Zealand's international reputation</i>                                      | <i>Public confidence in the financial system</i>   | <i>co-operation between reporting entities, and government</i> | <i>Cost to industry and consumers</i>  | <i>Net impacts</i>   |
|---|--|--|--|--|--|--|
| Inclusion of business sectors within the AML/CFT Act's coverage | Positive, particularly the proposed inclusion of TCSPs, a high risk sector, and stored value | Positive, particularly the proposed inclusion of TCSPs, which are of International | Positive, given the emerging profile of the sector | positive   | Negligible to economy, but material negative impact to affected sectors, and | Positive, as maintains efficiency of operation within the financial system, and improves ability |

|   |  |   |          |  |   |   |
|---|--|---|----------|--|---|---|
|   | instruments, a high risk product   | interest  |          |  | mixed impact on service users.  | to detect and deter criminal activity.  |
| Exemption of business sectors from AML/CFT Act coverage   | Neutral to negligible  | Neutral   | neutral  | neutral  | Positive  | Positive, particularly in terms of reducing compliance costs  |
| Determination of beneficial ownership   | positive   | positive  | neutral  | neutral  | Negative, particularly to banks   | positive<br><br>The proposal satisfies a core FATF requirement and is critical to the NZ regime's effectiveness |
| Application of customer due diligence obligations relating to specified financial activities above certain values | positive   | positive, particularly in respect of the proposed casino transaction threshold, which better conforms to the FATF standard. | positive | positive, as likely to identify increased suspicious activity and therefore engagement | Negative, particularly to casinos   | Positive, particularly in terms of intelligence benefits  |
| Business relationship required for participation in a designated business group.                                  | Positive, enabling assessment of a wider transaction base for suspicious activity across | Neutral   | Neutral  | Positive   | Positive, •<br>For example, providing potential compliance cost savings to the remittance sector of \$1.5 million in start up, and \$0.5 million in annual ongoing costs. | Positive, particularly in terms of intelligence benefits, and reduced compliance costs to industry.             |

## Implementation

The AML/CFT obligations on reporting entities need to be commenced by order in council. Until this occurs, financial institutions and casinos will continue to be obligated to undertake the more limited obligations of the FTRA.

The proposed commencement date (two years following gazetting of regulations) is intended to provide reporting entities certainty of when their obligations take effect, along with sufficient time to make the necessary systems and organisational investments to comply with the AML/CFT Act and proposed regulated obligations. The timing is generous recognising that commencing the provisions too quickly would see a large proportion of the financial sector exposed to potential civil liabilities under the Act. While such a timeframe is not devoid of costs and risks to realising the Act's law enforcement objectives, as reporting entities develop their systems and these take effect, intelligence provided to law enforcement will improve. New Zealand is scheduled to report to the FATF on its AML/CFT Mutual Evaluation report back in October 2011, and while having not been implemented the regime may draw some criticism, New Zealand is unlikely to draw measures attracting the attention of international capital markets.

The AML/CFT Supervisors, comprising Reserve Bank of New Zealand, Securities Commission and Department of Internal Affairs, will be responsible upon commencement of the Act for monitoring and enforcing reporting entities' compliance with the Act's obligations. The proposed commencement timeframe will allow Supervisors to be fully prepared upon commencement of the Act to properly monitor and support the industry sectors for which they are responsible.

## Monitoring, evaluation and review

The AML/CFT Act established the AML/CFT National Coordination Committee (the Committee). The Committee is chaired by the Ministry of Justice and its members include, New Zealand Police (FIU), AML/CFT supervisors and the New Zealand Customs Service. The Chair can invite other agencies to attend the meeting as and when needed. Part of the Committee's role is to monitor the AML/CFT regime to ensure that there is consistency across the supervisors and industries.

### *Evaluation and review*

As a part of its continuing work programme the National Coordination Committee is developing an evaluation framework for the AML/CFT regime. A formal review of the AML/CFT regime is expected to be undertaken two years following commencement of the obligations.

Assessing and evaluating the performance of the AML/CFT regime is one of the roles and responsibilities of the Ministry of Justice. As the agency responsible for the AML/CFT Act, the Ministry of Justice is required to monitor, evaluate, and advise the Minister of Justice on the performance of the AML/CFT regulatory system, and any changes necessary to improve its effectiveness. It is anticipated that a planned second phase of reform will provide a legislative opportunity to make minor revisions to improve the functioning of the AML/CFT Act.