



Anti-Money Laundering and Countering the Financing of Terrorism

The Institute of Financial Advisers make the following submission.

We appreciate that submissions may be the subject of a request under the Official Information Act. There is no part of our submission that needs to be withheld under the Act. We are happy to have our submission posted on the Justice Department website.

The Institute wishes to be involved in any consultation process. Our contact person is Ross Butler, Chief Executive Officer, on (04) 4998062.

Background

The Institute of Financial Advisers is New Zealand's largest professional body for Financial Intermediaries, representing nearly 1500 financial advisers nationwide.

The Association's primary focus is to improve and enhance the professional status of financial planners and insurance advisers, and to advance the interests of members and their clients.

The Institute aims to:

- Increase the awareness of the role of financial advisers by consumers.
- Increase the level of confidence that consumers have in advisers.
- Increase the level of usage of financial advisers by consumers.
- Raise advisory standards in ethics and professional conduct.
- Provide education standards designed to inspire greater confidence and trust between advisers and the public.
- Identify and serve the needs and interests of members.

SUBMISSION

Introduction

The Institute of Financial Advisers submission begins by referencing the release in Australia on 13 July of the amended anti-money laundering and counter-terrorism financing Bill.

This is followed by the Institute responses to the specific questions raised in the second discussion document.

Australian Revised anti-money laundering and counter-terrorism financing Bill

The Institute notes the recent release in Australia of amended legislative proposals and submits that the results of the Australian consultation process be utilised in informing the work being completed in New Zealand. We particularly refer you to two items of amendment in the Australian proposals of greater significance to our Institute, being:

- financial planners will not have to identify customers when they provide financial advice;
- the original due diligence rules on third parties have been replaced by a more general obligation that an AML/CTF program must apply to the provision of any functions relating to designated services carried out by third parties;

In respect of the first item, while it may be appropriate to retain an obligation to obtain sufficient information at the time of giving advice to support a report of a suspicious approach for services (similar to a flying school declining to provide services to a individual based on an assessment of suspicion), the full obligations to identify customers should only apply at the time that an account facility is opened and/or transactions are undertaken.

Additional comment on the impact on Institute members acting as third parties is contained later in the submission.

QUESTIONS FOR CONSIDERATION

The questions below focus on broader policy issues. The Justice Department also seeks views on the detailed preliminary proposals in Part Two.

Compliance costs (page 11)

1. Please state whether you agree with the following assumption from Part 1:

For many reporting entities, the compliance costs of our preliminary proposals would have been incurred in any event, at least in part, through the requirements of an overseas parent company to enhance AML/CFT measures.

If not, please explain why you disagree.

The Institute of Financial Advisers does not agree with this assumption in respect of many of our members.

The nature of our membership consists of individuals providing needs based financial advice to consumers. We believe that the majority of our members provide services through entities or legal structures that do not involve direct ownership by an overseas parent company. In addition to a simple employment based contract structure applicable to a number of members, there are many members who deliver advice to consumers through a variety of employment based structures or legal forms varying from sole practitioners, through partnerships, through smaller company structures partly or totally owned by the employees and advisers.

In providing needs based financial advice, our members will generally intermediate between the consumer and numerous other financial intermediaries including, for example, share brokers, custodians, security registers and security issuers such as banks, fund managers and individual managed funds and insurers.

In this role, our members will be at the front line for many of the financial institutions and will therefore be required to meet the provisions of AML/CFT measures on behalf of these institutions. Consequently, there is a high risk that a disproportionate share of the administrative load and the associated costs will devolve to our membership. This should be taken into account in making determination as to the amount of record keeping and potential duplication that might otherwise occur between the financial adviser and the financial institutions recommended by the financial adviser.

New legislation: framework and implementation (pp 12-16)

2. Do you have a preference for any of the legislative models discussed in Part 1?

If so, please indicate which is your preferred option and why.

For clarity, we list the three models proposed as follows:

- two tiered model comprising an Act and regulations;
- two tiered model comprising an Act, regulations and deemed regulations (rules);
- three tiered model comprising an Act, regulations and mandatory industry guidance material.

We note that the current structure of the Financial Transactions Reporting Act appears to have resulted in differential interpretation by some institutions as to what is required to fulfil the legal requirements. Without wanting to encourage provisions that are too prescriptive, we see benefit in adopting a model that will provide improved guidance and increased certainty as to what is required.

3. Do you think that a transitional period is required? If so, please indicate how long the transitional period should be.

We submit that a transitional period is required to develop processes, procedures and systems to meet any new requirements. A period of two years should be sufficient but may need to be extended if the requirements have a significant retrospective application to existing clients.

4. Do you have a preference for phasing in the new legislation on a service basis (as proposed by Australia), an entity basis or some other basis not outlined in this paper? If so, please indicate which is your preferred option and why.

Our preference is that the legislation be phased in on a service or functional basis. As any defined group of entities may deliver a completely different range of services, a phased introduction on an entity basis would not appear to be practical or appropriate.

Coverage (pp 21-24)

5. What are your views on our proposed definitions of “financial institutions” and “designated non financial businesses and professions”?

The proposed definitions appear to be comprehensive and appropriate.

However, it is not entirely clear whether the function of a security registry arranging transfer of ownership based on a privately submitted signed security transfer is encompassed within the definitions. If not, we submit that such a function should be caught to ensure that transfer of ownership cannot be effected by transfer documentation without an appropriate verification process encompassing the identity and authenticity of the security transfer. At this time, such private security transfers can be processed by a registry based on signatures that are not and cannot be verified. If the security registry is unable or unwilling to undertake the verification process, then it may be appropriate to consider introducing a requirement that security transfers may only be actioned following stamping by an authorised agent, that agent being responsible for completing the verification process.

6. Do you have a preference for our proposed institutional and functional basis for determining coverage or the purely functional basis proposed by Australia? If so, please indicate which is your preferred option and why.

A functional basis for determining coverage is more likely to ensure that appropriate activities are caught and is therefore preferred. Institutional lists may be useful in providing guidance, but the nature of institutions is such that prescribed institutional lists will potentially inappropriately capture or fail to capture relevant institutions or activities.

In preparing a list of functions that are intended to be caught, it is important that this be widely promulgated, to ensure that affected parties become aware of the intended application to provide the opportunity for such parties to have input to the design process. The objective should be to ensure that there is no unintended capture.

Suspicious transactions reporting (pp49-50)

7. Do you have a preference for maintaining the current transactions-based reporting or shifting to activity-based reporting? If so, please indicate which is your preferred option and why. We are particularly interested in your views on whether there would be efficiency gains from such a shift for those entities with Australian parent companies.

We do not express a preference for transactions-based or activity-based reporting. We regard this as a matter for the authorities to determine, based on the potential benefits measured by the authorities of either approach in meeting the AML/CFT objectives.

However, the decision will impact on service providers. Determining whether activities in general might be suspicious, as opposed to an individual transaction, does require a different assessment, while acknowledging that the assessment required around an individual transaction often requires assessment of a wider range of factors.

Irrespective of which approach is adopted, provision of guidance as to the matters to be taken into account would be useful to help determine whether a report is appropriate.

Finally, whatever reporting structure is adopted, we consider it important that it be seen that adequate resources are made available to properly assess and, where appropriate, to pursue suspicious transactions or activities that are reported. Any indication of a disinterested response from authorities would rapidly undermine the potential benefits of and commitment to the proposed regime.

Submissions on Detailed Preliminary Proposals in Part II (pp21-50)

Scope and Coverage of the Legislation (Page 21)

We concur with earlier submissions from other parties that the proposals should not create competitive disadvantage.

FATF Recommendation 5 – Customer Due Diligence (Pages 24 -33)

- a) Ban on anonymous accounts and accounts in fictitious names (Pages 25 – 26)

The issue should be about prohibiting the use of account names to deliberately conceal or hide identity for a criminal purpose, which we support. We do not wish to see a prohibition on the use of short names, acronyms or other mechanisms adopted for administrative ease to record an account relationship. For example, it is quite usual for an investment club of individuals to adopt a name for an account that has some meaning for them or that is easy and simple for the institution to record. Provided underlying records are obtained and held relating to the individuals making up the investment club and no criminal purpose has been identified, this should be permitted.

- b) Obligation to carry out Customer Due Diligence (Pages 26 – 28)

The proposals as outlined are supported.

- c) Customer Due Diligence Measures (Pages 28 – 31)

For multi-party facility holders, we are generally supportive of the extension of due

diligence to all parties associated with an account. For example, we acknowledge and highlight the risks associated with a legitimate “front” being established to conceal criminal activity, if the requirement is introduced to only identify and verify those persons who have control of the facility and/or access to the money directly from the facility.

However, we do have concern at the potential costs and inconvenience associated with this extension of due diligence and would welcome mitigation of the requirement wherever practical based on an assessment of risk. For example, we see justification for increased diligence when overseas parties are involved with the account. We see low risk associated with a New Zealand domiciled family trust established with unnamed family beneficiaries and New Zealand domiciled trustees and settlors.

d) Timing of verification (Page 31)

No submission

e) Steps to be taken where the financial institution cannot comply with the CDD Measures (Pages 31 -32)

We support the proposals outlined, provided the legal requirement to terminate an existing account relationship does not impose liabilities on the entity required to terminate the account relationship.

f) Risk-triggered retrospective application (Pages 32 -33)

We support the proposal to apply provisions retrospectively to existing customers only in those circumstances where warranted on the grounds of risk and materiality. Noting that the requirements listed are extensive, it is critical that identification of those circumstances suggesting risk and materiality be given careful consideration.

We note, for example, the suggestion that this retrospective provision apply when “a customer undertakes a significant transaction.” What is significant for one customer (or institution) will not be significant for another. For example, perhaps the focus should be on transactions “significantly different from normal, without adequate explanation or supporting documentation.”

FATF Recommendation 6 – Politically Exposed Persons (Pages 34 – 36)

The Institute supports the preliminary proposals outlined to address the international compliance gap identified.

FATF Recommendation 7 – Cross Border Correspondent Banking (Pages 36 - 38)

No submission, as not generally applicable to Institute membership, based as it is on individuals.

FATF Recommendation 8 –New Technologies and Non-Face-to-Face Business Relationships or Transactions (Pages 38 – 41)

The Institute supports the preliminary proposals outlined to address the international compliance gap identified. The interests of those groups, such as the elderly and very young, who may not be able to readily produce up to date photographic identification documentation need to be considered to ensure that they are not inadvertently precluded

from participating in a range of financial services.

FATF Recommendation 9 – Reliance on Intermediaries or Other Third Parties to Perform Customer Due Diligence or Introduce Business (Pages 41 – 42)

This recommendation has direct relevance to our members, because, as noted earlier, our members will often be at the front line where the customer due diligence is being conducted on behalf of one or more financial institutions, in a third party relationship as part of introduction of business.

There is insufficient detail in the discussion document to identify the potential impact on our membership. However, the potential requirement for financial institutions to “take certain measures when relying upon third parties” and for the legislative framework to include “requirements for financial institutions to mitigate their exposure to money laundering or to financing terrorism when relying on third parties for due diligence” leave open the potential for financial institutions to reduce their risks by passing costs and requirements onto many of our members.

Further work is required to ensure that an appropriate balance is obtained between costs and obligations in such scenarios.

FATF Recommendation 10 – Record keeping (Pages 43 – 44)

As worded, the proposal could require certain client records to be retained from the time that a business relationship is established until five years after cessation of the business relationship. Extreme examples can quickly be identified where this may require records to be kept in excess of 100 years. For example, where a business relationship is established for a newly born child that extends throughout their life.

The proposal requires modification to ensure that only appropriate records are required to be maintained during the time that the business relationship remains in place and for a fixed period beyond cessation of the business relationship. For example, old identification verification records should not be required to be maintained where replaced by more recent identification verification records. There must also be a period after which it is no longer appropriate or necessary to retain background correspondence and files in respect of transactions or activity in an ongoing business relationship, whether 5, 7 or 10 years later.

FATF Recommendation 11– Complex unusual large transactions and unusual patterns of transactions (Pages 44 – 45)

The Institute acknowledges the need to include a requirement in the legislative framework to address the international compliance gap identified. Care will need to be taken with design to ensure that the resulting provision is not unnecessarily onerous while still addressing the perceived risk.

FATF Recommendations 12 & 16 – Application of Various Recommendations to Designated Non-Financial Businesses and Professions (Pages 45 - 48)

The Institute supports the preliminary proposals outlined to address the international compliance gap identified.

FATF Recommendation 13 – Reporting suspicious transactions

Special Recommendation IV – Reporting suspicious transactions related to terrorism (Pages 48 – 50)

No additional submission, noting the Institute comment in answer to question 7 above.

FATF Recommendation 15 – AML/CFT Policies, Practices and Programmes (Pages 51 – 52)

The proposals will need to be practical enough to cater for the wide range of financial institutions in existence including sole practitioners, partnerships, company structures and others, as well as being targeted to those staff who have direct client contact or otherwise handle relevant financial processes.

FATF Recommendation 18 – Shell banks (Pages 52 – 53)

No submission, as not generally applicable to the Institute membership as individuals.

FATF Recommendation 21 – Countries that do not or insufficiently comply with the FATF Recommendations (special attention to business relationships and transactions) (Pages 54 – 55)

The Institute supports the preliminary proposals outlined to address the international compliance gap identified. However, this does require a financial institution to be aware of those countries that do not or insufficiently apply the FATF recommendations. Government agencies therefore have a role in ensuring that a list of such countries is available, kept up to date and regularly promulgated for financial institutions to have access to.

FATF Recommendation 22 - Countries that do not or insufficiently comply with the FATF Recommendations (requirements for overseas branches and subsidiaries) (Pages 55 – 56)

No submission, as not applicable to the Institute membership as individuals

FATF Recommendation 25 – Competent authorities to establish guidelines and provide feedback (Pages 56 – 57)

The Institute supports the preliminary proposals outlined to address the international compliance gap identified and looks forward to competent authorities issuing appropriate guidelines.

For further comment, please contact:

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