

16 September 2016

The Ministry of Justice
SX10088, Wellington,
NEW ZEALAND

**Improving New Zealand's ability to tackle money laundering and terrorist financing:
Ministry of Justice Consultation Paper on Phase Two of the AML/CFT Act**

Executive Summary

At the invitation of the Ministry of Justice, Transparency International New Zealand Inc (TINZ) has reflected on and documented its thoughts on Phase 2 of the AML/CFT Act (AML2). TINZ strongly advises that there be an extension of the Act to address high risk sectors of industry and society, as proposed in the Consultation Paper.

TINZ also supports a "risk based approach", to paraphrase the Consultation Paper, ensuring that "efforts are proportionate to the risks". The approach to managing corruption and crime must focus on taking preventative steps. Through education and transparency, the inherent respect for integrity by the New Zealand public, whether as business owners, professionals, employers, employees, consumers or citizens, will be a powerful preventative force.

It is clear to TINZ that the different business sectors covered by the AML Phase 2 extension are valid and an integral and supportive part of New Zealand business and society. It is important that AML2 encompasses as many financial institutions and individuals that deal in money as it can. Evidence of money laundering in New Zealand via high-value goods, as set out in the consultation paper, demonstrates why these sectors require coverage too.

TINZ regards Corruption-Prevention Training, aimed at identifying and preventing corruption, as a key supplementary tool. This needs to be backed up by proper identification documentation being easily passed on to the appropriate authorities to provide protection.

TINZ main recommendations are as follows:

1. The AML/CFT Act (2009) Phase 2 is extended to fully cover all professionals (including lawyers, accountants, real estate and conveyancing) and those involved in trading high value goods, in gambling and who are engaged in setting up and managing New Zealand any form of high value transaction, be it in the form of legal tender or goods and services. This also includes coverage any of these goods at the point of entry into New Zealand. TINZ recommends that the widest scope of coverage should be made to detect illegal funds at the placement stage of the money laundering cycle.
2. That there are regular assessments and reports about the integrity of the financial system based on the proposed TINZ *2017 New Zealand Financial Integrity System Assessment* (FISA), which already has wide conceptual support from the finance sector. This would cover government and industry financial activities, roles, responsibilities and activities. In doing so, a wider understanding of the current state of various aspects referred to in the Consultation Paper can be assessed, including the quality of Information sharing and the quality of supervision at both national and industry levels.

3. Ensure that “Know Your Customer” procedures are compliant for all sectors covering all service providers, based on best practice that is regularly reviewed as knowledge is gained about the nature of laundering activity and financial crime.
4. That the Act be aligned with setting of financial thresholds while providing guidelines and training to ensure proposed requirements are working. Its provisions should be designed to enhance the outcomes for all New Zealanders instead of being a stumbling block to normal economic activities.
5. Coverage specified consistent with the routines of in-house professionals employed within large organizations and to ensure their national associations provide professional development to sole traders.
6. Ensure the registry of beneficial ownership and identified settlors covers all relevant New Zealand enterprise structures (trusts, companies, co-ops, charities) to enable review and audit by law enforcement and compliance bodies. Additional effectiveness will be achieved if this is consistent with international initiatives.
7. Revise the current list of entities subject to simplified due diligence based on an updated risk assessment of these types of entities.
8. Develop an on-line training tool (Corruption-Prevention Training) that includes guidance about money laundering and can be used by existing and new residents to support New Zealand’s reputation for strong integrity systems.
9. Include provisions to report suspicious transactions that are occurring outside New Zealand but involve New Zealand entities and persons as illegal activity which enriches persons in this way is hard to detect and if an instrument is put in place, it could pick up this illegal activity. Example could be a NZ Trust or company holding funds in overseas bank accounts which can be operated through emails to transfer funds.
10. Expansion of the Act’s treatment of information sharing to allow government agencies, such as Inland revenue, to interrogate the database held by the FIU which contains suspicious transaction reports to allow early detection of money laundering activity. This also has the advantage of widening the number of law enforcement investigators who are working in this field.

In summary, TINZ regards the improved clarity achieved through well considered legal standards, guidance, professional development and training about money laundering will improve AML Phase 2 application and compliance, while avoiding the perverse risk avoidance and non-acceptance of normal economic transactions. This will address the unintended consequence of burdening smaller and medium sized operators in favour of the larger economic actors. These larger, often global organisations, are where the material financial portion of irregularities are evidently perpetrated.

TINZ has provided further evidence in support of the above recommendations in the appendix that follows. We would be delighted to present our thinking to an appropriate group of policy advisors and Parliamentarians.

Warm regards,

Suzanne Snively, ONZM
Chair, Transparency International New Zealand Inc
suzanne.snively@tinz.org.nz +6421925689

www.transparency.org.nz

APPENDIX Submission to the Ministry of Justice Consultation Paper on Phase Two of the AML/CFT Act

A. Introduction

On behalf of Transparency International New Zealand (TINZ), thank you for the opportunity to provide input to this important consultation regarding improvements to New Zealand's ability to tackle money-laundering.

We welcome the timely initiative to strengthen New Zealand's anti-money laundering framework. This is particularly timely in advance of the next Financial Action Task Force (FATF) review under the 4th evaluation round, which is scheduled for the year 2020¹. It is worth noting that the updated FATF methodology will also assess the *effectiveness* of New Zealand's AML/CFT system, in addition to technical compliance with laws and regulations². In recent years, there has been growing global policy awareness of the transnational dimension of corruption and the role of the professional services and other high value goods and services sectors, besides the financial sector, in facilitating corrupt and criminal activities through money-laundering. The issue of Illicit Financial Flows (including those channelled through goods and services sectors) is now at the forefront of the international agenda at the G8 and G20, including the most recent G20 meeting in Hangzhou, China.

Corruption and money-laundering undermine the integrity of the business sector in domestic markets. They also have a detrimental effect in the developing world through the misallocation of resources and the erosion of public trust in government institutions and the rule of law.

As the OECD's recent "Better Policies for Development" report states: "Every year, huge sums of money that could be used to finance health and education services, formal job creation and productive investment are transferred out of developing countries, weakening their financial systems and economic potential, as well as delegitimising the State in the eyes of their population." The OECD also finds that the problem of Illicit Financial Flows is "an area that falls squarely into the concept of policy coherence for development. OECD Ministers have long recognised the need to ensure that the policies and practices of their countries are consistent with their development objectives and do not damage developing countries"³.

¹ http://www.fatf-gafi.org/calendar/assessmentcalendar/?hf=10&b=0&r=%2Bf%2Ffatf_country_en%2Fnew+zealand&s=asc%28document_lastmodifieddate%29&table=1

² <http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatfissuesnewmechanismstostrengthenmoneylaunderingandterroristfinancingcompliance.html>

³ Available at <http://www.oecd.org/pcd/Better-Policies-for-Development-2014.pdf>

B. Questions posed by the Consultation Paper

Please find below TINZ responses to selected questions in the consultation document. Transparency International New Zealand has selected areas to respond based on its knowledge of international trends through its accreditation with Transparency International and the areas where policy change would make a difference in New Zealand

a) Sector Specific Issues & Questions

i. Accountants

1. How should AML/CFT requirements apply to the accounting sector to help ensure the Act addresses the risks specific to it?

In the normal course of providing audit and accounting services, best practice is to complete an initial Risk Assessment form for new clients, which is a checklist to assess for any red flags. These would include, inter alia, any publicly noted negatives such as media reports on key officers, negative or adverse company financial performance, risk associated with the industry sector, country of origin risk and any other indicators that should prompt a reasonable person with the commensurate professional qualifications to ask further questions to determine whether a client should be accepted or not.

Note that the usual Client Risk Assessment, however, is focused on conflict of interest management by professional services firms. While this differs from the Know Your Customer (KYC) regime imposed on the financial sector, it has the potential to do both and become part of good professional practise.

TINZ notes that "Professional Services" covers the breadth of professional service lines of law and accounting services which for accounting increasingly cover services beyond audit, attestation, reviews, tax advisory, corporate finance and management consulting.

TINZ proposes that a standard template for client Risk Assessment be promulgated by the Ministry of Justice to ensure there is a minimum checklist available for review and reference and is mandatory for any accountants or auditors to complete, to be signed off at partner level and to be filed for no less than seven years from the start of any client relationship.

For example, which business activities should the requirements apply to?

The proposed Client Risk Assessment and other requirements should apply to all clients of any professional services firm or sole trader, which covers any and all service lines traditionally provided. This includes: accounting, bookkeeping, tax advisory, auditing and attestation, corporate finance, public sector advisory, procurement and supply chain management and management consulting services.

Financial thresholds should be put in place to ensure that requirements are workable and to minimize regulatory burden on professional services firms. Their effectiveness would increase with oversight and regular review. The sector itself is well placed to define the threshold such as setting it on the basis of total client fee base to a professional firm, on an annual basis or some derivative thereof.

TINZ recommends that at the same time there be easily accessed and current professional development training available around the changing nature of international criminal activity

and its use of money laundering techniques. By including knowledge about the New Zealand Story and the ways that firms can increase their customer base and returns based on their brand, reputation and reliability, professionals will be able to shape their activities to achieve revenue that more than equals the compliance costs of AML2 requirements.

At what stage in a business relationship should checks, assessments and suspicious transaction reports be done?

As per above, the first Client Risk Assessment should be performed prior to accepting a client. TINZ recommends that additional regular checks be performed thereafter, on a three yearly basis and be signed off by a separate Partner or business owner from the original person approving the client.

Who should be responsible for doing them?

The responsibility for completing the Client Risk Assessment form should be the partner of any service line at the Professional Services firm concerned (or for sole traders, a governance relationship such as an independent Director or a partner from a professional services accounting or law firm).

TINZ notes that the Consultation Paper focuses on accounting services provided by professional accountants to clients. TINZ believes that the responsibility for performance of checks, assessments and suspicious transaction reports should equally be with in-house accountants and sole traders. For example, in-house accounting professionals are gatekeepers of financial information, converting the evidence arising from everyday operations into input for accounting and financial reporting. It is at the stage of input where it is critical that in-house accountants also take responsibility for identifying irregularities and are equally knowledgeable and encouraged to communicate such issues where necessary.

2. Given the level of risk associated with advisory and assurance services (for example, tax advice, bookkeeping and auditing), should these activities be subject to AML/CFT obligations even where the business is not involved in a transaction for their client?

Yes, TINZ holds that any client engagement, subject to the referred to pre-determined financial thresholds, should be subject to the Client Risk Assessment proposed. Any of the examples provided in Question 2 may give rise to or identify unusual, illegal and irregular fund flows. It is in the interest of any professional services firm (in-house accountant or sole trader) to identify risks formally before accepting clients, and subsequently to monitor for any such irregularities to ensure the initial Client Risk Assessment has been completed accurately.

ii. Real Estate and Conveyancing

Questions

1. How should AML/CFT requirements apply to the real estate and conveyancing sectors to help ensure the Act addresses the risks specific to them? For example, which business activities should the requirements apply to? At what stage in a business relationship should checks, assessments and suspicious transaction reports be done? Who should be responsible for doing them?

A number of national anti-money laundering risk assessments, for example in the UK⁴ and Canada⁵, have identified the real estate sector as being at risk for money-laundering. Recent media reports in New Zealand have also provided evidence of such activity in Australia and New Zealand.

FATF has produced guidance which specifically applies to the risks of money-laundering in the real estate sector. The guidance contains an extensive list of red flags which are not necessarily lined to specific business activities. It is important that due diligence is conducted which matches specific business activities or stages in a business relationship to the risk of money laundering.⁶

Linking anti-money laundering obligations to a narrow range of particular legally-defined business activities risks creating an incentive for potential launderers to target those areas which do not trigger due diligence and reporting.

Real estate agencies should identify to authorities a staff member responsible for anti-money laundering due diligence and reporting responsibilities. That staff members shall also receive appropriate professional development and training to carry out his or her duties. As for accountants and lawyers, including activities that build business on the basis of integrity, transparency and accountability will challenge the business towards doing high return, ethical transactions, offsetting the compliance costs of additional reporting to prevent money laundering.

iii. High-Value goods

1. Should the Act apply to all dealers of high-value goods or just particular ones?

The high-value good sector has a number of risk factors for money-laundering. For example, the reliance on expert valuations which can inflate or deflate the values of items to any extent unless similarly qualified experts independently assess the valuations can be time consuming, costly and often subjective.

By specifying only a subset of high value items noted, this may create an incentive for money-launderers to find the exceptions and use those as a channel for money laundering instead.

Therefore, TINZ recommends that the Act should apply to all dealers of high-value goods. Regardless of the class of items, the threshold set will determine whether a transaction is in scope or out of scope of the AML legislation and needs to be reported.

2. What is the appropriate threshold for cash transactions that would trigger AML/CFT customer due diligence and reporting requirements? Please tell us why.

The threshold maintained should be similar to those in the UK and EU to avoid trading off against different limits. The effectiveness of the threshold should be assessed over a period of time and reviewed on a regular basis, both to update knowledge about the nature of corruption and crime being prevented and about the most effective preventative approaches. Any such thresholds can and will be used to split transactions to stay under the limit and therefore remain

⁴ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/468210/UK_NRA_October_2015_final_web.pdf

⁵ <http://www.realtor.org/articles/spotlight-on-real-estate-money-laundering>

⁶ <http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20through%20the%20Real%20Estate%20Sector.pdf>

off the radar for reporting and monitoring purposes. There is evidence that this has happened with high value banking transactions in the USA, based on numerous actual money laundering and corporate fraud cases. For this reason, dealers should also be held accountable to report multiple similar sized transactions that remain just below the threshold.

This example highlights the value of having accessible and engaging online Corruption Prevention Training that enables the wider population to be knowledgeable about corrupt and criminal behaviour so that it can be prevented at source, no matter how large or small.

b) Supervision

Questions

1. Do you think any of our existing sector supervisors (the Reserve Bank, the Financial Markets Authority and the Department of Internal Affairs) are appropriate agencies for the supervision of Phase Two businesses? If not, what other agencies do you think should be considered? Please tell us why.

In order to answer this question, TINZ recommends that a review be commissioned of existing sector supervisors, to assess their independence, resources, coordination, and capacity for effective oversight. This could be timed to align with the 2017 New Zealand Financial Integrity System Assessment which TINZ is currently developing with inputs from government financial sector agencies and the financial industry.

For context, a recent report produced by TI UK indicates multiple vulnerabilities in supervisory effectiveness to counter money-laundering across sectors in the United Kingdom. No supervisor was found to have the combination of resources, capability or capacity to provide a credible deterrent against money-laundering issues⁷.

Given New Zealand's small population and tax base, the balance of government appropriation decisions tend to favour direct service provision such as health and education over investment in preventing corruption or bribery. In the case of the Police, dealing with crimes that have an individual victim tend to take precedence over the so-called "victimless crimes" of bribery and corruption. The review of existing supervisory agencies would provide strong case for when larger appropriations are required to prevent activities that would do more harm than the benefit of government funding for services directly to people.

i. Information sharing

1. Should industry regulators be able to share AML/CFT-related information with government agencies?

Yes. This would be in line with a whole-of-government approach to combating money-laundering, increasing the coordination and effectiveness of government policy. As noted in the consultation document, the OECD has recently published a number of recommendations to improve co-operation between tax and anti-money laundering authorities⁸. For the preparation of the Shewan Inquiry and following it, there was and now is cross-government agency co-operation that is leading to stronger policy. It is also timely to consider how government and the private sector (including professional

⁷ <http://www.transparency.org.uk/publications/dont-look-wont-find-weaknesses-in-the-supervision-of-the-uks-anti-money-laundering-rules/>

⁸ <https://www.oecd.org/ctp/crime/report-improving-cooperation-between-tax-anti-money-laundering-authorities.pdf>

services associations and non-profits as well as businesses) can cooperate to ensure New Zealand is protected from international corruption and crime.

Trust and company service providers

1. *Should the scope of the provision requiring persons providing trust and company services to comply with the AML/CFT Act be extended to activities carried out in the ordinary course of business, rather than just when they're the only or principal part of a business?*

Based on practical evidence, the scope should be for any such transactions or services regardless of whether these are carried out in the ordinary course of business. The reason is that the definition “in the ordinary course of business” is contentious and somewhat subjective. Trust and Company Services should also be required to complete Client Risk Assessments, authorized at senior level and filed for the purposes of legal review and reference.

TINZ re-iterates, too, the value of Corruption Prevention Training in that it provides people with the knowledge to be vigilant about inappropriate transactions and ensure that they are stopped at source.