

**INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ
INC**

SUBMISSION

ON THE

MINISTRY OF JUSTICE
DISCUSSION DOCUMENT

*Money Laundering and New Zealand's
Compliance with FATF Recommendations*

21 October 2005



Investment Savings and Insurance Association of NZ Inc.

Introduction

The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to comment on the Ministry's discussion document *Money Laundering and New Zealand's Compliance with FATF Recommendations*. ISI represents the companies that issue and manage life insurance, superannuation and managed funds in New Zealand.

It is important for New Zealand to be recognised as having robust anti-money laundering and counter financing of terrorism (AML/CFT) controls in place and for these to be effective. It is also important that implementation of the FATF Recommendations is sensitive to the overall New Zealand environment in terms of financial sector regulation and demonstrated level of crime and enforcement. Clearly New Zealand is an open society with a well-developed judicial and policing system but without systemic criminality or corruption.

ISI recognises the need for New Zealand to have in place sufficient policies to ensure compliance with the FATF Recommendations. We do, however, have some concerns about the extent of the possible amendments being considered and the compliance costs that would be entailed if those possibilities became law. We note that you have

specifically asked for an assessment of the compliance costs associated with the proposed changes.

The Ministry's proposals are at this stage necessarily broad and this makes the impact difficult to gauge. We look forward to the opportunity for further consultation when specific standards for the new regulatory environment are being developed. It will be the details of the proposals that will determine the degree of impact on businesses.

We note that the Government accepts the need for any reforms to "fit" within the financial sector regulatory framework and we endorse the planned coordination with the MED's review of financial products and providers. That should ensure that the proposed changes take into account the different business structures within the financial services industry. In our view, any changes need to be clear, unambiguous and able to be practically implemented across the full range of financial institutions so that there is a consistent application of standards. Also, substantial new requirements on non-bank financial institutions, with the potential for high compliance costs, should only be applied where a need has been demonstrated.

We are aware that the Australian Government is also about to release proposals for changes to their AML/CFT controls. Consistent Australasian AML/CFT regulation is important for our members who operate in both Australia and New Zealand and who are likely to be affected by 'foreign branch' requirements.

Once the final shape of the new system has been determined we recommend a graduated implementation. The changes will likely represent a significant challenge to financial institutions and there should be some recognition that there will be transitional issues/hurdles as businesses adapt their systems.

Feedback

We provide our feedback to the possible amendments in the same order as they appear in Section E of the Discussion Document. Our comments are necessarily general in the absence of policy detail.

Verification of Identity

The proposed closer compliance with Recommendations 5, 6 and 7 of the FATF Forty Recommendations would require financial institutions to extend their verification of identity significantly beyond their actual customers.

The objective of customer and transaction identification is to provide a trail for investigators and the obligations of financial institutions should be restricted to identifying their direct customers. If there are issues in the identification of beneficial owners, this needs to be the responsibility of the legal owners and the entity where these relationships are created.

In the case of a financial instrument owned by a trust we believe the obligation on the financial institution should be limited to verifying the identity of the trustees. If a family trust opens an account or makes a managed investment the obligation for identifying the beneficiaries needs to rest with the trustees, not the financial institution.

A requirement for all financial institutions to do more extensive customer due diligence will impose substantial compliance costs in order to have more information available for investigators in the unlikely event of an investigation. For example, the proposal under consideration could require the identity of all of the partners to be verified where a firm takes out a life insurance policy covering, possibly, twenty or more partners in the firm. At present it is sufficient to verify the identity of the principal facility holder(s) when there are three or more partners covered, in order to establish the bona fides of the firm.

We consider that the financial transactions reporting regime should be risk-based and that additional measures would only be warranted where there is a recognised risk. The

FATF Forty Recommendations acknowledges (under Recommendation 5) that the level of risk will vary between financial institutions and that they should take into account the level of risk applying to their particular business.

In the absence of any reason for suspicion, extending due diligence to require verification of identity when a person acts on behalf of another customer in carrying out a transaction should apply only for cash transactions.

There needs to be clarity around the meaning and scope of ‘acts on behalf of’. Would only identified individuals be able to make bank or other financial institution deposits or payments? Such a restriction would be almost impossible to enforce. What are the limits on the requirement to ‘identify all persons on whose behalf a facility is established’? Does this include company shareholders? Probably not shareholders in Telecom but are close companies intended to be covered?

In relation to ‘politically exposed persons’, financial institutions will not have the information necessary to recognise such people and assess their political relationships. The requirements for identification of foreign-born customers must be realistic and Government agencies with the necessary resources and contacts would need to provide information and processes to identify such people and countries that do not sufficiently apply FATF Recommendations. The use of commercial vendors of politically exposed person information raises issues of vendor quality and the cost of information, particularly for small financial institutions.

Prescribed Amounts

Removing or reducing the prescribed amount, in relation to the identification of persons on whose behalf a facility holder conducts a cash transaction, would increase compliance unnecessarily in the absence of other reasons for suspicion. If there are other reasons for suspicion there is already a requirement to verify identity, whether or not there is cash involved.

Under the Financial Transactions Reporting Act occasional transactions are cash transactions and it is not clear how extensive the changes proposed for occasional transactions are.

Retention of Information and Provision to Police

Financial institutions currently retain records, within the constraints of the Privacy Act, and would not envisage any problem in retaining information for at least five years. Similarly, provision of information to Police in the event of an investigation would not present any difficulty. We do recommend, however, that on request access to records by Police should be accompanied by clear and transparent rules to give financial institutions certainty about their responsibilities to facility holders as well as the Police.

Reporting Suspicious Transactions

We recommend that the focus of the legislation should continue to be on identifying and reporting suspicious transactions rather than more detailed investigation and information-gathering on all customers. Financial institutions' responsibility should extend only as far as alerting competent authorities to suspicious transactions, as is the present requirement under the Financial Transactions Reporting Act. Financial institutions need assistance from government agencies in identifying those individuals and organisations suspected of involvement in terrorist activities.

There also needs to be easily accessible information for financial institutions on which countries do not apply FATF Recommendations adequately.

Training Programmes and Audit Function

Regulation of AML/CFT measures within financial institutions needs to be outcomes focussed and not prescriptive; i.e. regulatory requirements need only to extend to verifying identity, identifying and reporting suspicious transactions etc. How financial institutions implement these requirements should be over to them. A legislated requirement for an AML/CFT compliance officer is an example of unnecessary prescription.

We agree that financial institutions should ensure they have programmes in place to train new employees in the processes for compliance with the Financial Transactions Reporting Act but again this does not need to be prescribed. This would form part of standard training in ISI member companies to ensure compliance with all legal requirements. Staff in key roles should also be monitored to ensure they meet the required standard of compliance and the system itself should be audited regularly to test its effectiveness.

Criminal Involvement in Ownership or Management

These considerations are appropriately left to the MED Review of Financial Products and Providers. We acknowledge the need to avoid financial institutions falling under the control of criminals and recommend that 'fit and proper person' requirements to address AML/CFT concerns should be considered in the context of good governance criteria and the overall regulation of non-bank financial institutions.

Limiting Reliance on Third Parties

Proposals to limit circumstances in which financial institutions can rely on third parties (typically other financial institutions) to do customer due diligence need to be clarified. We would be concerned if limitations were applied to financial institutions relying on third parties to do verification of customer identity. The current provision which allows a financial institution to rely upon verification of a customer's identity having been done by the customer's bank works very well in situations where all transactions will be conducted through the bank. In addition, issuers of workplace superannuation schemes verify the identity of the scheme trustees and rely on the employer to verify the identity of the employee members of the scheme. We would be reluctant to lose those provisions.

It is reasonable for the present exemption to continue where a financial institution can rely on another financial institution's or employer's verification of identity. Life insurance, superannuation and managed funds companies typically rely upon financial intermediaries as the point of contact with new customers. Those intermediaries provide

copies of identification documentation which is then retained by the financial institution. The nature of the point-of-sale process for life insurance, superannuation and managed funds makes this the appropriate means of identity verification. Significantly greater compliance costs would be incurred if verification of customer identity had to be done by the issuer. In fact the nature of the business would need to change completely.

If there are concerns with the verification process, we suggest consideration should be given to electronic means (perhaps using tax numbers) which we understand is under discussion in Australia.

Definition of ‘Financial Institution’

As mentioned above, the definition of financial institution needs to be wide enough to capture entities which are likely to be closest to illegal activities. It would be unreasonable to rely on the larger, ‘mainstream’ financial institutions to assume investigative responsibilities for which they are unsuited. Having requirements with high compliance costs apply only to a segment of the financial services market would also place that segment at a competitive disadvantage.

We endorse the proposal that a ‘risk-based’ approach should be taken and that, where there is a proven low risk of money laundering, a country may decide that some of the FATF Forty Recommendations are not appropriate.

Further Consultation

We look forward to the opportunity for further consultation with officials on these issues and the appropriate level of supervision and monitoring of non-bank financial institutions as part of the Review of Financial Products and Providers.