

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

SUBMISSION TO THE  
FOREIGN AFFAIRS, DEFENCE AND TRADE  
SELECT COMMITTEE

ON THE

ANTI-MONEY LAUNDERING AND  
COUNTERING FINANCING OF TERRORISM  
BILL

**6 August 2009**



**I·S·I**

## **Anti-Money Laundering and Countering Financing of Terrorism Bill**

### **Introduction**

1. The Investment Savings and Insurance Association (“ISI”) welcomes the opportunity to comment to the Foreign Affairs, Defence and Trade Committee on the Anti-Money Laundering and Countering Financing of Terrorism Bill (“the Bill”).
2. ISI represents the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. ISI members are responsible for assets in excess of \$60 billion
3. A list of ISI members is provided at the end of this submission.
4. ISI has appreciated the consultation with the Ministry of Justice on AML/CFT proposals in recent years but we still have significant concerns about some aspects of the Bill and the potential impact on the businesses of our member companies.
5. We have set out below our key recommendations, followed by detailed comment on those recommendations and then more general concerns.

### **Key Recommendations**

6. We have made a number of recommendations in this submission, but the ones we wish to emphasise are:
  - There should be a minimum implementation period of three years, commencing from the date of the release of the complete AML/CFT package.
  - For existing customers, there should be no requirement for customer due diligence unless a suspicious matter obligation arises.
  - A risk-based approach is preferable to prescriptive legislation but where determination of risk is beyond the scope of reporting entities they must be able to rely on the guidance of AML/CFT supervisors.
  - Where a reporting entity relies on an agent to conduct CDD the information obtained should also be able to be used for the purpose of the normal business relationship.
  - Pure risk insurance should be excluded from the scope of the legislation, following the Australian model.
  - The legislation should endeavour to harmonise with Australia to the greatest extent possible.

## Detailed Comment

### Timing of Implementation

7. The commencement date of the new regime is to be set by Order in Council but the Explanatory Note at the front of the Bill indicates the preferred option is for the legislation to become fully effective 2 years after enactment.
8. We are concerned that businesses will not be able to implement the new regime fully until they have access to details of the *entire* AML/CFT package which will include the Act, Regulations, any AMLCFT supervisor guidance publications and exemptions.
9. Many of the matters to be covered by Regulations will require the development of complex systems and processes and work on these will not be able to start until the Regulations are available. In addition, systems development within the financial services industry will have to cope with resource constraints resulting from other regulatory changes such as the new financial adviser regulatory regime.
10. We recommend a minimum implementation period of three years, commencing from the date of the release of the complete AML/CFT package.
11. Alternatively, we would also support the adoption of a staggered implementation of the legislation. This was the approach taken in Australia where the staggering of the requirements of the Act was designed so that the requirements that had the biggest impact on industry came into effect last to provide industry with sufficient time to prepare.

### Regulations and codes of practice

12. Our response to the Bill is qualified due to the absence of the regulations (and any codes of practice) that will define critical aspects of the regime. Accordingly, this limits our ability to comment on the impact on industry, and the effectiveness of the Bill in meeting its aims, until we are able to review the complete AML regulatory package comprising the Act, regulations, any codes of practice from AML/CFT supervisors and available exemptions.
13. We note that clause 61 and 148 (3) of the Bill requires persons who would be affected by any codes of practice or regulations to be given a reasonable opportunity to consider the proposed terms of the regulations. Given the strong emphasis on codes and the regulations in the Bill, and the serious impact they may have on business, we recommend that consultation on draft codes and regulations should commence as soon as possible. This recommendation also extends to Ministerial exemptions and Codes of Practice to be issued by AML/CFT supervisors

### Customer Due Diligence (CDD) requirements on existing customers or beneficial owners

14. Clause 12 (e) requires reporting entities to carry out standard due diligence on existing customers if "...doubt arises as to the adequacy or veracity of

documents, data, or information previously obtained for the purposes of identification or verification of the customer, the beneficial owner, or the person who is acting, or who has acted, on behalf of the customer.” We are concerned that all trusts and corporate customers could be caught by this requirement as there is no requirement at present for verification of the identity of beneficial owners.

15. The requirement is strengthened further in clause 76 (c) which creates a civil liability if a reporting entity continues the business relationship without having conducted the necessary identity verification. It is not clear if it is intended that reporting entities must retrospectively satisfy themselves for all existing customer records which were collected under a different regime of compliance.
16. A requirement to conduct customer identification procedures in respect of clients who were existing customers at the time the Financial Transactions Reporting Act was enacted would be disproportionate to the level of potential risk and would represent a commercial imposition and a significant cost and administrative burden. Given that many customers will have relationships with several reporting entities this has the potential to cause substantial inconvenience to those customers.
17. We recommend the Bill is amended to follow the provision in the Australian legislation which provides that existing customers will have to be identified, verified or re-verified only in the event that a suspicious matter obligation arises. This is included in ongoing due diligence requirements.
18. We recommend that clause 12 (e)(ii) should be removed and clause 12 (e)(iv) removed or redrafted to clearly provide the entity with the ability to carry out its own risk-based approach.

#### **Enhanced Customer Due Diligence**

19. Clause 20 of the Bill requires reporting entities to carry out enhanced customer due diligence on new customers that are trusts or other vehicles for holding personal assets. Enhanced due diligence requires the reporting entity to satisfy itself that it knows who is the beneficial owner of the facility.
20. There will be circumstances in which managed funds are owned by discretionary trusts and clause 22 requires the reporting entity to verify the identity of all beneficial owners. However, the definition of ‘beneficial owner’ does not cover the typical trustee/beneficiary relationship as the beneficiary does not ‘control’ or ‘own’ the trustee. If the intention is to identify beneficial owners, as commonly understood, under trusts, we recommend that the requirement should be limited to obtaining a copy of the front page of the trust document with details of the trustees and settlor and conducting CDD on those persons.
21. In the case of a discretionary trust, the identity of a beneficiary will not necessarily be known at the time the trust is set up and it would be more appropriate for due diligence to be conducted prior to the time that a

distribution is made. As trustees will be financial institutions under paragraph (xi) of the definition, CDD should be the trustees' responsibility and the definition of 'facility holder' amended to clarify situations where the name of the beneficiary is not known.

### **Ongoing Customer Due Diligence and Account Monitoring**

22. Clause 28 is unduly prescriptive and we recommend that it should be revised to reflect a risk management approach. Currently clause 28(4) requires a reporting entity to 'regularly' review a customer's account activity and customer information but does not give any indication of how frequently that might be expected.
23. Account monitoring is potentially a major additional compliance burden which will add no value in the vast majority of cases and does not take account of the level of risk involved. A reporting entity has an ongoing obligation under section 12(e) to conduct standard CDD where doubt arises about existing customers CDD. We recommend that monitoring should be focused on detecting exceptions (suspicious activities) rather than regular review of all activities.

### **Timing**

24. Clauses 14(3) and 22(3) allow 5 days for verification of identity if it is being completed after the business relationship has been established. We recommend that a more risk-based approach is taken and that verification should be completed "as soon as reasonably practicable". We note that a provision to limit transactions until the verification is complete should be adequate to address the AML/CFT risks.

### **Reliance on Third Parties and Agents**

25. The ability for reporting entities to rely on the CDD of third parties and to contract with agents to conduct CDD on behalf of the reporting entity is very important for the efficient implementation of the overall AML/CFT regime.
26. Currently, under section 12 of the Financial Transactions Reporting Act 1996 ("FTRA") financial institutions may rely in certain circumstances on the verification of identity that has been carried out by another financial institution. Those circumstances would include a fund manager establishing a new investment account for a customer who deposits funds using his own personal cheque from a bank. In that situation the fund manager would be able to rely on the bank having verified the customer's identity before the personal cheque account was opened.
27. In order to avoid duplication of CDD processes across the finance sector, we recommend that this provision of the FTRA should be carried over into the new legislation, allowing financial institutions to rely on verification of identity having been done by the bank where transactions on the new facility are done in the same name through an existing facility with the bank.
28. Like section 12 of the FTRA, clause 30 of the Bill allows a reporting entity to rely on another reporting entity's CDD. However, the Bill requires both

reporting entities to record and duplicate the verification information and the second reporting entity needs to confirm that the first reporting entity has a business relationship with the customer and consents to doing CDD. We also note that clause 30 (3) leaves ultimate responsibility for customer due diligence with the reporting entity. These requirements are too cumbersome and risky to be useful.

29. We welcome the provisions in clause 29 of the Bill for reporting entities to rely on verification previously done by other entities within the same business group. However, section 29(1)(ii) requires CDD information to be held by each entity in the group that establishes a business relationship with the customer. Financial services groups typically consist of a number of funds, trusts and other entities (e.g. unit trusts, superannuation schemes, KiwiSaver funds, life insurers) that will all be reporting entities. Records, including CDD, will typically be held centrally and it is therefore inefficient to duplicate verification information across reporting entities within the group.

We recommend that section 29 should be amended to allow verification information to be held by one reporting entity within the reporting group.

30. ISI members, as issuers and managers of life insurance, superannuation and managed funds, also rely extensively on financial advisers to distribute their products to the public. Clause 31 allows them to rely on those financial advisers to verify the identity of new customers as long as the adviser is authorised as the agent of the reporting entity.
31. However, clause 32 states that information obtained by a third party conducting CDD for a reporting entity may be used by that reporting entity only for the purpose of complying with the Act and regulations. This would appear to prohibit the reporting entity from using that information to establish and administer the customer's facility in the normal way or for other purposes permitted by law.
32. Subject to compliance with other laws (such as the Privacy Act 1993), we believe that reporting entities should be able to use this information for other purposes. This is particularly the case where the third party is an agent under clause 31, meaning that it essentially acts on behalf of the reporting entity in a principal/agent relationship.
33. We also recommend that clause 11(a) should be amended by replacing 'obtained from' with 'issued by' to reflect the practical reality that information will almost always be obtained from the customer rather than directly from the issuing entity.

### **Electronic Verification of Identity**

34. There is an increasing move towards business being conducted over the internet and the legislation needs to provide explicitly for CDD to be carried out electronically.

In cases where transactions are done electronically, an ISI member will have bank account details of the customer and should be entitled to rely on the bank to have conducted due diligence where that bank is subject to the same regulatory regime. The bank account information could be supplemented by scanned copies of other information such as a passport and/or utilities invoices addressed to the customer.

### **A Risk-based Approach**

35. We are disappointed that the provisions in the Bill are more prescriptive than those in the draft Bill issued for consultation in October 2008. The prescriptive approach is not consistent with the promotion of a true risk-based approach to managing the risks of AML/CFT.

### **Pure risk life policies**

36. We are particularly disappointed that our repeated recommendations to exempt pure risk life insurance from the regime have not been adopted.
37. Pure risk life insurance (Term Life; Trauma; Income Protection; Accident Cover and Total and Permanent Disablement) should be excluded from the financial activities covered by the Bill. Pure risk life insurance is neither suitable for, nor likely to be used by, individuals seeking to launder money or finance terrorism.
38. We refer to the table attached at Schedule 1 which identifies the benefit and surrender payment events for insurance products. It demonstrates that pure risk insurance policies have no surrender value, payment of any benefit is contingent upon the occurrence of events that are difficult and unappealing to manipulate and the policy-owner of a pure risk insurance product loses all entitlement to the premiums paid for the product.
39. Many of these products are sold by direct marketing and that relies on simple sales processes via direct mail, outbound telemarketing, and internet. The proposed change for verification of customer's identity would make it harder to transact direct marketing business and is likely to lead to lower response rates and higher costs for consumers.
40. We understand that life insurance is exempted from similar regimes in other jurisdictions on the basis that there is an extremely low risk of these products being used for AML/CFT. In Australia the application of the Act does not include policies without a prescribed minimum surrender value or policies with an annual premium of less than \$1,500 or a single premium of less than \$3,000 (unless the AML/CFT Rules set a higher limit). We recommend that the New Zealand legislation should follow a similar line. At the very least we recommend that sub-paragraph (a) (xii) of the definition of financial institution should be amended to 'underwriting or placement of investment-related life insurance'.

### **Politically Exposed Person (PEP) Requirements**

41. *Politically exposed person* is defined in clause 4 in relation to prominent public functions within New Zealand or any other country.

42. Domestic PEPs were not previously included in the draft Bill. In most cases the individuals who hold the specified positions will be identified easily but the definition now includes any immediate family member of a PEP and extends to the spouse or partner of the PEP's child. There is nothing in the Bill to indicate how financial institutions might identify such extended family members.
43. The level of risk will depend on the nature of the product and services offered and financial institutions should be able to apply the definition in a manner which is appropriate for their business. This is an area in which the guidance of AML/CFT supervisors will be helpful and we recommend a specific requirement for AML/CFT supervisors to provide guidance on the process that would be considered acceptable.
44. It is not reasonable to require a reporting entity to undertake steps to identify a PEP (even where a high PEP risk is identified) where the costs of doing so by accessing a list on a commercial database are prohibitive (particularly where those costs are ultimately passed onto the customers of the business).
45. In scenarios that have been assessed as low to medium risk, it should not be necessary to undertake a search of government or subscription based lists. Industry members should be able to rely on initial disclosures made by customers in applications for a relevant financial product or service and limited internal review of these disclosures in the first instance.
46. Alternatively, we would support a facility for reporting entities to rely on PEP disclosure by customers with appropriate declarations on product application and transaction forms. This approach would support the Bill's objectives as well as minimising the cost to industry.

**Inclusion of current KiwiSaver Act 2006 and FTRA exemptions.**

47. The current exemption at section 204 of the KiwiSaver Act 2006 for default providers (who rely on the IRD to carry out customer identification) has not been carried through to the Bill.
48. Section 204 of the KiwiSaver Act 2006 and clauses 17 and 18 of the KiwiSaver Regulations 2006 contain specific provisions relating to the application of the Financial Transactions Reporting Act 1996 to default KiwiSaver schemes. These provisions reflect the fact that it is not practicable to conduct CDD on default KiwiSaver members before their membership commences.

We recommend that these provisions should be continued under the new legislation.

**Audit requirements**

49. We recommend a more principle-based approach for the audit of an AML compliance programme, rather than a specified frequency. The frequency and coverage of the audit should be determined in consultation with the AML

Supervisor, based on the AML risks for the reporting entity, so that higher risk components will be reviewed more frequently and some low risk components less frequently, reducing unnecessary costs to the entity.

### **Liability of senior managers**

50. As noted earlier, the definition of “senior manager” (particularly sub-paragraph (c)) is currently vague to the extent that it could apply to a wide range of middle management positions. We recommend that the definition is narrowed to include only directors, the chief executive officer or the chief financial officer to ensure that the provisions of clauses 73 to 75 do not impose obligations beyond the scope of their direct accountabilities to persons with a managerial role in a reporting entity.

### **Definitions**

There is significant uncertainty in respect of several definitions in the Bill. For instance:

51. The definition of *beneficial owner* does not correspond to what is generally understood as beneficial ownership, particularly in relation to a trust. If the intention is to include beneficiaries of a trust this definition will need to be amended.
52. We assume that the concept of *beneficial owner* is designed to capture the beneficiaries of a trust in certain circumstances. It will often be difficult to determine whether a beneficiary of a trust has “effective control” of the trustee or “owns” a prescribed threshold of the trustee (or is it the trust?).

We recommend that the definition should be carefully drafted to take account of the circumstances in which the *beneficial owner* concept will apply.

53. The definition of *business relationship* is dependent upon an element of duration which introduces some uncertainty. We recommend that the definition should be clarified to provide certainty for reporting entities as to what stage of the relationship the requirements of the Bill begin to apply.
54. Also, a *business relationship* is not limited to a relationship with a person who establishes a *facility*. This means that a Reporting Entity may potentially need to conduct CDD on persons with whom they have a relationship of duration that does not involve an activity of concern from an AML/CFT perspective. We believe that this could be corrected by replacing *includes* with *means* in paragraph (b) of the definition of *customer*.
55. *Customer* is defined to include existing customers. If existing customers are not expressly excluded from the definition of customer, the costs and administrative burden of implementation will greatly exceed the already significant estimates in the Deloitte report. See also our earlier comments in relation to the requirement for customer due diligence for existing customers.
56. The definition of *existing customer* should also recognise the low risk nature of superannuation scheme investment and the commercial practice and ability

set out in the Superannuation Schemes Act 1989 to transfer the entire membership of one superannuation scheme to another.

57. The definition of *facility* includes a life insurance policy. We strongly recommend that pure risk policies are differentiated from investment related life policies and pure risk insurance policies are expressly excluded from the remit of the Bill for the reasons set out in paragraphs 36 to 40 above.
58. For clarity, paragraph (b) of the definition of *facility holder* should refer to the legal *owner* of a policy.
59. The definition of a *financial institution* includes a person who carries out underwriting or placement of life insurance or other investment related insurance. A pure risk insurance policy does not provide a significant opportunity for money laundering. On the basis that this is the intention, in order to remove ambiguity this definition needs to be reworded to ‘underwriting of investment related life insurance’.
60. We also recommend that the provision of financial services that consists solely of the provision of financial advice should be excluded from the definition, as is the case with the Financial Transactions Reporting Act.
61. The definition of *senior manager* is very vague and could potentially capture a wide range of ‘middle management’. We recommend the definition is narrowed to include only directors, the chief executive officer or the chief financial officer.
62. The definition of *occasional transaction* does not exclude transactions conducted through an existing facility by the facility holder. We recommend that the definition should be amended to remove the need conduct CDD on existing facility holders, given that they will have been subject to initial CDD and ongoing CDD.

### **Prohibitions**

63. The wording of Clause 34 may cause difficulties for a reporting entity that has an existing client who deposits a sum that is potentially suspicious.
64. The reporting entity is obliged to carry out the enhanced customer due diligence required under clause 20 (1) (b). If it is not possible to complete the enhanced due diligence (reasonably foreseeable where there is actual money laundering occurring) the reporting entity will be required by clause 34 (b) to terminate the existing business relationship.
65. In the managed funds industry, the termination of the business relationship would normally require the refund of all monies to the customer. In this situation, the reporting entity will be prevented by clause 34 (c) from refunding the sum that has been deposited.
66. The reporting entity is not permitted to disclose to the customer that a suspicious transaction report has been filed and will therefore have difficulty

explaining why the business relationship has been terminated without the refund of all monies.

67. We understand that, in that situation, the Australian legislation would allow the sum deposited to be refunded to the customer after a suspicious transaction report had been filed. We recommend that Clause 34 is amended to allow a refund to be processed after a suspicious transaction report has been filed.

### **Risk Assessment**

68. We fully support the requirement for a risk assessment and, as noted earlier, we believe risk assessment should be given greater weighting in the Bill. We note that clause 55(2)(g) requires the reporting entity to have regard to any guidance material produced by AML/CFT supervisors or the Commissioner. In terms of timing, that will delay the effective development of risk assessment programmes until that guidance material is available.
69. We recommend that the timing of implementation of the new legislation should not commence until all such material is available to reporting entities.

### **Codes of Practice**

70. The Bill provides for industry specific Codes of Practice to be published by the relevant AML/CFT supervisor. Compliance with these codes will be a defence to any civil or criminal liability. However, the codes are not compulsory. A reporting entity can opt out of compliance with the codes and rely on its own AML/CFT programme, risk management plan or codes of practice but compliance with those does not provide the reporting entity with any immunity from liability.
71. We recommend that the Bill should allow that compliance with an AML/CFT programme that has been approved by the AML/CFT supervisor provides a defence against liability under the regime.

### **AML/CFT Supervisors**

72. Life insurers that issue investment related insurance are typically part of a closely related business group that offers collective investments. Banks also often have subsidiaries that are issuers of securities. These entities would therefore be looking to use the designated business group concept with the likely result that both the Reserve Bank and the Securities Commission will be asked to be AML/CFT supervisors for all classes of reporting entities.
73. Section 127(2) should therefore be amended to 'If the products or services provided by a particular reporting entity *or reporting group ...*' with corresponding additions to the remainder of the section.
74. We also question why a single AML/CFT supervisor is not appointed on efficiency, centralisation and consistency grounds.
75. Clause 130 gives an AML/CFT supervisor the power to conduct on-site inspections without a court order. We recommend that such inspections should only be permitted if the AML/CFT supervisor has reasonable grounds

for believing that the reporting entity is not complying with the legislation. While it is appropriate for the AML/CFT supervisors to have the power to conduct on-site inspections they should not be a routine method of monitoring compliance

**Harmonisation with Australia**

76. As noted earlier in our comments on the timing of implementation of the new legislation, the extent of systems design work will depend to a great extent on whether the requirements of the New Zealand legislation are harmonised with those in Australia.
  
77. Trans-Tasman harmonisation is noted as a policy goal of both governments. In this instance it would also reduce the costs of systems development for New Zealand companies by enabling them to take advantage of work already done in Australia.

**Schedule 1**

<b>Life Insurance Products</b>					
<b>Product</b>	<b>Policy Type</b>	<b>Investment element</b>	<b>Sum insured</b>	<b>Surrender (cash) value</b>	<b>When Payable</b>
Term Life	Pure Risk Product	No	Yes	<b>No</b>	On death of the insured
Trauma	Pure Risk Product	No	Yes	<b>No</b>	on incidence of a trauma event involving the insured
Income Protection	Pure Risk Product	No	Yes	<b>No</b>	on (total) disablement of the insured
Total & permanent disablement	Pure Risk Product	No	Yes	<b>No</b>	on (total & permanent) disablement of the insured
Endowment	Hybrid Product – including elements of Pure Risk Products and Investment Products	Yes	Yes	<b>Yes</b>	On death (life risk element), voluntary surrender or maturity of the contract (investment element)
Whole of life	Hybrid Product – including elements of Pure Risk Products and Investment Products.	Yes	Yes	<b>Yes</b>	On death (life risk element), voluntary surrender or maturity of the contract (investment element)
Annuities	Pure Risk Product	Yes	No	<b>No</b>	Immediately, on commencement. Residual capital values may or may not be attached to the contract
Pure endowment	Investment Products	Yes	No	<b>Yes</b>	On death (no life risk element payable), voluntary surrender or maturity of the contract (investment element)
Investment bonds	Investment Products	Yes	No	<b>Yes</b>	On death (no life risk element payable), voluntary surrender or maturity of the contract (investment element)

## **List of ISI Members**

### **ISI MEMBERS**

AIG Life  
AMP Financial Services  
Asteron Life Ltd  
AXA New Zealand  
BNZ Investments and Insurance  
CIGNA Life Insurance NZ Ltd  
Dorchester Life  
Equitable Group  
Fidelity Life Assurance Co Ltd  
Gen Re LifeHealth  
Hannover Life Re of Australasia Ltd  
ING New Zealand Ltd  
Kiwibank Ltd  
Medical Assurance Society NZ Ltd  
Mercer  
Munich Reinsurance Co of Australasia Ltd  
Public Trust  
RGA Reinsurance Co. of Australia Ltd  
Sovereign Ltd  
Southsure Assurance  
Swiss Re Life & Health Australia Ltd  
TOWER New Zealand  
Westpac/ BT Funds Management Ltd

### **Associate Members**

Bell Gully Buddle Weir  
BNP Paribas  
Bravura Solutions  
Burrowes & Co  
Chapman Tripp  
Davies Financial & Actuarial Ltd  
Deloitte Touche Tohmatsu  
DLA Phillips Fox  
Ernst & Young  
InvestmentLink (New Zealand) Ltd  
KPMG  
Kensington Swan  
Melville Jessup Weaver  
Minter Ellison Rudd Watts  
Morningstar Research Ltd  
PricewaterhouseCoopers  
Russell Investment Management  
Russell McVeagh  
Simpson Grierson