In confidence

Office of the Minister of Justice

ANTI-MONEY LAUNDERING AND COUNTERING FINANCING OF TERRORISM REFORMS: PHASE II

Proposal

1. Further to the decision to pass legislation implementing the second phase of the Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) reforms, this paper:

a. Outlines benefits and anticipated costs of the reforms;

b. Provides an overview of the feedback on key issues received by the Ministry of Justice during consultation;

c. Seeks Cabinet's agreement to final policy decisions;

d. Seeks approval for funding associated with the reforms.

Executive summary

2. Cabinet has already made early decisions to extend the AML/CFT regime to Lawyers, Conveyancers, Accountants, Real Estate Agents and some entities who deal in high value products. Police's National Risk Assessment of Money Laundering and Financing of Terrorism states that these sectors are all at high risk of money laundering and financing of terrorism activity – of the estimated $1.35 billion of fraud and drug proceeds laundered each year in New Zealand it is estimated that around $120 million is laundered using luxury goods, $420 million real estate, and more than $50 million through legal and accounting services to facilitate this laundering. Not covering these sectors would leave key gaps which would be targeted and would impact on New Zealand's pending evaluation by the international Financial Action Taskforce (FATF) in 2020.

The figures for each sector are estimates prepared for the Ministry of Justice. The figures represent the final stage of laundering into these sectors and not the total laundering through these sectors, which may be many times greater.

Appendix A to this paper outlines my proposals to give effect to Cabinet's previous decisions. This includes the decisions I have taken under my Power to Act, which require Cabinet confirmation [CAB-16-Min-[0465]]. The key recommendations are:

a. Maintain the current model for existing sectors (multi-agency supervision) and establish DIA as the sole supervisor for all Phase II sectors;

b. That the legislation should be flexible: the primary legislation should broadly outline the activities to be covered, supported by specific regulations for each sector to provide guidance on coverage issues. This approach will enable the regulatory framework to more easily be adapted, as needed, over time;

c. Lawyers, conveyancers and accountants should be covered based on the activities specified in the recommendations of the Financial Action Task Force,

rather than simply including every person in these sectors (see section 3.1 of Appendix A);

d. Real estate agents and professionals should also be covered on an activity basis, which means that individuals and entities who conduct transactions as a business on behalf of, or as an agent of, a third party in the sale or purchase of real estate will have obligations.

e. NZ Racing Board's exemption will expire on enactment of Phase II, and it is appropriate that they should be covered when they operate accounts on behalf of customers or accept large cash transactions (as was always the intention in Phase 1);

f. Implementation of the regime should be staggered, bringing in lawyers and conveyancers first (after 6 months), followed by accountants (at 12 months), then real estate agents and the New Zealand Racing Board (after 18 months), then high value dealers (after 24 months);

g. There should be greater flexibility to share information to meet the purposes of the Act, including mechanisms to facilitate information flows between Government and the private sector;

h. The Secretary of Justice should have responsibility for considering exemptions from the regime;

i. The Act should contain a new "suspicious activity report" with criteria for what constitutes "activity", along with guidance for reporting entities.

j. The circumstances in which reporting entities can rely on each other to minimise duplication and reduce the compliance burden should be expanded.

k. The coverage of trust and company service providers should be consistent with the lawyers and accountants that provide the same services to ensure a 'level playing field'.

4. As part of the decisions in this paper I am seeking Cabinet direction on how to cover "high value dealers" – either by specifying a narrow range of the highest risk dealers and imposing a wide range of obligations, or by specifying a wider range of dealers but imposing lesser ongoing obligations. The latter option also includes sub-options of the cash threshold that could apply.

5. While official advice is that there is a need to extend the AML/CFT regime to the proposed sectors, the reforms must strike a balance that ensures appropriate regulation and oversight with compliance costs. The principle of ensuring that compliance costs are no greater than is necessary for effective oversight has informed the approach to the overall policy design as has feedback from consultation undertaken by the Ministry of Justice.

6. The benefits of the proposed changes include increased financial intelligence for criminal investigations; increased ability to restrain assets; reduced criminal incentives; reduced economic and market distortions; increased tax collection; decreased reinvestment in crime and improved international reputation. Based on the benefits that can be readily and reliably monetised, the proposals in this paper have a benefit to cost ratio of between 0.84 and 0.98. Other benefits, which are many times again the benefits included in the benefit cost calculation, have been monetised but not included because the figures have wide ranges.

7. It is estimated that at the top-end the compliance cost to business could be up to $1.6 billion over 10 years, in net present value terms. The operating cost to the Crown, once asset restraints are taken into account, is in the order of $12 million over 10 years present value. Extending the regime to the proposed sectors will work to prevent and disrupt the flow of between $1.4 and $1.7 billion of domestic predicate criminal activity and associated money laundering over 10 years.

8. Funding is required to ensure effective supervision of the new sectors, extend existing intelligence practices, and manage the increase in exemption applications from the sectors in Phase II. Funding is also required to ensure that additional AML/CFT investigations can be undertaken. Without investment in investigations we are unlikely to realise many of the early benefits of the changes. Prosecutions that arise from this work may form part of any future bid from Police.

9. This paper seeks a small amount of initial operating funding for this financial year from the between budget contingency. Withheld under section 9(2)(f)(iv) of the OIA

Background

Money laundering is a network of transactions and behaviours

10. Money laundering is the life-blood of profit-motivated crime. It allows criminals to fund their lifestyle and it fuels re-investment in criminal ventures. All criminals and crime groups that generate criminal proceeds need to transfer and disguise the illicit funds to give the appearance of legitimacy and avoid detection to be able to enjoy and use their ill-gotten gains.

11. Money laundering is not a simple process of a single transaction or trade, particularly for large amounts of criminal proceeds. When cash is involved, the first step is to 'place' the funds into the financial system. Criminals then need to 'layer' the funds through multiple transactions and purchases to disguise the origin of the funds. Finally, criminals 'integrate' the funds into their legitimate activity to use the funds without setting off red flags. This is not always a clean or linear process, but it always involves some part of this process because each move and change makes it increasingly difficult to trace the funds back to the crime.

12. The techniques criminals use to launder criminals funds vary significantly depending on the nature and scale of the proceeds. At one end of the spectrum, crime groups establish complex money laundering schemes to move significant funds generated from illicit drugs, scams and fraud schemes, or cybercrime. Criminal groups launder or generate a mixture of proceeds of crime in cash and in bank accounts depending on the crime. There is no single way that the funds are laundered: a range of methods are used and often combined. This includes using companies and trusts to hold or buy illicit funds or assets while disguising the criminal ownership when holding funds in the financial system or other high value assets.

13. At the other end, small time criminals often need to get cash generated from drug sales or tax evasion into the financial system to be able to use it. This commonly involves structuring transactions into smaller amounts of cash to avoid raising red flags in banks. This is also done by purchasing assets such as real estate or motor vehicles in cash before selling them and then putting the money into the financial system.

14. Criminals respond to changes in anti-money laundering controls by changing their techniques over time. Establishing controls in one sector often has a displacement effect that increases risk in another. For example, as it is increasingly difficult to move and hold funds anonymously through the financial sector, criminals have moved to establishing complex webs of trusts and companies to disguise their involvement.

15. Given the prominent role of the banking sector in New Zealand's financial system, banks play a key role in deterring and detecting money laundering. However, banks often do not see the complete picture - they may only be involved in part of a transaction or see a small part of the assets of a client. Criminals deliberately use multiple institutions to disguise the true value of their assets to avoid setting off red flags.

16. Non-financial businesses and professions, such as lawyers, accountants and real estate agents, may have greater oversight of their client's financial activities or be aware of other parts of the transaction. This leads to additional financial intelligence as these businesses report suspicious activity, and gives law enforcement better information to 'follow the money' in investigations by analysing transaction and customer identification records.

Phase I of AML/CFT reform in New Zealand and Phase II steps to date.

17. “Phase I”, which commenced in 2013, applies to what were considered the highest risk sectors (banks, financial institutions and casinos (referred to as reporting entities). When Cabinet decided in 2008 to implement the AML/CFT regime in two phases, it was agreed that non-financial sectors such as lawyers, accountants and real estate agents would be brought under the regime at a later date [CAB (POL) MIN [08] 17/3].

18. In June 2016, Cabinet agreed to progress Phase II of the reforms, with a view of enacting the reforms by July 2017 and in September confirmed that lawyers, accountants, real estate agents, conveyancers and some high value dealers would be covered in scope of the reforms [CAB-16-MIN-0251].

19. Appendix B provides some more detail on background and progress.

The case for change

20. Cabinet has already made early policy decisions to extend the AML/CFT regime to Lawyers, Accountants, Conveyancers, Real Estate Agents and some dealers in high value products.

21. Police's National Risk Assessment of Money Laundering and Financing of Terrorism states that the sectors being covered by Phase II are at high risk of money laundering and financing of terrorism activity. The Financial Intelligence Unit within Police considers these sectors are at risk of being increasingly targeted by criminals seeking other pathways to launder proceeds of crime now that more traditional pathways are less available as a result of Phase 1. As matters stand, these sectors provide a gap in which criminals are able to launder criminal proceeds without the oversight provided by AML/CFT.

22. While the "underground" nature of criminal proceeds and money laundering makes reliable calculations difficult, Police estimate that $1.35 billion of fraud and drug proceeds are laundered each year in New Zealand. Based on this figure, officials estimate that around $120 million of money laundering activity occurs using luxury goods, $420 million through real estate and more than $50 million through legal and accounting services.[1] These estimates do not include amounts of funds laundered as a result of tax evasion and criminal proceeds from generated in other countries that have been brought into New Zealand, as these estimates have not been quantified. Failing to extend the regime is also likely to have an impact on New Zealand's international and trade reputation. The Financial Action Task Force (FATF) –the global standard-setter for AML/CFT – is scheduled to assess NZ for effectiveness in 2020. Failing to bring in these sectors will likely result in adverse findings.[2]

Key feedback from consultation

23. To aid the development of policy proposals, the Ministry of Justice conducted targeted consultation from 18 August to 16 September 2016. The Ministry received almost 60 submissions from a cross-section of affected individuals, including members of the public and businesses in the affected sectors, industry bodies and consultants with an expertise in AML/CFT. A summary is included at Appendix C. A

1 To avoid double counting, the sum for lawyers and accountants does not include the assets themselves – these are captured in the asset figures for eg real estate. The critical issue with lawyers and accountants is that they enable structures to be created that facilitate transactions in other sectors, often at a later point in time, and so they do not often see all parts of the potential money laundering transaction.

2 Australia received an adverse report in 2015 because it has not extended the AML/CFT regime to these professions which called into question the effectiveness of the AML/CFT measures in the financial system 'as a whole'.

full summary of submissions is being finalised and I will consider releasing this along with other publicity material when the Bill is introduced.

24. This feedback has informed the proposals contained in this paper and will be used as officials engage further with the effected sectors on regulation and guidance.

Final policy decisions

25. As outlined above, Phase II of the AML/CFT reforms is intended to update an incomplete regime by ensuring coverage is comprehensive. The success of money laundering policy is determined by the success of its interruption of money laundering networks. A broad approach that targets multiple money laundering avenues provides a greater chance of capturing illegal activity, and closes potential loopholes before they emerge. This is why I recommend covering and regulating all high-risk sectors in order to provide the broadest coverage for intelligence gathering.

26. **Appendix A** to this paper outlines my proposals to update the regime. This includes the decisions I have taken under my Power to Act, which require Cabinet confirmation. The table in Appendix A outlines each issue, feedback from sectors, together with reasons for my preferred course of action.

27. I draw Cabinet's attention to the following key decisions which are outlined in this paper, firstly relating to decisions that require Cabinet approval (contained in the table following paragraphs 26) secondly to decisions that I am seeking Cabinet direction on (refer paragraphs 27 to 32) and finally as required by our earlier Cabinet decisions (CAB-16-Min-[0465]) to decisions that I seek Cabinet confirmation of (contained in the table following paragraph 32).

Decisions that require Cabinet approval

28. In September, I indicated that I would seek final Cabinet approvals on a group of decisions necessary to update the AML/CFT regime. The proposals are discussed in detail in Appendix A, and summarised below:

Issue	**Summary of proposal**
What supervisory model should apply? (Section 1 Appendix A)	The Ministry consulted on three models for supervision: (1) single supervisor (eg Australian model), (2) the current model (multi-agency model) and (3) industry-based supervision. The relative strengths and weaknesses of each model are set out in the appendix. I consider that it is necessary to choose a model that provides the best fit for the incoming sectors, but also is achievable under current timeframes. On that basis, I recommend maintaining the current model for existing sectors (multi-agency supervision) and establishing DIA as the sole supervisor for all Phase II sectors. As an existing supervisor, the DIA has experience in AML/CFT supervision and has established a risk-based approach across all

Issue	Summary of proposal
	supervisory activities. DIA has established structures, systems and mechanisms for an effective AML/CFT supervision capability which could be extended to the Phase II sectors. DIA has demonstrated the ability to establish risk-based supervision for the existing reporting entities, particularly for small businesses, which is relevant for Phase II. This model would support consistent supervision by limiting the number of supervisors and ensuring one supervisor for businesses that provide similar services. It is likely to be the cheapest and most effective system for supervising new sectors given DIA's existing supervisory functions. This is a compromise for most submitters, but strikes the best balance between the need for consistency and the desirability of not reinventing the wheel to enable rapid implementation.
How should the legislation be structured? (Section 2 Appendix A)	I consider that it is paramount for this regime to remain flexible enough to adapt to the needs of business, and to emerging international trends. To achieve this, I propose that the primary legislation include a generic definition of the activities to be covered, with regulations specific to each sector to provide specific guidance on coverage issues specific to each business or profession. This option would conform to the activity-based approach set out in the Act. For example, the Act does not refer to banks, financial investment firms, charities and other financial institutions as distinct sectors captured under the Act. It simply lists a set of activities that determines whether an entity is captured. Specific inclusions and exclusions of definitions are provided for in Regulations as to when certain compliance obligations apply. This approach provides a measure of flexibility to more promptly respond to evolving ML/FT risks by enabling amendments to be made through regulations, providing a more streamlined process than having to amend primary legislation. The regulations will need to provide sufficient prescription in light of the feedback received calling for clear guidance as to obligations on each sector. Supervisors will also have to provide early guidance to support both current and new reporting entities. It is also recommended that the legislation specify that a review of the Act take place immediately following the time when NZ's FATF evaluation is reported. This is currently expected in 2020. An in-built legislative review will enable us to respond in a timely way to this report and ensure that we maintain an appropriate balance between the impact on business and addressing criminal risks.
How should lawyers, conveyancers, and accountants	The critical issue in covering the professions is ensuring coverage is adequate but not over burdensome. Lawyers and accountants provide an enabling role as criminals seek to use their services to establish companies and trusts to hold funds and assets while disguising the

Issue	Summary of proposal
be captured? (Section 3 Appendix A)	beneficial ownership. New Zealand companies and trusts have been identified in significant international and domestic criminal investigations into fraud, tax evasion, drugs and weapons trading. The legislation should be designed to target known high risk activities and should not impose obligations on small businesses unless necessary. For this reason, I do not think it is appropriate to apply blanket coverage to *all* lawyers, accountants and conveyancers. I propose to cover lawyers, conveyancers and accountants based on the activities in which they engage. The activities to be covered should be based on those outlined in the FATF recommendations. This is set out in Section 3 of Appendix A. This provides a more targeted and cost effective option intended to ensure that compliance costs are incurred only where there is a need. There was no objection to this approach from affected sectors. The activities that will be captured for these entities will be refined and clarified in drafting to respond to feedback. I also propose to align the current AML/CFT statutory definition of 'privileged communication' more closely with the definition as set out in the Evidence Act, to ensure greater consistency and cover litigation privilege. This was supported by the NZLS and their members. Feedback from other stakeholders expressed concern that the exemption for privileged communication in the Act was too wide.
How should real estate agents and property developers be captured? (sections 3.4 and 3.5 Appendix A)	Similar to the professions, it is necessary to include the real estate sector within the scope of the AML/CFT regime. Real estate is an identified high risk sector and there is evidence in the National Risk Assessment and the Phase II Risk Assessment that money is being laundered in that sector. Case studies identify key risks as the buying and selling of real estate using illicit funds derived from both international and domestic criminal activity, and the use of real estate agent trust accounts to facilitate transactions. Real estate agents have a unique role in that they can be the only ones who interact face to face with both the parties to the sale. This means that they have access to information, and the ability to identify suspicious activity, that other participants (such as conveyancers) do not. However, it is not appropriate to expect the real estate agent to conduct due diligence on every participant in the transaction in all circumstances as this would raise significant practical issues for a real estate agent when dealing with the other party to the transaction that is not their client (e.g. conflict of interest issues arise if sales are lost due to customer due diligence (CDD) not being adequately completed on time). Therefore, I propose to target coverage in the real estate sector by imposing CDD obligations on agents only when they act on behalf of a client in the purchase or sale of real estate, or when they accept cash

Issue	Summary of proposal
	transactions (physical currency) over $10,000. This means that real estate agents would be required to carry out CDD on their customer but not the opposing party in the transaction unless it received a significant amount of cash (e.g. typically a real estate agent representing only the vendor would not be required to conduct CDD on the purchaser, and vice versa). This approach was supported by REINZ. In addition, I propose to define coverage in the sector by activity - conducting transactions on behalf of, or as an agent for, a third party for the sale or purchase of real estate. The proposal is intended to strike a balance between ensuring sufficient coverage in a high risk sector, without imposing an undue burden on individual sector participants.
How should the regime treat gambling sectors with an existing exemption that is set to expire? (Section 3.8 Appendix A)	Casinos were included in Phase I, but the New Zealand Racing Board (NZRB) and New Zealand Lotteries Commission (NZLC) were granted ministerial exemptions which expire on enactment of Phase II. This was an express policy decision to phase in coverage in the gambling sector. It is therefore appropriate to actively consider whether and to what extent they should be captured by the regime as part of the Phase II work. While gambling is an accepted high risk area that warrants coverage, it is necessary for the coverage to be proportional. There is a different risk profile for gambling done on account, for instance than there is for the average person purchasing a lottery ticket. I propose that NZRB should be covered when it operates accounts on behalf of customers or accepts large cash transactions over $10,000. The NZRB already has limited AML obligations under the Financial Transactions Reporting Act 1996 and the original intent from Phase I was to bring them within the scope of the new laws under Phase II. When their exemption expires, NZRB would be covered under the definition of financial institution for accepting repayable deposits for all their gambling activities. The recommended approach will provide certainty to the NZRB to cover the higher risk services they provide. NZRB agreed with the proposal to extend the regime to their services. It is recommended that the NZLC not be explicitly covered under the AML/CFT Act. When their exemption expires, NZLC will be covered under the existing definition of financial institution because they offer limited account-based services. NZLC has indicated they would seek to continue their current Ministerial exemption which will be considered based on risk and compliance impact under existing ministerial exemption processes. Using the exemption process for NZLC will ensure that the approach can be revisited if their business model changes or their risk profile increases.

Issue	Summary of proposal
Should the current process of ministerial exemptions be retained? (Section 6.2 of Appendix A)	The current provisions for Ministerial exemptions were added to Phase I to ensure that the Act retains the flexibility to respond on an ad hoc basis for entities that are low risk and have disproportionately high compliance costs. The provisions permit me to exempt any individual from any or all provisions in the Act. I consider that Phase II needs to retain this flexibility, but that improvements need to be made to ensure the exemptions system works in practice. A key improvement is providing the power to grant exemptions to the Secretary for Justice, along with technical amendments to the power to ensure greater efficiency. This will result in a faster and more streamlined process for considering exemptions, while still retaining sufficient controls on exemptions. It is also recommended that the statutory criteria for exemptions to make it clear that ML/TF risk is the first and foremost consideration. This should reduce the number of unsuccessful applications that are received. I also think it is important to improve operational aspects of the exemptions process, so I will instruct officials to work with the statutory supervisors to develop operational improvements that will further streamline the process.
Should entities be required to report suspicious *activity* (as opposed to simply transactions)? (Section 6.3 Appendix A)	One of the recommendations of the recent Shewan report was to include the ability for reporting entities to report suspicious activity. Currently, the Act requires reporting of suspicious transactions, which can be overly limiting (for instance not capturing instances in which a transaction does not occur because a reporting entity has raised a concern). I propose that the Act include a new requirement to report "suspicious activity" with criteria for what constitutes "activity", along with guidance for reporting entities. Reporting entities already have to report suspicious transactions; this proposal involves broadening the reporting requirement to include where they form a suspicion on reasonable grounds when a client seeks services related to an activity (short of a "transaction") or makes enquiries about such services. Suspicious activity reporting should complement, but not duplicate, suspicious transaction reporting. This option would give effect to the substance of the Shewan recommendation, while at the same time embedding some safeguards to respond to potential criticism of this new power. The majority of submissions supported the proposal. There were, however, concerns about the potential additional compliance costs. I will ask officials to work to minimise any such additional costs in implementing this proposal.
Can unnecessary duplication of effort be reduced through permitting	Unnecessary duplication of effort has been a key area of criticism during Phase I and the addition of new sectors will exacerbate this issue. A customer may come into contact with more than one reporting entity

Issue	Summary of proposal
reliance on third parties? (Section 6.4 Appendix A)	in a single transaction or service (e.g. banks, lawyers and estate agents in a house sale). The AML/CFT Act allows reporting entities to centralise some of their ongoing monitoring and risk assessment functions and rely on other reporting entities in certain circumstances to reduce duplication of compliance effort. However, currently the instances in which reliance is permitted are limited. I propose to expand the provisions to permit reporting entities to rely on each other more often. In addition, I propose to amend the definition of "designated business group" to ensure it is workable for non-companies and changing the timeframe for exchanging verification document from "within 5 days" to "upon request without delay". Given the ongoing risk of duplication of AML/CFT activities where multiple Phase II entities are involved in a transaction, the Ministry of Justice will continue to work with the Ministry of Business, Innovation and Employment to examine further options in regulations prior to the commencement of Phase II.

Decisions that require Cabinet direction

29. In September, I undertook to provide proposals on how to cover high value dealers. As this is a sector largely unaccustomed to regulation, I consider it is necessary to consider multiple options for coverage. I am seeking Cabinet's direction on two possible options in relation to high value dealers.

30. The two options (covered in more detail in section 3.6 of Appendix A) are:

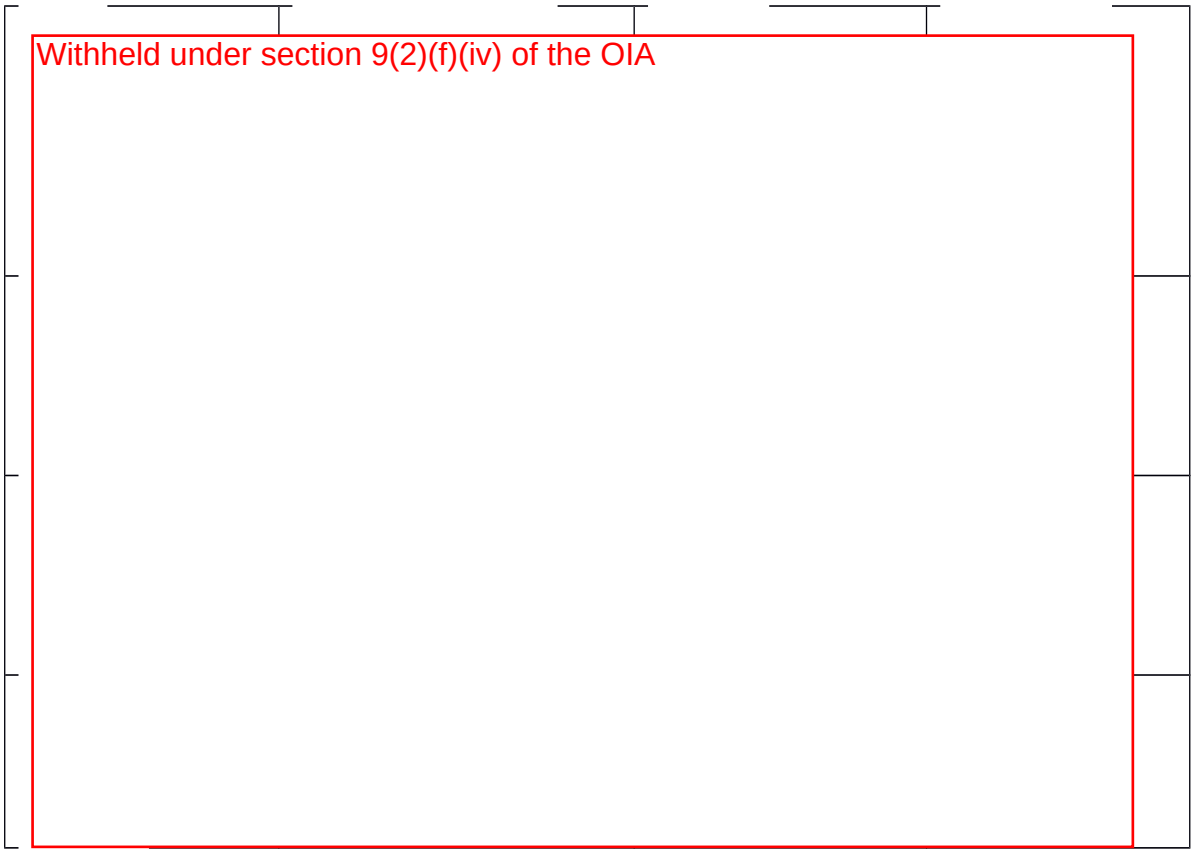
a. Option 1. capturing businesses dealing in a narrow range of the highest risk goods (precious metals and stones, cars and boats) when they deal in cash (physical currency) above $10,000, and requiring the complete set of AML/CFT obligations. This is a targeted approach and, because of the compliance cost, provides a strong incentive for businesses to stop accepting cash over the threshold. It also meets FATF obligations. This will be an effective option when cash over the threshold is accepted, as the broad range of obligations work together to ensure more effective compliance. However, compliance costs would be greater than option 2 given the wider range of obligations. Also, covering fewer sectors increases the displacement risk to other sectors.

b. Option 2. capturing businesses dealing in a wider range of goods (precious metals and stones, cars, boats, art and antiquities) when they deal in cash (physical currency) above a certain threshold, but only imposing a limited set of AML/CFT obligations (e.g. basic customer due diligence and significant cash reporting). I have considered three potential cash thresholds: $5,000, $10,000 and $15,000. This option (and its sub-options) covers more high

value goods than Option 1 and can therefore provide intelligence from a slightly broader range of sectors from which Police can identify patterns of activity and track the flow of money at a later stage should it be required. However, while this would reduce compliance costs, applying limited obligations is not as effective in achieving the goals of the Act as entities would not be required to report suspicious activity and have risk and compliance management processes in place.

31. Both options (and the sub-options for Option 2) run a risk of displacement as not all high value goods are covered (although the highest risk goods as identified through Police case studies are) and nor are private sales. In terms of cars, case studies also indicate that there is a preference to target registered motor vehicle dealers, potentially because of the legitimacy this provides.

32. The table below summarises the cost to the Crown of supervision and intelligence, the estimated compliance costs to business, and the proportion of assets that are potentially covered, for both Options and sub-options. The cost of capital, investigations and exemptions are not included below as these do not vary based on the HVD option chosen.



3 These costs are the operating cost to the Crown of supervising or receiving intelligence reports from all reporting entities under each Option, not including capital and its associated operating cost which are the same under all Options.

4 Compliance costs for Option 2 (under the various cash thresholds) are approximations only as the information necessary to calculate the costs more accurately was not available. The costs also do not include the cost to business of training staff. What the figures indicate is a relative order of magnitude between the various sub-options of Option 2.

33. Further analysis of both options and the relative pros and cons are set out in Appendix A. It is noted that existing cash thresholds for AML/CFT obligations (which will also apply to Phase II sectors) are set at $10,000. For example, reporting entities are required to conduct CDD and report to the FIU when engaging in a transaction of $10,000 or more in cash. Option 2b ($10,000) will align with existing thresholds and would be consistent with previous policy decisions relating to cash. Implementing either Option 2a ($15,000) or Option 2c ($5,000) would require consequential amendments to other cash thresholds for high value dealers.

34. Withheld under section 9(2)(g)(1) of the OIA

Decisions taken under the Power to Act, which require Cabinet confirmation

Issue	**Summary of proposal**
What should the implementation timeline be? (Section 4.1 Appendix A)	The regime needs to strike a balance between the need to close existing loopholes quickly while still allowing sufficient time for reporting entities and their new supervisor to get ready. I consider the best way to achieve that balance is by staggering implementation of the regime. Specifically, I propose bringing in lawyers and conveyancers first (after 6 months), followed by accountants (at 12 months), then real estate agents and the New Zealand Racing Board (after 18 months), then high value dealers (after 24 months). This reflects the relative risk profile of each sector, as well as a reasonable period to ensure each sector is ready for the new obligations. While extremely challenging, phasing implementation also provides DIA, as the proposed Supervisor, time to ramp up its activities.
How can information sharing be improved?	The recommendations in the recent Shewan Report on foreign trusts highlighted some key gaps in information sharing. These gaps only become more problematic when more sectors are brought into the regime. I propose a model of “structured flexibility” for the AML/CFT Act. This means extending the ability to share information to all

Issue	Summary of proposal
(Section 5.1 Appendix A)	agencies and relevant bodies with an interest in the AML/CFT regime, rather than its current restriction to law enforcement agencies and statutory supervisors. I also propose a "future proofing" mechanism to enable ad hoc agreements for greater sharing between Government and reporting entities, or among reporting entities. The mechanism would permit bespoke information sharing arrangements either by regulation, by agreement between relevant Chief Executives or by agreement between relevant Ministers. This approach is in keeping with the approach recently agreed to for the Customs and Excise Act Amendment Bill and the new legislation for the security agencies. This option modernises the current highly prescriptive regime but retains sufficient controls to ensure information is shared appropriately. This proposal was developed by a cross-Government group representing regulators, law enforcement and the intelligence community.
Should simplified due diligence apply to certain sectors? (Section 6.1 Appendix A)	The current Act permits reporting entities to conduct simplified due diligence (and hence lower their compliance costs) when they are dealing with a list of proven low risk entities. I propose to expand this list to include, at a minimum, State Owned Enterprises and wholly owned subsidiaries of publicly listed entities in low risk countries. This proposal seeks to minimise the burden on the new sectors to be included, as well as existing reporting entities. This proposal was supported by submitters.
How can the Act establish consistency in the treatment of TCSPs vs other professional who also form companies (such as lawyers and accountants)? (Section 6.5 Appendix A)	Phase I covers trust and company service providers (TCSPs) only where they are from those providing captured services as their *primary business*. This was a temporal definition that was necessary to implement the policy decision to exclude lawyers and accountants from the regime. With the decision to include lawyers and accountants, this definition needs to be refined to ensure consistency of treatment. I propose that the regime will now cover TCSPs who providing the relevant services in the *ordinary course of business*. This would ensure consistency with other reporting entities. It will establish a 'level playing field' for lawyers, accountants and TCSPs providing similar services. No submissions raised concern about this proposal and it was supported by lawyers and accountants to ensure consistency.

Issue	Summary of proposal

Who is not covered?

35. Businesses that do not provide services specified in the Act or Regulations have no compliance obligations, unless they start providing those services. High Value Dealers that do not deal in cash (physical currency) above the threshold would not be affected by the AML/CFT laws. International experience has shown that dealers often decide not to accept large amounts of cash and instead ask customers to deposit the funds into their bank account.[5]

36. Legal and accounting firms that do not provide the services that will be specified in regulations are not affected by the regime, and the laws only apply to businesses providing services to clients so it does not include in-house professionals.

37. Real estate agents and other real estate professionals would not be affected when providing leasing or property management services as they would only be captured when acting on behalf of, or as an agent of, a third party in relation to the sale or purchase of real estate.

38. Services provided or transactions undertaken through private sales or arrangements would also not be captured.

What will be required of reporting entities once the reforms are implemented - if they are subject to full obligations?

39. Initially, the new reporting entities will have to appoint a compliance officer, conduct a risk assessment and establish a compliance programme. The programme sets out the policies and procedures for the reporting entity to comply with their ongoing AML/CFT obligations.

40. A reporting entity's day-to-day obligations will depend on its size and the services it provides. The obligations are likely to include staff vetting and training, customer due diligence (verifying identity and retaining records), account monitoring, transaction reporting (suspicious activity and significant cash), and record keeping. Senior management must monitor and maintain oversight of the entity's compliance. In a small business this could mean the owner or the senior staff member.

41. The responsible supervisor will provide reporting entities with guidance and education to help them comply with the Act, and, where necessary, investigate reporting entities and enforce compliance with the Act.

The costs and the benefits of the proposed changes

42. The hidden nature of criminal money laundering means reliably identifying costs and benefits is challenging. Articulating the compliance costs for the new sectors is

5 As banks are covered by AML/CFT, the transaction will then be recorded and the customer would be subject to CDD.

difficult, but it is feasible to assign a dollar figure. Articulating all of the expected benefits from the reforms is more difficult as not every benefit can be given a tangible value and cannot be tagged against an individual sector.

43. Regardless of these challenges, officials have sought to provide us with as much information as possible to help information our decisions.

Business compliance costs

44. A key consideration has been that the reforms strike a balance that ensures appropriate regulation and oversight while minimising.

45. The Ministry of Justice commissioned Deloitte to estimate the compliance costs to business. Their full report is attached as **Appendix D**.[6] It provides an estimate of the business compliance costs associated with the full set of AML/CFT Act obligations applying to Lawyers, Accountants, Conveyancers, Real Estate Agents, Jewellers and Registered Motor Vehicle Dealers (in effect the proposals outlined in this paper including Option 1 for high value dealers).

46. Deloitte have noted that it is difficult to estimate the costs because the requirements are largely foreign to the sectors. Therefore, Deloitte have made a number of assumptions and judgements to produce their conclusions.

47. The table set out below paragraph 50 outlines the possible range of costs to business by sector. The low end costs were self–declared by the businesses that filled out a survey. However, experience from Phase I shows that business underestimated the costs involved. The high-end costs estimate the outside range of expected costs to business. They are prudent (for some of the reasons outlined below) but are closer to what Deloitte feel best represents the likely cost than the low-end estimate. Deloitte acknowledge that the cost impact will be greater for smaller businesses.

48. Sector compliance costs are driven by the number of reporting entities. It is expected that in some sectors the number of possible reporting entities (the last column in the table below) will reduce as businesses decide not to provide high risk services or accept cash payments for goods over the specified threshold. However, the scale of this change is unknown – it will be influenced for example by the cost of compliance, ongoing customer demand for cash transactions, and businesses being able to take up opportunities where possible to reduce compliance costs.

49. There are mechanisms in the Act whereby business compliance costs could be reduced. For example, a designated business group could be created (e.g. by a number of related real estate franchisees) so they can share the cost of both establishment and on-going compliance. Businesses can also decide to rely on a third party to undertake due diligence on their client – although the liability under the Act cannot be transferred. Early awareness-raising and education will be critical to

6 This may be released alongside any future public announcements or in response to Official Information Act requests

ensuring reporting entities understand the options available to them to achieve compliance so that they can make informed business.

50. The cost per client or transaction has also been estimated. This has been calculated by dividing the compliance cost by the estimated number of transactions/clients in each sector. The cost per client or transaction needs to be considered in the context of the sector, the likely transaction value and/or the nature of the business relationship (eg an occasional transaction or an enduring business relationship). On that basis while the real estate per client transaction is high, compared to other sectors it is a small proportion of the overall sale price of the average house and the fee charged.

	Establishment cost (Year 1)		**Ongoing costs (per annum)**		**Average cost per client or transaction (based on high end cost)**	**1. Estimated number of businesses within the Sector**	**Estimated number of reporting entities**
	low	**high**	**low**	**high**			
Lawyers and Conveyancers	$16.1m	$80.9m	$14.3m	$59.6m	$37.76	1,919	1,572
Accountants	$25.4m	$101.8m	$22.7m	$75.5m	$64.40	2,433	2,223
Real Estate	$13.3m	$35.0m	$11.8m	$23.1m	$355.88	1,019	1,006
Motor Vehicle Dealers	$13.9m	$65.8m	$12.1m	$45.7m	$77.65	3,255	2,106
Jewellery	$3.2m	$10.7m	$2.8 m	$7.1 m	$3.37	640	229

51. It is estimated that the overall cost to business could be up to $1.6 billion over 10 years, in net present value terms.

Cost to government

52. This paper is seeking new operating funding for 2016/2017 and outyears. This funding is primarily for the Department of Internal Affairs to cover its initial set up costs and the ongoing supervisory costs associated with AML Phase II reforms, and for Police to respond to forecast increases in reporting from entities and to provide a focus on investigations of AML/CFT offences by establishing a standalone AML/CFT investigations team. The Ministry of Justice is also seeking funding so that it can effectively respond to the forecast increase in exemption applications from Phase II entities. As part of the policy process officials have looked to streamline the

exemptions process and this has been reflected in the funding the Ministry of Justice is seeking.

53. Withheld under section 9(2)(f)(iv) of the OIA

54. I Withheld under section 9(2)(f)(iv) of the OIA

55. Withheld under section 9(2)(f)(iv) of the OIA

56. Withheld under section 9(2)(f)(iv) of the OIA

57. Withheld under section 9(2)(f)(iv) of the OIA

Option 1 High Value Dealers – narrower scope with full obligation (all figures are estimates until confirmed by departments)

	2016–2017 $ million	2017–2018 $ million	2018–2019 $ million	2019–2020 $ million	2020–2021 and out years $ million
Total	withheld under section 9(2)(f)(iv) of the OIA				

Option 2a High Value Dealers – wider scope with lesser obligations and $15,000 threshold for cash reporting (all figures are estimates until confirmed by departments)

	2016–2017 $ million	2017–2018 $ million	2018–2019 $ million	2019–2020 $ million	2020–2021 and out years $ million
Total	withheld under section 9(2)(f)(iv) of the OIA				

Option 2b High Value Dealers – wider scope with lesser obligation and $10,000 threshold for cash reporting

	2016–2017 $ million	2017–2018 $ million	2018–2019 $ million	2019–2020 $ million	2020–2021 and out years $ million
Total	withheld under section 9(2)(f)(iv) of the OIA				

Option 2c High Value Dealers – wider scope with lesser obligation and $5,000 threshold for cash reporting

	2016–2017 $ million	2017–2018 $ million	2018–2019 $ million	2019–2020 $ million	2020–2021 and out years $ million
Total	withheld under section 9(2)(f)(iv) of the OIA				

58. Police will be seeking funding as part of Budget17 which may include increased investment in prosecutions, including for AML/CFT. This funding would further impact on the effectiveness of the AML/CFT regime to deliver results.

Benefits of Phase II

59. Extending the AML/CFT regime to Phase II sectors targets criminal motives by ensuring that law enforcement can 'follow the money' in criminal investigations. Benefits include:

a) **Increased financial intelligence for criminal investigations**: The increased reporting requirements will produce additional financial intelligence, which will increase the law enforcement agencies' ability to detect criminal activity, and it provides the paper trail for law enforcement to 'follow the money' to target criminals by reviewing transaction and customer identification records held by Phase II entities. Better intelligence will also improve New Zealand's ability to cooperate with partner agencies overseas by providing better financial intelligence to disrupt transnational crime groups.

b) **Increased ability to restrain assets**: Bringing the Phase II sectors in scope of the AML/CFT regime will enhance the Police's ability to restrain assets obtained with proceeds of crime.

c) **Reduced criminal incentives**: The enhanced deterrent effect will reduce the incentive to commit financially motivated crimes as laundering the criminal proceeds is more difficult. For example, Phase II will make it harder for criminals to hide behind companies and trusts as law enforcement will have greater tools to pierce the corporate veil in investigations.

d) **Reduced economic and market distortions**: The competitive advantage businesses funded by criminal proceeds may have through keeping their prices disproportionally low or not paying taxes is reduced, which improves the level playing field for all businesses operating within a sector.

e) **Increased tax collection**: The increased financial intelligence improves the Government's ability to collect tax revenue as the Inland Revenue Department has additional intelligence to determine tax assessments and detect tax evasion.

f) **Decreased re-investment in crime**: The AML/CFT regime allows law enforcement to disrupt the money flows of criminal groups to limit their ability to reinvest in further criminal activity which will result in reduced social harm.

g) **Improved international reputation**: The Phase II reforms will enhance New Zealand's international reputation by contributing to New Zealand's compliance with the FATF Recommendations ahead of the Mutual Evaluation in 2020, the report of which will be made public. This protects New Zealand from being considered a 'soft target' by international crime groups that seek to move funds through the NZ financial system or NZ entities to 'trade on our good name' and globally to move funds without raising red flags.

60. The Ministry has calculated that the regime could frustrate and disrupt the flow of between $1.4 and $1.7 billion of domestic predicate criminal activity and associated money laundering efforts over 10 years in net present value terms. However, this does not fully capture the additional benefits that will likely be derived from Phase II as some of these cannot be assigned a reliable dollar value. The reduction in social harm could be in the order of $800 million over 10 years and the amount of crime deterred could be many times the benefits that form part of the benefit/cost calculation. It is not possible to put a figure on the benefits of reduced tax evasion and the impact on New Zealand's international reputation. Finally, the changes could also result in additional forfeitures of up to $97 million over 10 years.

61. It is difficult to monetise the benefits of the reforms to each sector – unlike the costs which can be clearly apportioned, the benefits of the reform largely relate to preventing or reducing the reinvestment of illicit cash, which has a system wide benefit. These system wide benefits have been calculated as shown in this paper.

Overall economic impact of the reforms

62. When business compliance and government costs are balanced against the quantifiable benefits described above, this results in an overall Benefit to Cost Ratio (BCR) of between 0.84 and 0.98. This range is done as part of testing the sensitivity of the numbers so reflects different assumptions about the success of restraints and the rate at which restraints of assets are ultimately converted to forfeitures.

63. However, the Ministry considers this BCR is conservative in that it reflects prudent compliance costs and does not include all monetised estimates of the benefits. As noted above there are strategic benefits to this policy which cannot be quantified within a specific band however these benefits are several times the benefits calculated as part of the economic analysis. Treasury comments of the Regulatory Impact Assessment states "although it (the BCR) results in no or marginal benefit in quantifiable terms, clearly signals that the overall net benefits are likely to be far more significant".

64. The advice I have receive indicates that the proposed regime is the most appropriate, because it interrupts the greatest number of high-risk avenues for money laundering. This is based on the premise that broad coverage of multiple money laundering avenues has the greatest disruption to criminal enterprise – it widens the net for discovering money-laundering and maximises intelligence gathering so that authorities can tailor their analysis and investigations.

Consultation

65. The Department of Internal Affairs, the Financial Markets Authority, the Reserve Bank of New Zealand (AML/CFT supervisors), New Zealand Police, the New Zealand Customs Service, the Ministry of Business Innovation and Employment, Ministry of Foreign Affairs and Trade and the Treasury have been consulted. The Department of the Prime Minister and Cabinet has been informed.

Human rights

66. The reforms are not expected to raise issues with the New Zealand Bill of Rights Act 1990.

Legislative implications

67. An Amendment Bill will be required to implement the AML/CFT Phase II reforms.

Binding on the Crown

68. The changes arising from the Amendment Bill will be binding on the Crown.

Associated Regulations

69. Amendments to current Regulations will be required to give effect to the provisions of the Bill. The amendments will be substantive and of medium complexity.

Regulatory impact analysis

70. The Regulatory Impact Analysis Team at the Treasury (RIAT) has reviewed the Regulatory Impact Statement "Second phase of reforms to the Anti-Money Laundering and Countering Financing of Terrorism regime" produced by the Ministry of Justice. The reviewers consider that the information and analysis summarised in the RIS meets the QA criteria.

71. The RIS demonstrates that in-depth consideration has been given to the nature and level of costs that the new regime will be creating for business, through a Business Compliance Cost survey. It also includes a formal cost benefit analysis (CBA) which, although it results in no or marginal benefit in quantifiable terms, clearly signals that the overall net benefits are likely to be far more significant. This is because benefits such as the deterrent effect and the impact on New Zealand's international reputation are valuable in nature but cannot be expressed in quantified terms.

72. However, the actual impact of decisions in practice will largely depend on the detailed design and implementation of the new regime and the way in which stakeholders respond to it. Therefore, it will important to maintain contact with stakeholders and to put in place a comprehensive monitoring and evaluation process, to measure the success of the second phase reforms and identify any additional changes needed.

Gender implications

73. The reforms will not have any gender implications.

Disability perspective

74. The reforms will not have any disability implications.

Publicity

75. The communications approach around this paper and associated issues will be managed by my office, in consultation with other offices as appropriate.

Recommendations

The Minister of Justice recommends that the Committee:

1. **Note** Cabinet has made early policy decisions in September 2016 relating to AML/CFT reforms, but that further and final decisions are required on a range of matters.

2. **Note** nearly 60 public submissions were received on the proposed Phase II reforms**,** with general support for the reform.

3. **Note** there is a strong rationale for extending the regime to new sectors given Police's National Risk Assessment of Money Laundering and Financing of Terrorism provides, and despite the compliance costs that will be imposed on new sectors there are sufficient benefits to justify their regulation.

4. **Agree** to each of the recommendations set out in **Appendix A**, the key proposals being:

    4.1. Maintain the current model for existing sectors (multi-agency supervision) and establish DIA as the sole supervisor for all Phase II sectors;

    4.2. The legislation needs to be flexible enough to adapt over time - the primary legislation should broadly outline the activities to be covered, supported by specific regulations for each sector to provide guidance on coverage issues;

    4.3. Lawyers, conveyancers and accountants should be covered based on the activities specified in the recommendations of the Financial Action Task Force (rather than simply including every person in the sector);

    4.4. Real estate agents and professionals should also be covered on an activity basis, which means that individuals and entities who conduct transactions as a business on behalf of, or as an agent of, a third party in the sale or purchase of real estate.

    4.5. NZ Racing Board's exemption will expire on enactment of Phase II, and it is appropriate that they should be covered when they operate accounts on behalf of customers or accept large cash transactions;

    4.6. Implementation of the regime should be staggered, bringing in lawyers and conveyancers first (after 6 months), followed by accountants (at 12 months), then real estate agents and the New Zealand Racing Board (after 18 months), then high value dealers (after 24 months);

    4.7. There should be greater flexibility to share information to meet the purposes of the Act, including mechanisms to facilitate information flows between Government and the private sector;

4.8. The Secretary of Justice should have responsibility for granting exemptions from the regime;

4.9. The Act should contain a new "suspicious activity report" with criteria for what constitutes "activity", along with guidance for reporting entities;

4.10. The circumstances in which a reporting entity can rely on another should be expanded to reduce the compliance burden.

4.11. The coverage of trust and company service providers should be consistent with the lawyers and accountants that provide the same services.

5. **Agree**, in relation to High Value Dealers, to either:

5.1 **Option 1** as follows:

5.1.1 capture businesses dealing in a narrow range of the highest risk goods and commodities in cash (physical currency) above a certain threshold, and requiring the complete set of AML/CFT obligations, and

5.1.2 **approve** the following changes to appropriations to give effect to this policy decision, with a corresponding impact on the operating balance:

	$m – increase/(decrease)				
Vote Police Minister of Police	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
withheld under section 9(2)(f)(iv) of the OIA					
Vote Justice Minister of Justice					
withheld under section 9(2)(f)(iv) of the OIA					
Vote Internal Affairs Minister of Internal Affairs					
withheld under section 9(2)(f)(iv) of the OIA					
Total operating	withheld under section 9(2)(f)(iv) of the OIA				

OR

5.2 **Option 2**, as follows:

5.2.1 capture businesses dealing in a wider range of goods and commodities (precious metals and stones, cars, boats, art and antiquities) when they deal in cash (physical currency) above a certain threshold but imposing a limited set of AML/CFT obligations (e.g. basic customer due diligence and significant cash reporting).

And, either

5.2.2 **Option 2a**: $15,000 cash reporting threshold, and

5.2.2.1 **approve** the following changes to appropriations to give effect to this policy decision, with a corresponding impact on the operating balance;

	$m – increase/(decrease)				
Vote Police **Minister of Police**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
withheld under section 9(2)(f)(iv) of the OIA					
Vote Justice **Minister of Justice**					
withheld under section 9(2)(f)(iv) of the OIA					
Vote Internal Affairs **Minister of Internal Affairs**					
Multi-Category Expenses					
withheld under section 9(2)(f)(iv) of the OIA					
Total operating	withheld under section 9(2)(f)(iv) of the OIA				

OR

5.2.3 **Option 2b**: $10,000 cash reporting threshold, and;

5.2.3.1 **approve** the following changes to appropriations to give effect to this policy decision, with a corresponding impact on the operating balance [financials];

	$m – increase/(decrease)				
Vote Police **Minister of Police**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
withheld under section 9(2)(f)(iv) of the OIA					
Vote Justice **Minister of Justice**					
withheld under section 9(2)(f)(iv) of the OIA					
Vote Internal Affairs **Minister of Internal Affairs**					
withheld under section 9(2)(f)(iv) of the OIA					
Total operating	withheld under section 9(2)(f)(iv) of the OIA				

OR

5.2.4 **Option 2c**: $5,000 cash reporting threshold, and

5.2.4.1 **approve** the following changes to appropriations to give effect to this policy decision, with a corresponding impact on the operating balance;

	$m – increase/(decrease)				
Vote Police **Minister of Police**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
withheld under section 9(2)(f)(iv) of the OIA					
Vote Justice **Minister of Justice**					

withheld under section 9(2)(f)(iv) of the OIA					
Vote Internal Affairs Minister of Internal Affairs					
withheld under section 9(2)(f)(iv) of the OIA					
Total operating	withheld under section 9(2)(f)(iv) of the OIA				

6 withheld under section 9(2)(f)(iv) of the OIA

7 withheld under section 9(2)(f)(iv) of the OIA

8 withheld under section 9(2)(f)(iv) of the OIA

9 **note** withheld under section 9(2)(f)(iv) of the OIA

10 withheld under section 9(2)(f)(iv) of the OIA

11 withheld under section 9(2)(f)(iv) of the OIA

12 **note** Withheld under section 9(2)(f)(iv) of the OIA

13 **Note** approval for a draft Bill will be sought in November 2016.

Hon Amy Adams
Minister of Justice

/ /

Appendix A

Section 1. Supervision

Description: This section outlines recommendations on the appropriate supervisory model, and the preferred supervisor, for Phase II sectors.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
1.1 Supervisory model for Phase II Supervision of Phase II entities is essential for the effective implementation of the AML/CFT regime to protect the integrity of the sectors and ensure a 'level playing field' for regulated businesses and professions Three supervisory models were assessed against three criteria: ▪ *Effectiveness:* The level of effectiveness takes into account: knowledge of the sector; supervision capability; risk-based approach; impact on affected sectors; and operational independence. ▪ *Practicality:* The extent to which the supervisory model can be implemented in the available timeframes, taking into account the organisational structure and legislative basis. ▪ *Resources:* The level of resources required for establishment and on an ongoing basis. .	Early decision to extend supervision to Phase II Cabinet decision required on the supervisory model	Three models were considered ***Model 1 – Single supervisor for all reporting entities (new agency)*** *Supervisor:* New agency (for all reporting entities) *Effectiveness:* The creation of a new agency as a single supervisor as a dedicated AML/CFT supervisor for all reporting entities was considered (for both Phase I and Phase II entities). A single government agency would have the capacity and capability to establish effective supervisory structures. This would also ensure that AML/CFT supervision is consistent for all sectors and that there is sufficient focus and quality of supervision. However, this option would not leverage AML/CFT existing sector-relationships that the Sector Supervisors currently have with their supervised sectors. This option may also undermine the existing supervision of reporting entities. *Practicality:* A new agency would take significant time to build the expertise, systems and structures required for effective supervision. It would be difficult to establish a new agency before the proposed commencement of Phase II. *Resources:* The cost of this option will likely be higher than the base case modelled – multi-agency model using DIA for cost purposes. It is higher largely because of the one-off cost of establishment. There will likely be additional corporate overhead costs which are balanced against the benefits of reduced duplication of effort and co-ordination. ***Model 2 – Multi-agency supervision (existing model)*** *Supervisor:* DIA (all Phase II sectors and existing entities), RBNZ & FMA (no change to existing entities). *Effectiveness:* Other than the gambling sector, the DIA does not have established relationships with Phase II sectors and would need to build expertise and knowledge. However, as an existing supervisor, the DIA has experience in AML/CFT supervision and has established a risk-based approach across all supervisory activities. The DIA has established structures, systems and mechanisms or an effective AML/CFT supervision capability which could be extended to the Phase II sectors. This model would support consistency in supervision by limiting the number of supervisors and ensuring one supervisor for businesses that provide similar services (e.g. lawyers, conveyancers accountants and trust and company service providers). *Practicality:* The DIA has existing supervisory structures and systems in place which could be extended to establish an effective AML/CFT supervisory regime	In general, submissions identified the need for effective and efficient supervision of Phase II entities to ensure an effective regime and a level playing field among affected businesses. Submissions highlighted mixed views on the preferred model. The single supervisor model was largely preferred, with the existing arrangements as a preferred alternative. Concerns were raised with the reliance on self-regulatory bodies. This is considered further below in outlining the broad sector themes: <u>Existing reporting entities and AML/CFT consultants:</u> The majority of these submissions supported the establishment of a single supervisor for all reporting entities, with the alternative preference being to maintain the existing three supervisors. This included the NZ Bankers Association and the Securities Industry Association on behalf of their members. In their view, this model supports the consistent supervision of the AML/CFT regime, ensures sufficient quality and focus on AML/CFT supervision in all sectors and reduces duplication between supervisors. <u>Lawyers:</u> NZLS and Auckland District Law Society submitted that NZLS was best placed to be the supervisor for lawyers given their existing activities. Alternatively, it suggested that it could be involved in supervision under delegation from the supervisor. Large law firms mainly preferred the single supervisor model, either as a new agency or if not, then the DIA. However, small-medium sized law firms were split between the preferred multi-agency supervision and NZLS as preferred options. <u>Accountants:</u> CAANZ supported a single supervisor model to ensure consistency across all reporting entities. It suggested working with the supervisor to consider possible options to leverage existing monitoring by CAANZ to avoid duplication. CAANZ noted that the supervision should be sufficiently funded by the Government. Other accountants supported both the single supervisor and self-regulatory	**Multi-agency model** Maintain the existing multi-agency model for currently covered sectors and establish DIA as the supervisor for all Phase II sectors. The DIA's existing supervisory systems could be leveraged and extended to the Phase II sectors. This would support consistent supervision across sectors, and would require limited legislative and structural changes. DIA has demonstrated the ability to establish risk-based supervision for the existing reporting entities, particularly for small businesses which is relevant for Phase II. This was generally the second preferred option in submissions. With appropriate resources and time, the DIA is well-placed to establish an effective supervisory regime for Phase II.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
		for Phase II sectors. Limited legislative changes would be needed, although preparation time would be required to understand and assess sector risks, build the compliance team & extend systems to Phase II entities. *Resources:* The cost of this option are contained in the body of the Cabinet paper and were used for assessing the relative difference between the other supervision options. ***Model 3 – Multi-agency supervision (self-regulatory bodies)*** *Supervisor:* NZLS (lawyers), NZICA & CPA Australia (accountants), REAA (real estate agents), DIA (others) *Effectiveness:* The advantage of establishing new supervisors of the self-regulatory bodies and the REAA for their sectors is the ability to leverage existing activities on education, communication, licencing and monitoring for AML/CFT supervision. Supervision by these bodies would also result in a lower impact on regulated businesses which would only have one supervisory body. However, these bodies do not have experience in AML/CFT supervision and would need to build capability to ensure effective risk-based proactive monitoring and enforcement. Establishing a wider range of supervisors increases the potential for inconsistent supervision. The UK found that this approach led to regulatory arbitrage as affected businesses are able to decide their preferred AML/CFT supervisor by becoming a member of a different body. Not all businesses providing the captured services are members of NZLS, NZICA or CPA Australia and as a result, another government agency would be required to supervise accountants that are not members of these bodies. This would also require oversight by a government agency. *Practicality:* The new supervisors would need to assigned appropriate powers for AML/CFT supervision and enforcement. This would require legislative change to the AML/CFT Act and their respective legislation. To ensure effective supervision under this model, an appropriate oversight mechanism from a Government body would also be required. It would take longer to establish effective monitoring as some bodies do not have the structural basis for monitoring and enforcement. *Resources:* The cost of this option could be higher than the base case modelled – multi-agency model using DIA for cost purposes. This is because there will be additional costs as the new organisations lean how to be an AML/CFT supervisor, there will be a cost associated with government oversight/monitoring of performance, and if several new entities the cost of duplicating systems. This is balanced against the ability to more readily integrate AML/CFT activities with the other regulatory roles of the entities.	body options. CPA Australia supported multi-agency model. Real estate agents: REAA submitted that they were best placed to be the supervisor for real estate agents given their existing activities. REINZ did not make a submission on this point and no submissions were received from real estate agents. High value dealers: Limited views were expressed on this issue by the sector (in the absence of a self-regulatory body) with one respondent commenting that the existing model appeared appropriate. Gambling service providers: The NZ Racing Board supported the current supervisory model with DIA as their supervisor given their existing relationship with the sector.	

Section 2. Structure of the legislation

Description: This section covers a threshold decision on the general structure of the legislation and how the primary and secondary instruments will work together.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
2.1 Relationship between primary and secondary legislation Expanding the regime to additional sectors raises a question regarding the level of prescription in the primary legislation.	Early decision to extend the AML/CFT regime to this sector.	The current regime contains a mixture of prescriptive and enabling provisions in the primary legislation, and has a large network of regulations that support the regime. However, there is a question about whether the current structure of the Act is fit for purpose with the addition of new and varied sectors. The legislation should be flexible enough to respond to changes in the AML/CFT environment. However, it should also be clear enough so that each sector, even those that are not accustomed to being regulated, can understand their obligations.	Many submitters called for the regime to ensure that obligations on new sectors are clear, but did not express a view whether this should be done in primary or secondary legislation.	**High level definition of activities set in the Act, supported by Regulations further defining specific elements of the activities** The Act will set out the broad activities that would be captured under the Act. Regulations will then define the specific elements of the activities and at what point of conducting those activities the compliance obligations would apply. This option would conform to the activity-based approach set out in the Act. For example, the Act does not refer to banks, financial investment firms, charities and other financial institutions as distinct sectors captured under the Act. It simply lists a set of activities that determines whether an entity is captured. Specific inclusions and exclusions of definitions are provided for in Regulations as to when certain compliance obligations apply. This approach provides a measure of flexibility to more promptly respond to evolving ML/CFT risks by enabling amendments to be made through regulations, providing a more streamlined process than having to amend primary legislation.
2.2 Statutory review period	Early decision to extend the AML/CFT regime to this sector.	Given the introduction of new sectors, there is some question about whether a statutory review is necessary to ensure that the Act remains fit for purpose for these sectors. There are existing models in the Search and Surveillance Act 2012 and the Criminal Investigations (Bodily Samples) Act 1995. A review could also be aligned with our upcoming FATF mutual evaluation, which is set to commence in 2020 and report in mid 2021. There are a couple of key areas in the Act that might benefit from a review once they are able to bed in for several years and after the FATF has provided its assessment of the regime. These include: how high value dealers are covered, the supervision model, the information sharing provisions, and the exemptions regime. This will allow us to consider the compliance burden on business and ensure that it is appropriately calibrated to address criminal risks.	The Ministry did not ask a specific question about a statutory review, but this option would be a response to mitigate some submitters' disquiet about the reach of the regime or concerns about whether the regime will work practice.	**Statutory review immediately after FATF report complete** This option would enable NZ to respond quickly to FATF recommendations or international pressures after the publication of our mutual evaluation report. This would also provide the opportunity to review the regime to ensure that it maintains an appropriate balance between the efficient conduct of business and addressing the criminal risks.

Section 3. Phase II sectors

Description: This section covers matters for decision on the coverage of Phase II sectors. This includes the extent to which sectors are covered, the specified services, and sector-specific issues.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
3.1 Coverage of lawyers and conveyancers Case studies and research here and internationally show that some services provided by legal professionals are attractive to criminals wanting to launder the proceeds of crime and to finance terrorism. While there are some instances of legal professionals being directly involved in money laundering, most lawyers/conveyancers who are exposed to it are not complicit.	Early decision to extend the AML/CFT regime to this sector. Final Cabinet decision required on scope of coverage of this sector.	The ML/TF risks associated with legal services include: 1. criminals may exploit lawyers as gatekeepers because this can give the impression of respectability and legitimacy, especially in large financial transactions 2. criminals may make a deposit or international wire transfer to a lawyer's trust account to send money anonymously 3. criminals may exploit conveyancing services when buying or selling property to make their transactions appear legitimate 4. criminals may seek lawyers' assistance to establish companies or trusts, which they then use to obscure who really owns or controls the funds and assets (that is, the beneficial owner) 5. criminals may seek to use lawyers to conduct multiple transactions that disguise the origin of different sources of funds, which hinders detection and investigation. The consultation paper proposed that, based on identified risks and international standards, lawyers should be subject to AML/CFT requirements when providing the following services in the ordinary course of business: 1. acting as a formation agent of legal persons or arrangements 2. arranging for a person to act as a nominee director or nominee shareholder or trustee in relation to legal persons or arrangements 3. providing a registered office, a business address, a correspondence address, or an administrative address for a company, a partnership, or any other legal person or arrangement 4. managing client funds, accounts, securities or other assets 5. preparing for or carrying out real estate transactions on behalf of a customer 6. preparing for or carrying out transactions for customers related to creating, operating or managing companies. The consultation paper proposed that conveyancers should be subject to AML/CFT requirements when providing conveyancing services as part of the sale or purchase of real estate.	Submissions from the NZ Law Society and their members agreed in principle with the coverage of lawyers providing certain services under the AML/CFT regime as part of Phase II given the risks associated with misuse of the sector (subject to the comments below). However, there was concern that some AML/CFT obligations are inconsistent with the traditional solicitor-client relationship of trust and confidence. Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of lawyers into the regime to enhance NZ's AML/CFT regime and NZ's reputation. The legal sector provided the following specific feedback: *Scope of activities* Submissions considered the scope of the services must be refined and clearly defined to address risk and avoid inadvertent capture. For example, ▪ The proposed service in relation to real estate transactions should only apply to transactions for the purchase or sale or real estate. ▪ The proposed service in relation to providing an address for use by a customer should be limited to a registered office rather than a business or correspondence address. Submissions from lawyers also noted that the scope of the services must be consistent for all entities providing similar services (e.g. conveyancers, trust and company services providers and accountants) to avoid regulatory arbitrage.	**Activities-based regime that covers activities specified in FATF recommendations/consultation document** Coverage is based on the type of activity the reporting entity undertakes, rather than the reporting entity's identity. Conveyancers would be covered when they provide conveyancing services as part of the sale or purchase of real estate. I do not consider arguments to remove any of the listed activities from scope as persuasive. Police research and case studies have identified the listed activities as posing clear ML/TF risks for NZ, which is also supported by international evidence. However, in drafting the wording of the activities will be further refined to clarify what is intended to be captured under the Act.
3.2 Legal professional privilege Legal professional privilege plays an important role in our legal system and it is important to ensure that it is protected in the implementation of Phase II.	Early decision to extend the AML/CFT regime to this sector. Final Cabinet decision required on how privilege	In New Zealand, the main types of legal professional privilege are lawyer/client privilege and litigation privilege. Potential tension between the Act's obligations and legal professional privilege may occur in the following circumstances: • when a lawyer is required to file an suspicious transaction report under the Act but information relating to the transaction may be privileged, or	The NZLS and their members broadly supported the existing exemption for privileged communication but suggested that it should be amended to align with the evidence and search laws and should also include litigation privilege. Feedback from other stakeholders expressed concern that the exemption for privileged communication in the Act was too wide and would allow the claiming of privilege in	**Align privilege in AML/CFT Act with Evidence Act definitions** The current definition of 'privileged communication' should be more closely aligned with the definition as set out in the Evidence Act, to ensure greater consistency and cover litigation privilege.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
	will apply in this sector.	• when a sector supervisor requests information from a lawyer under the Act but information relating to the request may be privileged. The AML/CFT Act currently provides protection from criminal, civil and disciplinary proceedings for a person who supplies information about a suspicious transaction if the information is provided in good faith. The consultation paper sought feedback on whether • the legislative protection of legal professional privilege in the Act is sufficient, or whether the current provision is too broad and allows claims of privilege in a wide range of circumstances that aren't appropriate • whether there's a need to consider addressing AML/CFT issues in practicing rules, or • whether it would help to publish supervisor or industry guidance on the relationship between the Act's requirements and legal professional privilege. For example, in the UK, the Law Society has published guidance on the interaction between legal privilege and suspicious transaction reporting.	circumstances that are too broad.	
B. Accountants				
3.3 Coverage of accountants Accountants' specialised skills and services may be attractive to criminals seeking access to the financial system so they can avoid detection or raising red flags. As with the legal profession, case studies and research show some accounting services have been exploited by criminals such as organised crime groups, corrupt public officials and fraudsters.	Early decision to extend the AML/CFT regime to this sector. Final Cabinet decision required on scope of coverage of this sector.	The ML/FT risks associated with accountancy services include: • criminals may seek to conduct their financial activity through an accountant to disguise their criminal involvement • criminals may seek out accountants as gatekeepers to the financial system to give the impression of respectability and legitimacy • criminals may misuse accountants' trust accounts for deposits or international wire transfers to avoid detection • criminals may seek the assistance of accountants to establish companies or trusts which they use to obscure who really owns or controls the funds and assets (that is, the beneficial owner). The consultation paper proposed that, based on identified risks and international standards, accountants should be subject to AML/CFT requirements when providing the following services in the ordinary course of business: 1. acting as a formation agent of legal persons or arrangements 2. arranging for a person to act as a nominee director or nominee shareholder or trustee in relation to legal persons or arrangements 3. providing a registered office, a business address, a correspondence address, or an administrative address for a company, a partnership, or any other legal person or arrangement 4. managing client funds, accounts, securities or other assets 5. preparing for or carrying out real estate transactions on behalf of a customer 6. preparing for or carrying out transactions for customers related to creating, operating or managing companies.	Submissions from accountants agreed in principle with the coverage of accountants providing certain services under the AML/CFT regime as part of Phase II given the risks associated with misuse of the sector (subject to the comments below). However, they considered that there needed to be greater clarity over the captured services that would an accountant within the scope of the AML/CFT regime and wanted to ensure that the regime was in proportion to the risks identified. Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of accountants into the regime to enhance NZ's AML/CFT regime and NZ's reputation. The accounting sector provided the following specific feedback: *Scope of activities* Submissions considered the scope of the services must be refined and clearly defined to address risk and avoid inadvertent capture. It was submitted that the proposed services should be narrowed to correlate to services where risk arises. Submissions from accountants considered that the tax advice, advisory services, insolvency services, and bookkeeping should not be included within the AML/CFT regime as there were limited risks associated with these services.	**Activities-based regime that covers activities specified in FATF recommendations/consultation document** Coverage is based on the type of activity the reporting entity undertakes, rather than the reporting entity's identity. I do not consider arguments to remove any of the listed activities from scope as persuasive. Police research and case studies have identified the listed activities as posing clear ML/TF risks for NZ, which is also supported by international evidence. However, in drafting the wording of the activities will be further refined to clarify what is intended to be captured under the Act.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
C. Real estate agents				
3.4 Coverage of real estate agents The real estate sector has been identified by NZ Police as being vulnerable to money laundering and terrorist financing.	Early decision to extend the AML/CFT regime to this sector. Final Cabinet decision required on scope of coverage of this sector.	The real estate sector has been identified by NZ Police as being vulnerable to money laundering and terrorist financing. Real estate is particularly attractive because it allows criminals an avenue to convert their illicit cash proceeds into a legitimate asset by using layering techniques, such as complex loan structures and mortgages, to disguise their ML. Police investigations and analysis shows that in a high number of asset recovery cases, real estate was involved as a means to convert illicit funds into an apparently legitimate asset. Police has been aware for some time that the real estate holdings of gang members, their partners and associates are often funded by proceeds of crime. In these situations, reports from the real estate sector about suspicious activity are critical for Police to identify underlying offending that is generating the funds, identify who is holding assets and moving the illicit proceeds, and to target investigations.	The Real Estate Institute of NZ submitted that the services must be specific to avoid inadvertent capture of real estate agents. The REINZ considered that the real estate agent should be required to conduct customer due diligence on the vendor (their customer) rather than the purchaser. It considered that AML/CFT obligations should not apply unless an agent received funds from a vendor into their trust account. The Real Estate Agents Authority supported the inclusion of real estate agents in the AML/CFT regime due to the risks of misuse by the sector. The REAA submitted that AML/CF obligations should commence in a real estate transaction when an agent establishes a relationship with a client, when receiving funds from a vendor, or when receiving funds from a purchaser. The REAA also submitted that other parts of the property sector should be included in the AML/CFT regime including property traders and finders, and commercial real estate service providers. Feedback from financial institutions, civic society and AML/CFT consultants supported the inclusion of real estate agents into the regime to enhance NZ's AML/CFT regime and NZ's reputation.	**Require real estate agents to apply AML/CFT obligations to their client only** Real estate agents will be captured as a reporting entity and have to comply with AML/CFT obligations when they represent either a purchaser or vendor in the purchase or sale of real estate. Real estate agents would be required to carry out customer due diligence (CDD) on their customer but not the opposing party in the transaction. However, where a real estate accepts cash (physical currency) deposits over $10,000, it would be required to conduct CDD on the person making the deposit. E.g. a real estate agent representing the vendor would not be required to conduct CDD on the purchaser, and vice versa. Other obligations such as reporting suspicious activity and large cash transactions, and maintaining a compliance programme would also apply.
3.5 Property developers Property developers may also unwittingly facilitate money laundering through the real estate sector.	Early decision to extend the AML/CFT regime to some entities in this sector. Final Cabinet decision required on scope of coverage of this sector.	As noted above, the real estate sector has been identified by NZ Police as being vulnerable to money laundering and terrorist financing because it allows criminals an avenue to convert their illicit cash proceeds into a legitimate asset. Property developers typically sell real estate directly to the public without using a real estate agent. Developers that sell real estate on their own behalf may unwittingly be involved in money laundering through the real estate sector by selling property to criminals seeking to invest illicit funds. Applying AML/CFT obligations to property developers would mitigate this risk by conducting due diligence on a customer with whom they have a business relationship (not intended to include one off purchases) and reporting suspicious activity and large cash transactions to the FIU. This will have a deterrence effect and produce financial intelligence for the investigation of money laundering. In particular, the capture of real estate agents may cause a displacement effect towards property development as criminals seek other ways to purchase real estate while avoiding controls. For example, criminals may seek to make payments in cash directly to a property developer for real estate to circumvent the AML/CFT controls and due diligence conducted by real estate agents or NZ banks. However, limited information is available on the level of risk in property	The consultation sought comment on the capture of property developers when whey purchase and sell real estate. Only a few submissions referred to property developers, most in support of them being covered. However there was no strong indication from submissions.	**Property developers will only be caught by Act when conducting transactions on behalf, or as an agent of, of a client in the sale or purchase or real estate** Property developers would only be captured when conducting transactions as a business on behalf of or as an agent of a client in the sale or purchase of real estate in the ordinary course of business. Developers would not be captured when acting on their own behalf in the sale of real estate. The developer would conduct CDD on the customer on whose behalf they are acting and they have a business relationship with and any other person with whom they conduct a transaction of $10,000 or more in cash (physical currency). Other obligations such as reporting suspicious activity and large cash transactions, and maintaining a compliance programme would also apply.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
		development. Media reports have suggested that new properties have been purchased off the plan by foreign investors, raising questions about the origin of the funds coming into the country. The international standards set by the FATF do not require countries to apply AML/CFT obligations to property developers. International practice is mixed as some countries have identified this as a risk and placed obligations on developers (e.g. Canada, Spain), other countries have not (e.g. UK, EU).		
D. High value dealers				
3.6 Coverage of high value dealers Buying and selling high-value assets is attractive for criminals because such transactions can avoid interaction with the financial sector. Many such assets may be easily hidden and can be transferred to third parties with limited documentation. In particular, criminals may buy such goods with cash (that is, physical currency) and give them to other parties to avoid detection by financial institutions.	Early decision to extend the AML/CFT regime to some entities in this sector. Final Cabinet decision required on scope of coverage of this sector.	Unlike other economic crimes, the New Zealand domestic drugs and gang sector is primarily cash-based. The use of AML/CFT activity to disrupt and detect New Zealand's drug and gang networks is therefore of particular value. Case studies demonstrate that cash from drugs directly allows for the purchasing of high value good through legitimate dealers (e.g. cars, boats, jewellery). Where high value goods are easily trade-able, particularly when purchased for cash, and realised in electronic funds, the appeal of the high value commodity increases substantially. This critical 'placement' stage would provide the FIU with important intelligence that could then be directly utilised to tackle drugs and organised crime in New Zealand. High value commodities are used in ML/FT activities where they exhibit the following: • Capable of holding significant value and likely to continue to do so; • Easily transported; • Unlikely to look out of place; • Easily managed through collaborative processes; • Untraceable to the untrained eye. An analysis of asset recovery cases highlights that cars and boats are part of the domestic criminal process – although it is not possible to determine whether these cars have been part of the placement or other stages of the ML process, or are purely purchases from the proceeds of crime. Case studies also highlight how vehicles can be used for laundering in multiple ways – payment 'in kind' for criminal services, as trade-ins with legitimate dealers, as transport (instruments of crime), and as status symbols (as proceeds). Precious metals and stones as well as art and antiquities are also evident in case studies. The high value dealer sector extends to private sales, trading platforms and other 'peer to peer' market in most high value commodities in New Zealand. So, any retail-based regulation in this sector will only partially manage the risks, and, depending on the option chosen, may displace money laundering activity involving high value commodities from retailers to the private market. However, Police data demonstrates that the deliberate use of legitimate dealers is an important step in the money laundering process.	A limited number of submissions were received from the sectors potentially captured as high value dealers. The Motor Trade Association (MTA) considered that there was merit in capturing high value dealers but that may cause a displacement effect. The MTA suggests that all businesses could be targeted, although it recognised the significant challenges of this approach. Submissions by motor vehicle dealers noted that most car transactions in NZ were private sales (around 70%) which would remain outside of the AML/CFT regime. Retail NZ made a submission on behalf of the Jewellers Association of NZ (JANZ). JANZ noted that some jewellers are already registered as second-hand dealers and comply with client identification requirements under the relevant laws. JANZ submitted that their members already comply with a code of ethics which was sufficient for AML/CFT purposes, and that only dealers which are not a member of a recognised jewellery industry or trade organisation should be covered. They state that applying the Act to all jewellers would be a 'huge burden' and not be welcomed by the majority of small business owners they represent. They state that ideally, JANZ members tend not to accept large cash transactions, but there may well be instances where they believe their customer to be legitimately dealing in cash and, under the new regime, would not feel comfortable questioning the origin of the funds for fear of losing a sale and valued customer. We have received limited feedback relating to the potential application of the regime to the sale of boats and motorbikes.	**There are two options for Cabinet to consider:** **Option 1 – Extend the regime to a limited range of high value dealers operating as a business (precious metals and stones, cars and boats) dealing in cash over $10,000 and apply all AML/CFT obligations** Businesses dealing in precious metals and stones, cars and boats would be captured when they deal in cash (physical currency) above a certain threshold. These high value dealers would be required to comply with all AML/CFT obligations including developing a risk assessment and programme, CDD, account monitoring, staff training and vetting, suspicious and significant cash reporting, and compliance monitoring. This approach would cover dealers in those goods and commodities most commonly identified in criminal cases. Applying all AML/CFT obligations would implement a strong regime to support the deterrence and detection of these goods and commodities being purchased with illicit cash to circumvent controls in the financial sector. This will be an effective option as the broad range of obligations enhances compliance (e.g. training, oversight, monitoring, and audit) and include requirements to report suspicious activity and significant cash transactions. However, compliance costs would be greater given the wider range of obligations than option 2. In addition, this option may cause a displacement effect as criminals seek to purchase other goods or commodities in cash outside of these sectors to avoid CDD requirements. Alternatively, they may seek to structure transactions to avoid thresholds through multiple smaller cash payments. **Option 2 – Extend the regime to a wider range of high value dealers operating as a business (precious metals and stones, cars, boats, art and antiquities) dealing in cash over a threshold ($5,000, $10,000 or $15,000) but apply limited AML/CFT obligations (customer due diligence and significant cash reporting)** Businesses dealing in the goods above as well as art and antiquities would be captured when they deal in cash

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
				(physical currency) above a certain threshold. These high value dealers would be required to comply with a limited set of AML/CFT obligations of basic customer due diligence and reporting of significant cash transactions. Dealers may also report suspicious activity, although this would be optional rather than a mandatory requirement. This option would increase the number of affected businesses as it would extend to art and antiquities which have been identified in criminal cases. However, the compliance burden would be reduced, particularly on small businesses, by only requiring affected businesses to comply with limited obligations. E.g. requirements that would not apply include preparing a risk assessment and programme, staff vetting and training, enhanced due diligence, account monitoring, and monitoring compliance. This option would provide some financial intelligence to the Police through the significant cash reports. The FIU has the capability to receive these reports and apply data analytics, combined with other reports received from the financial sector, to develop intelligence to directly support the prevention and detection of illicit drugs and gang activities. However, this option would not be as effective as option 1 in the covered sectors as limited obligations would apply, including suspicious activity reporting requirements. Entities would not be required to have the full set of risk and compliance management processes in place which enhances compliance (e.g. training, oversight, monitoring, and audit). This option is also not compliant with international standards set by the FATF. The sub-options relating to the appropriate threshold are set out below.
3.7 Applicable cash threshold for option 2 under 3.6 The obligations for high value dealers under option 2 will be triggered when there is a cash transaction above a certain threshold.	Early decision to extend the AML/CFT regime to this sector. Final Cabinet decision required on scope of coverage of this sector.		The majority of submissions supported a cash threshold of $10,000 to align with the existing CDD requirements for occasional transactions and the obligation to report cash transactions over this threshold to the FIU (which commence July 2017). One large auction house and second hand car vendor noted that based on the analysis of sales in one month, it would have been required to conduct CDD and report to the FIU in 30 transactions (as they were cash transactions above the proposed threshold of $10,000). A gold bullion dealer submitted that a cash threshold of $20,000 was appropriate and proportionate for the risk.	**Under Option 2for high value dealers, there are thee sub-options for Cabinet to consider** **Option 2a - $15,000** The applicable threshold to trigger AML/CFT obligations for high value dealers would be set at $15,000. This would align with the FATF Recommendations which require that high value dealers conduct CDD on cash transactions over 15,000 USD/Euro. However, this threshold would not align with existing thresholds in the AML/CFT regime – e.g. reporting entities are required to conduct CDD and report to the FIU when engaging in transactions over $10,000 in cash. This would establish a separate regime for high value dealers which would cause confusion in the industry and would require consequential amendments to the other cash thresholds for

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
				high value dealers. Alternatively, this could be implemented by changing existing thresholds from $10,000 to $15,000, but this would be inconsistent with the prescribed transaction reporting regulations being finalised and would add compliance costs for entities already subject to the regime. This option would reduce coverage of assets in these sectors to 44% with compliance costs of $2.6m for set-up and $2.2m. **Option 2b - $10,000** The applicable threshold to trigger AML/CFT obligations for high value dealers would be set at $10,000 to align with other AML/CFT obligations including conducting customer due diligence and submitting reports to the FIU for cash transactions over $10,000. This option would include coverage of 59% of assets within these sectors with compliance costs of $3.2m for set-up and $3.3.m ongoing. **Option 2c - $5,000** The cash threshold could be set lower to address additional risk, and to address the large number of transactions in certain sectors (e.g. motor vehicles) between $5,000 and $10,000. This option would increase coverage of the assets in these sectors to 79% and compliance costs would be $3.8m for set-up and $6.5m ongoing.
E. Gambling service providers				
3.8 Coverage of gambling service providers Some parts of the gambling sector are known to be at high risk of being misused by criminals for money laundering and terrorist financing. To reflect this, casinos were already covered in scope of the AML/CFT Act during Phase I. Phase II enables the inclusion of further gambling service providers in scope of the AML/CFT regime.	No previous decision For decision by Cabinet	The New Zealand Racing Board (NZRB) and the New Zealand Lotteries Commission (NZLC) are already captured as reporting entities under the AML/CFT Act. This is due to the fact that they accept deposits or other repayable funds from the public, and therefore fall under the definition of a financial institution. The NZRB also has limited existing AML/CFT obligations under the *Financial Transaction Reports Act 1996* which is intended to be repealed upon commencement of Phase II. However, the NZRB and the NZLC have been granted Ministerial exemptions from the Act that expire either when Phase II comes into force or on 30 June 2018, whichever comes first. These exemptions were granted partly because Cabinet explicitly agreed to include the NZRB and the NZLC within the Phase II reforms. While the mere enactment of the Phase II reforms would revoke the Ministerial exemptions, it is necessary to consider whether the NZRB and the NCLC are captured appropriately under the activity-based AML/CFT regime. In addition to the NZRB and the NZLC, the consultation sought views on other gambling activities that should be covered in scope of the reforms. This included the activities of junket operators. Due to the low risk associated with pokies in clubs and pubs, it is not considered appropriate to capture these under Phase II. To reduce compliance costs and focus efforts on higher risk activities, we	The NZRB agrees with the proposal to include betting services in scope of the AML/CFT Act. It noted that it is important to craft the legislation in a way that allows them to focus on the areas of highest risk as opposed to low-risk, routine transactions. The NZRB raised concerns around the compliance cost of AML/CFT requirements applying to cash betting below $10,000. The NZRB also identified concerns with offshore providers providing bookmaking services online to NZ, given the territorial scope of the existing gambling and racing laws. The NZLC considers it appropriate to consider their full capture under the AML/CFT Act. However, their submission is calling for a renewal of the Ministerial exemption based on the low risk of money laundering and terrorist financing associated with their activities. The Christchurch and SKYCITY casinos supported the inclusion of NZRB and NCLC in scope of the reforms. SKYCITY submitted that societies operating gaming machines in clubs and pubs should be considered for coverage. It is not supportive of including junket operators in scope of the reforms.	**Include NZRB where they operate accounts or accept large cash transactions above the threshold** NZRB (or any other racing club authorised under the *Racing Act 2003*) would be captured when they provide accounts to customers, or accept cash above the occasional transaction threshold in the course of their business. This option would need to be followed by regulations to determine the appropriate threshold to trigger customer due diligence requirements when accepting cash. This option makes it explicit that the higher risk services provided by the NZRB are captured by the Act. It is proposed that NZLC not be explicitly captured under Phase II. We note that the NZLC would be captured under the existing definition of financial institutions for their limited account services, and Phase II will revoke their Ministerial exemption [redacted] Withheld under section 9(2)(b)(ii) of the OIA

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
		recommend to: ▪ Include businesses that provide accounts for the purposes of gambling or betting ▪ Exclude cash betting below the occasional transaction threshold from the scope of the reforms at this stage; and ▪ Exclude the activities of junket operators from the scope of the reforms at this stage, and conduct further research on the risk associated with them. The main money laundering risk associated with providing gambling or betting accounts is the potential for customers to deposit and withdraw illegitimate funds from their accounts, which makes them appear as winnings from gambling or betting.	Both casinos considered that the appropriate cash threshold for triggering AML/CFT obligations on occasional transactions should be $6,000 to retain consistency with casinos. Both also called for increasing the threshold for all gambling providers to $10,000.	

Section 4. Implementation period

Summary

This section outlines recommendations on the appropriate implementation period for the Phase II reforms.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
4.1 Implementation period for Phase II sectors An appropriate implementation period must be provided to allow reporting entities and the supervisor to establish the required systems and controls prior to commencement of the regulatory regime.	Early decision to phase implementation across the sectors with lawyers to be first, and all sectors within 2 years. Power to Act to set the implementation dates and any conditions.	In order to fully implement AML/CFT requirements, businesses will need time to develop risk assessments and programmes, put in place the associated procedures and controls, and train staff in the new procedures. Many will also need to procure assistance from external providers (eg consultants) which is a small market that already has little capacity left. Phase I allowed 4 years for full implementation, however officials considered that Phase Two businesses would not need the same length of time to prepare. The AML/CFT regime has been operational for 3 years now, and there's a body of knowledge, expertise and guidance available to help businesses get ready. That said it will still require investment to make sure this advice and guidance is developed in advance and is suitable to the sectors being covered. The supervisor(s) will also need time to recruit and train staff. There is a risk that a quick implementation period would push up costs both for the private sector and government. Poor preparation and guidance would have a similar effect. During consultation, the Ministry sought feedback from sectors on the appropriate implementation period. In particular, we encouraged sectors' to provide estimates based on informed analysis of how long it will take businesses to develop and put in place the required AML/CFT measures.	Many submissions, including those from law and accountancy firms, stated that they would require a minimum of 12 months to enable them to meet their compliance requirements. A few indicated a 6 month period while others indicated 24 months or longer.	**Implementation period of six months for lawyers 12 for accountants, 18 for real estate sector and gambling (eg NZ Racing Board), and 24 months for high value dealers.** This option would enable phasing the different sectors into the regime based on the level of readiness to meet compliance requirements. While submissions from the legal professions have indicated that they would require a minimum lead in period of 12 months, anecdotal evidence from Phase I (which had a commencement period of four years) suggests that the vast majority of work undertaken by Phase I entities to get ready for the regime did not occur until the six months prior to commencement. This option would also be most closely aligned to the Shewan Inquiry recommendation to extend the AML/CFT regime to the legal and accounting sector as soon as possible. Phasing sectors in this manner would allow the relevant supervisor time to progressively build up capacity to effectively supervise the highest risk sectors. It will require funding be made available in the 2016/2017 financial year. This option is likely to result in a favourable FATF evaluation in 2020 as the highest risk sectors (lawyers, accountants and real estate sector) would have been subject to the Act for a relatively sufficient period to demonstrate effectiveness.

Section 5. Information sharing

Description: This section outlines recommendations on the detail of information sharing proposals.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
5.1 Information Sharing – detail of information sharing arrangements to be considered/confirmed by Cabinet.	Cabinet decision in July 2016 to adopt Shewan rec to review info sharing between Government departments Early Cabinet decision to consider improvements to info sharing among agencies Power to Act to determine the details of the information sharing proposals between agencies Final Cabinet decision to determine final form of information sharing proposals	The AML/CFT Act has a prescriptive regime for sharing information, which is set out at ss 137-141 of the Act. In general, Police/FIU, Customs and supervisors (the AML agencies) are able to share information freely, but the process for sharing is highly prescribed. In practice, AML agencies have developed operational practices and entered into MOUs to speed up the flow of information, but this system has some inefficiencies. AML agencies can share information with other agencies only in limited circumstances (s139): • non-personal information • for law enforcement purposes *law enforcement purposes* means— (a) the administration of the AML/CFT Act (b) the detection, investigation, and prosecution of • an AML/CFT Act offence; or • a money laundering offence; or • any offence under tise of the Tax Administration Act 1994; or • any serious offence under the Crimes Act 1961 (c) the enforcement of the Proceeds of Crime Act 1991 or the Criminal Proceeds (Recovery) Act 2009 (d) the enforcement of the Misuse of Drugs Act 1975 (e) the enforcement of the Terrorism Suppression Act 2002 (f) the administration of the Mutual Assistance in Criminal Matters Act 1992 (g) the investigation of matters relating to security under the New Zealand Security Intelligence Service Act 1969 AML/CFT supervisors can disclose personal information under section 48 for law enforcement purposes and for the detection, investigation and prosecution of any offence under other legislation. In practice, this regime has proven unworkable because: • the restriction to non-personal information for agencies other than AML agencies greatly restricts the information that can be shared and therefore the value of the sharing; agencies with a clear interest in AML (eg, IRD) are excluded • some info can only be shared in one direction or requires a production order, rather than permitting proactive release • limiting the purpose to law enforcement purposes has constrained the flow of information and excludes, for instance, information that is relevant to supervision or other regulatory management, but not a crime • there is uncertainty in the regime about what information is permitted	Feedback on the information sharing proposals was mixed, with vocal minorities at both extremes (eg share nothing vs share everything). On the whole, the submissions were tentatively supportive of greater information sharing, provided that appropriate constraints are in place to ensure that private information is not mistreated. We have consulted with all relevant agencies to come up with agreed proposals for information sharing that will best fit agencies' needs. We have also consulted with the Office of the Privacy Commissioner (OPC) to solicit their views on the current provisions in the Act (but have not yet consulted them on a preferred proposal). Broadly, the OPC is happy with the Shewan recommendation to facilitate info sharing among government agencies for AML/CFT purposes, provided there are sufficient controls in place on the handling of information. We asked for OPC's specific views on section 139 of the Act and, in particular, its limitation to non-personal information. The OPC regards this as an anomaly and would not be opposed to correcting it.	**Create a new mechanism for "structured flexibility" in information sharing, including a mechanism to update information sharing arrangements as needed** While this option creates a new mechanism, it builds upon the existing structure of the Act. Sections 48 and 139 will be amended (with consequential amendments to other provisions) to create a more flexible regime for sharing information within Government: • Expand purpose for sharing in s139 from "law enforcement purposes" to "effective administration of the AML/CFT regime" • Create a new definition of "effective administration of the AML/CFT regime" that includes (a) law enforcement purposes, (b) supervisory purposes, (c) intelligence, and (d) enforcement of a specified list of legislation (which could either be specified in the principal act or in regulation) • Expand the purposes for supervisors to disclose personal information from "law enforcement purposes" to "effective administration of the AML/CFT regime" and include specified legislation such as the Non-Bank Deposit Takers Act 2013, Insurance (Prudential Supervision) Act 2010, Racing Act 2003 and any other legislation in regulations. • Create a "future-proofing" provision that enables decision makers to create new sharing arrangements provided certain safeguards are in place. This could be achieved in one or more of following ways: ○ Minister/Minister MOU, consultation with OPC (model in the Security Services Bill before Parliament) ○ CE/CE MOU, consultation with OPC (model in the Customs and Excise Bill before Parliament) ○ AISAs (to be facilitated by Ministerial exemption, if necessary) ○ Sharing arrangements to be specified in regulation (either with explicit requirement to consult OPC, or based on the convention that OPC would be consulted on any regulations) This option strikes a balance between a prescriptive regime

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
		to be shared, leading to risk aversion The recent John Shewan report into the Panama Papers highlighted information sharing as a key gap in the current AML/CFT regime and an area where improvements are required. Improving the information sharing regime in the AML/CFT Act is also consistent with the broader government goal of ensuring that information sharing is efficient and effective and enables better enforcement of our key regulatory regimes.		and a wide open enabling provision, and has the support of relevant government agencies.

Section 6. Enhancing the AML/CFT regime

Description: This section outlines recommendations to enhance the AML/CFT regime to ensure its efficient and effective operation. These issues have been identified through various sources including the Shewan Inquiry, and engagement with Sector Supervisors, Phase II sectors, and existing reporting entities.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
6.1 Simplified due diligence Discussions with supervisors and industry have identified similar low risk customer types which are also appropriate for simplified due diligence.	Early decision to extend simplified due diligence to SOEs and majority owned subsidiaries in NZ & in overseas jurisdictions with sufficient AML/CFT systems. Power to Act was granted to extend simplified due diligence to other types of entities.	Extending the circumstances for simplified due diligence will reduce the compliance burden for reporting entities in similar low risk situations. The AML/CFT Act allows reporting entities to conduct simplified due diligence on certain low risk customers such as government agencies and listed companies. This means that a lower level of due diligence can be applied to reduce compliance impact in low risk situations. State-owned enterprises (SOEs) and majority owned subsidiaries of publicly traded entities represent a similar level of risk and are also appropriate for simplified due diligence. This proposal is in line with the international standards set by the FATF.	Submissions were generally in agreement that simplified due diligence should be extended to the entities proposed in the consultation paper. In addition, submissions suggested simplified due diligence to be extended to the following: ▪ Businesses licensed and supervised by recognised regulatory authorities (lawyers, financial institutions, accountants) ▪ New Zealand registered charities ▪ Foreign financial institutions in low-risk overseas jurisdictions with sufficient AML/CFT regimes ▪ Majority-owned subsidiaries that are themselves subject to simplified due diligence ▪ Workplace Savings Schemes registered under the FMCA.	**Add proven low risk categories of entities to the simplified due diligence provisions in the Act** It is proposed that the types of customers on which reporting entities can conduct simplified due diligence be extended to the following: ▪ SOEs as defined by Schedule 1 of the State Owned Enterprises Act 1986; and ▪ Majority owned subsidiaries of publicly traded entities in New Zealand and in overseas jurisdictions with sufficient AML/CFT systems. These two types of entities have a demonstrably low risk profile and extending simplified due diligence to them is consistent with our international partners.
6.2 Ministerial exemptions The power to grant exemptions from the AML/CFT Act lies with the Minister of Justice. The current process is inefficient and time-consuming, with the average exemption taking 13 months to process, some applications taking up to 3 years to reach a final decision. With the addition of the new sectors and increased reporting entities, the volumes of applications is expected to rise to between 300 and 500 more applications (Phase I resulted in 140 applications to date).	Early Cabinet decision to include new sectors requires consideration of whether exemptions regime will still work in practice. Final decision for Cabinet	The ministerial exemption process is necessary as a vehicle for addressing unintended capture. The exemptions process is a way to ensure that Supervisors and the FIU efficiently allocate resources towards higher-risk activities or entities, in line with the AML/CFT risk based approach. This is managed by excluding the very low risk entities from the Act, or establishing conditions that mitigate residual risk for low risk entities. This also aligns with our international obligations to the Financial Action Task Force. With the increased numbers of reporting entities captured under Phase II, there will be an increased likelihood of unintended capture or very low-risk individual reporting entities being captured. In order to increase the efficiency of the process and decrease the time it takes to reach a final decision, policy and operational changes are required to the process. These include: The final decision on a ministerial exemption sits with the Minister of Justice with analytical support from the Ministry of Justice. Assessment of the process and discussions with the current Supervisors has indicated that delegation of this to the respective Chief Executive offices with appropriate controls and service level agreements in place will decrease processing times and improve application decision rates. Making ML/FT risk the primary consideration in legislation will align the process with international expectations and reflect the current practice, increasing transparency on the decision making process. Furthermore, this will help streamline the process and reduce the amount of applications that come to the Ministry of Justice as an obvious decline, but still require the full analysis against all considerations. Moving forward, if an	Given the technical nature of this amendment, it was not subject to consultation and there is no anticipated impact on reporting entities as a result of this amendment.	**Vest exemption power in the Secretary for Justice and make other operational improvements** This option would shift responsibility for granting exemptions to the Secretary for Justice and include key improvements to achieve greater efficiency: 1. It is an onerous task that is unusual in the way that it requires a Minister's sign off. The Secretary for Justice, as chair of the AML/CFT statutory committee - the National Coordination Committee (NCC)- could hold (at least) some of the decision-making power around exemptions. 2. The considerations for granting Ministerial exemptions under the Act could be improved to better reflect the primacy of ML/TF risk over the other considerations. 3. Cost recovery has been proposed as an option to recuperate costs. Further work is required to establish whether or not this is a feasible option.

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
		application is complete, it needs to be demonstrably low risk to progress to full assessment and analysis. If the application does not meet the criteria for exemptions, i.e is not low risk or the application is really a request for legal advice about the application of the Act, then the application can be rejected immediately. A conservative estimate would see a 30% reduction in applications at this point. In addition, it has been proposed by the Supervisors that a cost recovery model be explored in the form of a fee be charged. This would help incentivise proper time sheeting/recording and analysis of exemption applications by government, and give more of a customer-focus. It would also help to subsidise the cost to government spent on considering these applications. Further analysis on cost recovery is required.		
6.3 Suspicious activity reporting Limitations in the suspicious transaction reporting (STR) regime have been identified in the Shewan Inquiry and by the FIU, as suspicious activity is not reported when it is identified outside of a specific transaction. For example, suspicious activity is not reported when: 1) a trust and company service provider identifies suspicious transactions involving NZ entities that do not go through a NZ bank (Shewan report recommendation); 2) suspicious behaviour is identified when a customer seeks information from reporting entities to understand how to avoid detection (identified by the FIU); 3) suspicious activity is identified when a customer establishes complex legal structures without an underlying transaction (Identified by the FIU).	No early decision For decision by Cabinet	Reporting entities are required to file a STR with the FIU when there are reasonable grounds to suspect that a transaction may be related to a criminal offence. As a result of the limitations, valuable financial intelligence is not being reported to the FIU by reporting entities when they identify suspicious activity. Extending the STR requirements will increase the volume of reports to help the detection and investigation of criminal activity in New Zealand, and involving NZ companies and trusts offshore. This helps to protect NZ's reputation. While this proposal extends beyond the international standards set by the FATF, the US, UK and Australia require reporting entities to report suspicious activity beyond a specified transaction. Their experience has demonstrated the value of the additional financial intelligence. This proposal will have an impact on reporting entities which would be required to revise their monitoring and reporting systems and train staff on the changes. However, with sufficient lead-in time, reporting entities could implement changes through planned updates and training mechanisms to minimise the cost impact. An implementation period will be necessary to prepare new regulations which set out the required information to be included in a suspicious activity report, and to ensure that FIU has the capability to receive the new reports.	<u>Existing reporting entities & AML/CFT consultants:</u> The majority of these submissions supported the proposal. There were, however, concerns about the potential additional compliance costs. <u>Lawyers:</u> The legal sector was broadly comfortable with the proposal, but had concerns about defining 'suspicious activity' in the legislation as this can be highly subjective. There were concerns that reporting on suspicious activities may breach client confidentiality and legal professional privilege. <u>Accountants:</u> CAANZ submitted that SARs were unlikely to be useful as they do not indicate the movement of funds. <u>Real estate agents:</u> While REEA supported the proposal (if appropriately defined), REINZ had concerns over how far real estate agents would need to go to monitor activity – such as monitoring the behaviour of all participants at an open home. <u>High value dealers:</u> These submissions expressed some concerns over the proposal. They considered the compliance cost may not be justified, and it may be difficult to find reasonable grounds to suspect an activity is suspicious. In addition, it was considered beneficial to align the definition of 'suspicious activity' with international practice (e.g. UK, Australia). It was also considered important to define when reporting entities are liable for not reporting suspicious activities.	**Create a new requirement to report suspicious activities with safeguards and guidance around its use** This option would involve amending the Act to require reporting entities to report suspicious activities in addition to the existing requirement to report suspicious transactions. A reporting entity would be required to report to the FIU when it forms a suspicion on reasonable grounds: When the client seeks services related to an activity (short of a "transaction") or makes enquiries about such services. The relevant regulations would be amended to outline the information required when a suspicious activity is reported, and when there is a transaction involved. This option would give effect to the substance of the Shewan recommendation, while at the same time embedding some safeguards to respond to potential criticism of this new power. It is recommended this amendment come into effect 12 months after commencement of the Act to provide reporting entities and the FIU sufficient time to implement the changes, and to allow the development of supporting regulations.
6.4 Reliance on third parties A customer may come into contact with more than one reporting entity in a single transaction or service. The AML/CFT Act allows reporting entities to share controls and rely on other reporting entities	No early decision For decision by Cabinet	The reliance provisions should be expanded to align with Phase II business types to allow Phase II entities to share AML/CFT obligations to reduce the compliance burden. *Designated business groups* Allowing related Phase II businesses to share AML/CFT resources under a designated business group (DBG) is an effective measure to reduce the	While existing reporting entities in the financial sector generally found that existing provisions were sufficient, feedback from other entities supported the need for more flexible reliance provisions for Phase II entities. Some submissions from Phase II sectors called for more flexible DBG arrangements to ensure that compliance obligations can be shared among related entities such as	**Expand the instances in which reporting entities can rely on each other to reduce their compliance burden and amend the definition of "designated business group" to ensure it is workable for non-companies** This option would allow Phase II reporting entities to form a DBG for their specific circumstances, for example:

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
in certain circumstances to reduce duplication of compliance effort. Given the increase in the number of small businesses, partnerships and franchise businesses in the Phase II sectors, the circumstances when reliance is permitted could be expanded.		compliance burden by allowing related entities to share a programme and risk assessment. The AML/CFT Act currently allows related companies that are reporting entities to share compliance obligations by forming a DBG, subject to certain conditions. In practice, the DBG concept has proved suitable for the financial sector as it focuses on related companies. However, this definition will not be able to be widely used by Phase II entities due to the large number of partnerships and franchise businesses in the sectors. This would prevent related businesses and firms from sharing resources to reduce duplication of compliance effort. *Other reliance provisions* The AML/CFT Act allows customer due diligence (CDD) conducted by one reporting entity can be relied upon where the person has consented to the information being provided to another entity and the reporting entity retains liability (s33). Phase II entities suggest that there should be an exemption from CDD where a bank or other reporting entity is involved as they would have conducted CDD. Alternatively, it was also suggested that a reporting entity should be able to rely on a certificate from another reporting entity which confirms that CDD was conducted without having liability for the CDD carried out appropriately. While duplication should be reduced, ensuring that the reporting entity conducts CDD and retains liability when relying on another entity is important to ensure that the entity understands their customer and can identify suspicious activity. It is not appropriate for one reporting entity to indemnify another and it will be difficult to determine in some instances which entity has responsibility to conduct CDD, and how to ensure that similar standards apply. While a form of certificate confirming CDD may address this to some extent, this does not address the issue of responsibility. This suggested approach would also be inconsistent with international practice (e.g. UK, EU, Australia) and the international standards set by the FATF which state that the reporting entity relying on another for CDD should retain ultimate responsibility. Currently, a reporting entity that relies on the CDD of another must obtain the verification documents within 5 days. However, international practice (e.g. UK, EU) and the international standards set by the FATF allow a reporting entity to rely on another reporting entity, as long as verification documents are provided without delay *upon request* rather than within 5 days. The recent review of Australia's AML/CFT laws recommended adopting this approach.	law and accounting firms. Some submissions from Phase II sectors expressed concern over potential duplication of customer due diligence (CDD) requirements where a client engages with more than one reporting entity in a transaction. E.g. Real estate agents and lawyers submitted that where the funds are from a NZ bank, there should be no CDD requirement for the on the customer. Some submissions stated that the current circumstances under which reporting entities may rely on the CDD conducted by others are too restrictive as the entity retains liability and must receive the complete CDD documentation. NZ Bankers Association and some of their members submitted that reporting entities should be ultimately liable for CDD and would be concerned if the reliance provisions were extended to allow one reporting entity to rely on another in the absence of consent or agreement. Some submissions suggested letters of assurance or other form of certificate that one reporting entity could provide to another confirming that CDD had been carried out on a common customer.	▪ each member is a related law firm, or a subsidiary of a law firm, that is a reporting entity in NZ (or foreign equivalent) ▪ each member is a related accounting practice, or a subsidiary of an accounting practice, that is a reporting entity in NZ (or foreign equivalent) ▪ each member is a related trust and company service provider (TCSP), or a subsidiary of a TCSP, that is a reporting entity in NZ (or foreign equivalent) ▪ each member is a related real estate agent Related entities would refer to being part of the same franchise, providing products or services under a common-brand name, or having common strategies, processes and controls. The circumstances under which reliance on another reporting entity is permitted for CDD be amended to require verification documents to be provided without delay *upon request* rather than *within 5 days*. While this will not address the key issue raised by sectors seeking to limit liability, this will alleviate some compliance burden. Given the ongoing risk of duplication of AML/CFT activities where multiple Phase II entities are involved in a transaction, the Ministry of Justice will continue to work with the Ministry of Business, Innovation and Employment to examine further options in regulations prior to the commencement of Phase II.
6.5 Trust and company service providers (TCSPs) The capture of trust and company service providers (TCSPs) as is based on certain services they provide as the only or principal part of their business. This is inconsistent with the capture of other reporting entities as financial	No early decision For decision by Cabinet	Trust and company service providers (TCSPs) are defined as reporting entities under regulations based on certain services they provide as the 'only or principal part of their business'. This is inconsistent with the capture of other reporting entities as financial institutions, and proposed capture of Phase II sectors, which covers services 'provided in the ordinary course of business'. TCSPs were initially intended to be brought into scope in Phase II, but were brought forward in 2011 through regulations due to the high risks identified. It will be important to ensure a level playing field among businesses providing similar services (such as lawyers and accountants) to ensure that there is no	Submissions supported the change in the definition of TCSPs to services 'provided in the ordinary course of business' to ensure consistency with the proposed captured of services provided by law and accounting firms. No submissions were opposed to this change.	**Option 1 – status quo** This option would retain the current provisions in which TCSPs are only covered if they provide the relevant services as their *primary business* rather than in the *ordinary course of business*. This definition was intended to be a temporal solution put in place while lawyers and accountants were exempt from the act. Retaining the status quo would result in uncertainty in the market and an 'uneven playing field' as obligations for

Issue	Previous decisions	Analysis	Feedback from consultations	Recommendation
institutions, and proposed coverage of Phase II sectors, which covers services provided in the ordinary course of business.		displacement effect. This may have a compliance impact as businesses that provide these services in the ordinary course of their businesses, but not the principal part of their business, would be subject to the Act. However, no such businesses were identified in consultation which may be due to the fact that most businesses providing these services are lawyers or accountants. This will also bring the TCSPs requirements in line with international standards set by the FATF which requires businesses to be subject to AML/CFT laws when they provide certain services as a business.		lawyers and TCSPs would be triggered at different points. E.g. a TCSP could structure their firm by providing various service offerings (in addition to creating companies and trusts) to avoid capture by the AML/CFT Act as it would not be their *principal business*. We are not aware of any firms that have structured their business in this way to avoid capture. **Option 2 – treat TCSPs as any other DNFBP if it engages in the activities listed in the Act in the ordinary course of business** This option would mean that any TSCP that engages in the listed activities in its ordinary course of business (not primary business) would be covered by the Act. This would be consistent with the treatment of all other types of businesses and avoid the risk of regulatory arbitrage. While this change may bring some businesses within the scope of the Act, we are not aware of any firms that have structured their business to avoid capture and no concerns were raised in submissions. There are currently 109 TCSPs captured by the AML/CFT Act which will not be affected by this change. Lawyers and accountants have indicated their support for the change to ensure a level playing field and we anticipate similar views from the existing TCSP reporting entities. This would mean that the current regulations regarding TCSPs would be unnecessary.

Appendix B

Phase I of AML/CFT reform in New Zealand and Phase II steps to date.

1. The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) commenced in 2013. It was the first step in establishing a regulatory regime to detect and deter financial crime in relation to businesses that offer products or services that may be misused by criminals to launder the proceeds of crime or finance terrorism.

76. All profit-motivated crimes such as drug trafficking, fraud and tax evasion require the movement of funds. The AML/CFT regime prevents criminals from moving funds anonymously, and generates valuable financial intelligence for law enforcement to 'follow the money' in investigations.

77. An effective AML/CFT regime also protects New Zealand businesses from being misused and enhances financial integrity across the economy. It protects New Zealand's reputation by implementing international standards on AML/CFT and ensures that we are not considered a 'soft target' by international criminals.

78. "Phase I", which commenced in 2013,[7] applies to what were considered the highest risk sectors (banks, financial institutions and casinos (referred to as reporting entities)).

79. Under the regime reporting entities must establish controls to deter and detect criminal activity, including carrying out risk assessments, identifying their customers to know who they are dealing with, and filing suspicious transaction reports (STR) with the Police's Financial Intelligence Unit.

80. From November 2014 to June 2016, 621 STR disseminations (individual instances of intelligence) were provided to partner agencies by the FIU. The FIU has received feedback on 68% of disseminations. While these STR disseminations ultimately resulted in only one money laundering prosecution being brought, 55 led to prosecution of criminal offences, 27 of which have resulted in convictions to date. Of the remainder, 172 have resulted in ongoing investigations, while 145 contributed to investigations into criminal offences that resulted in no prosecutions.

Phase II reforms – steps to date

81. In June 2016, Cabinet agreed to progress Phase II of the reforms, with a view of enacting the reforms by July 2017 [CAB-16-MIN-0251].

82. In July 2016, Cabinet also agreed that certain recommendations made in the foreign trust inquiry be considered as part of the AML/CFT Phase II reforms [CAB-16-Min-0342]. These recommendations included bringing lawyers and accountants into the

7 When Cabinet decided in 2008 to implement the AML/CFT regime in two phases, it was agreed that non-financial sectors such as lawyers, accountants and real estate agents would be brought under the regime at a later date (CAB (POL) MIN [08] 17/3).

regime as soon as possible, considering possible changes to the STR regime and improving information sharing.

83. In September 2016 Cabinet made early policy decisions and granted me a limited power to act so that drafting could commence and ensure the timeframe to enact the reforms will be met. Early Cabinet decisions included confirmation that lawyers, accountants, real estate agents, conveyancers and some high value dealers would be covered in scope of the reforms, and that commencement of the reforms would be staged. It was agreed that final decisions on policy matters would be put to Cabinet in October with the objective of having a Bill introduced before the end of the year.

84. Good progress has been made on drafting, and now that consultation has closed, I am seeking Cabinet's final decisions on policy matters.

Appendix C

High level summary of submissions

Comments received from affected sectors are also included in the decisions table in **Appendix A** where applicable. The following key themes emerge from the submissions:

a. Generally there is support for the reforms. The public understands the value of detecting and deterring both money laundering and the financing of terrorism.

b. There are questions about what a fit for purpose AML/CFT regime looks like in each sector. For instance, some real estate and high value dealer submitters questioned what the appropriate level of oversight is in their sectors, when most of their transactions involve funds from banks, which are already covered. Other submitters, however, felt that all parties need to play their part in order to avoid being a weak link in the chain. Some submitters suggested widening the scope of sector coverage beyond those listed in the consultation document, for instance covering all transactions of commodities above a $10,000 threshold rather than focusing on the dealers in certain commodities.

c. Almost all submissions sought clarity about how the regime would apply and what their precise obligations would be. These concerns fall into two themes:

    i. what level of detail will be provided in the legislation and any accompanying guidance; and

    ii. how will government provide education and awareness-raising both to reporting entities and the public. Submitters almost uniformly requested that we leverage existing regulatory and sector business practices[8] – in particular as a means to reduce both compliance cost and additional regulatory burden.

d. There is no consensus on the supervision model, and good arguments were put forward for all three models (single supervisor, the current multi-agency model, or industry-based supervision). Some submitters that supported a single supervisor also supported the multi-agency model as a second choice. Submitters that supported the multi-agency model were split between whether DIA and FMA should supervise the new sectors. Some key industry bodies, such as the NZLS, strongly (and now publicly) support industry-based regulation.

e. There was also no consensus on whether to require the reporting of suspicious activity as well as suspicious transactions. In part, this related to the desire for clarity about what was meant by activity.

8 For instance, the audits and checks that membership organisations such as Chartered Accountants New Zealand or Motor Vehicles Traders Association already impose.

f. Finally, most submitters raised compliance costs as a key factor for government to consider. There was a similar call for government, to the extent possible, to align the regime with key trading partners such as Australia.

Appendix D