In confidence

Office of the Minister of Justice

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

Proposal

1. This paper:

    1.1. Seeks agreement to one substantive change to the Anti-money Laundering and Countering Financing of Terrorism Amendment Bill arising from consultation;

    1.2. Seeks agreement to a number of other minor and technical amendments in order to clarify the provisions of the Bill;

    1.3. Seeks confirmation of Cabinet's October 2016 policy decisions [CAB-16-MIN-0552];

    1.4. Notes a reduction in compliance costs with a consequent increase in the anticipated benefits associated with the reforms;

    1.5. Seeks approval for funding associated with the reforms;

    1.6. Seeks approval to introduce the Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill into the House.

Executive summary

2. In June 2016 Cabinet made early decisions to extend the Anti-money Laundering and Countering Financing of Terrorism (AML/CFT) regime to lawyers, conveyancers, accountants, real estate agents and some entities who deal in high value products [CAB-16-MIN-0251]. In October 2016, because of the nature of the compliance costs and size of the regulatory change, Cabinet agreed to consult on an exposure draft Bill with the aim of limiting the compliance burden and avoiding unintended consequences [CAB-16-MIN-0552].

3. The consultation process has highlighted the need for some changes to the exposure draft of the amendment Bill before introduction and helped to reduce the earlier anticipated compliance costs.

4. Engaging closely with affected sectors has helped them to understand their obligations, ways of structuring their affairs and using tools in the Act to minimise their compliance costs. Over time with effective supervision and support, compliance costs could reduce by up to $0.8 Billion from initial cost estimates. It is now estimated that ongoing costs could be in the order of $1.1 billion to $0.8 billion NPV over 10 years, down from the top end estimate of $1.6 billion. The reduction is largely attributable to reducing the number of reporting entities – we better

understand how many businesses are covered, and of those covered, how they will respond to the reforms so as to further reduce their compliance costs. As a result, there is a small net benefit from implementing the reforms of 1.11 to 1.14 (up from a range of 0.84 to 0.98 in October), even before taking into account many billions of dollars of strategic benefits that have not been included in the benefit/cost calculation.

5. As well as a number of minor and technical changes aimed at making the Bill more workable for affected sectors, I propose a change to the policy agreed by Cabinet in October 2016 regarding the commencement period for lawyers and conveyancers, accountants, and New Zealand Racing Board. I recommend the lead-in period be set by Order in Council and that, from enactment, commencement for lawyers and conveyancers be no later than 12 months, accountants no later than 15 months, and for the New Zealand Racing Board no later than 24 months. This will ensure the sectors have sufficient time to prepare for and implement the necessary changes so that the reforms are effectively implemented, and if sectors and government are ready earlier then commencement can be brought forward.

6. I propose that we fund the Department of Internal Affairs at a level that will enable them to develop a more business focused delivery model and work closely with Phase 2 businesses as they implement the reforms - this will help reduce both the short and longer term cost to business. This level of funding will also ensure that DIA can meet its obligations for monitoring and enforcement under the Act alongside their obligations for the Phase 1 sectors they are responsible for.

7. Consistent with advice in October, I also propose funding the Ministry of Justice to process exemptions under the AML/CFT Act and to fund the delivery of a public information campaign. Funding for Police (the Financial Intelligence Unit and AML/CFT investigations) has been included in a wider Police budget bid agreed by Cabinet earlier this month.

Background

8. New Zealand's regulatory response to money laundering and countering terrorist financing is in the AML/CFT Act. Currently the Act applies to what were considered the highest risk sectors (banks, financial institutions and casinos (referred to as reporting entities). Cabinet decided to implement the AML/CFT regime in two phases, with non-financial sectors such as lawyers, accountants and real estate agents to be brought under the regime at a later date [CAB (POL) MIN [08] 17/3].

9. In June 2016, Cabinet agreed to progress Phase 2 of the reforms, with a view of enacting the reforms by July 2017 [CAB-16-MIN-0251] 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 -0465]. In October 2016, because of the nature of the compliance costs and size of the regulatory change, Cabinet agreed to further consult on an exposure draft Bill with the aim of limiting the compliance burden and avoiding unintended consequences [CAB-16-MIN-0552].

10. In October 2016, Cabinet made a number of key decisions including that: real estate agents are required to undertake due diligence on their customer or when they receive a cash deposit of $10,000 or more; high value dealers would be subject to a simplified set of compliance obligations when they accept cash transactions at or over $15,000; implementation would be phased; reporting entities would be required to report suspicious activity, not just suspicious transactions. Attachment A sets out these and other key policy decisions.

11. Consistent with Cabinet's decision, these key policy decisions were reflected in the exposure draft of the amendment Bill.

12. Implementing Phase 2 will close the existing regulatory gaps, with a consequent impact on predicate crime, and enhance New Zealand's international and trade reputation.

Feedback from consultation on exposure draft

13. Consultation on the exposure draft of the AML/CFT Amendment Bill closed on 27 January 2017. Thirty four submissions were received on the Bill with a further four late submissions.

14. The consultation focussed on the following three issues:

    14.1. Is the exposure draft of the AML/CFT Amendment Bill clear and does it accurately reflect the initial proposals outlined in this paper?

    14.2. Can businesses use provisions in the Bill to reduce compliance costs associated with Phase 2?

    14.3. What else can be done to help businesses reduce compliance costs associated with implementation of Phase 2?

15. The Ministry also conducted five workshops with affected Phase 2 sectors across New Zealand (Auckland, Hamilton, Wellington and Dunedin). There were 57 participants across the workshops.

16. The process revealed there remains broad acceptance of, or support for, the reforms. However, there were mixed views about how clear parts of the Bill were and the extent to which businesses could use some of the compliance reducing provisions. On specific issues:

    16.1. Most submissions commented that the implementation period was too short. They felt that the timeframes for lawyers, accountants and real estate in particular were too short, with most proposing a minimum extension of 6 months. A number of submissions went further and stated that various sectors (e.g. lawyers and accountants) should be covered at the same time.

    16.2. Many commented on the way in which the activities were described and some on how lawyers and accountants were defined. Many submissions

asked that the Bill, regulations or guidance provide greater clarity around who and what was captured.

16.3. Submissions were broadly comfortable with the scope of legal professional privilege as captured in the Bill but suggested some further refinements to ensure consistency with the Search and Surveillance Act.

16.4. Some submissions commented that high value dealers should have to meet the full set of obligations. They were very concerned that limited obligations was not addressing the identified ML/FT risks, that it left a gap that would be exploited, and that it was unfair to create a two tier regime.

16.5. There was support for measures to reduce compliance cost although from some sectors this support was somewhat reserved. Workshops gave a particularly useful insight into the extent to which they could be used. Submitters made a range of suggested improvements.

16.6. Feedback from workshops and submissions reinforce the challenge of covering real estate. The suggested changes primarily related to the timing of customer due diligence. Flexibility in timing was generally the preferred industry position.

16.7. Feedback on information sharing remains mixed. Some submissions support the proposals; some feel that the proposals go too far and are unnecessary; others commented that it does not go far enough.

16.8. Other issues were also raised. A few submissions commented on the supervision model chosen, suggesting again either industry supervision or FMA for accounting. A number of other matters were raised including establishing a beneficial ownership register for trusts and companies.

17. Most submissions and workshop participants indicated a substantial degree of uncertainty and confusion about how to comply with AML/CFT requirements. This included when and which activities were covered, what a suspicious activity was, etc. They commented on the critical nature of regulations, clear guidance and training to the successful implementation of the regime. They all called for detailed regulations and rules and guidance to be in place well in advance of implementation so that it could help them implement the changes more readily and thus at less cost.

18. Independent summaries of feedback from workshops and an analysis of submissions are attached to this paper as Attachments B and C.

The cost to business

19. Engaging closely with affected sectors has helped them to understand their obligations, ways of structuring their affairs and using tools in the Act to minimise their compliance costs. It has also helped us to understand how business will respond.

20. In October, it was estimated that the ongoing operating cost to business was up to $1.6 billion dollars NPV over 10 years. These costs were calculated using the upper end estimates of cost and of reporting entity numbers.

21. Post consultation the October estimate has been revised and, over time with effective supervision and support, could reduce by up to $0.8 Billion. It is now estimated that ongoing costs to business could be in the order of $1.1 billion to $0.8 billion NPV over 10 years. The reduction in cost is largely attributable to reducing the number of reporting entities by understanding how they will respond to the reforms.

22. The range acknowledges that some businesses can make choices that affect how much it will cost them to comply (for example, related businesses can set up a designated business group to share compliance effort and thus cost) and that until they are faced with implementation the extent to which these decisions are made will be unclear. Once the regime is in place and DIA as the supervisor begins to work with them, we expect the cost to business could reduce over time.

Proposed changes to the Bill

23. There is only one area where I seek agreement to depart from the policy agreed in October 2016 – delaying the implementation period for lawyers, conveyancers, accountants and the Racing Board.

24. I also propose a number of minor and technical changes based on feedback from submissions and workshops, to ensure the regime is workable for the affected sectors.

Changes to lead-in times

25. I recommend the lead-in period be set by Order in Council and for lawyers and conveyancers that the period be no later than 12 months, accountants no later than 15 months, and for the New Zealand Racing Board no later than 24 months. This will ensure the sectors have sufficient time to prepare for and implement the necessary changes so that the reforms are effectively implemented. If regulations and guidance are ready earlier then commencement can be brought forward.

26. In October, Cabinet agreed to the following implementation time-frames for the various sectors: 6 months for lawyers and conveyancers, 12 months for accountants, 18 months for real estate agents and the NZRB 18 months and 24 months for high value dealers - from the date of enactment of the legislation.

27. Submitters suggested that the proposed transitional periods for lawyers and the New Zealand Racing Board was too short.

28. The current timeline for lawyers means that relevant final Regulations and guidelines are unlikely to be in place until very late this or early next year which is likely to provide lawyers with only one or two months' time to put the appropriate systems in place and train staff on compliance requirements.

29. The Racing Board has submitted that a commencement period of 18 months after enactment is insufficient to develop and rollout the necessary software and hardware upgrades and the flow-on costs and subsequent impact on the racing industry from a short timeline would be out of proportion with the ML/FT risks.

30. I also propose to slightly extend the implementation for accountants, so that they will have a transition period of up to 15 months. This is consistent with the initial Cabinet decision to bring accountants in after lawyers and conveyancers.

31. This recommendation would allow these sectors to prepare their businesses in order to effectively comply with the regime. The proposed extensions are short and would not compromise the overall timeframe for having the reforms as a whole in force two years from enactment.

Changes to clarify current proposed provisions in the Bill

32. The remaining changes are minor and technical amendments necessary to enhance clarity, and which are consistent with the earlier policy decisions. These amendments are informed by feedback from workshops and submissions on the Bill. The key changes relate to:

    a. Coverage and scope of activities: these include changes to clarify the definition of designated non-financial businesses and professions (DNFBPs) and clarify the scope of activities captured;

    b. Coverage of customer due diligence: Minor provisions to the Act to allow CDD requirements for real estate agents to be determined in regulations; technical changes to extend simplified CDD to some low-risk entities;

    c. Legal professional privilege: minor changes to clarify the threshold for legal privilege and further align with the Search and Surveillance Act 2006 and the Evidence Act 2012;

    d. Information-sharing: minor changes to the provision allowing the sharing of information for law enforcement regulatory purposes. This approach will clarify how relevant parties can share information, including personal information.

33. A detailed table setting out all the proposed amendments is attached as Attachment D.

Areas where no change is proposed

34. There are some areas where I propose making no changes to the approach adopted in the consultation draft Bill. These include:

    34.1. High Value dealers: Businesses that deal in high value goods and commodities (precious metals and stones, cars, boats, art and antiquities) will be covered when they deal in physical currency above $15,000. However, there will be a limited set of AML/CFT obligations.

34.2. Real estate agents: Real estate agents and professionals will be covered when they conduct transactions on behalf of, or as an agent of, a third party in the sale or purchase of real estate.

34.3. Structure of legislation: Legislation should be flexible enough to adapt over time. The primary legislation to broadly outline the activities, supported by specific regulations

34.4. Statutory review period: A review of the operation of the Act should take place after the publication of the FATF mutual evaluation.

34.5. Ministerial exemptions: The Secretary for Justice should have responsibility for granting exemptions from the regime.

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

35. A summary of feedback on these key areas, with a brief explanation of why no change is recommended, is attached as Attachment E.

Issues likely to be contentious

36. There are two issues within the Bill that may be contentious:

36.1. The scope of legal professional privilege under the Act: Some members of the legal profession could raise concerns that the scope of legal professional privilege is too narrow. However, I am satisfied that the current settings are well balanced between lawyers' duty to their clients with the obligation to report potentially criminal behaviour and transactions. Lawyers already have a duty to report under the Financial Transactions Reporting Act 1996, but this obligation has not been well understood and, without a supervisory regime, reporting has been extremely low. The provision in the Bill provides clarity by aligning the obligation with the threshold in the evidence and search laws as to when privilege does not apply. In addition, the proposal provides the necessary structure to support implementation by introducing a supervisory regime. Submissions from the New Zealand Law Society and the legal sector broadly supported the proposed provision.

36.2. Proposed information-sharing provisions: concerns may be raised with the privacy implications of enabling greater information-sharing between government agencies, regulators and the private sector. The information sharing amendments are intended to contain sufficient safeguards and strike an appropriate balance between allowing the sharing of information in order to detect and deter financial crime, and protecting the individual's right to privacy. A Privacy Impact Assessment (PIA), is being prepared by the Ministry of Justice. Initial work on the assessment has highlighted some potential privacy risks posed by the proposed Bill in relation to the collection, use and disclosure of information but considers that the Select Committee process

would provide the appropriate opportunity for these to be further clarified and refined.

Regulations and guidelines

37. The AML/CFT Act is seeking to regulate very diverse businesses – this makes it hard to develop legislation that provides clarity yet responds to this diversity. To provide this balance the Act provides for the development of regulations in certain circumstances and guidelines by Supervisors.

38. I propose using regulations to address a number of key matters raised in consultation including the timing of customer due diligence by real estate agents. Where possible and appropriate, officials will work with businesses to co-produce regulations so that they are practical and useable, while also staying consistent with the intent of the Act.

39. It also became clear through consultation that businesses want, and need, support to reduce their compliance costs. Learnings from implementing Phase I show that clear, fit-for-purpose guidelines play a critical role in this. Again, where possible and appropriate officials will work with business to agree what guidelines are required as a matter of priority and then co-design those priority guidelines.

40. Where co-design is not appropriate then officials will develop draft regulations and guidelines prior to consultation with business.

Financial implications for the Crown

41. In October 2016 Cabinet noted that the reforms would have fiscal implications for DIA, Police and MOJ. Since then:

    41.1. Police has submitted a separate bid for Budget17 which covers their proportion of financial costs – therefore the figures in this paper do not include funding for Police.

    41.2. The cost or capital for the Department of Internal Affairs has been confirmed and incorporated into the funding being sought.

42. The final costs for which this paper seeks approval are:

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

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

43. For the Ministry of Justice, funding covers:

    43.1. The cost of approving exemptions for Phase 2 businesses, and is consistent with the October Cabinet paper. It is not expected that the number of exemptions will change materially from that estimated in October as it is influenced more by the number of businesses in a sector rather than the number of reporting entities (those business who at the end of the day have to comply).

    43.2. The development of a public information campaign. This is as per the October Cabinet paper, although phased over three rather than two years.

44. For the Department of Internal Affairs funding covers:

    44.1. The cost of meeting their regulatory obligations under the Act. This investment is relative to the number of reporting entities and the investment made in Phase 1.

    44.2. The cost of working with business to support the development of business facing systems and tools, and more deliberate and widespread regional engagement with in particular the small to medium businesses (which will likely make up over 80% of reporting entities). This investment will have

greatest significant impact on providing business friendly interfaces and services, and supporting businesses reduce their compliance costs.

44.3. The cost of commencing the development of guidance in the 2016/2017 financial year. This will provide more time for business to engage in their development and reduce the risk of guidance not being ready sufficiently in advance of implementation.

44.4. The cost of capital and associated operating costs. The capital primarily relates to the development of a new IT system to interface with reporting entities. These costs were not included in the October Cabinet paper, but the need for capital investment and its approximate capital cost was noted by Cabinet.

45. When considering the costs in paragraphs 48, 49 (a) and 49 (b), the sum of money sought for DIA and the Ministry of Justice is less than in the October Cabinet paper. The level of investment reflects the need to support business meet their obligations and to reduce their costs, over time.

The benefits

46. As previously advised, it is extremely difficult to calculate the benefits of AML reforms – however the modelling fairly reflects the information that is available and evidence from both New Zealand and internationally.

47. On that basis 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.

Balancing the costs and benefits

48. We have calculated that there is a small net benefit from implementing the reforms (from between 1.11 to 1.14), even before taking into account many billions of dollars of strategic benefits that have not been included in the benefit/cost calculation. This is up from a range of 0.84 to 0.98 in October.

Compliance

Treaty of Waitangi

49. The AML/CFT Amendment Bill complies with the principles of the Treaty of Waitangi.

New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993

50. Overall the proposals contained in this paper appear to be consistent with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

51. The AML/CFT Bill has been forwarded to the Crown Law Office, which is still considering its consistency with the rights and freedoms affirmed in the New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

52. I will give an oral update at EGI/Cabinet once final advice is received.

Privacy Implications

53. The provisions in the AML/CFT Bill that relate to information-sharing have privacy impacts. A Privacy Impact Assessment (PIA) is being completed. Preliminary assessment highlights some potential privacy risks posed by the proposed Bill in relation to the collection, use and disclosure of information. The Select Committee process will offer opportunities to clarify and further refine these provisions, while still enabling effective information sharing in support of the AML/CFT regime.

54. Officials will draw this issue to the Select Committee's attention, so that it can be considered alongside submissions on the Bill.

FATF Recommendations and International Obligations

55. The AML/CFT Amendment Bill has been developed to bring New Zealand's AML/CFT framework in line with the recommendations made by the Financial Action Task Force (FATF). The Bill is designed to apply to entities that are part of the high-risk sectors identified by FATF, and to be broadly FATF compliant. However, the degree of New Zealand's compliance is ultimately a decision for FATF, who will be evaluating New Zealand in 2020.

LAC Guidelines

56. The AML/CFT Bill is compliant with the LAC Guidelines on the Process and Content of Legislation (2014 edition).

Disclosure statement requirements

57. A disclosure statement has been prepared, complies with the disclosure statement requirements, and is attached to this paper (Attachment D).

Legislative implications

58. An Amendment Bill will be required to implement the AML/CFT Phase II reforms. This paper seeks approval to introduce the Bill into the House.

Binding on the Crown

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

Associated Regulations

60. 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

61. 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.

62. 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.

63. 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

64. The reforms will not have any gender implications.

Disability perspective

65. The reforms will not have any disability implications.

Publicity

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

67. I propose that a public information campaign be undertaken. A review of Phase I indicates that not only do possible reporting entities need to be made aware of the changes but so do the general public who may be affected by the changes. The funding sought in the paper enables such a campaign to be undertaken.

Consultation

Sector and public consultation

68. The Ministry of Justice has undertaken two rounds of consultation on the proposed reforms. In August 2016, the Ministry of Justice consulted on policy proposals on how to improve New Zealand's ability to tackle money laundering and terrorist financing. In December 2016, the Ministry released an exposure draft Bill and sought feedback on how to reduce compliance costs. This included running workshops in late 2016 and early 2017 with a small number of businesses from the Phase 2 sectors.

69. The feedback provided an understanding of how businesses may change their practises in reaction to the new legislation. It also helped the Ministry of Justice to gauge the best ways for businesses to minimise their compliance costs.

Consultation with Government agencies

70. The Ministry of Justice has consulted with the AML/CFT Supervisors (Reserve bank of New Zealand, Department of Internal Affairs, Financial Markets Authority), the New Zealand Police, the Treasury, the Ministry of Business, Innovation and Employment, NZ Customs, Inland Revenue and the Ministry of Foreign Affairs and Trade.

71. The Department of the Prime Minister and Cabinet has been informed.

Treasury comment on financial recommendations

72. Funding is being sought ahead of the Budget process to meet timeframes for getting legislation passed and implemented by July 2018. While there is likely to be some benefit in allowing implementation planning to commence, Treasury is not aware of any critical imperative for agreeing funding ahead of the Budget and our preference is for funding decisions to be taken through the Budget process, allowing for more rigorous assessment and prioritisation against other initiatives.

73. Treasury is broadly comfortable with the approach DIA and Justice have taken to the number of FTEs required. However, we consider the costs require further testing and this is not been possible in the time available. Many of the costs appear high on an FTE basis and some are based on DIA averages rather than being marginally costed.

74. If Ministers wish to agree funding ahead of the Budget process, Treasury recommends that:

    74.1. funding for 2016/17 only be approved now, and

    74.2. funding for 2017/18 and outyears be placed in a tagged contingency with delegated authority for the Minister of Justice, the Minister of Internal Affairs and the Minister of Finance to approve once DIA's detailed costings have been reviewed.

75. The Department of the Prime Minister and Cabinet has been informed.

Privacy Commissioner comment on the information sharing framework

76. The information sharing framework proposed in clauses 139-143 is overly broad, disproportionate and confusing. As currently drafted the Bill will go beyond the objective of providing greater flexibility to share information to meet the purposes of the Act.

77. Clause 139, with its various sub-clauses, creates a confusing mixture of powers for agencies to share information. This clause is overly broad and does not contain adequate safeguards. For example, clause 139(1) would allow the Police, the New Zealand Customs Service, or an AML/CFT supervisor to disclose information to "any other government agency or to any regulator" for the purposes of "law enforcement", the definition of which is expanded by clause 5 to include a wide range of administrative functions under many other Acts. In addition, clause 139(2) would allow agencies to disclose information when, in their view, the receiver has a "proper interest" in receiving the information. Such broad powers to share personal information for a wide range of purposes are disproportionate given the purpose of the Anti-Money Laundering and Countering Financing of Terrorism Act.

78. I recommend that the Committee direct officials to amend the information-sharing provisions in the Bill to ensure they are clear, appropriately constrained and include proper safeguards before the Bill is approved for introduction.

79. My staff would be available to assist officials in this process. I would also be available to speak to the Committee directly if that would assist its consideration of this Bill.

Consultation with Coalition parties

80. It is not necessary to consult with other political parties on the AML/CFT Amendment Bill.

Consequential amendments

81. The AML/CFT Amendment Bill consequentially repeals the Financial Transactions Reporting Act 1996

Allocation of decision making powers

82. The AML/CFT Amendment Bill complies with the criteria and procedures set out in the Legislation and Advisory Committee (now the Legislation Design and Advisory Committee) report, LAC Guidelines: Guidelines on Process and Content of Legislation 2014 Edition.

Associated regulations

83. A suite of regulations will need to be amended to bring the AML/CFT Amendment Bill into effect 12 months from enactment date. The regulations will be of medium complexity.

Other instruments

84. The proposed Bill will allow the Secretary of Justice to exempt, either individually or as a class, entities, transactions and/or services from the AML/CFT Act. These exemptions are legislative and disallowable instruments under the Legislation Act 2012. This proposal seeks to streamline the exemptions process by removing the need for Ministerial sign-off, as this power is currently held by the Minister of Justice.

Definition of Minister/department

85. This Amendment Bill does not contain a definition of Minister, Department or Chief Executive. These definitions were made the first Phase of reforms under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009.

Commencement of legislation

86. The different sectors within scope of the Bill will be brought into the AML/CFT regime in a staged manner by Order in Council. A staged implementation is appropriate to enable the necessary regulations and guidance to be made. It is also necessary to ensure the Department of Internal Affairs (the relevant AML/CFT supervisor) has sufficient time to build capacity to appropriately supervise and monitor compliance across the diverse sectors. The expected timetable for commencement is:

    86.1. for lawyers and conveyancers, no later than 12 months from enactment;

    86.2. for accountants, no later than 15 months from enactment;

    86.3. for real estate agents, no later than 18 months from enactment;

    86.4. for the New Zealand Racing Board and high value dealers, 24 months after enactment.

Parliamentary stages

87. The Bill should be introduced on 13 March 2017 and passed by the end of July at the latest.

88. I intend to refer the AML/CFT Amendment Bill to the Law and Order Select Committee.

Recommendations

The Minister of Justice recommends that the Committee:

Policy recommendations

1. **Note** that consultation on the exposure draft of the Anti-money laundering and Countering Financing of Terrorism Amendment Bill has highlighted the need for some changes to the Bill before introduction and helped to reduce the earlier anticipated compliance costs;

2. **Agree to rescind** the decision to bring 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) [CAB-16-MIN-0552 at 9.6] **and instead;**

3. **Agree** to extend the commencement period, to be brought in by Order in Council, for lawyers, conveyancers, accountants and New Zealand Racing Board as follows:

    3.1. Lawyers and conveyancers to be brought in to the AML/CFT regime within 12 months after enactment;

    3.2. Accountants be brought in to the AML/CFT regime within 15 months after enactment;

    3.3. Real estate agents to be brought in to the AML/CFT regime within 18 months after enactment;

    3.4. New Zealand Racing Board and high value dealers to be brought in to the AML/CFT regime 24 months after enactment;

4. **Agree** to the proposed minor and technical amendments attached as Attachment D;

5. **Confirm** the remaining policy decisions from October 2016 made under [CAB Min refers];

6. **Note** that the Ministry now estimate that there will be fewer reporting entities, with a consequent reduction in estimated business compliance cost to between $1.1billion to $0.8 billion NPV over 10 years;

Financial recommendations

7. **Note** that, based on feedback from consultation on the exposure draft, the Ministry now estimate that there will be fewer reporting entities, with a consequent reduction in estimated business compliance cost to between $1.1billion to $0.8 billion NPV over 10 years, this is down from the top end estimate in October of $1.6 billion;

8. **Note** that there is a small net benefit from implementing the reforms (cost benefit of between 1.11 to 1.14 (up from a range of 0.84 to 0.98)), even before taking into account many billions of dollars of strategic benefits that have not been included in the benefit/cost calculation;

9. **Note** that funding is required for:

    9.1. The Department of Internal Affairs to supervise reporting entities, provide timely and comprehensive guidance, and provide effective business facing

services, and for the capital associated with their expanded supervision role; and

9.2. The Ministry of Justice to approve exemptions for Phase 1 entities, and to undertake a public information campaign;

10. **Note** that funding for Police was included in Cabinet's decision of [CAB -17- MIN 0008];

If you agree to the proposals and timeline in this paper:

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

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

12. **Agree** that the proposed changes to appropriations for 2016/17 above be included in the 2016/17 Supplementary Estimates and that, in the interim, that the increases be met from Imprest Supply;

13. **Note** that the between-Budget contingency established as part of Budget 2016 is exhausted for 2016/17;

14. **Agree** that the expenses under paragraph 12 above be charged as a pre-commitment against the Budget 2017 operating allowance;

15. **Agree** to establish the below tagged contingency as a pre-commitment against the Budget 2017 operating and capital allowances:

16. **Note that** the funding below covers both the Ministry of Justice and the Department of Internal Affairs funding requirements;

Tagged Contingency: **AML Phase II funding**	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & Outyears**
withheld under section 9(2)(f)(iv) of the OIA					

17. **Agree** that the draw down by DIA and the Ministry from the above contingency be contingent on a review of the Department of Internal Affairs' overhead costings for this initiative;

18. **Agree** that authority to approve draw down from the tagged contingency be delegated to the Minister of Justice, the Minister of Internal Affairs and the Minister of Finance;

19. **Note** that this pre-commitment will reduce the operating and capital funding available for initiatives in Budget 2017 by commensurate amounts;

Approval for Introduction

20. **Note** that the Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill holds a category 3 priority on the 2017 Legislation Programme;

21. **Note** that the Bill extends compliance obligations to other high-risk sectors in order to detect and deter money laundering and the financing of terrorism;

22. **Approve** the Anti-Money Laundering and Countering the Financing of Terrorism Amendment Bill for introduction,

23. **Agree** that the Government propose the Anti-Money Laundering and Countering the Financing of Terrorism Amendment Bill be:

    23.1. introduced on 13 March 2017, which is the first available date after Cabinet approval;

    23.2. referred to the Law and Order Committee for consideration; and

    23.3. reported back by the Committee in time for it to be enacted by the end of July at the latest.

Hon Amy Adams
Minister of Justice

Attachment A

Key October Cabinet Decisions

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

2. 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;

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 these sectors;

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 will have obligations.

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 (as was always the intention in Phase 1);

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);

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;

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

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

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

11. 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'.

12. to cover 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 $15,000, but imposing a limited set of AML/CFT obligations (eg basic customer due diligence and significant cash reporting);

Attachment B – Summary of feedback from workshops

Attachment C – Analysis of submissions on exposure draft Bill

Attachment D – Amendments to clarify provisions of the Bill

	Issue	Submissions	Analysis and recommendation
1	**Definitions and activities.** Phase 2 of the Act covers designated non-financial businesses and professions (DNFBPs) - lawyers, accountants, real estate agents and some high value dealers.	Submitters thought that some of the definitions for the DNFBPs and their activities were insufficiently clear or defined. Submissions were supportive of bring entities captured by Phase II into the AML/CFT regime and appreciated the need to strike a balance between combating crime, minimising costs and enabling NZ to meet its international obligations. Submissions were also supportive of a risk based approach and having AML/CFT obligations commensurate with risk.	**Minor technical changes in the definition of DNFBPs to provide more clarification of their activities**. This will remove ambiguity and reduce any inadvertent inclusion of reporting entities under the Act.
2	**Activities and risk.** The requirement that the listed activities for inclusion under the Act need to also give rise to a risk of money laundering or terrorism financing creates a situation where a reporting entity must assess such risks before determining whether the Act applies.	The need for clarification on this topic was raised in submissions.	**Minor changes to the wording around the application of the Act to the listed activities.** This will remove potential confusion around whether an activity is captured under the Act or not.
3	**Coverage of customer due diligence (CDD) for real estate agents and lawyers.** The Act requires reporting entities to conduct CDD prior to establishing a business relationship. In regards to real estate agents and lawyers the timing and nature of CDD is not straightforward.	Submissions and workshops advocated for both early and late CDD (REINZ and REAA preferred early CDD) but the general consensus was for a more flexible approach to conducting CDD. Submissions and workshops supported the inclusion of the real estate industry under the Act though some submissions suggested that only the vendor be covered. Police supported AML/CFT obligations for real estate agents for both parties to the transaction. Lawyers also raised the issue of the timing of CDD in relation to their clients via submissions citing a number of situations where CDD at the beginning of a business relationship would be difficult.	**Minor provisions to the Act to allow CDD for real estate agents to be determined by regulation.** This allows for further consultation with industry to design a more cost effective and business friendly CDD process. Real estate agents will apply AML/CFT obligations to their client only (vendor or purchaser) but not the opposing party in the transaction. Where a real estate agent accepts cash deposits over $10,000, they are required to conduct CDD on the person making the deposit. In relation to lawyers there are sufficient existing provisions in the

	Issue	Submissions	Analysis and recommendation
			Act to allow for delayed CDD.
4	**Changes to Simplified CDD.** There is scope to expand simplified customer due diligence (meaning lower levels of CDD) to more State Owned Enterprises and other low risk entities, including those in overseas jurisdictions with sufficient AML/CFT systems.	Expanding simplified customer due diligence was supported by submissions as was bringing simplified customer due diligence rules from regulation into the Act.	**Minor technical changes to who can be subject to simplified customer due diligence.** This will result in lower compliance costs when dealing with these entities who have a demonstrably low risk profile. This is consistent with international partners.
5	**Legal professional privilege.** Concerns were raised during consultation about how privileged communication would operate with the Act and the requirements to submit suspicious activity reports (SARs).	Submissions requested further guidance on this topic.	**Minor changes to clarify the threshold for legal privilege.** This will help remove potential confusion for when AML/CFT obligations come into effect, including SARs.
6	**Coverage of gambling service providers.** It is intended NZRB only have AML/CFT obligations with respect to its accounts, betting vouchers and large cash transactions. Note: Casinos were covered in Phase I.	NZRB raised a concern that class 4 gambling (pokie machines) may inadvertently be captured under the current drafting of the Act. Due to the low risk associated with pokie machines in clubs and pubs, it is not considered appropriate to capture these under Phase II. Submissions were supportive of the $10,000 threshold for the gambling sector.	**Minor changes to the Act to exclude class 4 gambling.** This will ensure NZRB only has obligations with respect to its accounts, betting vouchers and large cash deposits.
7	**Definition of transaction for placing of bets and gambling activities.** The definition of transaction in the Act excludes the placing of bets and gambling activities. This is appropriate for casinos, which are existing reporting entities, to limit transaction monitoring compliance burdens. However, this limits the scope of capture of the NZRB and would lead to gaps in AML/CFT controls.	Submissions on the gambling sector predominantly reflected a concern over wording and definitions in the Bill. Others related to reporting threshold inconsistency between gambling and high value dealers.	**Minor changes to the definition of transaction in respect to placing of bets and gambling.** This will close any inadvertent gaps in AML/CFT controls associated with the NZRB.
8	**Information-sharing.** It is important to create an environment where relevant agencies can share information in an effective manner. AML agencies can share information	Submissions supported the sharing of information while ensuring appropriate precautions. Submissions also noted the importance of effective information sharing to enforce the AML/CFT regime, again with appropriate safe guards.	**Minor changes to provisions around information sharing.** Police, Customs and supervisors will be able to share any information,

	Issue	Submissions	Analysis and recommendation
	with other agencies only in limited circumstances. The recent Shewan report highlighted information sharing as a key gap in the current AML/CFT regime and an area where improvements are required. The current drafting could lead to some confusion in regards to sharing personal information.		including personal information, to any other government agency (including international counterpart govt agencies) and to any regulator which has enforcement functions under statute (for example, NZ Law Society). Such sharing must be for law enforcement or regulatory purposes, and the disclosing agency needs to be satisfied that the other agency/regulator has a proper interest in receiving the information. Unless permitted under another statute, any other sharing of information relevant to the Act, for example to or from reporting entities, or from regulators, can be made in accordance with regulations or an information sharing agreement. This approach will clarify how relevant parties can share information, especially personal information.
9	**Alignment of reporting thresholds.** There is an issue of consistency between certain reporting thresholds which has resulted in some regulatory inconsistency. For instance $9999.99 as opposed to $10,000.	Submissions on this topic ranged from inconsistency between the gambling sector and high value dealers	**Minor changes to reporting thresholds.** This will ensure thresholds are consistent and equal to or above an agreed amount. This means round figures can be used which are easier to communicate and avoids reporting confusion.
10	**Audit period.** Reporting entities must have an AML/CFT audit every two years or at any other time at the request of the relevant AML/CFT supervisor. However, certain low risk sectors may warrant a longer	Some submissions supported the reduction of the frequency of the AML/CFT audit.	**Minor changes to include a provision to extend audit periods for certain reporting entities.** This will reduce compliance costs for some low risk reporting entities.

	Issue	Submissions	Analysis and recommendation
	period between audits.		
11	**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.	Having a multi-agency supervision (the existing model) was generally the preferred option in submissions. However, a submission did advocate for the FMA to supervise the accountancy sector and others stated a preference for a single supervision model. The Law Society made a submission detailing their rationale for making them the AML/CFT supervisor for the legal profession.	**Amendment to the current provision that would enable supervision of Phase II sectors to be transferred to another agency via Regulations** The change would maintain the position of having a multi-agency model and establish DIA as the supervisor for all Phase II sectors, but would allow a flexible approach to transferring supervisory functions to another agency should this be considered appropriate.

Appendix E – No changes to the Bill

	Issue	Submissions	Recommendation
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. 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.	Some submissions supported bringing existing obligations from Regulations in to the Act.	**Maintain the position of having 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 and Regulations will define the specific elements of the activities and at what point of conducting those activities the compliance obligations would apply.
2	**Statutory review period.** The Bill proposes a statutory review of the AML/CFT regime after the next FATF mutual evaluation in 2020.	One submission was received on this topic supporting the proposal.	**Maintain the position to have a statutory review immediately after the FATF evaluation is complete.** This option would enable NZ to respond quickly to FATF recommendations or international pressures after the evaluation report.
3	**Property developers.** 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 apply.	No formal submissions received on this topic.	**Maintain the position that 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.** This will ensure a level playing field for real estate agents and property developers and close and potential gaps in AML/CFT coverage.
4	**Coverage of high value dealers.** High value dealers have reduced AML/CFT obligations under Phase II. `	Submissions generally indicated that high value dealers should be subject to full AML/CFT obligations given the risk they present, including full SAR responsibilities. Submissions also highlighted the inconsistency in reporting thresholds (see below).	**Maintain the position of extending the AML/CFT 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 but apply limited AML/CFT obligations (customer due diligence and significant cash reporting).** Compliance burden would be reduced, particularly on small businesses, by only requiring affected businesses to comply with limited obligations. Entities would not be required to have the full set of risk and compliance management processes in place

	Issue	Submissions	Recommendation
			which enhances compliance. Dealers may also report suspicious activity, although this would be optional rather than a mandatory requirement.
5	**Applicable cash threshold for high value dealers.** The obligations for high value dealers under option will be triggered when there is a cash transaction above $15,000.	Submissions were mixed on the threshold. Most highlighted the inconsistency of thresholds and the difference between the gambling sector and those trading in high value goods. While others supported aligning the threshold to other parts of the regime ($10,000). Some submitters reported they, or their industry, would stop taking cash over the threshold to avoid AML/CFT obligations.	**Maintain the position of having the applicable threshold to trigger AML/CFT obligations for high value dealers would be set at $15,000.** While the proposed threshold does 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)it align with the FATF Recommendations which require that high value dealers conduct CDD on cash transactions over 15,000 USD/Euro. The limited AML/CFT obligations will reduce compliance costs
6	**Ministerial exemptions.** The power to grant exemptions from the Act currently lies with the Minister of Justice. Assessment of the process has indicated that delegation of this power to the Secretary of Justice, with appropriate support and controls, will decrease times frames and improve application decision rates.	Submissions supported the streamlining of the Ministerial exemption process.	**Maintain the position where exemption power is vested in the Secretary for Justice.** This option would shift responsibility for granting exemptions to the Secretary for Justice and include key improvements to achieve greater efficiency. Further analysis on process improvement is required.
7	**Suspicious activity reporting (SARs).** Limitations in the suspicious transaction reporting (STR) regime have been identified in the Shewan report and by the FIU, as suspicious activity is not reported when it is identified outside of a specific transaction. As a result of the limitations, valuable financial intelligence is not being reported to the FIU by reporting entities when they identify suspicious activity.	Most submissions supported SARs but some voiced concerns over compliance costs. Submitters strongly indicated they wanted clear guidance on SARs to ensure consistency and an efficient process.	**Maintain the position where reporting entities are required to report suspicious activities.** This option would address concerns from the Shewan report while at the same time embedding some safeguards to respond to potential criticism of this new power.
8	**Reliance on third parties.** Provisions were made to expand the circumstances where reliance on third parties could operate. ***Designated business groups:*** Allowing related Phase II businesses to share AML/CFT resources under a	Overall submissions supported expanding the circumstances of reliance on third parties to allow reporting entities to share AML/CFT obligations to reduce compliance burden.	**Maintain the position to expand the instances in which reporting entities can rely on each other to reduce their compliance burden.** These options would allow, for example, reporting entities to form a DBG for their specific

	Issue	Submissions	Recommendation
	designated business group (DBG) is an effective measure to reduce compliance burden by allowing related entities to share an AML/CFT programme and risk assessment. ***Reliance:*** Expanding the reliance provisions, for instance through the use of prescribed entities, could lead to reduced compliance costs and reduced duplication of AML/CFT measures. ***Documentation***: Currently, a reporting entity that relies on the CDD of another must obtain the verification documents within five days. However, in line with international practice, under new provisions a reporting entity can rely on another reporting entity, as long as verification documents are provided without delay upon request rather than within five days.	They also requested guidance and suggested clarification of the wording in the Bill. Issues of trusts between reporting entities and capability were also raised in workshops. ***Designated business groups***: Submissions were supportive of expanding the definition of DBGs along with relevant clarifications. Some submissions suggested Limited Partnerships and industry bodies could be part of a DBG. ***Reliance:*** Submissions were supportive of the proposed enhancements for reliance while others felt that liability and responsibility for CDD should rest with the reporting entity conducting CDD. ***Documentation:*** Submissions were generally in support of this option apart from Police	circumstances and expand circumstances under which reliance on another reporting entity is permitted for CDD. While the reliance provisions will not address the key issue raised by sectors seeking to limit liability and resolve the issue of consent, they will alleviate some compliance burden.
9	**Trust and company service providers (TCSPs).** Bringing TSCPs under the Act according to activity will ensure a level playing field among businesses providing similar services (such as lawyers and accountants) and stop any displacement effect. This will also bring TCSP requirements in line with international standards set by the FATF.	No formal submissions were made in relation to this topic.	**Maintain the position to treat TCSPs as any other DNFBP if it engages in the activities listed in the Act in the ordinary course of business.** This would be consistent with the treatment of all other types of businesses and avoid the risk of regulatory arbitrage.