TO THE FOREIGN AFFAIRS, DEFENCE AND TRADE COMMITTEE

RE: NEWSED TERRORISM BILL (THE BILL)

24 AUG 2009

FOREIGN AFFAIRS, DEFENCE & TRADE

13 AUG 2009

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This submission is from Chapman Tripp, PO Box 993, Wellington 6140.

We would be happy to appear before the Committee to speak to our submission, if required. Our contacts are:

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Chapman Tripp has been developing expertise and advising various clients on anti-money laundering (AML) matters, as well as tracking the experience of overseas jurisdictions.

As a national law firm with a large corporate practice and client base, Chapman Tripp would expect to be engaged in advising clients on the implementation of the requirements of the legislation.

Our submission therefore focuses on achieving clarity in the law and practicality in the design of the new regime. Key issues we have identified are:

(a) ongoing customer due diligence poses significant practical and compliance costs issues. We submit that a “risk filter” should be included in clause 28 (refer pages 48 and 49);

(b) the “beneficial owner” test poses difficulty, particularly in the context of trusts and politically exposed persons (refer pages 29 to 32 and 40 to 43);

(c) the definition of “financial institution” is very broad, and inconsistent with other legislation, causing uncertainty around the fundamental issue of to whom the regime is intended to apply (refer pages 7 to 10);

(d) the key concept of “money laundering” is not defined (refer pages 12 to 14);

(e) it is not clear how a reporting entity is to obtain and verify information on the source of wealth or funds of a customer (refer page 39);

(f) it is not clear what would satisfy the obligations to “review” and “regularly review” (refer pages 48, 49 and 56 to 57);

(g) there is uncertainty regarding the various commencement dates for different parts of the Bill (refer pages 3 and 4).
(h) clarification would be helpful as to when a business relationship is established, and what constitutes a change in its nature or purpose (refer pages 16 and 19);

(i) the occasional transaction requirements are potentially very onerous (refer pages 9 to 10, 17, 41 to 43);

(j) the consequences of simplified due diligence applying in a particular circumstance are not clear (refer page 27);

(k) some similar concepts are treated inconsistently, which can give rise to subsequent interpretational difficulty and - potentially - to additional compliance costs (refer pages 8 to 10, 15, 21, 22 to 23 and 28);

(l) there are potential issues around the timeframe for completing delayed and delegated verification, particularly when the five day period currently provided for spans days which are not working days for the particular reporting entity (refer pages 24 to 25);

(m) we are also concerned about obligations imposed on reporting entities when a reporting entity does not and cannot be expected to know that the obligation applies, with significant consequences for getting it wrong. While supervisory and prosecutorial discretion and common sense should apply, a fence at the top of the cliff in terms of clear obligations for reporting entities would be preferable (refer pages 29 to 32, 33 to 35, 36, 39, 40 to 44, 45, 47, 48 to 49, 50, 56 to 57 and 58);

(n) the penalty for avoidance is set too high, and should be set instead at evasion (refer pages 59 and 60); and

(o) we also comment on some points of drafting that we have noticed as we worked through the Bill.
CLAUSE 2 COMMENCEMENT

5 Different parts of the Bill are intended to come into force at different times. Clarification of when provisions will come into effect will assist reporting entities to prepare for meeting their obligations.

6 Clause 2 provides that the Act comes into force on a date to be appointed by the Governor-General by Order in Council, but that one or more Orders in Council may be made appointing different dates for the commencement of different provisions.

7 A staged implementation is planned for the Bill. More clarity over when particular provisions will come into effect would be helpful.

8 The explanatory note to the Bill states at page 22 that implementation of the anti-money laundering (AML) and countering the financing of terrorism (CFT) regime is expected to take place in late 2011, two years following expected legislative assent in October 2009. The two-year lead time is to allow any necessary regulations to be finalised and guidance material to be developed, and to allow reporting entities time to become aware of their compliance obligations and to make the necessary adjustments to their internal systems and procedures (page 29).

9 We assume the provisions in Part 4 establishing the supervisory regime and granting the power to make regulations, and the provisions relating to codes of practice in subpart 5 of Part 2, will come into force on enactment.

10 It would seem logical that the customer due diligence provisions in subpart 1 of Part 2 should not commence until after reporting entities have had time to understand their obligations and make the necessary adjustments to their internal systems and procedures. We would also hope that commencement of the enforcement provisions, at least in respect of offences and penalties for failure to comply with the customer due diligence procedures, would also be delayed until at least that time. This would allow reporting entities to establish their systems and get up to speed with the requirements within the safe harbour of a “prosecution-free” period.

11 It is not clear when the provisions relating to risk assessments and AML/CFT compliance programmes and officers are expected to come into force. Will the requirements in subpart 4 of Part 2 for reporting entities to undertake a written risk assessment, regularly review it, have it audited, and prepare annual reports, as well as the requirements to establish, implement and maintain an AML/CFT compliance programme and appoint and designate an employee as an AML/CFT compliance officer, come into force on enactment? We would expect that they would come into force before the customer due diligence provisions themselves, as reporting entities must undertake their risk assessment before conducting any customer due diligence (clause 55(1)). Given that the Bill is expected to be enacted in only a few weeks’ time, it would be helpful if the timeframes could be clarified so that reporting entities can be advised accordingly.
It would also be helpful to clarify if the provisions relating to reporting suspicious transaction reports (subpart 2 of Part 2), cross-border transportation of cash reports (subpart 6 of Part 2) and search and seizure (subpart 4 of Part 3) will also come into force on enactment, or at some later time.

RECOMMENDATION 12 We recommend that clarification be provided as to when various provisions are expected to come into force, so that reporting entities can be aware of what their obligations will be on enactment of the Bill, and can prepare accordingly.
INTERPRETATION

13 There appears to be a drafting error in paragraph (e)(iv) of the definition of "designated business group" in clause 4.

Membership of a "designated business group" should require relation to only one of a government department, state enterprise or crown entity

14 Paragraph (e)(iii) of the definition of "designated business group" is satisfied if each member of the group is a government department, state enterprise or Crown entity.

15 Paragraph (e)(iv) of the definition of "designated business group" is satisfied if each member of the group is related to "the entities" specified in paragraph (e)(iii), through the provision of common products or services.

16 The use of the plural in paragraph (e)(iv) may create confusion if - as seems likely - the policy intent is that relation by all members to only one of the entities in paragraph (e)(iii) would suffice to meet the requirements for forming a "designated business group".

RECOMMENDATION

17 We recommend that paragraph (e)(iv) of the definition of "designated business group" in clause 4 be deleted and replaced by the following:

"related to one or more of the entities in subparagraph (iii) through the provision of common products or services; and"
Some definitions appear to have been omitted from clause 4. Cross-references to definitions should be inserted into clause 4.

Clause 4 contains a comprehensive list of terms defined in the Bill. Where terms are defined in specific clauses of the Bill, clause 4 contains a cross-reference to those definitions. For example, “correspondent banking relationship” is defined in clause 26(3) for the purposes of the Act, and “shell bank” is defined in clause 36(2) for the purposes of section 36(1). Both of these definitions have cross-references in clause 4.

It appears that some cross-references have been inadvertently omitted from clause 4. For example, “domestic wire transfer” is defined in clause 24(7), “code of practice” and “proposed code of practice” in clause 59, “privileged communication” in clause 39, and “document”, “dwellinghouse”, “enforcement officer”, “evidential material”, “occupier”, “place”, “seize” and “thing” in clause 113.

We recommend that clause 4 be amended by inserting, in appropriate alphabetical order, a cross-reference to the following definitions along the following lines:

“code of practice has the meaning set out in section 59

document has the meaning set out in section 113

domestic wire transfer has the meaning set out in section 24(7)

dwellinghouse has the meaning set out in section 113

enforcement officer has the meaning set out in section 113

evidential material has the meaning set out in section 113

occupier has the meaning set out in section 113

place has the meaning set out in section 113

proposed code of practice has the meaning set out in section 59

privileged communication has the meaning set out in section 39

seize has the meaning set out in section 113

thing has the meaning set out in section 113”.
The definition of “financial institution” is very broad, and inconsistent with other similar statutes.

The definition of “financial institution” should be amended to be consistent with other Acts, and further consideration given to its scope.

The first phase of the Bill defines “reporting entity” by reference to financial institutions and casinos. The definition of “financial institution” is therefore fundamental to a determination of whether an entity is in or out of the AML regime.

The definition of “financial institution” in the Bill is very broad. “Financial institution” means a person who, in the ordinary course of business, carries on one or more of the following activities:

(i) accepting deposits or other repayable funds from the public;
(ii) lending to or for a customer, including consumer credit, mortgage credit, factoring, and financing of commercial transactions (including forfeiting);
(iii) financial leasing (excluding in relation to consumer products);
(iv) transferring money or value for, or on behalf of, a customer;
(v) issuing or managing the means of payment (for example, credit or debit cards, cheques, traveller’s cheques, money orders, bankers’ drafts, or electronic money);
(vi) undertaking financial guarantees and commitments;
(vii) trading on the person’s own account or for the accounts of customers in: money market instruments (such as cheques, bills certificates of deposit or derivatives), foreign exchange, exchange, interest rate or index instruments, transferable securities, and/or commodity future trading;
(viii) participating in securities issues, and the provision of financial services related to those issues;
(ix) managing individual or collective portfolios;
(x) safe keeping of, or administering, cash or liquid securities on behalf of other persons;
(xi) investing, administering, or managing funds or money on behalf of other persons;
(xii) underwriting or the placement of life insurance or other investment related insurance;
(xiii) money or currency changing.
We understand the definition of “financial institution" was intended to match the definition of “financial service" in section 5 of the Financial Service Providers (Registration and Dispute Resolution) Act 2008 (FSP Act). While there are many parallels, the two definitions are not consistent. For example:

- the FSP definition refers to “deposit takers” as defined in the Reserve Bank of New Zealand Act 1989 (the Reserve Bank Act), whereas the Bill refers to persons “accepting deposits or other repayable funds from the public”. Section 157C of the Reserve Bank Act defines “deposit taker” to mean a person who offers debt securities to the public in New Zealand, and carries on the business of borrowing and lending money, or providing financial service, or both. Offering debt securities to the public is specifically defined in section 3 of the Securities Act 1978 and contains some notable exclusions. The definition of “deposit taker” in the Reserve Bank Act also includes a list of inclusions and exclusions. The phrase “accepting deposits or other repayable funds from the public” does not cover the same ground as paragraph (b) of the “financial service” definition in the FSP Act;

- the definition in the Bill includes financial leasing (paragraph (iii)), whereas the FSP definition does not; and

- paragraph (i) of the FSP definition refers to participating in the offer of a security to the public as an issuer, promoter, manager etc, whereas paragraph (viii) of the definition in the Bill refers to “participating in securities issues and the provision of financial services related to those issues”. It is clear that legal and other professional advisers to a securities issue are not inherently caught by the FSP definition, whereas it is not similarly clear with respect to the definition in the Bill. Would a corporate doing a one-off equity raising be participating in securities “issues”?

Additionally, we note that paragraph (n) of the FSP definition includes the provision of “any other financial service that is prescribed for the purposes of New Zealand complying with the FATF Recommendations”. It therefore appears that the broad and somewhat unclear definition of “financial institution” in the Bill is arguably to be read into (and added to) the definition of “financial service” in the FSP Act.

In addition, there are a number of words and phrases used in the definition of “financial institution” in the Bill that are not defined. For example:

- “ordinary course of business”. How does this affect companies that are under a moratorium? Ordinarily they might, for example, accept deposits from the public, but the terms of the moratorium will most probably prohibit this. Do such companies remain caught by the definition of financial institution in the Bill?
“public”. Does this have the same meaning as in section 3 of the Securities Act 1978?

“repayable funds”. What is the difference between accepting repayable funds and accepting "deposits"?

“lending to or for a customer”. Does this include a purchaser of accounts receivable?

“transferring value”. What does this phrase mean? Does it correlate with "operating a value transfer service" in paragraph (f) of the FSP Act definition? If so, should the two references not be the same? Would the clearing and settlement systems of NZX Limited constitute "transferring money or value for, or on behalf of, a customer"?

"issuing or managing the means of payment". Is this intended to catch an entity that issues vouchers to its (consumer) customers? Issuing a voucher that is redeemable for later payment appears to be "managing the means of payment". Are entities that facilitate payment between two unrelated entities (like PayPal or Trademe) intended to be caught? What about “back office” payment service providers who facilitate information transfer between merchants and, say, credit card providers?

"financial services" (paragraph (viii)). This is not defined in the Bill. Is it intended to import the meaning of the term as defined in the FSP Act?

"administering" money (paragraph (xi)). What does this mean? Does a person running a cake stall “administer” money? How is "money" different to "cash", used in (x)?

There is no exception for intra-group arrangements. For example, an entity would be caught as a “financial institution” even if it only carried out the listed activities intra-group.

The breadth of the definition potentially catches entities and activities that are outside the intended scope of the legislation. The concept of "ordinary course of business" is very broad. A loan by a company may be in the ordinary course of business even though it is not something that the company ordinarily does. There is no requirement for a specified financial activity to be a material part of an entity's business. A manufacturing company, for example, providing lines of credit to large customers from time to time would technically fall within the concept of "financial institution" as defined. What would be the consequences of that? If an entity is caught as a reporting entity as a result of carrying out a specified financial activity, albeit however small, in the ordinary course of its business, to whom must it apply customer due diligence? To all of its customers, or only the customers involved in the specified financial activity? Would any transaction over the "applicable threshold" fall within the concept of "occasional
transaction" requiring due diligence, for example of a manufacturing company's purchasers? The requirements of the Bill are "one size fits all" - the same no matter what the type of transaction or entity. We appreciate that much detail has been specifically reserved for regulation, however, the definition of "financial institution" is such an important and fundamental concept within the context of the Bill, importing potentially onerous compliance obligations with serious consequences for failing to comply, that legislative clarification is desirable. Businesses need to know whether the regime is to apply to them, and what they need to do in order to comply with it.

RECOMMENDATION 29 We recommend that the definition of "financial institution" be substantively reviewed, including for consistency with other Acts such as the FSP Act and the Securities Act 1978. Additionally, we recommend that further guidance is given as to which entities are intended to be caught by the regime, and the definition of "financial institution" amended as appropriate.
The reference to offences under the Income Tax Act 2007 in the definition of "law enforcement purposes" is incorrect, as the Income Tax Act 2007 does not provide for any offences.

The reference to offences under the Income Tax Act 2007 should be replaced with a reference to offences under the "Inland Revenue Acts".

Paragraph (b)(iii) of the definition of "law enforcement purposes" includes within the scope of the definition the "detection, investigation, and prosecution of... any offence under the Income Tax Act 2007".

Tax offences were removed from the core income tax legislation during the process of reorganising the income tax legislation in 1994. Tax offences are now contained largely in the Tax Administration Act 1994, although not exclusively (refer, for example, to Part 12 of the Child Support Act 1991, Part 6 of the Student Loan Scheme Act 1992 and sections 197-199 of the Kiwisaver Act 2006).

Due to the spread of tax legislation over several Acts, tax offences are usually incorporated by reference to "the Inland Revenue Acts" (see, for example, section DB 3(2)(b) of the Income Tax Act 2007, section 20A(3)(b) of the Goods and Services Tax Act 1985 and section 152(16)(b) and (c) of the Tax Administration Act 1994). The "Inland Revenue Acts" are defined in section 3(1) of the Tax Administration Act 1994 to include, among others, the Income Tax Act 2007, the Goods and Services Tax Act 1985, the Gaming Duties Act 1971, the Stamp and Cheque Duties Act 1971, the Estate and Gift Duties Act 1968, the Child Support Act 1991, the Student Loan Scheme Act 1992, and the Kiwisaver Act 2006. It would seem logical that the detection, investigation and prosecution of an offence in respect of payments made under any of these Acts would constitute "law enforcement purposes" for the purposes of the Bill.

We recommend that the definition of "law enforcement purposes" in clause 4 be amended by deleting paragraph (iii) and replacing it with the following:

"(iii) any offence under the Inland Revenue Acts (as defined in section 3(1) of the Tax Administration Act 1994); and"
CLAUSE 4

35 The term "money laundering" is not defined in the Bill.

36 The Bill refers to "money laundering" in various places: a suspicion of "money laundering" in relation to a customer triggers the requirement to conduct standard due diligence, whether or not customer due diligence has been conducted on that customer before (clause 12(1)(c)); a reporting entity must establish, implement and maintain an AML/CFT programme to detect, manage and mitigate the risk of money laundering (clauses 53(1) and 54(f)) and to prevent the use, for money laundering, of products and transactions that might favour anonymity (clause 54(j)); a reporting entity must assess the risk of money laundering that it may reasonably expect to face in the course of its business (clause 55(1)); the functions of an AML/CFT supervisor are to monitor and assess the level of risk of money laundering across all of the reporting entities it supervises (clause 128(a)); the Commissioner of Police is to produce guidance material on the typologies of money laundering transactions, and risk assessments relating to money laundering (clause 128(b) and (k)); before recommending regulations, the Minister must have regard to the risk of money laundering (clause 148(2)(b)); and before deciding to grant an exemption, the Minister must have regard to the risk of money laundering associated with the reporting entity, including the products and services it offers and the circumstances in which they are provided.

37 The concept of "money laundering", although fundamental to the regime, is not defined.

38 In places, the Bill uses the concept of a "money laundering offence":

- a reporting entity must take additional measures to prevent any new or developing technologies and products from being used in the commission of a "money laundering offence" (clause 27(a));

- suspicion that a transaction may be relevant to the investigation or prosecution of any person for a money laundering offence is grounds for a suspicious transaction report (clauses 37(b)(i) and 40(1)(a)) and offences apply if one is not made or is unlawfully disclosed (clauses 90(b)(i), 92(1)(b)(i) and 92(2)(b)(ii)(A));

- the Commissioner of Police must issue guidelines setting out any features of a transaction that may give rise to a suspicion that the transaction is or may be relevant to the investigation or prosecution of any person for a money laundering offence (clause 139(1)(a)(ii)); and

- in connection with branches and subsidiaries in a foreign country, reporting entities must take additional measures to effectively handle the risk of a money laundering offence (clause 58(2)(b)).
“Money laundering offence” is defined in clause 4 to mean an offence against section 243 of the Crimes Act 1961 or section 12B of the Misuse of Drugs Act 1975, or any act committed overseas that, if committed in New Zealand, would be an offence under those sections.

These provisions turn on the concept of a “money laundering transaction”, which is also used in the Bill in clause 42(1)(c). Section 243(4) of the Crimes Act 1961 (the Crimes Act) provides that a person engages in a “money laundering transaction” if, for the purpose of concealing any property or enabling another person to conceal any property, that person deals with that property or assists any other person, whether directly or indirectly, to deal with that property. Under section 243(2) of the Crimes Act, it is an offence punishable by up to 7 years’ imprisonment to knowingly engage in a money laundering transaction in respect of any property that is the proceeds of a “serious offence”. Under section 243(3) of the Crimes Act, it is an offence punishable by up to 7 years’ imprisonment to have any property in one’s possession knowing that it is the proceeds of a “serious offence” committed by another person and with intent to engage in a money laundering transaction. A “serious offence” is an offence punishable by at least 5 years’ imprisonment, and includes any act that if committed in New Zealand would constitute a serious offence as so defined.

Section 12B of the Misuse of Drugs Act 1975 (the MDA) links in to the same definition of “money laundering transaction”. Under section 12B(2) of the MDA, it is an offence punishable by up to 7 years’ imprisonment to engage in a money laundering transaction in respect of any property that is the proceeds of a “specified drug offence”, knowing or believing that all or part of the property is the proceeds of a specified drug offence, or being reckless as to that fact. Under section 12B(3) of the MDA, it is an offence punishable by up to 5 years’ imprisonment to have any property in one’s possession that is the proceeds of a “specified drug offence” committed by another person, with intent to engage in a money laundering transaction and knowing or believing that all or part of the property is the proceeds of a specified drug offence, or being reckless as to that fact. A “specified drug offence” relates to dealing with controlled drugs (sections 6 and 12A MDA), cultivation of prohibited plants (section 9 MDA), and importing or exporting precursor substances (section 12A8 MDA), and includes any act that if committed in New Zealand would constitute a specified drug offence as so defined. There are defences and limitations contained within the MDA as to what constitutes a specified drug offence, and what constitutes a money laundering transaction in respect of any property that is the proceeds of one.
Does the concept of "money laundering" in the Bill relate to dealing with the proceeds of a "serious offence" or a "specified drug offence", as envisaged by sections 243 of the Crimes Act and 12B of the MDA? If so, reporting entities will need a thorough knowledge of the Crimes Act and the MDA in order to be able to identify "money laundering" as defined, but the term "money laundering offence" could conceivably be used in place of the term "money laundering" in the Bill. Alternatively, does the concept of "money laundering" in the Bill relate to dealing with any proceeds that have been illegally obtained? If so, it would be helpful for the concept of "money laundering" to be defined, so that reporting entities know what it is they have to look for.

RECOMMENDATION 43 We recommend that the concept of "money laundering" be clarified, so that reporting entities know what it is that they have to detect, manage and mitigate the risk of. We also recommend that, following the result of that process, either clause 4 be amended to include a definition of "money laundering" or the term "money laundering offence" be used in the Bill in place of the term "money laundering", as appropriate.
Various defined terms are not used as defined in the Bill.

"Chief executive" is defined in clause 4 to mean the chief executive of the Ministry responsible for administering the AML/CFT Act, and is used in this sense in clause 144 in the context of the establishment of the AML/CFT co-ordination committee. However, in other places it is used in a different sense: paragraphs (a)(vii) and (b)(vii) of the definition of "politically exposed person" refer to the "chief executive" of any State enterprise; the definition of "senior manager" refers to "chief executive" in a generic sense; and clauses 68 and 111 refer to the chief executive of the New Zealand Customs Service.

"Minister" is defined in clause 4 to mean the Minister responsible for the AML/CFT Act, and is used in this sense in clauses 143 and 148-153 in the context of the AML/CFT co-ordination committee, recommending regulations and Ministerial exemptions. However, in other places the term "minister" is used in a different sense: paragraphs (a)(ii) and (b)(ii) of the definition of "politically exposed person" refer to "Ministers of the Crown" and "government ministers" clearly in a wider sense, and clause 60(1) defines the concept of "responsible Minister" in the context of clauses 59-61 and codes of practice as the Minister responsible for the various AML/CFT supervisors.

Defined terms are often capitalised where they are used elsewhere in a document. The term can then be non-capitalised when used other than in its defined sense to distinguish the difference. While we appreciate that overuse of capitals makes a text more difficult to read, it seems curious that some defined terms in the Bill are not capitalised whereas some non-defined terms are capitalised (such as "Judge" and "State", but interestingly not "governor", "ambassador", or "high commissioner").

We note that in the rewritten Income Tax Act 2007, defined terms are listed at the bottom of a section (see for example, section CB 1). We suggest a similar approach would be helpful in the AML/CFT Bill. Alternatively, it may be helpful to list in the definitions of "chief executive" and "Minister" the provisions in which those terms are actually used as defined. The capitalisation of non-defined terms could also perhaps usefully be reconsidered.

We recommend clause 4 be amended so that the definition of "chief executive" only applies for section 144, and so that the definition of "Minister" only applies for sections 143 and 148-153. Alternatively, defined terms could be listed at the end of each section of the Act, as is the practice in the Income Tax Act 2007.
It is not clear when a business relationship is "established" for the purposes of the Bill.

Clause 12(a) requires a reporting entity to conduct standard customer due diligence if the reporting entity "establishes" a business relationship with a new customer.

When is a business relationship "established" for the purposes of clause 12(a)? Various interactions or negotiations may occur between a reporting entity and a prospective customer before a business relationship could be said to have been "established".

It would be helpful to indicate what constitutes the establishment of a business relationship to clarify the point at or before which customer due diligence must be conducted.

This issue also arises with respect to the timeframes for verifying identity (clauses 14(2), 18(2) and 22(2)), and with respect to politically exposed persons (clauses 20(2) and 23).

We recommend that the point at which a business relationship could be said to be "established" be clarified.
CLAUSE 12

CIRCUMSTANCES WHERE STANDARD CUSTOMER DUE DILIGENCE APPLIES

56 It is not clear how clause 12(b) is to work in practice.

Clause 12(b) potentially covers a huge range of “business as usual” transactions.

57 Clause 12(b) requires standard customer due diligence to be conducted if a customer seeks to conduct an occasional transaction through the reporting entity. An occasional transaction is defined in clause 4 to mean a transaction that is over the “applicable threshold value”, excluding cheque deposits.

58 The concept of “occasional transaction” covers a huge range of “business as usual” transactions. If the applicable threshold value is, say, $10,000, a monthly payment to a reporting entity by a purchaser could trigger a requirement to conduct or re-conduct standard customer due diligence. Is a reporting entity to undertake a verification process with its customers on a monthly basis?

59 How does clause 12(b) work in the context of electronic transactions?

The electronic context in particular needs to be considered. An individual may make an electronic transfer between accounts above the applicable threshold. Such a transaction would be an “occasional transaction” as defined requiring standard customer due diligence under clause 12(b). However, many such electronic transfers will simply happen automatically. Unless there is a process for them to be blocked, how is a reporting entity meant to conduct customer due diligence prior to the transaction in those circumstances?

60 In our view, exemptions will be important in the context of clause 12(b) – it is excessive to require due diligence for each occasional transaction conducted through an existing facility where due diligence has already been done. There is no added value in requiring additional due diligence just because a transaction is over a particular amount. In our view, it is important that a category of transactions are carved out from the ambit of clause 12(b), otherwise a huge raft of innocuous transactions will trigger ongoing requirements to conduct standard customer due diligence.

61 RECOMMENDATION

We recommend that the circumstances in which clause 12(b) is intended to apply be clarified. In particular, repeat customer due diligence should not be required in respect of a customer upon whom due diligence has already been conducted just because an otherwise innocuous transaction is over a particular amount.
CLAUSE 12

CIRCUMSTANCES WHEN STANDARD CUSTOMER DUE DILIGENCE APPLIES

Clause 12(e) appears to be a transitional provision, designed to ensure that identity information is ultimately obtained and verified for all customers with whom a reporting entity had a business relationship immediately before the commencement of Part 2, but as circumstances arise, as opposed to all at once on commencement of the Bill. If this is the case, it would be helpful for this to be clarified.

The requirement to conduct standard due diligence on existing customers on a "slow burn" basis should be made clear.

Clause 12 sets out the circumstances in which a reporting entity must conduct standard customer due diligence: if the reporting entity establishes a business relationship with a new customer, if a customer seeks to conduct an occasional transaction through the reporting entity, or if in relation to any customer a reporting entity suspects money laundering (clause 12(a)-(d)).

Clause 12 also requires standard due diligence to be conducted in additional circumstances in relation to "existing customers" only: if there has been a change in the nature or purpose of the business relationship, if doubt arises as to information previously obtained, if the reporting entity suspects that a transaction the customer is seeking to conduct may involve money laundering, or if the reporting entity considers that according to the level of risk involved it has insufficient information about the customer (clause 12(e)).

"Existing customer" is defined in clause 4 as a person with whom the reporting entity had a business relationship immediately before the commencement of Part 2. If a reporting entity establishes a business relationship with a customer after the commencement of Part 2, standard due diligence will not be required to be performed again under clause 12(e), even if the nature or purpose of that business relationship changes, if doubt arises as to information previously obtained, or if the reporting entity considers that according to the level of risk involved it has insufficient information about the customer. Standard due diligence would be required to be conducted again in relation to those customers, however, if the reporting entity suspects that money laundering may be involved (clause 12(c)). In addition, enhanced customer due diligence would be required if a reporting entity considers that the level of risk is such to warrant it (clause 20(1)(c)).

Clause 12(e) appears to be a concessionary transitional provision of sorts, under which the reporting entities are provided with a "slow burn" period to conduct customer due diligence on their existing customers. However, the fact that clause 12(e) only applies to customers with whom the reporting entity had a business relationship before the commencement of Part 2 is not immediately obvious and appears to be causing some confusion. It would be helpful for clause 12(e) to be clarified.
There are significant consequences for not conducting customer due diligence on an existing customer when there has been a "change in the nature or purpose of the business relationship", but it is not clear what that means.

It would also be helpful for there to be more clarity regarding what exactly constitutes a "change in the nature or purpose of the business relationship" for the purposes of clause 12(e)(i). This circumstance triggers a requirement to conduct customer due diligence on an existing customer, and there are significant consequences if this is not done when required (see clauses 76(a) and 88(3)). But what does a change in the nature or purpose of a business relationship mean? For example, if a customer currently holds term deposits with a bank, is there a "change" in the nature or purpose of that relationship if the customer subsequently withdraws those deposits to part-fund the purchase of a house, while contemporaneously taking out a mortgage for the balance? On one level, this would constitute a fundamental change in the nature of the relationship, as the customer would move from being a creditor to a debtor of the bank. However, at another level, there has been no change to the inherent nature or purpose of the relationship at all, as the customer may have been saving to purchase a house all along.

Relationships between financial institutions and customers are potentially "changing" all the time, and there are potentially significant logistical issues in monitoring all relationships to assess whether there has been a "change". Whether a sufficient "change" has occurred for clause 12(e)(i) to be triggered may be one of degree. Logically, there should at least be an overriding element of "suspicion" before the requirement to conduct due diligence is triggered. More clarity is essential, as it would otherwise be impossible to put in place meaningful procedures.

It is also not clear how clause 12(e) interacts with the remainder of clause 12. Is it intended that an occasional transaction by an existing customer will trigger an obligation to do standard due diligence? Alternatively, is it intended that clause 12(e) sets out all the circumstances where standard due diligence is required for an existing customer? In this regard, we note that the requirement under clause 12(e)(iii) to conduct standard due diligence if a reporting entity suspects, in relation to an existing customer, that a transaction the customer is seeking to conduct may involve money laundering, appears to duplicate the requirement under clause 12(c).

**Recommendation**

We recommend that clause 12(e) be removed from clause 12 and inserted into a different provision, clause 12A, with the heading "Transitional provision: existing customers to have customer due diligence conducted as certain circumstances arise".

We also recommend that the concept of a "change in the nature or purpose of the business relationship" for the purposes of what is currently clause 12(e)(i) be clarified, for example, by limiting it to changes which cause suspicion, and that is made clear that the remainder of clause 12 does not apply to existing customers.
The information required to be obtained under clause 15 does not appear to be required to be verified. If this is the case, it would be helpful for this to be made clear.

To avoid doubt, it should be made clear that the information required to be obtained under clause 15 is not required to be verified.

It may be that the information required to be obtained under clause 15 has been intentionally omitted from the verification requirements. It may be that simply obtaining this information is sufficient for AML/CFT purposes, without any additional requirement to ensure this information is current and correct. The information appears to feed into clause 28(2), which requires a reporting entity to conduct ongoing customer due diligence to ensure that the business relationship and transactions relating thereto are consistent with the reporting entity's knowledge about the customer and the customer's business and risk profile. In addition, clause 48(2) requires a reporting entity to keep records that are reasonably necessary to establish the nature and purpose of, and activities relating to, the business relationship.

However, to avoid doubt, it would be helpful to clearly state that the information required to be obtained under clause 15 is not required to be verified. The same issue arises with clause 19. (A related issue arises in relation to enhanced customer due diligence, for which this information appears not to be required, as discussed above).

We recommend that the legislation clearly state that the information required to be obtained under clause 15 is not required to be verified under clause 14 (but instead is subject to ongoing customer due diligence under clause 28).

We also recommend that the legislation clearly state that the information required to be obtained under clause 19 is not required to be verified under clause 18 (but instead is subject to ongoing customer due diligence under clause 28).
Clause 14(1)(a) only requires verification of information that has been “provided”. A similar issue arises with clauses 22(1)(a) and 25(1)(a).

Clauses 13, 21 and 24 (the identity information clauses) require a reporting entity to obtain certain identity information. Clauses 14(1)(a), 22(1)(a) and 25(1)(a) (the verification clauses) then require the reporting entity to verify that information. The verification requirement is that the reporting entity must be satisfied that the identity information “provided” under the respective identity information clauses is current and correct.

However, information is obtained rather than provided under the identity information clauses. The different terminology is not helpful. To minimise subsequent interpretational difficulty, it would be helpful for the verification clauses to use wording consistent with the wording in the identity information clauses.

We recommend that clause 14(1)(a) be amended by deleting the word “provided” and replacing it with the word “obtained”.

We also recommend that clauses 22(1)(a) and 25(1)(a) be amended by deleting the word “provided” and replacing it with the word “obtained”.

RECOMMENDATION 80

The verification provisions should use consistent wording with the identity provisions, in order to minimise doubt as to exactly what information is required to be verified.
STANDARD CUSTOMER DUE DILIGENCE/ENHANCED CUSTOMER DUE DILIGENCE: VERIFICATION OF IDENTITY REQUIREMENTS

Verification requirements should be consistent unless there is a reason for the inconsistency.

Clauses 14(1) and 22(1) set out respectively the verification requirements for standard and enhanced customer due diligence.

The key additional verification requirement for enhanced customer due diligence is to take all reasonable steps to verify the source of wealth or funds of the customer (clause 22(1)(d)). In other respects, clauses 14(1) and 22(1) are inherently identical, other than the respective references to clauses 13 and 21 in the respective paragraphs (a).

However, there are inconsistencies between the two provisions.

For example, clause 14(1)(d) requires a reporting entity to verify “any other information prescribed by regulations”, whereas clause 22(1)(e) requires a reporting entity to verify “any other information prescribed by regulations or required by codes of practice”. There is no apparent reason why codes of practice should be legislated for in the context of enhanced customer due diligence but not in the context of standard due diligence. Codes of practice are likely to be particularly relevant in the area of standard customer due diligence.

In addition, clause 22(1)(c) requires a reporting entity to verify “the customer’s identity and the identity of the person acting on behalf of the customer in accordance with section 21”, whereas clause 14(1)(c) requires a reporting entity to verify “both the customer’s identity and the person’s identity”. The two provisions are addressing the same subject matter in this context, and there is no apparent reason for the difference in wording.

Further, clause 22(1)(c) refers to a person acting “on behalf of a customer in accordance with section 21”. This reference is incorrect, as clause 21 deals with additional identity information. A person does not act on behalf of a customer “in accordance with section 21”.

Inconsistent approaches between two provisions dealing with the same subject matter imply that there is some significance to the difference, which can give rise to subsequent interpretational difficulties and - potentially - to additional compliance costs. The two verification provisions (clauses 14 and 21) should be consistent as far as possible.
RECOMMENDATION 89  We recommend that clause 14(1)(d) be deleted and replaced with the following:

"verify any other information prescribed by regulations or required by codes of practice."

We also recommend that clause 22(1)(c) be deleted and replaced with the following:

"if a person is acting on behalf of the customer, verify both the customer's and the person's identity and that person's authority to act on behalf of the customer, so that the reporting entity is satisfied it knows who the person is and that the person has authority to act on behalf of the customer;"
CLAUSE 14/CLAUSE 22/CLAUSE 29/CLAUSE 30

STANDARD CUSTOMER DUE DILIGENCE/ENHANCED CUSTOMER DUE DILIGENCE: VERIFICATION OF IDENTITY REQUIREMENTS/RELIANCE ON MEMBER OF DESIGNATED BUSINESS GROUP/RELIANCE ON OTHER REPORTING ENTITIES OR PERSONS IN ANOTHER COUNTRY

The 5-day window for delayed and delegated verification should be 5 working days.

Clauses 14(2) and 22(2) require a reporting entity to carry out verification of identity before establishing a business relationship or conducting an occasional transaction. However, clauses 14(3)(c) and 22(3)(c) provide a 5-day window in which such verification can be carried out (delayed verification), if it is essential not to interrupt normal business practice, and money laundering and financing of terrorism risks are effectively managed through procedures of transaction limitations and account monitoring.

Similarly, clauses 29(1)(a)(ii) and 30(2)(c)(ii) allow a reporting entity to rely on customer due diligence conducted by another person as long as any (relevant) verification information is given to the reporting entity no later than 5 days after the business relationship (presumably with the customer) is established, or the occasional transaction conducted (delegated verification).

Are reporting entities expected to carry out verification on days when they are not open for business? It seems reasonable that longer periods, such as 20, 21 and 90 days (in clauses 61, 96 and 125, for example), are measured in terms of days rather than working days. However, for obligations imposed on reporting entities within a timeframe as short as 5 days, it seems reasonable to expect that a reporting entity should have "working days" to carry such obligation out (as is the case, for example, with reporting suspicious transactions, and providing information on domestic wire transfers). Are reporting entities expected to have 24/7 cover in order to allow in particular the verification timeframes to be met? What if a business relationship was established on the Thursday before Good Friday - the delayed or delegated verification timeframe would then equate to only one working day. This does not seem reasonable.

We note that "working day" is not defined in the Bill. Section 29 of the Acts Interpretation Act defines working day "in an enactment" to mean: "a day of the week other than -

(a) a Saturday, a Sunday, Waitangi Day, Good Friday, Easter Monday, Anzac Day, the Sovereign’s Birthday, and Labour Day; and

(b) a day in the period commencing with 25 December in a year and ending with 2 January in the following year; and

(c) if 1 January falls on a Friday, the following Monday; and

(d) if 1 January falls on a Saturday or a Sunday, then the following Monday and Tuesday."
This generic definition does not cater for days, such as Wellington Anniversary Day, on which a reporting entity may not be open for business, but which would nevertheless constitute a working day as defined. The definition is also New Zealand-based, and does not take into account days on which branches, subsidiaries or entities conducting business overseas may not be open for business within the laws of the particular country in which they are operating. This may particularly be an issue within respect to clause 30 (reliance on other reporting entities or persons in another country).

Consideration should be given to defining “working day” for the purposes of the Bill, and to whether it should be defined generically or by reference to an individual reporting entity’s circumstances. In the limited circumstances in which delayed and delegated verification are permitted, reporting entities should either be given a longer period to carry this out, or the reference to “5 days” should be at least be changed to “5 working days”.

RECOMMENDATION 96 We recommend that clause 14(3)(c) be amended by inserting the word “working” before the word “days”.

We also recommend that:

- clauses 22(3)(c), 29(1)(a)(ii), and 30(2)(c)(ii) be amended by inserting the word “working” before the word “days”; and
- consideration be given to inserting a definition of “working days” into the Bill.
CLAUSE 16

CIRCUMSTANCES WHEN SIMPLIFIED CUSTOMER DUE DILIGENCE APPLIES

The New Zealand Security Intelligence Service Act 1969 is listed in clause 16(1)(e) as a "customer".

97 The reference to an Act of Parliament appears to be a mistake.

RECOMMENDATION

We recommend that clause 16(1)(e) be deleted and replaced with the following:

"the New Zealand Security Intelligence Service, continued by the New Zealand Security Intelligence Service Act 1969:"
Simplified customer due diligence appears to relieve a reporting entity from conducting due diligence on a customer or on any beneficial owner of a customer. If this is the case, it would be helpful for it to be made clear.

Clause 16 provides that a reporting entity may conduct simplified customer due diligence in the context of certain customers (such as, interestingly, local authorities and related organisations, but only those that provide water services (see clause 16(1)(c), and the definition of “local government organisation” in section 124 of the Local Government Act 2002)).

The identity requirements for simplified customer due diligence are that the identity information listed in clause 17 must be obtained in relation to a person acting on behalf of the customer. The identity information required to be obtained is identical to that required under clause 13 for standard customer due diligence, with the exception of the person’s address or registered office and company identifier or registration number.

Clause 18 requires the reporting entity to verify the identity of a person acting on behalf of a customer and that person’s authority to act for the customer. Unlike standard and enhanced customer due diligence, there is no 5-day window for simplified customer due diligence, meaning that this verification must be carried out before the business relationship is established, the occasional transaction is conducted or the person acts on behalf of the customer, without exception.

It therefore appears that the key feature of simplified due diligence is that due diligence is only required to be performed on the person acting on behalf of the customer, and not on the customer itself or on any beneficial owner of the customer. If this is the case, it does not appear to be widely understood.

We recommend that it be clarified, either in the legislation itself or in guidance material, that the key feature of simplified customer due diligence is that it requires due diligence to be performed on the person acting on behalf of the customer only, and not on the customer itself or on any beneficial owner of the customer.
106 Verification requirements should be consistent unless there is a reason for the inconsistency.

107 Clause 18 requires a reporting entity to verify the identity of a person acting on behalf of a customer and that person’s authority to act “for” the customer so that “it” is satisfied it knows who the person is and that the person has authority to act on behalf of the customer.

108 The verification wording for simplified customer due diligence in clause 18(1) is materially identical to the corresponding verification wording for standard customer due diligence in clause 14(1)(c), and enhanced customer due diligence in clause 22(1)(c) (apart from the additional references to the customer itself which are not relevant for simplified customer due diligence). However, there are two exceptions.

109 The first exception relates to the word “for” in clause 18(1). Clauses 14(1)(c) and 22(1)(c) consistently refer to the person “acting on behalf of” the customer. There is no apparent reason why clause 18 should refer twice to the person acting on behalf of the customer, and once to the person acting “for” the customer, in contrast to clauses 14(1)(c) and 22(1)(c). Inconsistency of provisions dealing with essentially the same subject matter can give rise to subsequent interpretational difficulty, and the compliance costs that would be associated with that. The wording of the verification clauses should be consistent where possible.

110 The second exception relates to the use of the word “it” in the third line of clause 18(1). The “it” refers back to the previous noun, which in clause 18(1) is the customer. However, the “it” is in fact referring to the reporting entity. Clauses 14 and 22 make this clear by referring to the reporting entity itself.

RECOMMENDATION 111 We recommend that clause 18(1) be deleted and replaced with the following:

“A reporting entity must, according to the level of risk involved, verify the identity of a person acting on behalf of a customer and that person’s authority to act on behalf of the customer so that the reporting entity is satisfied it knows who the person is and that the person has authority to act on behalf of the customer.”
Upon whom does clause 20(1)(a)(i) impose an obligation to perform customer due diligence?

112 How the legislation is to work in respect of trusts is not clear.

113 Clause 20(1)(a)(i) requires a reporting entity to conduct enhanced customer due diligence if the reporting entity establishes a business relationship with a customer, or if a customer seeks to conduct an occasional transaction through the reporting entity, and that customer is a trust or other vehicle for holding personal assets. Enhanced customer due diligence is required to be conducted on the customer, any beneficial owner of a customer and any person acting on behalf of a customer (clause 9). A beneficial owner is defined in clause 4 as the individual who has effective control of, or owns a prescribed threshold of, a customer.

114 A "trust" is not a legal person and cannot therefore be a customer. In broad terms, a trust is simply a legal relationship, whereby a person, "the settlor", grants legal ownership of assets to a trustee, who holds those assets on the terms of the trust for the beneficiaries.

115 That said, however, there are different kinds of trusts. Family trusts, which are very common in New Zealand, may be effectively controlled by the settlor, with a very broad range of discretionary beneficiaries. Private equity funds may have an institutional manager, and a large number (potentially thousands) of individual investor beneficiaries. Charitable trusts are different again.

116 Upon whom should customer due diligence be conducted in the case of a trust? The "customer" in the case of a trust would arguably be the trustee as legal owner of the trust assets (see for example clause 4 of the Charities Act 2005, which lists the "trustees of a trust" together with societies and institutions within the definition of "charitable entity". Also note section 33 of the Interpretation Act 1999 which provides that, in legislation, words in the plural include the singular). If the trustee is a natural person, there is unlikely to be a separate individual who has "effective control" or "owns a prescribed threshold" of that person. There would therefore arguably be no "beneficial owner" in the case of a trust with only natural person trustees. Where the trustee of a trust is a company (a corporate trustee), a very common arrangement nowadays, the beneficial owner of "the trust" will be the shareholders or other persons who have effective control of that company. However, this may bear no relationship whatsoever to the individuals behind "the trust".
If the focus is on "the trust" as some kind of deemed notional entity, the person who has control of the trust and legally owns all of the trust assets (arguably the "beneficial owner" as defined) is again the trustee. That said, however, effective control may arguably reside in the person who can appoint and remove trustees which, under some trust deeds, may be reserved to the settlor or a separately-defined appointor (otherwise, the power to appoint and remove trustees will generally reside in the current trustees). Should due diligence be conducted on the settlor or appointor? If the focus is on the individual who funded the trust then perhaps the tax concept of "settlor" should be used. But what would be the position if that person is deceased? And what happens when a trust was settled by a husband and wife who have since divorced, with one party having received a distribution from the trust and having no further involvement in it, leaving the trust to the other party?

How does the definition of "beneficial owner" work in relation to a discretionary trust?

Should the focus of the due diligence be on the beneficiaries of the trust? We understand that the intention of the Bill is for reporting entities to take reasonable steps to identify the beneficial owner of trust assets. Although, legally, the trustee is the owner of trust assets, the beneficial ownership of the trust assets resides in the beneficiaries. Should customer due diligence in the context of trusts therefore be conducted on all beneficiaries, as well as all the trustees (as the "customer") and any persons acting on behalf of the trust? If so, what would be the position in the context of a discretionary trust, when distributions are made from the trust at the discretion of the trustees? In this context, the extent to which any beneficiary could be said to "own" any of the trust assets, when they may receive no distribution at all, is not clear. There is arguably no "beneficial owner" in the context of discretionary trusts. Should the focus in respect of discretionary trusts be on the person who controls the right to appoint the trustees? Discretionary trusts are very common in New Zealand, and regularly, for example, open bank accounts and conduct property transactions.

What about in the case of private equity funds, controlled by an institutional investor with thousands of beneficiary investors? What is the purpose of verifying the identity of the institutional manager? Whom exactly is the legislation directed at?

It does not seem at all clear how and upon whom customer due diligence is to be conducted in the context of trusts, and in particular discretionary trusts.

In addition, clause 21 requires the reporting entity to obtain information relating to the source of funds or the wealth of the customer. As discussed above, the customer in the context of trusts is the trustee. The trustee(s) will hold the assets of the trust on the terms of the trust, but the source of funds or wealth of the trustee acting in its capacity as trustee of the trust is arguably limited to the assets of the trust itself. The inquiry into the source of funds or wealth of the trustee, in its capacity as trustee, will not necessarily shed light on where the funds of the trust were originally derived.
Is the focus on the source of funds or wealth of the "customer" intended to focus on the source of the trust's assets?

Is clause 21(a) intended to require reporting entities to obtain information about the origin of the trust's assets? As set out above, we do not see that the trust itself can be a customer and therefore the clause as currently drafted would not achieve that outcome. In any event, we think this requirement would be very onerous on reporting entities and unachievable in many scenarios. As discussed above, given the realities of investment there are many examples of trusts which have thousands of beneficiaries. Such trusts may also be the last of a series of investment layers which means that the reporting entity would be required to look through the various layers to identify the ultimate beneficiaries. In practice, this would be very difficult, if not impossible, as the reporting entity is unlikely to have access to the information required to perform this exercise due to practical or confidentiality restrictions. In the case of a trust that is a managed fund, should a reporting entity be able to rely on the fact that the trustee or manager will be required to conduct customer due diligence on investors? Should the amount and type of due diligence that a reporting entity has to do in respect of a managed fund vary depending on whether or not the fund manager or trustee is subject to regulatory oversight?

It is also not clear what exactly is meant by the term "personal assets" in clause 20(1)(a)(i), and we note that the term is not defined. Legally, a distinction is often made between personal property and real property; real property being essentially land and personal property everything else. However, it seems likely that a vehicle for holding, say, a family home would be included within the concept of "vehicle for holding personal assets", although a family home would not fall within the concept of "personal" property. It is also not clear what "vehicles" for holding personal assets are being referred to. Would a family company be a "vehicle for holding personal assets"? What about superannuation schemes?

We note that the association of "trusts" with "another vehicle for holding personal assets" implies that trusts are always vehicles for holding personal assets. However, in the case of charitable trusts, for example, assets will be held in order to derive income for charitable purposes and, in order to meet the definition of "charitable purpose", such income must essentially be derived for the benefit of the public. Also, unit trusts may not be vehicles for holding personal assets (whatever personal assets may be). Will unit trusts be "trusts" for the purposes of the AML/CFT legislation, or will they follow tax law and be treated as a company?
We recommend that further thought be given as to how and upon whom customer due diligence is required to be conducted in the context of trusts. In particular, the legislation should deal expressly, both for the purposes of this clause and the rest of the Bill, with the fact that a trust is not a legal person separate from the trustees. If it is intended that the legislation should apply as if a trust is a legal entity, separate from its trustees, then the Bill requires provisions that deem this to be the case for the purposes of the Bill. Thought should also be given to how other entities that are not companies or individuals are treated under the Bill. For example, how is a limited partnership to be treated?
CLAUSE 20/CLAUSE 30
CIRCUMSTANCES WHEN ENHANCED CUSTOMER DUE DILIGENCE APPLIES/RELIANCE ON OTHER REPORTING ENTITIES OR PERSONS IN ANOTHER COUNTRY

126 It will not always be clear when clause 20(1)(a)(ii) applies.

127 Clause 20(1)(a)(ii) requires a reporting entity to conduct enhanced customer due diligence if the customer is a non-resident customer from a country that has insufficient anti-money laundering or countering financing of terrorism systems or measures in place. "Country" is defined in clause 4 to include any State, territory, province or other part of a country.

128 In the absence of a comprehensive and regularly-updated list of which "countries", and parts of countries, have insufficient anti-money laundering or countering financing of terrorism systems or measures in place, how will a reporting entity know when clause 20(1)(a)(ii) would apply? If the non-resident happens to have a New Zealand driver's licence or dual passports, it may not appear to the reporting entity that they are even non-resident, let alone a non-resident from a "black list" country. There may be some states, territories, provinces or other parts of a country that do not have sufficient systems in place when the country, taken as a whole, in fact does. It may not therefore be apparent to the reporting entity that enhanced due diligence and the additional information under clause 21 is required.

129 We note that a failure to conduct customer due diligence as required by subpart 1 of Part 2 is a "civil liability act" for which a penalty of up to $2 million may be imposed (clauses 76(a) and 88(3)). A similar issue arises in the context of clause 20(1)(a)(iii).

130 Clause 96 provides a defence to a charge of failing to comply with the customer due diligence requirements of the Bill, if the reporting entity can prove it took all reasonable steps to ensure compliance or that, in the circumstances of the particular case, it could not reasonably have been expected to ensure compliance. The defence does not apply unless a reporting entity advises the prosecutor in writing of its intention to rely on it within 21 days after being served with a summons. In determining whether a reporting entity took all reasonable steps, a court must have regard to the nature of the reporting entity, the activities in which it engages, and the existence and adequacy of any compliance procedures established by the reporting entity.
How will a reporting entity know when a person is a non-resident “from” a “blacklist” country?

131 There does not appear to be any equivalent “defence” in respect of a civil liability act. In the case of a reporting entity which did not conduct enhanced due diligence because it simply did not know it was required to do so, it could be expected that common sense would prevail and none of the responses under clause 77 would be invoked. Nevertheless, it is an unsatisfactory and vulnerable position for reporting entities to be in to face technically breaching the Bill, through the existence of a clause that they are unable effectively to comply with, and then having to rely on discretion and interpretation in order not to face consequences and potentially penalties. From a policy design perspective, an objective test is not reasonable: there should be no obligation on reporting entities to perform an obligation except where they actually know they are required to perform that obligation. It is not reasonable to expect reporting entities to know which countries as defined have insufficient AML/CFT systems or measures in place, and then to penalise them for not knowing something they could not have known.

132 Further, even if a reporting entity identified a country that had insufficient AML/CFT systems in place, it will not always be apparent when a person is “from” any such country. A person may present a New Zealand passport yet still be “from” a blacklist country. Is a person “from” a country in which they are resident for tax purposes or does “from” import some other test? Where, for example, is a company that is incorporated in one country but operates in a second country “from” for the purposes of this test? Similarly, where is a limited partnership “from” where the general partner is incorporated in one country, the limited partnership is registered in a second country, the partnership’s business is carried on in a third country and the limited partners are resident in various countries? Determining residence for tax purposes can often be a complicated exercise invoking “tie breaker” clauses of double tax agreements, and potentially legal opinions. Is a reporting entity to seek a legal opinion in order to determine where a person is “from” for the purposes of the Bill?

133 The focus is on the country where the person is subject to anti-money laundering or countering financing of terrorism systems. Given that, the appropriate test of where a person is “from” may be where they are “resident” for tax purposes, as the person is also likely to be subject to other regulation in that country. This test would have the benefit that the tax authorities in some countries will provide confirmation of the tax residence of a person. This could be used by the reporting entity to determine the relevant country. It would also be helpful to clarify whether the concept of “residence” in clauses 24(6), 30(2)(1)(b), and paragraph (e)(1)(B) of the definition of “designated business group” in clause 4 also corresponds with tax residence, or whether it has some other meaning.
RECOMMENDATION 134

We recommend that a comprehensive list of countries, including parts of countries, that are considered to have insufficient anti-money laundering or countering financing of terrorism systems in place be publicly available and regularly updated, with the intention that reporting entities be able to rely on it for the purposes of clauses 20(1)(a)(ii) and 30(2)(a)(ii). We also recommend that protection be available for reporting entities when non-residents from blacklist countries, or blacklist parts of countries, are able to disguise their blacklist status by, for example, presenting a passport or driver's licence from a non-blacklist country, such that the requirement for enhanced due diligence may not be apparent to the reporting entity. There should be no obligation on reporting entities to perform an obligation except where they actually know, or ought on the basis of the above list to know, that they are required to perform that obligation. Further, the legislation should define what is meant by "from" a country or use an alternative well-understood term (for example, where the person is resident for tax purposes).
CLAUSE 20  CIRCUMSTANCES WHEN ENHANCED CUSTOMER DUE DILIGENCE APPLIES

135 It is not clear the circumstances when clause 20(1)(a)(iii) will apply.

136 Clause 20(1)(a)(iii) requires a reporting entity to conduct enhanced customer due diligence if the customer is a company with nominee shareholders or shares in bearer form.

137 However, any company can have shares that are held by a nominee shareholder, and whether this is the case will not be disclosed by the share register. Similarly, it would not necessarily be possible to know whether shares were in bearer form, and again this information would not be able to be ascertained from a company search. As with the submission above on clause 20(1)(a)(ii), if it is not apparent to a reporting entity that a company has nominee shareholders, and enhanced due diligence is accordingly not conducted, penalties of up to $2 million apply.

138 In addition, "company" is not defined. The definition of "company" in the Companies Act 1993 extends only to companies that are registered on the companies' register in New Zealand. On the basis of that definition, overseas-registered companies establishing a business relationship or conducting an occasional transaction with a reporting entity in New Zealand would not be subject to clause 20(1)(a)(iii), even if they had nominee shareholders or shares in bearer form. Is the concept of "company" intended to extend to any body corporate? We note that the concept of "body corporate" as opposed to "company" is used in the penalties provisions (clauses 73-75, 88, 98, 103 and 110).

RECOMMENDATION 139 We recommend that the circumstances in which clause 20(1)(a)(iii) is intended to apply be clarified.
ENHANCED CUSTOMER DUE DILIGENCE: IDENTITY REQUIREMENTS

If information on the nature and purpose of the proposed business relationship is required to be obtained under enhanced customer due diligence, this should be made clear.

In contrast to standard and simplified due diligence, information on the nature and purpose of the proposed business relationship does not appear to be required for enhanced due diligence.

Under clause 9(3), enhanced due diligence is imposed as a prescribed requirement in the circumstances listed in clause 20. In contrast to clauses 9(1) and (2) which impose standard and simplified customer due diligence as a minimum standard. In the circumstances set out in clause 20, the legislation does not clearly impose the requirements of standard customer due diligence as an addition to the requirements of enhanced customer due diligence, except in specifically stated circumstances.

The identity information required to be obtained under enhanced due diligence is set out in clause 21. Clause 21 requires information on the source of funds or wealth of the customer to be obtained, in addition to the identity information required for standard due diligence under clause 13.

However, under standard and simplified customer due diligence, additional information is also required to be obtained, by clauses 15 and 19, respectively. Clauses 15 and 19 require information to be obtained on the nature and purpose of the proposed business relationship between the customer and the reporting entity.

Clause 21 does not require information on the nature and purpose of the proposed business relationship to be obtained for enhanced customer due diligence, and it does not appear that any other provision does either. It seems odd that more information should be required for standard and simplified customer due diligence than for enhanced customer due diligence.

This is particularly the case given that clause 48(1)(b) imposes an obligation on reporting entities to keep any records relating to and obtained during the course of a business relationship that are reasonably necessary to establish the nature and purpose of, and activities relating to, the business relationship. If the intention is that information on the nature and purpose of the proposed business relationship is required for enhanced customer due diligence, this should be made clear. (We note that under standard and simplified customer due diligence, the information required to be obtained under clauses 15 and 19 does not appear to be required to be verified (see above submission in respect of clause 15)).
RECOMMENDATION 146 We recommend that, if it is intended that information on the nature and purpose of the proposed business relationship is required for enhanced customer due diligence, a new clause 22A be inserted along the following lines:

"Enhanced customer due diligence: additional requirements

A reporting entity must also obtain information on the nature and purpose of the proposed business relationship between the customer and the reporting entity."

PAGE 38 FOREIGN AFFAIRS, DEFENCE AND TRADE COMMITTEE
ENHANCED CUSTOMER DUE DILIGENCE: IDENTITY AND VERIFICATION OF IDENTITY REQUIREMENTS

147 It is not clear how a reporting entity is to obtain and verify information relating to the source of wealth or funds of a customer.

148 The key additional requirement for enhanced customer due diligence is the requirement to obtain information relating to the source of the funds or the wealth of the customer (clause 21(a)), and to take all reasonable steps to verify the source of wealth or funds of the customer (clause 22(1)(d)).

149 It is not clear, from a practical perspective, how exactly this additional requirement is to be met. For example, a high profile, high net worth individual, may seek to conduct a particular transaction that is "complex" and "unusually large" by reference to normal standards, such that enhanced due diligence appears required under clause 20(1)(b). However, the transaction may not be particularly complex or large by reference to the standards of this particular person (they may be simply refinancing some of their debt). When does a transaction become "unusually large"? Is the concept of "unusual largeness" in clause 20(1)(b) determined by reference to a particular customer, or, for example, to what is usual in the context of a general sector of business, or on the basis of a reporting entity's particular experience, or on a "one size fits all" or some other basis?

150 Assuming the transaction is complex and unusually large for the purposes of clause 20(1)(b), simply by virtue of the numbers and the facets that may be involved, how does a reporting entity verify how this particular individual made that money? Will a reporting entity be able to rely on certification, such as a customer declaration, or on a director's certificate in respect of a company, stating where the funds or wealth were derived from? How could a reporting entity be otherwise expected to "verify" the source of a customer's funds or wealth? Surely if a reporting entity is reasonably satisfied that a customer's funds or wealth are not sourced from money laundering, for example through a certification process as above, this should be sufficient for compliance with clause 22(1)(d)? We assume that some guidance will be provided as to what will be required, as otherwise clause 22(1)(d) seems extremely broad and uncertain.

RECOMMENDATION 151 We recommend that clarification and guidance be provided as to how exactly and when reporting entities are to obtain and verify information relating to the source of the funds or wealth of a customer. We submit that if a reporting entity is reasonably satisfied that a customer's funds or wealth are not sourced from money laundering, this should be sufficient for compliance with clause 22(1)(d).

We also recommend that clarification be provided as to how and by what benchmark "complexity" and "unusual largeness" are to be determined in the context of clause 20(1)(b).
CLAUSE 23

POLITICALLY EXPOSED PERSONS

152 Clause 23 is likely to be practically impossible to comply with.

153 Clause 23 applies to reporting entities establishing a business relationship or conducting an occasional transaction that involves a customer or a beneficial owner who is a "politically exposed person" (PEP). Before doing so, the reporting entity must obtain and verify the person's identity information, obtain information on and verify the source of funds or wealth of the customer, take all reasonable steps to verify the identity of any beneficial owner of the customer so that the reporting entity is satisfied that it knows who the beneficial owner is, verify the identity of any person acting on behalf of the customer and that person's authority to act on behalf of the customer, and have approval from its "senior management" for establishing the business relationship. "Senior manager" is defined in clause 4 to mean a director, trustee, partner or any other person who occupies a position within a reporting entity that allows that person to exercise an influence over the management or administration of the reporting entity, such as a chief executive or a chief financial officer, and "senior management" is "correspondingly" defined.

154 Clause 4 defines "politically exposed person" very widely as an individual who holds the prominent public function of: head of state, government minister, Supreme Court judge, governor of a central bank, senior foreign representative, ambassador or high commissioner, high-ranking member of the armed forces, and board chair, chief executive or chief financial officer of any state enterprise, whether in New Zealand or in any other country. The definition also includes:

- any spouse, partner, child or parent of any such person;
- any spouse or partner of any child of any such person;
- any individual who, having regard to any publicly available information, is known to have joint beneficial ownership of a legal entity or legal arrangement, or any other close relationship, with any such person; and
- any individual who has sole beneficial ownership of a legal entity or legal arrangement that is known to exist for the benefit of any such person.
Accordingly, if a person seeks to establish a business relationship or conduct an occasional transaction with a reporting entity, that reporting entity must:

- ascertain if that person holds a specified prominent public function;
- ascertain if that person is beneficially owned by a person holding a specified prominent public function;
- ascertain if that person is the spouse, partner, parent or child of a person holding a specified prominent public function;
- ascertain if that person is beneficially owned by a spouse, partner, parent or child, of a person holding a specified prominent public function;
- ascertain if that person is the spouse or partner of a child of a person holding a specified prominent public function;
- ascertain if that person is beneficially owned by a spouse or partner of a person holding a specified prominent public function;
- ascertain if that person has beneficial ownership of a legal entity or arrangement jointly with a person holding a prominent public function;
- ascertain if that person has any other close relationship with a person holding a specified prominent public function; and
- ascertain if that person has sole beneficial ownership of a legal entity or arrangement that is known to exist for the benefit of a person holding a specified prominent public function;

and if so:

- obtain identity information on the person and, if applicable, the beneficial owner of that person;
- obtain information on the source of funds or wealth of the "customer", being the person seeking to establish the relationship or conduct the occasional transaction;
- verify all of the above information, on the basis of documents, data or information obtained from a reliable and independent source (clause 11); and
- seek approval from the reporting entity's "senior management", as defined.
All of this must be done before the business relationship is established, or the occasional transaction conducted. In other words, the source of funds or wealth of a government minister, Supreme Court Judge or other prominent public person will need to be verified each time that person, for example, transfers any sum over the "applicable threshold value."

If the reporting entity is unable to do any of that, the reporting entity must not establish the business relationship or conduct the occasional transaction with the person (clause 34). If the reporting entity fails to do any of that before establishing the business relationship or conducting the occasional transaction, the reporting entity commits a civil liability act for which a penalty of up to $2 million may apply (clauses 76(a), 77(d) and 88(3)). In addition, if a senior manager knew that that civil liability act was occurring and failed to stop it, that senior manager is also liable to a civil penalty of up to $200,000 (clauses 74 and 88(3)).

The width of the definition of "politically exposed person" is such that clause 23 seems practically impossible to comply with. If a reporting entity does not, and could not reasonably be expected to, have actual knowledge of a particular circumstance requiring enhanced due diligence under clause 23, how can it be expected to conduct that enhanced due diligence?

We note that clause 96 provides a defence to a charge of failing to comply with the customer due diligence requirements of the Bill if the reporting entity can prove either that it took all reasonable steps to comply or that it could not reasonably have been expected to ensure compliance.

There does not appear to be any equivalent defence in respect of a civil liability act. We would expect the existence of the clause 96 defence and common sense to lead any responses for breach under clause 77 where the entity simply did not know that it was dealing with a "politically exposed person". But, from a policy design perspective, it would be preferable for reporting entities to have a "fence at the top of the cliff" in the form of knowing what is expected of them, and being permitted a reasonable opportunity to comply, rather than "an ambulance at the bottom" in the form of reporting entities having to rely on supervisors/prosecutors not taking action.

For example, if a customer completes a declaration at the outset covering all aspects of the definition of "politically exposed person" and associated relationship status, a reporting entity's reliance on such a declaration, in the absence of reasons clearly indicating otherwise, should be sufficient for compliance with clause 23. What more could a reporting entity be expected to do? It would be helpful for a reporting entity's ability to rely on such a declaration to be made clear.

If a person becomes a "PEP" as defined after a business relationship is established, or ceases to be a PEP.
Does "senior management" mean all senior managers, or can a business relationship with a politically exposed person proceed with prior approval from one senior manager?

Clarification would also be helpful in respect of the requirement to have approval from a reporting entity's "senior management" in clause 23(b). Is the requirement satisfied by approval from one of a director, trustee, partner, chief executive, chief financial officer, or other person who occupies a position within the reporting entity that allows that person to exercise an influence over management or administration? Or does "senior management" mean all of the above acting collectively? Must the board of directors meet and resolve to approve the establishment of a business relationship with a partner of a child of a government minister or board chair of a state enterprise? Or could a single director be "senior management"? This issue also arises with respect to clause 26(1)(d).

We also note that, despite the breadth of clause 23, it does not appear to apply to discretionary trusts that have a politically exposed person as a discretionary beneficiary, and a corporate trustee. Paragraph (d)(i) of the definition of "politically exposed person" includes individuals who have joint beneficial ownership of a legal entity or legal arrangement, or any other close relationship, with a person holding a specified prominent public function. Paragraph (d)(ii) of the definition includes individuals who have sole beneficial ownership of a legal entity or legal arrangement that is known to exist for the benefit of a person holding a specified prominent public function. This does not clearly extend to a discretionary trust, unless the person holding the specified prominent public function could be said to have sole beneficial ownership of a legal arrangement known to exist for their own benefit. Even if the definition of "beneficial owner" could be said to include discretionary beneficiaries, it would only take the addition of another discretionary beneficiary, such as the person's spouse, to fall outside the definition. Enhanced due diligence would be required due to the existence of a trust, but the additional PEP requirement for approval from senior management (clause 23) would arguably be circumvented. Discretionary trusts are very common in New Zealand and it is not clear how the PEP structure works in this context.

**RECOMMENDATION**

We recommend that further thought be given to the practical implementation of clause 23, as it does not appear to be workable in its current form. For example, consideration should be given to a practical solution allowing a reporting entity to rely on declarations made by a customer.

We also recommend that whether "senior management" means all or only one of the senior managers for the purposes of clauses 23(a) and 26(2)(d) be clarified.
CLAUSE 24/CLAUSE 25 WIRE TRANSFERS: IDENTITY REQUIREMENTS/WIRE TRANSFERS: VERIFICATION OF IDENTITY REQUIREMENTS

165 What constitutes a “domestic wire transfer” is not clear.

166 Clause 24(7) defines a domestic wire transfer as a wire transfer where the ordering institution, the intermediary institution, and the beneficiary institution “are all in New Zealand”.

167 It is unclear what “in” New Zealand means in this context. For instance, must the institution be incorporated or registered in New Zealand, have its main place of business here, or have any business operations based in New Zealand?

RECOMMENDATION 168 We recommend that the circumstances under which an institution would be regarded as being “in” New Zealand be clarified.
CLAUSE 26

169 More clarity is required around correspondent banking relationships.

170 Clause 26 provides that a financial institution that has or proposes to have a correspondent banking relationship with a respondent financial institution must conduct enhanced customer due diligence in relation to correspondent accounts that are used for payments to, or receipts from, foreign financial institutions.

171 If a correspondent financial institution must conduct enhanced customer due diligence with respect to respondent financial institutions with which it "proposes to have" a correspondent banking relationship, it seems odd that such due diligence is only required in relation to accounts that are already used for payments to, or receipts from, foreign financial institutions.

172 In addition, some of the concepts used in clause 26 do not appear clear. For example, what are "correspondent accounts" (clause 26(1))? What does it mean to gather enough information to "understand fully the nature of the respondent's business" (clause 26(2)(a))? How does a correspondent financial institution "assess" the respondent's AML and CFT controls (clause 26(2)(c))? What is a "permanent establishment" for the purposes of clauses 26(3)? The Organisation of Economic Development Committee on Fiscal Affairs discusses a concept of "permanent establishment" in its July 2008 Model Tax Convention on Income and on Capital (the OECD Model Tax Convention), at Article 5. The OECD Model Tax Convention is used as a base for negotiating New Zealand's network of double tax treaties, but it is not uncommon for different treaties to have different definitions. What definition is to be used for the purposes of the AML/CFT Bill?

RECOMMENDATION 173 We recommend that, if enhanced due diligence is required in the context of correspondent banking relationships in respect of correspondent accounts that are not yet used for payments to or receipts from foreign financial institutions, clause 26(1) be amended by inserting the words "or are proposed to be used," after the words "in relation to correspondent accounts that are used".

We also recommend that clarification be provided as to the intended requirements of clause 26, in particular what is to be meant by the term "permanent establishment".
CLAUSE 27/CLAUSE 54
NEW OR DEVELOPING TECHNOLOGIES AND PRODUCTS
THAT MIGHT FAVOUR ANONYMITY/MINIMUM
REQUIREMENTS FOR AML/CFT PROGRAMMES

174 Clause 27 imposes additional due diligence requirements on reporting
tentities before they establish a business relationship or conduct an
occasional transaction that involves "new or developing technologies
and products that might favour anonymity".

Enhanced due diligence should apply to either or both of
new or developing technologies and
products that might favour anonymity.

175 The wording of clause 27 seems to imply that enhanced due diligence
is required only if both technologies and products are involved. This
would seem to be an oversight as the issue is anonymity regardless
of whether it is achieved through a product or a technology. This is
similarly an issue with respect to clause 54(j).

RECOMMENDATION
176 We recommend that clause 27 be amended by deleted and replaced
with the following:

"Before a reporting entity establishes a business relationship or
conducts an occasional transaction that involves new or developing

technologies, or products, that might favour anonymity, the
reporting entity must, in addition to the requirements in sections 21
and 22, –

(a) take any additional measures that may be needed to prevent
any new or developing technologies or products from being
used in the commission of a money laundering offence or for
the financing of terrorism; and

(b) meet any other requirements prescribed by regulations and
that apply to the particular technology or product."

We also recommend that clause 54(j) be amended by deleting the
word "and" and replacing it with "and/or".
NEW OR DEVELOPING TECHNOLOGIES AND PRODUCTS THAT MIGHT FAVOUR ANONYMITY

177 Is it reasonable to expect reporting entities to take the additional measures needed to “prevent” new technologies from being used in the commission of a money laundering offence, and if so, how is this to be assessed?

It is a very high standard to expect reporting entities to “prevent” new or developing technologies and/or products from being used in the commission of a money laundering offence.

178 Clause 27 provides that, before a reporting entity establishes a business relationship or conducts an occasional transaction that involves new or developing technologies and/or products that might favour anonymity, the reporting entity must, in addition to conducting enhanced customer due diligence, take any additional measures that may be needed to prevent any new or developing technologies/products from being used in the commission of a money laundering offence or for the financing of terrorism.

179 This ties in with clause 54(j)), which provides that a reporting entity’s AML/CFT programme must include adequate and effective procedures, policies and controls for preventing the use, for money laundering or the financing of terrorism, of products (“for example, the misuse of technology”) and transactions (“for example, non face-to-face business relationships or transactions”) that might favour anonymity.

“Prevent” is a very high standard, and it is not clear how a reporting entity’s compliance with that standard would be assessed. “Inhibit” may be a better word, as its definition includes “prevent” but also extends to “restrain” or “hinder”. This would more appropriately cover those circumstances where, for example, the technology is such that absolute prevention is simply not possible. Taking reasonable steps, rather than being expected to achieve prevention, also seems more realistic.

RECOMMENDATION

181 We recommend that clause 27(a) be amended by deleting the words “take any additional measures that may be needed to prevent”, with the words “take any reasonable steps to inhibit”.

We also recommend that guidance be provided as to what exactly is expected of reporting entities in terms of clause 27(a).

We recommend that clause 54(j) be amended by deleting the word “preventing” and replacing it with the word “inhibiting”.

FOREIGN AFFAIRS, DEFENCE AND TRADE COMMITTEE
The ongoing customer due diligence and account monitoring provisions lack precision.

**Clarification is needed around the requirements for due diligence and account monitoring.**

Clause 28(4) provides that, when conducting ongoing customer due diligence and account monitoring, a reporting entity must at least "regularly review" customers' account activity, transaction behaviour and information. It is not clear exactly what account activity, transaction behaviour and customer information should be regularly reviewed for. Many entities have automatic systems in place to trigger a review if there is any unusual activity, such as a transaction over a certain threshold. Although such systems appear sufficient to manage risks of money laundering, such an "occasional" review would not on its face meet the requirement for at least a "regular review". There is no indication of what "regularly review" means. Arguably, it could mean more often than once every two years (see discussion below under clause 56).

Is clause 28 requiring the transactions of every account to be reviewed, say, every month? Some reporting entities would have tens of thousands of accounts. This seems a massive requirement with huge associated compliance costs. What if an account is dormant — should the account be regularly reviewed to confirm it is still dormant? Clause 28(4) is not risk-based, and requires "regular review" whether there is risk or not.

A key difficulty appears to be the requirement to conduct the regular review in addition to any reviews carried out as a result of any systemic alerts, and irrespective of risk. The non-ongoing customer due diligence provisions import an "according to the level of risk involved" component (see, for example clauses 12(e)(iv), 13(g), 14(1), 17(e), 18(1), 22(1), 24(1)(e), 25(1) and 26(1)). Where systems are in place that effectively provide alerts to unusual activity, the requirement to additionally review transaction behaviour and account activity seems to impose disproportionate cost for questionable benefit. Although it is not entirely clear what "according to the level of risk involved" means, we submit that a similar "risk filter" should nevertheless be inserted into clause 28(4).
The categories in clause 28(4)(b) are not mutually exclusive and will potentially give rise to unnecessary compliance costs for questionable benefit.

It would also be helpful for clarification to be provided with respect to the requirement to conduct differential reviews in clause 28(4)(b), depending on whether a particular customer has had customer due diligence conducted or is an existing customer. The two categories are not mutually exclusive: an "existing customer" (being a customer with whom a reporting entity had a business relationship immediately before the commencement of Part 2) may come to have customer due diligence conducted under the provisions mentioned in clause 28(4)(b) by virtue of any of the circumstances in clause 12(e) arising. Such a customer will then, technically, forever fall under both limbs of clause 28(4). For such customers, it will not be sufficient to review the customer due diligence information; it will also be necessary to review "any customer information the reporting entity holds about the customer". As time passes tracking the customers to whom this applies will become increasingly onerous, for questionable benefit. If customer due diligence has been conducted under the first limb of clause 28(4)(b), this should "trump" the apparently transitional requirement contained in the second limb of clause 28(4)(b).

RECOMMENDATION 387 We recommend that clause 28(4) be amended by inserting the words "according to the level of risk involved," after the word "must."

We also recommend that clause 28(4)(b) be amended by inserting the words "upon whom customer due diligence under any of the aforementioned provisions has not yet been conducted" after the words "existing customer".
CLAUSE 30

RELIANCE ON OTHER REPORTING ENTITIES OR PERSONS IN ANOTHER COUNTRY

It is not clear which reporting entity is responsible for customer due diligence under clause 30(3).

For the sake of clarity, the "entity A and B" construct should be used in clause 30.

Clause 30(1) provides that a reporting entity may rely on another person to conduct the customer due diligence procedures required for customer due diligence under the Bill.

Clause 30(2)(a)(i) provides that the person being relied on may be a reporting entity.

Clause 30(3) provides that, despite clause 30(1), "a reporting entity", and not the person carrying out the customer due diligence procedure, is responsible for ensuring that customer due diligence is carried out in accordance with the Act.

The predecessor to clause 30(3), clause 19(3) of the consultation draft of the Bill (issued in October 2008), referred to "reporting entity A", as the person who may rely on another person and also as the person who remained responsible. However, under clause 30(3) as currently drafted, it is not necessarily clear which "reporting entity" is being referred to, as the person being relied on may itself be a reporting entity.

RECOMMENDATION 193 We recommend that clause 30 be redrafted to revert to the "entity A" and "entity B" construct used in its predecessor in the consultation draft.
PROTECTION OF PERSONAL INFORMATION AND DESIGNATED BUSINESS GROUPS

Clause 33 only grants privacy protection to information provided by a reporting entity.

Clause 33(2) provides that any information supplied by any member of a designated business group to another member of that group must be subject to privacy protections.

The definition of "designated business group" in clause 4 does not require each member of the group to be a reporting entity.

Clause 29(1)(a) provides that a reporting entity may rely on another member of the group to conduct any customer due diligence procedures required.

Clause 33 applies to information received for the purposes of clauses 29(1)(a) or (b). Clause 33(4) provides that "the reporting entity" that provides information to another member of its designated business group remains responsible for the use or disclosure of that information. However, the reference to "the reporting entity" in clause 33(4) is incorrect, as the provider of the information may or may not be a reporting entity. Although the Bill's ambit relates to "reporting entities", it is to be expected that the privacy protection should be the same whether information is provided within a designated business group by an entity which is a reporting entity or not.

We recommend that clause 33(4) be amended by deleting the reference to "the reporting entity" and replacing it with "the entity".
CLAUSE 39

PRIVILEGED COMMUNICATION DEFINED

200 There appears to be a drafting error in clause 39(1)(a)(iii).

Clause 39(1)(a)(iii) appears to have inadvertently omitted a reference to one party to a confidential communication.

201 Clause 39(1)(a) refers to confidential communications passing between lawyers, a lawyer and his or her client and an agent. In particular, clause 39(1)(a)(iii) refers to confidential communications passing between an agent of the persons named in subparagraphs (i) and (ii).

How can a confidential communication pass "between an agent"? The communication needs to be between the agent and somebody else.

202 Confidential communications passing between an agent of a lawyer, or a client of a lawyer, and that lawyer or client should be privileged. In addition, a communication that would be privileged if it came from a party should remain privileged if it comes from that party's agent. For example, communication between a lawyer's agent and the lawyer's client should be privileged in the same way as communication between the lawyer and the client.

RECOMMENDATION

204 We recommend that clause 39(1)(a)(iii) be deleted and replaced with the following:

"(iii) an agent of any person described in subparagraph (i) or (ii) and any person described in subparagraph (i) or (ii), either directly or indirectly; and"
DESTRUCTION OF RECORDS

205 The record-keeping requirements could potentially extend for many decades, with all the associated compliance costs.

206 Clauses 46-48 require AML/CFT records to be kept for 5 years after the completion of a transaction or after the end of a business relationship. After this time, clause 51 requires those records to be destroyed.

207 Business relationships may continue indefinitely. To retain records for 5 years after a business relationship ends requires tracking of business relationships to clarify when they in fact they may have ended, and then tracking 5 years after that. Although many of the records required to be kept for AML/CFT purposes will overlap with the records required to be kept for tax purposes under section 22 of the Tax Administration Act 1994 (TAA), the retention period required for AML/CFT purposes is potentially substantially longer than that required for tax purposes, due to the fact that it is relationship-based. Section 22 of the TAA requires records to be kept for a minimum of 7 years after the end of the income year to which they relate, or potentially a further 3 years after that under section 22(5).

209 There is potential for systems error in having different overlapping periods in respect of the same records.

RECOMMENDATION 209 We recommend that guidance material cover the interaction between the record-keeping requirements under the Bill and under section 22 of the Tax Administration Act 1994, to reduce the scope for error, and that a time limit, for example the 7-10 year limit required for tax purposes, be imposed on the retention of records relating to business relationships that endure for extended periods of time.
REPORTING ENTITY MUST HAVE AML/CFT PROGRAMME AND AML/CFT COMPLIANCE OFFICER

It would be helpful for the requirement for the AML/CFT compliance officer to be an "employee" to be clarified.

Clause 53(2) requires a reporting entity to designate an "employee" as an AML/CFT compliance officer to administer and maintain its AML/CFT programme.

"Employee" is not defined. How would this provision apply to, say, a sole practitioner or small partnership which has no employees? Are the partners to be considered self-employed and are they therefore to fill the role themselves? Or must they take on a specialist AML/CFT compliance officer?

We recommend that guidance be provided as to how clause 53(2) is to apply in the context of small operations which have no employees.
Clause 54(c) and (g) should be combined.

Clause 54(c) requires a reporting entity’s AML/CFT programme to include adequate and effective procedures, policies and controls for complying with customer due diligence procedures, including ongoing customer due diligence.

Clause 54(g) requires a reporting entity’s AML/CFT programme to include adequate and effective procedures, policies and controls for account monitoring.

Clause 28 requires a reporting entity to conduct ongoing customer due diligence and undertake account monitoring. Clause 28(4) provides that, when doing so, a reporting entity must regularly review both the customer’s account activity and transaction behaviour, and any customer information held about the customer. Neither “ongoing customer due diligence” nor “account monitoring” are defined, and they are used in clause 28 in tandem.

It is not clear why two concepts used in tandem in the operative clause are separated in clause 54. It is likely that reporting entities will have different processes for undertaking account monitoring, compared to regularly reviewing information held about a customer. Nevertheless, account monitoring falls squarely within subpart 1 of Part 2, and therefore within the concept of “customer due diligence requirements”.

We recommend that clause 54(c) and (g) be deleted, and a new clause 54(c) be inserted as follows:

“complying with customer due diligence requirements (including ongoing customer due diligence and account monitoring); and
CLAUSE 56

REVIEW AND AUDIT OF RISK ASSESSMENT AND AML/CFT PROGRAMME

220 The Bill is unclear as to when, or how often, risk assessments and AML/CFT programmes are to be reviewed.

221 Clause 53 requires a reporting entity to establish, implement, and maintain a compliance programme (an AML/CFT programme) that includes internal procedures, policies, and controls to detect, manage and mitigate the risk of money laundering and the financing of terrorism.

Before establishing an AML/CFT programme and before conducting any customer due diligence, a reporting entity must undertake an assessment of the risk of money laundering and the financing of terrorism (a risk assessment) that it may reasonably expect to face in the course of its business (clause 55). We would hope and expect that the provisions requiring risk assessments and AML/CFT programmes would come into force before the commencement of the customer due diligence and enforcement provisions, in order to give reporting entities the safe harbour of a "prosecution-free period" in order to establish their systems. However, as discussed above, it would be helpful for this to be clarified.

In addition, some clarification would be helpful regarding the circumstances under which the risk assessment and AML/CFT programme are to be reviewed. Clause 56(1) requires a reporting entity to conduct "a review" of its risk assessment and AML/CFT programme, to ensure they "remain current" and to identify any deficiencies in their effectiveness. Clause 56 does not state when, or how often, such a review is to be carried out.

On its face, clause 56 may require only one review, presumably not long after the risk assessment has been undertaken and the AML/CFT programme established, following which two-yearly audits would supersede any requirement for review. The use of the disjunctive "or" in clause 57(2)(b) arguably supports this view: In the first year, the annual report must take into account the review, but thereafter arguably only the audit.

However, if that is the case, it is not clear. Section 33 of the Interpretation Act 1999 states that words in the singular include the plural, meaning that clause 56(1) could require many reviews. The wording in clause 56(1)(a) requiring a reporting entity to ensure the assessment and programme "remain current" arguably imply an ongoing requirement to review. In addition, by definition, an "annual report" on the risk assessment and AML/CFT programme, taking into account the review or the audit, would be prepared annually. Does this then mean that "a review" required by clause 56 should be conducted annually also? The explanatory note to the Bill, at page 23, does mention a preferred option of reporting entities conducting "annual assessments and 2-yearly independent audits". Alternatively, if an audit is required biennially, and the annual report must take into
account the results and implications of either the review or the audit, perhaps reviews are required biennially also, on alternate years to the audit.

226 It would be helpful for clarification to be provided as to when a "review" must be conducted under clause 56(1). We note that, contextually, the other requirement for reporting entities to "review" under the Bill appears in clause 28(4), under which reporting entities must "regularly review" customers' account activity, transaction behaviour and information. This contrasts with the requirement to simply "review" assessments and programmes under clause 56. Does this mean that "review" is to be interpreted as annual or even biennial, and "regularly review" in clause 28(4) is to be interpreted as more regularly than annually or biennially?

RECOMMENDATION 227 We recommend that, if annual or biennial reviews are required by clause 56, that the legislation clearly state that requirement, so that reporting entities can be aware of their obligations.
The use of the word "or" in clause 57(2)(b) appears to be causing some confusion.

Under clause 57(2)(b), a reporting entity must prepare an annual report on its risk assessment and AML/CFT programme, taking into account the results and implications of the review required by clause 56(1) "or" the audit required by clause 56(2).

The use of the disjunctive "or" in clause 57(2)(b) arguably means that an annual report must take into account the results and implications of either the audit or the review, but not both. In the years in which an audit takes place, arguably then an annual report need not take into account the results and implications of any review: the audit would "trump" the review for the purposes of the annual report. If only one review is required (see earlier discussion on clause 56), annual reports arguably would only take into account the results and implications of audits, with the exception of the first year only when the annual report would take into account the review.

It is not clear how often "reviews" of risk assessments and AML/CFT programmes are required to be carried out (see earlier discussion under clause 56). If annual or biennial reviews are required under clause 56, it would be helpful for the interaction between reviews and two-yearly audits for the purposes of the annual report be clarified.

RECOMMENDATION

We recommend that, if in a year in which both a review and an audit takes place, the annual report is required to take into account the results and implications of both the review and the audit, that the legislation replace the word "or" with "and/or".
CLAUSE 99

STRUCTURING TRANSACTION TO AVOID
APPLICATION OF AML/CFT REQUIREMENTS

233 The penalty for "avoiding" AML/CFT requirements is in our view too high. We submit that the bar should be set at evasion rather than avoidance.

234 Under clauses 76 and 89, it is an offence to "knowingly or recklessly" fail to conduct customer due diligence. Under clause 99, it is an offence to structure a transaction to "avoid" the application of any AML/CFT requirements. The penalty for structuring a transaction to so avoid requirements is up to 2 years' imprisonment for an individual and a fine of up to $5 million for a body corporate.

The concept of "avoidance" is not defined. In other contexts, it is notoriously unclear (see for example the vast volume of litigation and uncertainty on the concept of "avoidance" in the tax context). In the tax context, a distinction is made between "avoidance", which is subject to a penalty of up to 100% of the tax shortfall, and "evasion" which is a criminal offence. Given the high penalties applicable to clause 99, we submit that "evasion" is more appropriate than "avoidance" in this context.

RECOMMENDATION 236 We recommend that clause 99 be amended by deleting the word "avoid" and replacing it with the word "evade".

It is not clear what constitutes "avoidance" for the purposes of clause 99.
CLAUSE 106

STRUCTURING OF CROSS-BORDER TRANSACTION TO AVOID APPLICATION OF AML/CFT REQUIREMENTS

237 The penalty for "avoiding" AML/CFT requirements is in our view too high. We submit, as with clause 99, that the bar should be set at evasion rather than avoidance.

238 Under clauses 76 and 89, it is an offence to "knowingly or recklessly" fail to conduct customer due diligence. Under clause 106, it is an offence to structure a cross-border transaction of cash to "avoid" the application of any AML/CFT requirements. The penalty for structuring a transaction to so avoid requirements is up to 3 months' imprisonment for an individual and a fine of up to $50,000 for a body corporate.

239 We submit that evasion would be more appropriate than avoidance (refer clause 99 for arguments).

RECOMMENDATION 240 We recommend that clause 106 be amended by deleting the word "avoid" and replacing it with the word "evasion".