INVESTMENT SAVINGS & INSURANCE ASSOCIATION OF NZ INC

SUBMISSION

ON THE

MINISTRY OF JUSTICE

FATF-COMPLIANCE REVIEW:

RESPONSE TO STAKEHOLDER COMMENT ON AML PROPOSALS

12 July 2007

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Introduction

The Investment Savings and Insurance Association ("ISI") welcomes the opportunity to comment on the response of the FATF Inter-agency Working Group to industry stakeholder submissions on the third FATF Discussion Document.
ISI represents the companies that issue and manage life insurance, superannuation and managed funds in New Zealand. Reserve Bank financial statistics for the quarter ending 30 September 2006 indicate that this industry is responsible for assets in excess of $62 billion. A list of our member companies appears at the end of this document.

ISI members have an obvious interest in legislation that affects the relationship between financial services companies and their customers. The nature of that relationship will vary considerably depending on the type of financial product the customer holds.

ISI members have a particular interest in the proposals generally, as indicated by the fact we have made submissions on all three of the Ministry's previous discussion documents on AML.

General Comment

ISI is disappointed at the relatively short time frame available to analyse the proposals and prepare our responses to what will be an important piece of legislation. As a result we are not able to respond to all questions and our replies may not have the depth we would have preferred.
We appreciate the extension that was granted from requiring our submission on the 12th July to the 16th July but note that this included a weekend. We make this observation in the understanding that the paper was originally intended to be available in April.

We have a number of members who are part of international or global groups who simply have not had sufficient time to engage their parent organisations.

The key points that arise from our submission which follows below are:

- ISI members generally support the two tiered proposal.

- ISI believes financial institutions must be able to apply their own risk assessment methodology.

- Many financial institutions are part of groups and have a strong requirement for AML policies and practices that are at the very least consistent with those in Australia.

- We have significant concerns regarding the introduction of a multi-supervision model and the risks and uncertainly of overlapping responsibilities.

- We believe that the proposals around identification of beneficiaries create significant compliance and are unworkable.

Legislative Arrangements

ISI members are generally supportive of the two-tiered model proposed, comprising an Act and regulations. We have concerns at the suggestion that some supervisors may also issue enforceable obligations through some form of sub-ordinate legislation. Our concern is that a further set of enforceable obligations may prove to be overly prescriptive and therefore inconsistent with the concept of promoting a risk-based approach to managing the risk of money laundering and terrorist financing. If sector specific guidelines are warranted we would suggest these guidelines should be set up in a flexible way and subject to on-going industry consultation. We would suggest an advisory body made up of industry members, established for the purpose of reviewing the guidelines on a periodic basis and when called upon to do so by industry.

Central to our concerns with an overly prescriptive approach is our view that financial institutions should be able to apply their own risk assessment methodology and framework for achieving compliance with the AML legislation. In many cases this would enable the NZ organisation to leverage off the policies and practices developed by a parent company, say in Australia, and as far as possible ensure a consistent Group approach which will assist in achieving overall compliance.

Multi-Supervisor Model

While we are supportive of the multi-supervisor model, we have significant concerns at the current split of industry sectors to supervisors. Under the current proposal ISI fund managers would be subject to the Securities Commission for our advice business, managed funds and other securities offerings, and life insurers will be responsible to the Reserve Bank for insurance business and debt securities. Groups that include fund management and life insurance will be responsible to both the Securities Commission and Reserve Bank for different parts of the business. How will products containing a mix of savings and insurance respond to the supervisors? We would also have reporting obligations to the FIU and the Companies Office.

While the current proposal will avoid Banks who offer insurance having more than one Supervisor, it will not work for financial providers. It may be more appropriate for insurance business to also sit under the Securities Commission given that many securities issuers also offer insurance.

Our concern is based on the practical and cost implications of having to comply with more than one set of regulations or enforceable obligations including duplication of reporting obligations. We would also question how supervisors would work together to ensure consistency of regulations and how entities such as the Reserve Bank would ensure their monitoring and oversight is appropriate for the range of activities its members undertake. We would also welcome some details on the proposed audit function of each Supervisor and the planned frequency of such audits.

We would strongly support the need for a designated ‘lead’ supervisor for entities that would be subject to multiple supervisors under the current proposals, and assurances that entities would only be subject to one set of sub-ordinate rules.

Two-staged implementation of reforms

We would welcome further clarification on aspects of the legislation that would be effective immediately and aspects that are likely to have a lead in period. We would suggest a minimum two year implementation period would be required from the date of release of the final package of legislation, including rules and guidelines.

Question 1: Approach to Risk Management

1. ***Do you prefer an approach to the identification and management of high and low risks where either:***

    a. ***The legislation and regulations provide you with detailed guidance on how low and high risk situations are to be identified and managed; or***

    b. ***The legislation requires you to develop policies and procedures for identifying and managing low and high risk situations and in doing so you are audited and monitored by supervisors against statutory criteria?***

2. ***What are the reasons for your preference?***

We could support either approach but have a preference for (b) for the reason that this allows development of solutions appropriate for individual business.

We would suggest that the most effective way of guarding against money laundering and terrorist financing is to allow organisations to determine the extent of their obligations based on a risk assessment of individual situations using their own risk assessment methodology.

We believe that this approach is more likely to assist in fulfilling the stated objectives of FATF - to reduce the instance and impact of money laundering - by allowing individual organisations to focus their efforts and resources towards those areas that they identify (as part of a formal risk assessment) as being areas of increased money laundering risk.

A centralised approach may lead to an overly prescriptive and procedure focused regime. Therefore we support the devolved model 1 b. where the legislation requires development of policies and procedures for identifying and managing low and high risk situations. As noted earlier this will allow consistency with an overseas (eg Australian parent company) and leverage off existing policies and practices already implemented. It would also enable establishment of meaningful policies and practices that compliment current risk management and compliance framework and IT systems.

Customer Identification, verification and ongoing due diligence

We have concerns regarding the requirements to verify the identity of underlying beneficial owners of products. There are inherent difficulties with identification of beneficiaries where these beneficiaries can be changed easily and without recourse to the product provider. For example, beneficiaries of a will or shareholders of corporate entities. Product providers simply will not be in a position to monitor such changes. We would suggest that for financial services products, identification of customers making the initial application would be more appropriate as these individuals or entities are likely to be involved if there is any suspicious activity.

We would suggest that this aspect is made subject to reporting entities own risk based criteria as well as allowing exemptions for wrap accounts, administrative platforms, collective investment schemes, discretionary trusts and other legal entities where identification of the underlying investor by the end product provider will be unduly onerous and in some cases not possible.

We must also be able to rely on the identification and verification undertaken at the beginning of the business relationship by the reporting entities that have the primary relationship with the customer for these types of accounts/services.

We would welcome further details on how entities would be expected to meet on-going due diligence requirements for business relationships and associated transactions and exactly what these requirements would be.

Question 4: Identification and verification requirements for non-cash transactions

What (if any) would be the operational implications for your business of extending the proposed identification and verification requirements for occasional cash transactions of $10,000 or more to non-cash transactions?

The operational impact of extending the proposed identification and verification requirements for cash transactions over $10,000 to non-cash transactions would be significant and onerous. We do not agree that this is necessary and would endorse views made clear in previous industry submissions that in the absence of any reason to suspect money laundering or terrorist financing, customer due diligence (CDD) should not be required where the nature of the transaction provides clarity on the source of funds. For example, further lump sum contributions to established superannuation schemes which form the basis of many New Zealanders' savings plans.

We would suggest also that the threshold figure of $10,000 is reviewed in line with inflation and FAFT thresholds which are currently USD/Euro 15,000.

Question 6: Process for identifying customers

What (if any) would be the operational implications for your business of the proposed process to identifying customers?

While we are comfortable with the legislation setting minimum standards, the process for identifying customers is overly prescriptive and moves away from a risk based approach. We would support the proposed requirements for natural persons in i) to iv) and also vi). We would not support the inclusion of occupation details as this is such a changeable variable. We would suggest that other than minimum standards, KYC criteria should be developed as sector based guidance for reporting entities rather than being enshrined in the legislation.

We also express concern at the ability of organisations to identify who (in relation to clubs, societies or charities) are the individuals exercising control or significant influence over its assets.

We would also welcome more detail on the KYC measures required for verifying beneficial owners of legal entities.

Question 8: Verification of existing customers

What (if any) would be the operational implications for your business of proposed requirements to verify the identity of existing customers?

What would be appropriate circumstances to trigger the requirement to re-verify the identity of existing customers?

The proposed obligation to verify the identity of our existing customers would have a significant operational impact and place a significant burden on the financial services industry. ISI members consider that they already have in place sound customer verification measures across a range of products. While we are supportive of improving these procedures for new customers, the costs of verifying existing customers would far outweigh any benefit. We consider there will be a negative impact on customers if such requirements are imposed as well as difficulties achieving compliance.

The events suggested as triggers for re-verification are not events which necessarily involve direct contact with the customer or adviser. Often, the issuing of distribution notices or financial statements will only require a mailing address.

It will also be difficult and in some cases impossible to carry out verification of longstanding customers on legacy systems/products. We would strongly suggest that in the absence of any direct suspicion around existing customers there should be no obligation to re-verify identity.

We strongly advocate that resources would be far better employed to promoting and embedding a risk based AML culture with focus on successfully implementing a programme to support this culture.

Question 10 : Reliance on third parties to identify customers

Are the proposed conditions for allowing reporting entities to rely on third party verification of customer identity reasonable and if not why not?

We would support the proposal that reliance should be able to be placed on third parties to carry out verification of customer identity.

We are concerned however that the ability to rely on another financial institution would require having in place a contract with that institution and that we also must obtain the details of their CDD process. We consider that we must be able to rely on other financial institutions where they are also reporting entities and that the minimum requirements should be limited to paragraphs i) and ii) of your paper.

We also consider that these minimum requirements should extend to other third parties where they are also reporting entities and subject to the AML legislation. The practical effect of the proposals (that would require every financial institution to be responsible for a third party compliance with customer ID) is that financial services organisations would have to oversee and monitor a multitude of advisers/distribution channels' AML compliance programmes as well as non-aligned advisers and IFA's with whom we do not have any direct or contractual relationship. We would be forced to put in place a second layer of verification which would be impractical, excessively costly and time consuming.

We consider that the third parties themselves are best placed to perform and be responsible for the checks as they have the primary business relationship with the customer. Further these third parties will in many cases be reporting entities them selves and already subject to the legislation. Therefore we do not agree that a second layer of checking/monitoring their compliance should be added to the transaction as this would place a significant burden on the industry. We would support greater industry involvement in setting minimum standards so that reliance can be placed on the CDD processes of other reporting entities.

Question 11: Politically Exposed Persons

What (if any) would be the operational implications for your business of the proposed approach to the identification of politically exposed parties?

ISI members would not be in a position to identify whether a person or customer falls within the definition of a PEP (assuming that the legislation would follow FATF's broad definition). We would support access to a government operated and maintained list of PEPs. This would ensure cost effectiveness and would also ensure a uniform approach is taken to the identification of PEPs.

Question 12:

Operational implications for keeping records for 5 years *after the end* of the business relationship

We do not see any impact with this requirement as we often keep records for longer than this period. We would ask that the time periods are consistent with the record keeping requirements specified in other relevant legislation such as the Tax Administration Act, The Life Insurance Act and Superannuation Schemes Act.

Question 13: AML Compliance Programmes

What (if any) would be the operational implications for your business of the proposal to have an AML compliance programme?

We are comfortable with the requirement to develop an appropriate AML/CTF compliance programme provided the legislation favours a risk-based approach and allows financial institutions to tailor their own programmes after applying their own risk assessment methodology. This would enable us to structure an effective programme consistent with our existing risk management structure, policies and IT systems.

We would suggest that financial institutions would need a minimum period of two years from the issue of all legislation and related regulations, for a comprehensive programme to be in place. We would also suggest New Zealand follows the implementation timetable adopted in Australian with staged release dates for various parts of the legislation and a prosecution free or 'grace' period of 15 months in which the Australian regulator has a discretion not to impose civil penalties.

Questions 18 and 19: New technologies

Do you consider the amended proposals relating to new technologies to be reasonable and if not why not?

What (if any) would be the operational implications for your business of the proposals relating to new technologies?

We are supportive of the proposals relating to new technologies provided that the framework is again based on a risk assessment methodology and is not overly prescriptive.

Question 20: Trans Tasman Consistency

Are there any specific differences between the Working Group's proposed AML / CFT requirements and those of Australia that would materially impact the operation of your business?

We have raised some general issues below some of which touch on Trans-Tasman issues. We would again re-iterate the need for a longer consultation period for reviewing draft legislation to enable us and our members to undertake a comprehensive impact assessment of the two regimes.

General issues:

- We would strongly support the Australian AML legislative model where corporate groups are able to act as a single reporting entity to avoid onerous or repetitive compliance obligations in the business process within related company groups.

- Given the nature and characteristics of superannuation and life insurance products, these should generally be considered low-risk products. The draft legislation/regulations should ensure entities can make the appropriate risk assessments for their own products and services. Extending AML/CTF obligations to all clients and all transactions in equal measure is onerous and impractical and ultimately ineffective as it reduces the ability of resources to concentrate on those areas/products of higher risk.

- As noted above regarding reliance on third parties, the legislation should ensure there is no duplication of record keeping requirements or reporting obligations between reporting entities and distribution channels where one entity has relied on another for identity verification or other compliance aspects.

Verification of identity of existing clients should be based on a true risk based approach. This would mean only being required to verify identity where suspicious activity has been undertaken by them.

Given the volume of new legislation facing the industry, such as the Review of Financial Products and Providers, and the proposed co-regulatory regime for financial advisers, we would ask that AML requirements are consistent with this new legislation so that providers are not subject to differing standards and requirements.

ISI Members

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Asteron Life Ltd
AXA New Zealand
BNZ Investments and Insurance
CIGNA Life Insurance NZ Ltd
Equitable Group
Fidelity Life Assurance Co Ltd
Gen Re LifeHealth
Hannover Life Re of Australasia Ltd
ING New Zealand Ltd
Medical Assurance Society NZ Ltd
Munich Reinsurance Co of Australasia Ltd
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