Submission on the

Ministry of Justice Discussion Document

Money Laundering and New Zealand's Compliance with FATF Recommendations

From

The Association of Superannuation Funds of New Zealand Inc.

31 October 2005

Introduction

Thank you for the opportunity to comment on the Ministry's discussion document *Money Laundering and New Zealand's Compliance with FATF Recommendations*.

The Association of Superannuation Funds of New Zealand Incorporated (*ASFONZ*) is a not-for-profit, non-political independent organisation which represents the trustees and sponsoring employers of over 100 of New Zealand's largest employer-based superannuation schemes and close to 50 product and service provider organisations. Our mission is to promote workplace superannuation in New Zealand by advocacy, education and networking (refer the final page of this submission).

ASFONZ recognises that full compliance with the recommendations made by the Financial Action Task Force on Money Laundering (*FATF*) does require policy makers to consider imposing additional obligations on financial institutions with regard to due diligence, record-keeping and suspicious transaction reporting, as well as stricter internal anti-money laundering systems and procedures.

We agree that it is critically important for the New Zealand regulatory environment to be designed so as to minimise the threat to our business communities from money-laundering and terrorist financing, and to maintain our international reputation as a nation fully committed to anti-money laundering and anti-corruption efforts.

However, we agree with comments from the Investment Savings and Insurance Association (*ISI*) to the effect that the Ministry's proposals are at this stage necessarily broad and this makes their impact difficult to gauge. We look forward to the opportunity for further consultation when specific standards for the new regulatory environment are being developed, as it will be the details of those proposals that will determine the degree of impact on superannuation schemes' issuers and service providers.

Relevance of proposed "risk-based analysis" to employer superannuation schemes

Paragraph 68 of the discussion document notes that the glossary within the FATF recommendations provides that, in strictly limited and justified circumstances, and based on a proven low risk of money laundering, a country may decide not to apply some or all of the FATF recommendations to certain financial activities which the FATF generally requires to be covered.

This mirrors similar observations made in the consultation paper released earlier this year by the Joint Money Laundering Steering Group in the United Kingdom. That Steering Group considered that the law must recognise more clearly that various sectors in the financial services industry can be materially different, and so an approach to preventing money laundering that is appropriate for one sector may be wholly inappropriate for another.

The Interpretative Notes to the FATF recommendations make it clear that the due diligence requirements recommended by FATF are not intended to be applied strictly in all cases. Notably, Interpretative Note 12 contemplates that reduced measures could be acceptable for pension, superannuation or similar schemes that provide retirement benefits to employees, where contributions are made by way of deduction from wages and the scheme rules do not permit the assignment of a member's interest in the scheme.

Registered superannuation schemes in New Zealand are required (relevantly) to operate principally for the purpose of providing retirement benefits to natural persons, and this necessitates withdrawal restrictions. They also involve contributions by way of wage or salary deductions, and almost invariably prohibit the assignment of members' interests to third persons.

Money laundering through an employer-based superannuation scheme will accordingly be a fairly unusual occurrence, to put it mildly.

This should be borne in mind in relation to some of the more prescriptive amending proposals currently under discussion, such as requirements for detailed compliance management arrangements, ongoing employee training programmes, and audit functions to test/evaluate anti-money laundering systems and procedures.

The discussion document appears to contemplate that these prescriptive requirements will be imposed upon all issuers of securities, which will include the trustees of employer-based superannuation schemes.

Stand-alone, employer-based superannuation schemes commonly have company-appointed and possibly member-elected individuals (employed by sponsoring companies) acting as trustees. Those trustees typically do not have specialist experience in financial services and, more particularly, they are not normally personally involved in transactions with members. As a matter of practical necessity, most employer-based superannuation schemes are fully managed by an external administration manager which attends to identity verification, record-keeping and other due diligence requirements.

For these reasons, any additional procedural and record-keeping requirements imposed on employer superannuation schemes (by which we mean "stand-alone" schemes, as distinct from the multi-employer schemes offered on a for-profit basis by financial institutions) must recognise that not only do such schemes involve a very low risk of money laundering but also that their issuers rely upon financial intermediaries as the point of contact with new members. Those financial intermediaries are the appropriate entities for the imposition of:

(i) any comprehensive monitoring framework to ensure schemes meet standards for countering money laundering and terrorist financing; and

(ii) the imposition of statutory due diligence requirements and anti-money laundering systems and procedures (including record-keeping procedures).

We note that this is congruent with FATF's recommendation 9, which permits countries to allow financial institutions to rely on intermediaries or other third parties, subject to conditions.

Care must also be taken to ensure that the same principle extends to:

(i) any requirements to appoint compliance officers and/or implement on-going "employee training programmes"; and

(ii) requirements to report suspicions of funds related to terrorist financing, or of property owned or controlled by known or suspected terrorists or terrorist organisations.

The "whistle blower" provisions prescribed in sections 18A and 18B of the Superannuation Schemes Act 1989 operate according to this principle. They impose disclosure obligations on administration managers, investment managers, actuaries and auditors of registered superannuation schemes (and protect them against resulting civil or criminal liability for disclosures made in good faith).

"Fit and proper person" requirements

The FATF proposals contemplate (unobjectionably) that financial institutions must take reasonable measures to prevent criminals or their associates from holding or being the beneficial owners of significant or controlling interests, or holding management functions in, a financial institution.

However, we have some concern with the further statement (in the FATF's *Methodology for Assessing Compliance*) that:

> *"Directors and senior management of financial institutions ... should be evaluated on the basis of "fit and proper" criteria, including those relating to expertise and integrity".*

ASFONZ would be very concerned about the imposition of any requirements for pre-existing levels of expertise in the financial services sector being imposed in "black letter" terms upon company-appointed or member-elected trustees of employer-based superannuation schemes. Such schemes are already subject to prescriptive annual reporting, accounting and disclosure obligations and (as noted above) they are, of necessity, fully externally administered in most cases. They are also subject to the normal fiduciary responsibilities associated with trust-owned property.

Particularly in view of the very low risk of money laundering through an employment-related scheme, which is required to operate principally for the purpose of providing retirement benefits for the employees (and retired employees) of the sponsoring employer, ASFONZ would be concerned at any imposition of "fit and proper person" requirements which operated to dissuade individual employees of a sponsoring employer from performing a valuable service for schemes.

ASFONZ also notes that the discussion document states that "*some form of registration for the entities being monitored is an option that will need to be considered*". We express corresponding reservations about the appropriateness of a registration requirement for groups of individual trustees.

Reliance on third parties – existing legislative protections

Section 6(4) of the Financial Transactions Reporting Act 1996 (*FTRA*) currently prescribes that a trustee or manager of a superannuation scheme is not required to verify the identity of any person:

(i) who becomes a member of that scheme by virtue of the transfer to the scheme of all members of another superannuation scheme; or

(ii) who becomes a member of a section of that scheme by virtue of the transfer of all members from another section of the same scheme.

Additionally, section 12(5) of the FTRA prescribes that where:

(i) the FTRA requires a trustee or manager of a superannuation scheme to verify the identity of any person by reason of the person becoming (or seeking to become) a member of that scheme; and

(ii) the scheme is established principally for the purpose of providing retirement benefits to employees,

that trustee or manager shall be deemed to have complied with the requirement to verify the identity of that person if that person's identity has been verified by his or her employer.

These are critically important protections, the necessity for which was explained at length prior to the introduction of the FTRA.

ASFONZ is concerned to ensure that those provisions survive the imposition of any limitations imposed on trustees' reliance on third parties.

Significantly greater compliance costs would be incurred if trustees had to verify members' identities in any such circumstance. Compliance would be impracticable, as well as something of a nonsense from a common sense perspective.

For completeness, we note that, sensibly, there appears to be no suggestion that section 8(6) of the FTRA, which operates to relieve "investment-only" schemes of the requirement to verify the identity of wholesale investors (in this context, trustees of other superannuation schemes) is to be amended or repealed.

Transitional provisions

The discussion document does not mention the possibility of transitional provisions. However, a reasonably rapid schedule for the implementation of the FTRA amendments is outlined.

We note that the Ministry of Justice predicts that the necessary Cabinet papers will be finalised in early 2006 and that (subject to the 2006 legislative programme) draft legislation should reach a select committee by mid-2006.

Given the swift pace at which any FTRA amending legislation may be enacted, and the fact that it is likely to impose significant new obligations on financial institutions, the need for transitional provisions is clear.

The FTRA recommendations do not provide any guidance on appropriate transitional provisions or timeframes, but we note that the Money Laundering Regulations 2003 (UK) contained transitional provisions which could be adapted to New Zealand circumstances.

Further consultation

We note that the FATF Working Group will review the submissions on the proposed amendments to the FTRA and then draft Cabinet papers proposing amendments to the FTRA.

We look forward to the opportunity for further consultation with officials on the high-level issues raised in this submission (and others) and we would be pleased, if required, to clarify any of the points made. We suggest that our contribution to the development of requirements that fit the particular circumstances of employment-related superannuation schemes should avoid unintended requirements. In view of the reasonably close roll-out of the new KiwiSaver arrangements (by 1 April 2007), we think that the consequences of change need close attention. Eventually, every single employee will be touched by a workplace superannuation scheme.

Our organisation

The Association of Superannuation Funds of New Zealand Inc. (“ASFONZ”)

ASFONZ is an independent national, non-profit organisation founded in 1969. Its current membership comprises around 100 major workplace superannuation schemes and around 50 organisations and individuals representing the various product and service providers for workplace superannuation.

The mission of ASFONZ is to promote workplace superannuation in New Zealand.

ASFONZ seeks to achieve that mission through:

1 **Advocacy –** being the recognised voice for all employers and trustees involved in workplace superannuation, through:

   (i) advocating legislative and public policy initiatives beneficial to the industry;
   (ii) making submissions and commentary on existing legislative and public policy initiatives;
   (iii) issuing regular press releases and other public commentary on matters of wider concern or interest to members; and
   (iv) staying in regular contact with responsible Ministers, regulatory and industry bodies, the Retirement Commissioner and Government Departments to project, promote and advance members’ interests.

2 **Education** – promoting trustee, employer and member education through dedicated training programmes, newsletters and special interest seminars.

3 **Networking** – providing trustees, employers and service providers involved in workplace superannuation with a regular forum for sharing ideas and information on industry matters.

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