
Anti-money laundering and countering the financing of terrorism – the Reserve Bank’s responsibilities and approach

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Taking action to reduce money laundering and the financing of terrorism is important, not only because of the social harm caused by these illegal activities, but also because of the damage these illegal activities can do to the stability and reputation of a nation’s financial system.

This article sets out the Reserve Bank of New Zealand’s role and responsibilities with regard to the Anti-Money Laundering and Countering Financing of Terrorism Act 2009. It briefly explains the regulatory and supervisory framework established by the Act, discusses the Reserve Bank’s Risk-Based Approach in this context and outlines some of the major areas of work to be undertaken in order to develop and implement the Reserve Bank’s supervisory framework.

1 Introduction

Money laundering is the method by which criminals disguise the illegal origins of their wealth in order to protect and enjoy their assets.

Financiers of terrorism use similar techniques to money launderers to avoid detection by authorities and to protect the identity of those providing and receiving the funds.

The underlying criminal acts (money laundering and terrorist financing) are of course matters for the Police. However, because financial firms are at risk of being used by criminals to further these illegal activities, those firms and their supervisors have important roles to play in minimising the risks of money laundering or terrorist financing.

When a financial system makes it more difficult for criminals to hide and use their illegal funds, criminals may be caught more easily, a criminal lifestyle becomes less attractive and crime can be reduced. In addition, money laundering and terrorist financing activities can undermine the integrity and stability of financial institutions and systems, discouraging both domestic and foreign investment.

For these reasons, the international community has increasingly prioritised the fight against money laundering and terrorist financing and New Zealand has recently

enacted legislation consistent with developing international standards.

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (‘the Act’) seeks to implement recommendations of the Financial Action Task Force, the international body (of which New Zealand is a member) set up to promote and develop policies for combating money laundering and terrorism financing at an intergovernmental level.

Under the Act, certain financial institutions as well as casinos (collectively referred to as ‘reporting entities’) are required to establish and maintain Anti-Money Laundering and Countering Financing of Terrorism (‘AML’) compliance programmes and regular AML risk assessments. This includes developing and implementing effective policies and procedures for customer due diligence, reporting of suspicious transactions and record keeping.

Although the Act is in force, these requirements will not come into effect until around November/December 2012. This delay is intended to give industry the opportunity to prepare themselves for compliance with the Act and also allow supervisors time to develop their own supervisory programmes.

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Under the Act, the Reserve Bank is the AML supervisor for banks, life Insurers and non-bank deposit takers. This means that we are charged with:

- monitoring and assessing the level of money laundering and terrorism financing risk across these reporting entities;
- developing a supervisory programme that will monitor reporting entities for compliance with the Act and any subsequent regulations;
- providing guidance to assist reporting entities to comply with the Act and any subsequent regulations;
- investigating reporting entities and enforcing compliance with the Act and any subsequent regulations; and
- co-operating with domestic and international counterparts to ensure consistent, effective and efficient implementation of the Act.

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2 What approach will the Reserve Bank take?

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 sets out the high level responsibilities placed on reporting entities. These include:

- developing and maintaining a risk assessment and a risk-based AML programme;
- customer identification and verification;
- ongoing customer due diligence and transaction monitoring;
- suspicious transaction reporting;
- record keeping;
- auditing; and
- annual reporting.

Certain minimum standards are set out in the legislation (for example, the requirement for firms to monitor their customers' activities). The specifics of how this might be carried out can vary greatly depending on the nature of the risks reporting entities face and the types of products they sell. For example, a large retail bank with many customers will most likely develop or purchase customer transaction monitoring software, whereas a smaller organisation may be able to monitor its customers' transactions manually.

Statutory obligations are intentionally set at a high level in order to allow sufficient flexibility for reporting entities. Important parameters such as what reporting entities will be required to do and proposed exemptions (which reporting entities are covered by the Act and in relation to which particular activities) will be specified in forthcoming regulations. In addition, supervisors expect to publish Codes of Practice and other guidance (discussed below) in the lead-up to full implementation.

Multi-agency approach

The Act establishes a multi-supervisor regime for supervision, monitoring and enforcement of AML obligations involving three supervisors – the Reserve Bank, the New Zealand Securities Commission ('SecCom') and the Department of Internal Affairs ('DIA') – each supervising different portions of the regulated sector.

The Reserve Bank is responsible for banks, life insurers and non-bank deposit takers. SecCom is responsible for issuers of securities, trustee companies, futures dealers, collective investment schemes, brokers and financial advisers. DIA is responsible for casinos, non-deposit-taking lenders, money changers and all other reporting entities.

In addition, the Act provides central roles for the Ministry of Justice (administering the legislation and driving AML policy) and the Financial Intelligence Unit of New Zealand Police (receiving, analysing and referring suspicious transaction reports and producing guidance and feedback).

This multi-supervisor approach was preferred primarily in order to use existing industry knowledge and expertise and to leverage off existing supervisory relationships. This will minimise compliance costs for reporting entities and supervisory costs.

With supervisors producing Codes of Practice and Guidance and establishing their own individual supervisory programmes, it will be important to achieve consistency and cost-effectiveness.

In order to assist in this, the Act establishes a national Co-ordination Committee, comprising representatives from the three supervisors, the Ministry of Justice, the New Zealand Customs Service and the Commissioner of Police.

This Committee is tasked with ensuring the necessary connections between the AML supervisors, the Commissioner and other agencies in order to ensure the consistent, effective, and efficient operation of the AML regulatory system.

To date this Committee has been largely focussed on the development of the Act and regulations, but is expected to focus on ensuring consistency across the national AML framework as the supervisors' own programmes take shape.

In addition to this Coordination Committee, the RBNZ also participates in a regular supervisors forum as a mechanism for ensuring consistency at an operational level. This has proved to be an effective way of sharing experiences, resolving operational issues and providing consistent feedback to the Ministry of Justice with regard to their proposals. Striking an appropriate balance between consistency and sector focus will be one of the main challenges of New Zealand's multi-supervisory model.

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Risk-based approach

Fundamental to the regime established by the Act is the concept of a "risk-based approach". A key principle of this approach is the recognition that individual businesses are best placed to make decisions on how to manage and mitigate their own money laundering and terrorism financing risks. The risk-based approach is intended to allow reporting entities to be flexible in their risk mitigation arrangements in order to maximise the benefits from the resources they put into AML.

To this end, the Act requires reporting entities to formally assess the AML risks in their own business context and to develop effective policies and procedures in proportion to those risks.

Reporting entities will need to identify higher risk customers, products, services, delivery channels and geographical locations in order to introduce appropriate mitigation or controls. These are not static assessments and will change over time, depending on how circumstances develop and how threats evolve.

For this type of approach to be successful, the Reserve Bank's supervisory regime will require the following characteristics:

(i) A thorough understanding of current risks.

The risk-based approach recognises that a lot of the expertise in assessing risk lies with firms because it is they who have the knowledge and experience of their customers and products. However, firms need up-to-date, constructive information in order to effectively gauge current risks. While firms will need to be proactive in seeking out information regarding money laundering trends and threats from external sources such as law enforcement, as well as relying on their own experiences and observations, we also need to be willing to provide information, guidance and advice in this context.

(ii) A regulatory focus on principles.

We accept that firms will be seeking to achieve real outcomes and not implement prescriptive, detailed and inflexible rules. Our regime should focus on results. The supervisory framework should empower firms to be innovative and creative in their mitigation of money laundering risk so that

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they may meet their obligations, while minimising the cost and inconvenience to themselves and their customers.

(iii) An acceptance that money laundering or terrorism financing will never be completely eliminated.

We will be realistic about what a firm with appropriate controls can reasonably achieve. We do not expect a zero-failure regime. What we expect is that firms take reasonable steps to identify and strengthen the weak links in their controls.

This will not be an easy task. But we are committed to this risk based approach to AML in order to deliver an efficient, effective and proportionate regime.

3 Where do we want to be?

National / Sector Risk Assessments

For a risk-based approach to AML to be effective, supervisors and firms require up-to-date information on the money laundering and terrorism financing risks at national, sector and firm-specific levels.

In December 2009, we surveyed the firms we supervise, as the first step in the process of assessing the money laundering and terrorism financing risks in our sector. The data collected has been referred to the Financial Intelligence Unit (FIU) of New Zealand Police, to assist them in developing a draft National Risk Assessment. This will be a public document, containing information on the nature and scale of money laundering and terrorism financing in New Zealand. It will also identify any weaknesses in AML systems and controls and other features of the national environment that make it attractive to money launderers and terrorism financiers.

In addition to assisting in the development of the National Risk Assessment, we will produce our own Sector Risk Assessment in relation to the sector for which we have responsibility. This will provide more sector-relevant detail

on risks and typologies. It will also provide context and assistance for the business-level risk assessments made by reporting entities, allowing them to focus their resources on areas where they can make the most impact.

Information gathered during this process will also allow us to make our own assessments on where the risks are in our sector (at a firm-specific or product-specific level). This will assist in the risk-scoring of reporting entities and the subsequent allocation of supervisory resources to the areas of most risk, helping to ensure an efficient and effective supervisory programme.

Development and implementation of supervisory framework

In the lead-up to full implementation, we will develop and implement our supervisory framework for AML.

Much of the development of this framework will be undertaken in a collaborative manner between supervisors to deliver a reasonably consistent regime across the regulated sector.

The specific detail of much of this work will develop as information continues to be gathered from reporting entities and our understanding of the risks and countermeasures prevalent in our sector increases. However, we set out below preliminary indications of the scope of our supervisory arrangements and the major areas of work to be undertaken.

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Risk Framework

As a general principle, we will supervise firms according to the risks they present to the objectives of the Act (namely: to detect and deter money laundering and the financing of terrorism; to maintain and enhance New Zealand's international reputation; and to contribute to public confidence in the financial system).

This will require a formal Risk Framework that identifies, assesses and prioritises the risks to these statutory objectives in terms of their probability (the likelihood of the particular risk crystallising) and impact (the effect of such an event). This assessment will inform any decisions regarding appropriate regulatory responses.

Supervisory approach

One of the Reserve Bank's functions under the Act is to monitor our reporting entities to ensure they are complying with their regulatory obligations. The nature and extent of our supervisory relationship with any individual firm will depend on how much of a risk we consider it poses, as established via the Risk Framework discussed above.

We intend that the level of supervisory intensity assigned to a firm or group of firms will be a mixture of baseline and risk-sensitive monitoring.

Baseline monitoring will be undertaken for all firms regardless of their risk scores. This will likely involve desk-based activities such as analysing firms' financial returns and annual compliance reports.

In addition, we will undertake further supervisory work sensitive to the size and riskiness of the firm concerned, including any specific risks identified by the baseline monitoring. This may include product, entity or risk-specific surveys or questionnaires, firm-specific information requirements or targeted on-site inspections.

Enforcement approach

A risk-based approach to supervision requires us to focus on firms' AML outputs, and recognise that firms have a lot of scope in their decisions over how best to manage their money laundering and terrorism financing risks.

A risk-based regime is not a zero-failure regime and both our supervisory and enforcement approach will recognise this. We recognise the possibility that firms may not meet required standards and may not be in a position to satisfy their obligations upon the date they become effective. Some will require remedial action to address shortcomings and this is where outreach and communication will have an important role to play in ensuring that minimum standards are met.

Nevertheless, we are tasked with investigating the firms we supervise and enforcing compliance. To this end, the Act sets out a range of both civil and criminal sanctions for breaches of firms' obligations.

As part of our overall approach to AML supervision, we will be prepared to use appropriate sanctions against firms who are not meeting their legal obligations or not taking AML risk management seriously, and are falling short of the required standards.

Not every breach of the Act will result in enforcement action and each specific breach will be judged on its individual merits. We intend developing an enforcement strategy that makes it clear that a firm will more likely face sanctions if there are significant and serious breaches; if a firm has been notified of breaches and failed to deal with them appropriately; or if breaches are deliberate or reckless.

Details of our enforcement strategy, including when criminal sanctions might be appropriate, will be developed in conjunction with the other AML supervisors and communicated to our regulated entities in advance of full implementation of the regime.

Codes of Practice/Guidance

As stated above, AML supervisors may develop Codes of Practice and/or Guidance material in order to clearly communicate our expectations and key areas of concern to reporting entities. This is to give firms some certainty about their obligations and our expectations in order to enable planning and infrastructure expenditure.

The function of Codes of Practice, as set out in the Act, is to assist firms by suggesting methods by which they can meet

their obligations. Codes of Practice are not mandatory and firms will not be required to follow these methods. They may instead implement alternative methods, provided they are at least as effective. The Codes will merely provide a 'safe harbour' for firms when demonstrating compliance with the Act.

We plan to commence dialogue with reporting entities in order to identify specific areas where Codes of Practice may be necessary or desirable. We also anticipate industry input being valuable in developing day-to-day best practice at an operational level for inclusion in Codes of Practice.

We also intend producing guidance to inform reporting entities of our general supervisory and enforcement approach and, where appropriate, provide an indication of how we interpret the obligations placed upon firms.

Outreach/communication

Given that all participants in the financial sector are faced with new concepts and requirements under the Act, we believe it is imperative to have open and constructive dialogue between supervisors and reporting entities.

Firms will be relying on us to provide clear and timely communication of expectations in order to develop their own risk-based AML assessments, strategies and programmes. Firms will be looking to us to provide good-practice guidance, industry studies, typologies and other materials to assist them in complying with their obligations.

At the same time, we will be relying on firms to provide us with information on the risks that they have identified in their own business models to help shape our thinking on where to focus our supervisory efforts. We will also be requesting input from industry in developing best practice risk mitigation techniques and methodologies.

We hope to foster an open, transparent and constructive relationship with the firms that we supervise, particularly in the lead-up to full implementation.

4 Conclusion

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 places new obligations on financial firms and on the Reserve Bank as AML supervisor.

The fight against money laundering and the financing of terrorism is an important one and we are committed to a risk-based regime that allows firms the flexibility to deal with risks in a proportionate and effective manner.

We do not expect firms to eliminate money laundering or terrorist financing, but we do expect firms to take these risks seriously and act appropriately.

Please keep an eye on our website <http://www.rbnz.govt.nz/aml/index.html> for further updates, Codes of Practice, Guidance and other information.

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