



SUBMISSION
TO THE
FINANCIAL MARKETS AUTHORITY
ON THE
CONSULTATION PAPER:
PRACTICAL IMPLICATIONS OF REPORTING ENTITIES TRANSACTING
WITH OTHER REPORTING ENTITIES
AND THE FACTSHEET ON MANAGING INTERMEDIARIES

31 JULY 2013

1. Introduction

1.1. This submission is from Trustees Executors Limited (“TEL”).

1.2. We can be contacted at:

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2. Who is TEL?

2.1. TEL was established in 1881 and is the oldest Trustee Company in New Zealand.

2.2. It is authorised under the Trustee Companies Act 1967 to accept appointment to, and act in, various positions, and to perform and discharge all acts and duties pertaining to those positions, including being an executor or administrator of an estate; a trustee of a trust; an attorney under any power of attorney, or agent without power of attorney, for any trustee, person, company, or corporation; a custodian trustee under section 50 of the Trustee Act 1956; and/or an arbitrator or umpire for the purposes of the Arbitration Act 1908 or pursuant to any submission to arbitration by parties to any dispute.

2.3. TEL is also licensed under section 16(1) of the Securities Trustees and Statutory Supervisors Act 2011 to act as:

2.3.1. trustee in respect of debt securities;

2.3.2. statutory supervisor in respect of participatory securities;

2.3.3. trustee in respect of unit trusts;

2.3.4. KiwiSaver scheme trustee; and

2.3.5. statutory supervisor in respect of a retirement villages;

TEL also acts as trustee to a number of superannuation schemes; and provides custodial and registry services.

The types of financial product with which TEL has involvement include debt securities, debenture stock, unsecured notes, convertible notes, unit trusts, participatory securities, retirement villages, syndicated investments, credit union and building society products, externally managed group investment funds, and superannuation products.

2.4. TEL complies with the Trustee Corporations Association of New Zealand Inc (“TCA”) minimum standards of the practice guidelines for the performance of personal client services and corporate trust appointments including custody and back office services. These guidelines set standards for integrity, competence, financial capacity, internal controls, powers and duties, standards for conflict of interest and for reports from scheme operators.

- 2.5. TEL provides investor and beneficiary protection in a number of ways and at various levels including independent prudential supervision of financial arrangements and custody in respect to those arrangements. In certain instances fund managers must appoint a corporate trustee to meet regulatory requirements before they can launch a financial product. Where a corporate trustee has been appointed in relation to a financial product, the investors have the benefit of a competent and professional organisation is there to watch and protect their position.

3. TEL's General Comments

- 3.1. TEL appreciates the opportunity to comment on the Financial Market Authority's ("FMA") Consultation Paper entitled *Practical implications of Reporting Entities transacting with other Reporting Entities and the Factsheet on Managing Intermediaries*.
- 3.2. As a member of the TCA, TEL has been a party to submissions prepared and submitted to date by or on behalf of the TCA.
- 3.3. The objectives of the FMA consultation hold merit. It would be a great outcome if the Factsheet on Managing Intermediaries clarified the law in a useful and practical way and accordingly reduces administrative difficulties and costs in the approach taken without adversely affecting fairness to all parties.

4. TEL's Submission

- 4.1. We do however have issues with the proposals as to their effect and impact and/or how they will work in practice.
- 4.2. A significant investment of time and money has already been expended in putting together and implementing TEL's AML/CFT policies and procedures – particularly those specific to customer due diligence ("CDD"). TEL, like a number of other reporting entities, had discussed and agreed the approach to be taken with regard to determining beneficial owners of a customer.
- 4.3. To have an alternative and differing view, subsequent to the AML/CFT legislation's commencement date, taken by the FMA regarding CDD as it pertains to dealing with certain other reporting entities and how beneficial owners are determined is problematic at best. At a minimum, it will require the integration of this view point and its effects into TEL's AML/CFT policies and procedures and the way in which TEL will interact with other reporting entities.
- 4.4. TEL seeks to make a submission on specific areas of interest and/or concern as follows.
- 4.5. **Determination of "beneficial owner"**
 - 4.5.1. As part of completing customer due diligence ("CDD") on a customer, it is necessary to identify and verify the beneficial owner(s) of that customer.

- 4.5.2. Under the Anti-Money Laundering and Countering Financing of Terrorism (“AML/CFT”) Act 2009 (“AML/CFT Act”), a *beneficial owner* is any individual who:
- a) has effective control of a customer;
 - b) has effective control of a person on whose behalf a transaction is conducted;
 - c) owns a prescribed threshold (which is more than 25%) of the customer; and/or
 - d) owns a prescribed threshold (which is more than 25%) of the person on whose behalf a transaction is conducted.
- 4.5.3. As can be seen, the term beneficial owner does not include “a person on whose behalf a transaction is conducted” without qualification.
- 4.5.4. The AML/CFT Act definition for the term beneficial owner would need to be specifically amended to enable a *beneficial owner* to be defined simply as “a person on whose behalf a transaction is conducted”.
- 4.5.5. This makes the inclusion of this ‘element’ (being “a person on whose behalf a transaction is conducted”) in the Beneficial Ownership Guideline and the proposed Factsheet on Managing Intermediaries incorrect (and very difficult to implement from a practical standpoint).
- 4.5.6. The inclusion of the ‘element’ in the Beneficial Ownership Guideline did not ruffle too many feathers at that juncture due to interaction by reporting entities (including TEL) with representatives from both Ministry of Justice and the Financial Markets Authority (“FMA”) around this issue of determining a customer’s beneficial owner(s).
- 4.5.7. At one such meeting, the way (explained by representatives from FMA) to determine whether a party who is an ‘underlying client’ (that is, a customer’s client) is also considered a beneficial owner of the customer depends on:
- a) the degree of control of the ‘underlying client’;
 - b) the nature of interaction (if any) between the ‘underlying client’ and the party undertaking CDD; and
 - c) how the product or service (that is, fund or scheme) operates.
- 4.5.8. The discussion also encompassed the view that in most cases (in the (fund) manager or scheme provider scenario), an ‘underlying client’ and any CDD is the responsibility of the (fund) manager or scheme provider. The ‘underlying client’ would not also be considered a beneficial owner to be identified and verified by the trustee, custodian or administration manager (unless the ‘underlying client’ owned more than 25% of the fund or scheme). The direct business relationship and contact is with the (fund) manager.
- 4.5.9. On the basis of this explanation (and confirmation from Ministry of Justice representatives supporting the approach), TEL developed an analysis tool to assist TEL staff internally in determining

circumstances where the 'underlying client' did need to be identified and verified due to being a beneficial owner of a (fund) manager or like type of customer. At the request of representatives of the FMA, TEL supplied a 'clean' version of this analysis tool (a copy of which is forwarded with TEL's submission).

- 4.5.10. Further steps taken by reporting entities like TEL, in line with the way this issue was (previously) approached, are:
 - a) to seek and obtain a form of written certification from their customer regarding their AML/CFT policies and procedures thereby providing a level of assurance around then handling funds received from the customer and/or being associated as a provider of services to the customer's 'financial' product; and
 - b) the integration of details of AML/CFT responsibilities into any contract, service level agreement or terms of engagement as between TEL and its customer (and any other linked service providers).
- 4.5.11. The new approach by FMA to interpreting this 'element' is problematic from a practical perspective.
- 4.5.12. The practical effects of characterising 'underlying clients' as *beneficial owners* of (for example) a (fund) manager or scheme provider are to:
 - a) place a greater responsibility on every reporting entity dealing with that (fund) manager or scheme provider to conduct CDD on the 'underlying clients' with whom they do not necessarily have direct contact or dealings;
 - b) substantially duplicate effort;
 - c) create a much bigger pool or group of *beneficial owners* to identify and verify for any of the reporting entities dealing with that (fund) manager or scheme provider; and
 - d) lead to further compliance costs (time and money) for reporting entities to integrate the new approach and interpretation into their AML/CFT compliance programmes.
- 4.5.13. The change in approach adds layers to the regulatory requirements with little or no benefit to reporting entities and financial sector participants in achieving the AML/CFT Act purposes – particularly for a regime that is supposed to be risk-based.
- 4.5.14. Even with the benefit of the existing reliance provisions, another drawback in respect of this new group of beneficial owners is that the membership will continue to change (from time to time) as 'underlying clients' enter and exit the fund or scheme (thereby having an effect beyond undertaking initial CDD).
- 4.5.15. The further compliance costs for reporting entities will likely then be pushed (to the extent possible) on to other financial sector participants and investors. Such increases will lessen the

attractiveness of investing in financial products rather than the usual residential and commercial property choices.

- 4.5.16. TEL does not consider that the manner in which the term beneficial owner is proposed to be clarified in guidance should overreach the legal definition in the AML/CFT legislation and thereby impose further and wider obligations on reporting entities.

4.6. **Concept of “managing intermediary”**

- 4.6.1. The term “managing intermediary” is not used in the AML/CFT Act or associated regulations.
- 4.6.2. The concern with the meaning ascribed to this new term is the apparent removal of the existing delineation between a (fund) manager and the products offered by that (fund) manager.
- 4.6.3. The ‘underlying client’ is connected to the (fund) manager’s product not the (fund) manager entity itself.
- 4.6.4. In essence, an ‘underlying client’:
- a) is not liable for the fund’s obligations;
 - b) holds limited proprietary rights in the fund’s assets;
 - c) cannot control or direct the transactions conducted in respect of the fund;
 - d) has little ability to control or direct the (fund) manager; and
 - e) has no right or interest in the (fund) manager.
- 4.6.5. Taking as an example a (fund) manager that is a company, at best with the present AML/CFT legislative definition of a beneficial owner, the possible beneficial owners would be:
- a) a director of the (fund) manager (as they could be said to have effective control of the (fund) manager);
 - b) a CEO or CFO of the (fund) manager (as they could be said to have a form of effective control of a person on whose behalf a transaction is conducted);
 - c) a shareholder of the (fund) manager (as they can own more than 25% of the (fund) manager); and
 - d) an investor in the (fund) manager’s product (if they own more than 25% of the (fund) manager’s product).
- 4.6.6. As a comparison, and probably already referred to by other submitters, it has never been suggested that depositors are beneficial owners of a bank to be identified and verified as part of the CDD process on the bank or that policy holders are beneficial owners of an insurance company to be identified and verified as part of the CDD process on the insurance company.
- 4.6.7. TEL does not consider that the concept of “managing intermediary” should attempt to treat as one (as an example) a (fund) manager and its financial offerings to the market.

4.7. Use of reliance (section 33) and agency (section 34) provisions

- 4.7.1. It is agreed that having a CDD obligation in respect of a customer or a customer's beneficial owner does not mean that a reporting entity has to conduct that CDD.
- 4.7.2. Sections 33 and 34 of the AML/CFT Act do allow a reporting entity to engage other entities to undertake and complete CDD on its behalf. This could potentially lead to CDD being performed by just one party in a chain of (reporting) entities or "managing intermediaries".
- 4.7.3. Section 33 is not considered to be limited to being used in the way indicated by the proposed guidance. Section 33 enables reliance on other reporting entities; whilst section 34 allows reporting entities to engage parties other than reporting entities to be an agent for them to conduct CDD.
- 4.7.4. Use of either section would require agreement in writing between the relevant parties seeking to use it to confirm what information and documentation is to be:
- collected,
 - provided immediately to the party seeking to rely on the other,
 - retained as records by the party collecting, and
 - made available on request.
- 4.7.5. As well, most reporting entities seeking to utilise either section would also ensure that the party being relied upon:
- has satisfactory processes in place that are AML/CFT compliant; and
 - verifies this in writing by obtaining (for example) a certificate from the party being relied upon from time to time confirming this.
- 4.7.6. At a meeting with representatives from both Ministry of Justice and the FMA in January 2013, TEL was advised that in terms of using section 33 the party relying would receive the full name of the customer and the number from identification used for verification purposes. There was no need though to receive and retain the identification and verification documentation – a written agreement for the customer to supply that documentation to TEL would be sufficient. This view alleviated the practical issues of receipt and retention of information and documentation from the party undertaking and completing the CDD. It can also be integrated relatively easily into any contract, service level agreement or terms of engagement as between TEL and its customer.
- 4.7.7. The proposed guidance also does not refer to a (fund) manager or scheme provider as being best placed to identify and verify its customers (where if it is considered that as 'underlying clients' they are *beneficial owners* of the (fund) manager or scheme provider).

4.7.8. TEL does not consider that it should alter its approach to using sections 33 and 34 to date.

5. Consultation

- 5.1. TEL is happy to discuss any of these comments in further detail.
- 5.2. Further TEL would like to be involved in the consultation process in respect of any legislative amendments and/or any regulations, codes of practice and guidelines intended to be promulgated as a result of the AML/CFT legislation.

Trustees Executors Limited
31 July 2013