Macquarie Group Holdings New Zealand Limited
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Thursday, 1 August 2013

Kirsty Campbell
Manager Commercial Supervision
Financial Markets Authority
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Email: aml@fma.govt.nz

Dear Kirsty,

SUBJECT: Practical implications of Factsheet on Managing Intermediaries feedback

Thank you for the opportunity to provide a submission on the FMA Consultation paper on the "Practical implications on Factsheet on Managing Intermediaries feedback".

Whilst we acknowledge that the FMA's Consultation Paper has been formulated on the basis of the legislation as drafted, the proposals contained in the Consultation Paper, while seeking to be pragmatic where possible, are likely to have some unintended consequences that may extend as far as limiting the amount of international investment into NZ. For the reasons set out below we suggest that further consultation be undertaken or that the release of the Consultation Paper is delayed pending legislative consideration of broader issues. Irrespective of the manner in which the matter progresses, we would welcome the opportunity to have continued input into the process.

About Macquarie

Macquarie Group is a global financial services provider. It acts primarily as an investment intermediary for institutional, corporate and retail clients and counterparties around the world.

Macquarie has established leading market positions as a global specialist in a wide range of sectors, including resources, agriculture and commodities, energy and infrastructure, with a deep knowledge of Asia-Pacific financial markets.

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Macquarie's diverse range of services globally includes corporate finance and advisory, equities research and broking, funds and asset management, foreign exchange, fixed income and commodities trading, lending and leasing and private wealth management.

Macquarie Group Limited is listed in Australia (ASX:MQG; ADR:MQBKY) and is regulated by APRA, the Australian banking regulator, as the owner of Macquarie Bank Limited, an authorised deposit taker. Macquarie also owns a bank in the UK, Macquarie Bank International Limited, which is regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

Founded in 1969, Macquarie employs more than 13,600 people in 28 countries. At 31 March 2013, Macquarie had assets under management of $A347 billion.

Requirements as set out in the Consultation Paper

The Consultation Paper seeks to address how the AML/CFT Act should be applied to situations where a transaction is executed for a "Managing Intermediary". For Macquarie in New Zealand, such Managing Intermediaries may include the likes of:

- Fund managers (international and domestic (including Kiwisaver))
- Brokers (domestic or international)
- DMA clients
- Financial advisers
- Trustees

According to the Consultation Paper, where those Managing Intermediaries have underlying investors, each and every one of those underlying investors are likely to be persons "on whose behalf the transaction is conducted" (see paragraph 23):

> If a primary purpose of a transaction conducted by a managing intermediary is to invest funds for the benefit of (any number of) underlying clients, then even if a defined profit is taken by the managing intermediary, those underlying clients would usually be *persons on whose behalf the transaction is conducted*. This is the case whether or not the underlying clients have any direct rights or control over any part of the transaction conducted by the managing intermediary.

Prima facie, as a person on whose behalf the transaction is conducted (e.g. an investor in an investment trust), the implication is that CDD needs to be carried out on each of the underlying investors by the person providing the financial service (e.g. the broker to the fund manager), whether or not those underlying clients have any

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direct rights or control over any part of the transaction (as would be the case where the underlying client is an investor in another vehicle e.g. investment funds).

The Consultation Paper goes on to note that the Reporting Entity may not necessarily need to conduct CDD on the underlying clients itself as it can rely on others in the chain to perform the CDD obligations as those obligations will "match" the reporting entities (paragraph 26):

> This means that where a reporting entity deals with a managing intermediary, the reporting entity will usually have a CDD obligation to look through any managing intermediaries to the beneficial owners of the underlying clients. This does not necessarily mean that a reporting entity needs to complete the CDD itself, as its obligations will match those of any managing intermediary down the chain.

The Consultation Paper then suggests how section 33 and 34 may be used to meet those obligations (paragraph 34):

> Having a CDD obligation in respect of an underlying client does not mean that you personally have to conduct CDD on that individual. Where a number of connected reporting entities/managing intermediaries have CDD obligations in respect of the same underlying client in a transaction chain, not every reporting entity/managing intermediary in the chain needs to separately conduct CDD on the underlying client. Sections 33 and 34 of the AML/CFT Act allow CDD to be performed on the underlying client by just one person in a chain of reporting entities/managing intermediaries. Subject to the terms of the AML/CFT Act, other reporting entities may rely on that third party to discharge their CDD obligations.

As noted in Appendix 3 of the Consultation Paper, the corollary of this is that the FMA considers it "likely" that the Broker would include provisions in its terms and conditions requiring fund managers to act as agent of the RE in relation to conducting CDD. This somewhat understates what would be required in arranging such an agency agreement as various aspects of the agency relationship would need to be addressed. Furthermore, paragraph 39 of the Consultation Paper states that where the reporting entity uses a third party to conduct CDD, the reporting entity will nonetheless always be responsible for ensuring that the CDD is carried out in accordance with the AML/CFT Act. It is therefore in the reporting entities interest to ensure the arrangements under the agency agreement are sufficient to meet their AML requirements and this is likely to include provisions other than simply stating the agent is responsible for carrying out CDD.

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Application to some typical scenarios

As we seek to highlight through the various scenario's below, applying the proposals contained in the Consultation Paper has the potential to have serious adverse economic consequences in our view:

Scenario 1

An internationally located fund manager wishes to trade TEL on the NZX. The fund manager is not listed on an exchange (and therefore must be subjected to standard CDD and not simplified CDD). The international fund manager is located in a jurisdiction that has its own AML regime and the fund manager is regulated (and/or authorised) by their home regulator for the purposes of AML. The fund manager carries out CDD to the standard required by its home jurisdiction AML regulator. The fund manager approaches an NZX firm to execute the trade.

As set out in the Consultation Paper, the NZX broker, on identifying that the fund manager is a "managing intermediary" is faced with two options:

1. Collect CDD on all underlying clients of the international fund seeking to execute the TEL trade; or
2. Appoint the international fund manager as its agent for AML/CFT purposes.

As the number of investors that comprise the makeup of underlying clients in the international fund can be quite substantial, it is wildly impractical for the NZX broker to request and check that information. As such, the only practical solution would be to appoint the fund manager as their agent.

Assuming for the moment that the international fund manager is prepared act as an agent of their NZX broker for AML purposes (which is somewhat an odd arrangement given that the fund manager is appointing the broker to act as their agent in executing the trade on the NZX), it is likely that the international fund managers customer due diligence programme would not be fully aligned with the requirements of the NZ regime where they are subject to their own overseas AML regime. As the NZ regime makes no provision to recognise equivalent CDD requirements under a comparable AML regime (i.e. regimes in Australia, UK, Canada, US etc) it is not practically possible for the NZ RE to appoint and rely on the fund manager to meet the NZ AML/CFT requirements at any rate.

Practically, under the proposals contained in the Consultation Paper, we do not see how an NZ firm when acting for an overseas fund manager could fully meet its obligations under the AML/CFT Act given the differences in AML regimes globally and the limitations under the NZ regime in this respect.

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Scenario 2
An overseas broker (who is not an NZX participant) that is acting in respect of its own underlying client, seeks to execute a trade on the NZX through their NZ broker. The broker is acting as agent for its own underlying client. The broker is subject to an AML regime (whether in NZ or elsewhere) and carries out its obligations to the standard required in its own jurisdiction.

The same issues as those outlined above apply. In addition however, where a broker has a relationship with a client, they are very protective of their client relationship and are very reluctant to provide any information to a competitor that would enable that competitor to potentially poach that business. As such, the process of appointing the broker as an agent for CDD purposes is likely to be more of a protracted discussion, including non-solicitation issues.

As there is the potential for a number of brokers to be involved in the chain, this process can very quickly become very complicated. Where the process is too difficult to execute, NZ will simply be overlooked as a destination for international investment.

Scenario 3
DMA clients that access the NZX market via a NZX participant will enter into a relationship with the NZX participant for those services. Typically, DMA clients are brokers or fund managers in their own right who are subject to AML requirements.

Similar issues as those outlined in scenario 1 and 2 will apply, as DMA clients have their own underlying client relationships and one of the reason for them to have DMA access to the NZ market may include providing a full international service to their clients. When the DMA client executes a trade, the broker has no knowledge of the underlying client or fund that the trade is for and this is typically recognised in the DMA agreements.

Scenario 4
An investor that is advised by investment adviser invests in retail PIE fund managed by asset manager X. The retail PIE invests in wholesale PIE. Both PIEs holdings are via custody platform/nominee company. Wholesale PIE invests in fund manager Y with nominee company listed as holder. Fund manager Y executes trades through multiple Brokers.

Each broker is viewed as responsible for:

1. CDD on fund manager Y, including its authorised parties, beneficial owners, etc.
2. Nominee company
3. Ascertaining wholesale PIE is the first investor
4. Ascertaining there is another retail PIE underneath

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5. Asset manager as authorised person on the accounts
6. Underlying adviser if any, along with its authorised parties, beneficial owners, etc.
7. Original investor, its beneficial owners
8. Transaction monitoring having no visibility over trades

See also comments under the section Agency Agreements below for further comments about the practical implications of this proposed requirement.

Scenario 5
NZ based broker facilitates a float, placement etc. The broker facilitating the corporate activity on behalf of the Company etc will meet their own AML requirements with regard to their client (i.e. the Company undertaking the corporate action).

Typically, where a broker is facilitating a float, they will co-ordinate with other third party brokers for the placement of stock to the third parties underlying clients and the collation of the requisite funds. Under the Consultation Paper, a possible construction is that the broker facilitating the corporate action would be obligated to collect CDD on the underlying investors of the third party or appoint the third party broker as their agent.

As with other scenarios, commercial sensitivities appear to have been overlooked. It cannot be understated how highly valued and coveted broker relationships with their clients are. They are the basis upon which the broker is able to run their business. The requirement (or even the potential requirement) to hand over those details will be strongly resisted on commercial grounds as well as on the practical basis that each RE has its own AML obligations to fulfil (whether they be domestic or another jurisdictions requirements), which the proposals merely seek to duplicate.

Scenario 6
Investment advisers provides investment advice services to Trustees of an employer pension fund. As per the Consultation Paper the customer is the pension fund with trustees as authorised parties. According to the interpretation under the Consultation Paper, the investment adviser is responsible for CDD on beneficial owners of the pension fund e.g. the employees investing in it.

This is a very broad compliance obligation and results in an interpretation we do not think was attended. It is our view that fund managers (and those executing the trades – i.e. brokers) transact on behalf of the fund and not for the underlying investor.

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General comments

It is important to note that in relation to the scenarios above, a broker/financial adviser/fund manager can only realistically be expected to observe what is happening through its business – i.e. the trading activity that actually occurs through its systems. For example, a broker has no sight of the activities of the underlying investors of a third party broker or a fund e.g.:

1. buying and selling units in funds or individual shares
2. introducing or withdrawing funds to the managing intermediary
3. new clients joining or leaving the managing intermediary

Essentially any activity that would enable someone to enter and withdraw funds from financial products, or the financial system, is the sole domain of the financial institution responsible for the underlying client, even if the broker were to have an agency arrangement in place with that managing intermediary.

We submit that the intention of the AML/CFT regime is for each constituent participant in the financial services industry to meet their obligations under the regime.

The Securities Commission Risk Assessment (page 16) itself notes that:

> The industry (sharebrokers) generally does not accept cash from customers for the sale and purchase of securities listed on the NZX. Sharebrokers that do not accept cash are much less likely to be used by money launders to place funds into the financial system. Sharebrokers are typically used to layer funds by moving funds between various sharebroking accounts.

Agency arrangements

As noted above, on an international scale, Agency arrangements with other financial service participants (particularly where those participants are subject to their own AML regime in another jurisdiction) are likely be impractical or ineffectual.

Looking at the matter from a domestic point of view, implementing a vast number of agency agreement has the potential to impose a significant duplication of costs across industry for very little, if any, benefit. As noted in scenario 4, there is the possibility that agency paperwork may go full circle, when the primary responsibility for CDD rests with only one RE in the chain.

Furthermore, in order for REs to be comfortable with agency agreements, it is inherent that there will be a certain amount of on-going DD. The REs will end up having to spend significant resources of managing agency relationships and reviewing each other. The guidance underestimates the work involved in maintenance of agency relationships if these were to be done right – eg with routine reviews and audits. Such arrangements therefore have a high risk of becoming form

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over substances, paper over quality. In addition, we contend that the current interpretation of "on whose behalf the transaction is being carried out" is unworkable as it is possible that entity may be held liable for breaches regardless of how far removed the underlying investor is down the chain may be from the entity. Apart from concerns around efficiency and cost, such an interpretation has the potential to turn draconian in its application.

International compatibility

The Ministry of Justice's Regulatory Impact Statement published in October 2010 states:

> Key considerations have been to comply with the FATF standards, ensure the response is proportionate, ensure costs to industry are minimised, and harmonise New Zealand's AML/CFT regime with Australia's wherever possible and appropriate.

In our view, the proposals under the Consultation Paper do not fundamentally align with Australian, or indeed international regimes. As noted above (see scenario 1), the NZ regime does not specifically have a mechanism making it permissible to recognise CDD carried out in under an equivalent AML regime. As such, the proposals under the Consultation Paper are unduly onerous when dealing with a foreign jurisdiction as the NZ regime prima facie requires "agents" to adhere to NZ CDD standards. We also note that similar issues exist within the NZ simplified customer due diligence regime requirements (as entities that are regulated overseas and subject to simplified customer due diligence in their own regime are not recognised by the NZ regime), however that issue (and our previous submissions on the matter) is largely beyond the scope of this Consultation Paper, though we submit the two issues should be considered in tandem.

We recognise each participant in the financial market industry has their part to play in the fight against financial crime. The regime is cognisant of this fact and imposes that obligation on each financial institution by designating them as an RE. As an RE, financial service providers accept that they have a range of obligations to the supervisors and the FIU that they are required to fulfil. Imposing obligations that effectively seek to duplicate these requirements does nothing to enhance the effectiveness of the regime, it merely creates a more complicated regime that is unwieldy, impractical and has the potential to be highly detrimental to international investment in NZ.

We would welcome the opportunity to discuss our reservations and observations from an international perspective with both the AML Supervisors and the Ministry of Justice as appropriate.

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Yours sincerely,

Craig Nimmo
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