WESTPAC NEW ZEALAND LIMITED

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

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1. INTRODUCTION

1.1 This submission to the Financial Markets Authority ('FMA') is made on behalf of Westpac New Zealand Limited and its designated business group, in respect of the Consultation Paper: *Practical implications of Reporting Entities transacting with other Reporting Entities and the Factsheet on Managing Intermediaries* ('consultation paper').

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2. SUBMISSIONS

2.1 The consultation paper raises the following key issues around the impacts of "*look-through*" customer due diligence under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ('Act'), where the parties to a transaction are both reporting entities, or where there is a chain of reporting entities:

(a) the FMA's interpretation that investors in a collective investment scheme ('CIS') are beneficial owners, when read with the suggestions in the section *Having a CDD obligation and conducting CDD*, is too broad and gives rise to practical difficulties; and

(b) the approach where multiple reporting entities are required to undertake customer due diligence in respect of the same underlying customers should be simplified so that there is one reporting entity that takes primary responsibility for the due diligence, which other reporting entities can rely on.

2.2 It would also be helpful if the FMA provided more guidance in the section *Having a CDD obligation and conducting CDD* on the utilisation of s33 and s34.

Interpretation of "beneficial owner"

2.3 The consultation paper infers that a manager of a CIS will be regarded as "*acting on behalf of*" the underlying investors. If this is correct, then a look-through customer due diligence obligation arises in respect of those investors by any other reporting entity that wishes to transact with the fund.

2.4 That approach is too broad. The manager of a CIS is more correctly considered to be acting on behalf of the scheme. An ordinary person investing in a CIS does so without any expectation of substantive control over the actions of the scheme or its manager, which is consistent with the spirit of the Act. In the absence of such control it is difficult to see how the presence of investors would increase AML risks on a look-through basis.

2.5 There are also significant practical difficulties in managers of a CIS being regarded as "*acting on behalf of*" the underlying investors. In particular, a manager of a CIS will conduct numerous transactions with other reporting entities over time, including situations where a CIS invests into a wide portfolio of other CISs. Imposing customer due diligence obligations on all of the reporting entities gives rise to considerable duplication and will be unworkable. This is discussed further below.

Customer due diligence by multiple reporting entities

2.6 Any proposals on how to manage customer due diligence where both parties to the transaction are reporting entities must be considered within the constraints imposed by the Act. As indicated by the FMA in the consultation paper, the comments that follow below deal with the content of the Act and should be passed onto the Ministry of Justice for consideration by the Minister.

2.7 Where a transaction arises between reporting entities, there are effectively two options under the present law:

(a) both reporting entities (or multiple reporting entities, depending on the structure of the transaction) complete customer due diligence in respect of the same customers; or

(b) the reporting entities use the mechanisms provided in s33 and s34 to "*outsource*" customer due diligence to one reporting entity.

2.8 If the first option is adopted, there is clearly major duplication of effort which the FMA has correctly identified should be avoided.

2.9 However, reporting entities that outsource their customer due diligence obligations via s33 or s34 (option two) are not excluded from liability under the Act. Accordingly, any reporting entity that looks to another reporting entity to satisfy its customer due diligence requirements will instead have to implement a significant assurance workstream in order to protect itself from liability. This has the effect of making a reporting entity into a supervisor of another reporting entity – a situation which should be avoided. Similarly, the reporting entity that undertakes the customer due diligence will be exposed to a significant reporting obligation to the other reporting entity. The degree of resource required to satisfy these roles is expected to be significant.

2.10 It is likely that a number of reporting entities will also be reluctant to pass on personal information about clients to competing entities in the market. We anticipate that clients may also have privacy concerns in this regard.

2.11 Furthermore, the nature of the market for CIS is such that there will be multiple agency scenarios in play at any given time. This web of agency agreements will be very complex and would require multiple compliance arrangements in order to be managed properly. It is unlikely that these arrangements would be practical or indeed effective.

2.12 Different reporting entities have different approaches to risk-rating customers. This will impact on the ability of one reporting entity to rely on another. Issues are also likely to arise where the obligations of the various parties required to undertake customer due diligence arise at different times. Class discretionary investment management schemes ('DIMS') provide an illustrative example:

(a) a DIMS provider will have a number of existing clients and will therefore, either have on-boarded them previously and conducted customer due diligence at that time, or have other specific customer due diligence obligations in respect of those clients as "*existing customers*" if they had been on-boarded before 30 June 2013; and

(b) if a new CIS was introduced to the client portfolio operated by the DIMS provider, that DIMS client would be considered to be a new customer of the CIS at the time of introduction and customer due diligence on that client would be required to be undertaken by the CIS manager in accordance with s14 of the Act.

2.13 However, the DIMS provider in the example above would have already completed customer due diligence (or may not have an obligation to conduct customer due diligence at that time on the basis that the client is an existing customer) – and will be reluctant to undertake "*new*" customer due diligence on behalf of the CIS when it is not required to do so itself (because the client has already been subject to customer due diligence or is an existing customer). In practice, this will make agency arrangements in this context impractical and uncommercial, given the differing customer due diligence obligations of the intermediary and the product provider.

2.14 It is difficult to justify the practical complexity or commercial risks set out above where there is effective regulation and supervision of reporting entities. Where reporting entities share customer due diligence obligations in respect of the same customers, the approach should be simplified so that there is one reporting entity that takes primary responsibility for the due diligence, which other reporting entities can rely on. Westpac and its designated business group would welcome the opportunity to discuss with the Ministry of Justice how the obligations of reporting entities could be more sensibly treated under the Act.

Practical application of s33 and s34

2.15 Paragraphs 36 and 37 of the proposed Factsheet set out examples of situations in which the FMA considers it would be appropriate to use s33 and s34, respectively. It is arguable that the reverse position could be taken, for example, a reporting entity may not consider a full agency arrangement is required for another reporting entity it has an existing ongoing relationship with and may consider s33 gives rise to a less substantial compliance assurance

obligation. The decision as to which approach to take should be a matter of discretion for the reporting entity in question.

2.16 However, the FMA could assist reporting entities in exercising that discretion by providing more guidance on how to implement the differing approaches. For example, s34 does not contain any minimum standards for the agency agreement, such as a requirement to provide relevant identity information to the reporting entity. Further guidance from the AML supervisors on the types of matters that a principal may wish to include in such agency agreements, such as the timing of customer due diligence, may be useful for some sectors of the industry in order to ensure that on-going customer due diligence obligations are being met.

2.17 Finally, where s33 and s34 are utilised in respect of a purely bilateral relationship, their practical limitations are reduced. However, in instances where there are multiple parties to a transaction (the "*transaction chain*" referred to in the consultation paper), the application of s33 and s34 becomes more problematic. It would appear that multiple agreements would need to be executed between the various parties in the chain, and paragraphs 34 and 35 of the Factsheet should reflect this.