Consultation Paper:

Practical implications of Reporting Entities transacting with other Reporting Entities and the Factsheet on Managing Intermediaries.

Issues for comment

1. The Factsheet clarifies the AML/CFT Act obligations of reporting entities that transact with other reporting entities. We encourage submissions on whether the practical suggestions for compliance set out in the section of the Factsheet titled 'Having a CDD obligation and conducting CDD' are the most appropriate suggestions to make to reporting entities. In particular, should any further practical or alternative suggestions be made?
2. We are aware that some reporting entities are of the view that where they transact with other reporting entities the AML/CFT Act should not impose an obligation for both reporting entities to identify the '*persons on whose behalf a transaction is conducted*'. FMA is not seeking submissions on the content or interpretation of the AML/CFT Act, but if submissions are received that propose specific limits on the obligation to identify the '*persons on whose behalf a transaction is conducted*', then these submissions will be passed on to the Ministry of Justice for consideration by the Minister.

Response to request for comments

I have outlined below my thinking around the "practical solutions" and note the fact sheet does not address the Obligation of "Transaction Monitoring" in an intermediary environment.

I support the concept of Managing Intermediaries and believe in the case of a WRAP platform or any Nominee structure that they need to accept a substantial role in the chain of events. When we consider the types of Intermediaries, we have two primary categories:

a) The Advisory Intermediary, or AFA, who will have a direct relationship with the Customer and should have a good understanding of the client's financial affairs, structures and can collect their identity documentation. (Under the VOICOP they cannot certify as a Trusted Referee, so they are independent.)
b) The WRAP / Custodian perform a valuable role in providing administrative assistance to both the Customer and the Advisory Intermediary. They also provide another level of protection as an independent custodian.

There may also be levels of involvement from Wealth Management Groups or a collective of AFA's sitting above the Advisory AFA. These groups generally provide non-custodial support, compliance infrastructure and lead generation.

The hierarchy

If you start with the Fund Manager as the Issuer of a Managed Fund, they have the ultimate obligation for every Unit they issue. Unitholders in the Fund can be direct investors or investors via an intermediary.

The Fund Manager / Issuer have the Obligation to perform a Risk Assessment of their product and take the necessary steps to mitigate the AML/CFT risks associated with that product. Central to the

risk mitigation, is effective CDD and the identification of the beneficial owners. If the Investor applies directly to the Issuer, then the issuer will complete the appropriate level of CDD, apply the Beneficial Ownership test, and carry out the transaction monitoring and ongoing CDD in compliance with the Act. Where the intermediary is the registered holder the Issuer needs to satisfy itself that "issuing" units to that entity does not cause the Issuer to breach their AML/CFT obligations or their own AML/CFT controls.

The Fund Manager also has the obligation to perform transaction monitoring and ongoing CDD which they can do for direct investors on the register. However if the Fund Manager only sees the Intermediaries name on the register, and they have no visibility of the underlying client transactions, or source of funds or who is instructing, then they cannot perform the function.

Global standards and the Act clearly intend to target Trusts and other structures which support anonymity as being high risk and seek to unravel the layers to identify the beneficial owners.

It is therefore necessary that the Intermediary provide comfort to the Issuer that they have sufficient AML/CFT controls and procedures in place to comply with the standards that should reasonably be expected by the industry, and, at a minimum, comply with the Act. (If the Intermediary does not wish to comply with the Issuers requirements then I am sure the Issuer would be prepared to provide a direct investment solution to the Investor so that they are not disadvantaged. It should also be noted that this type of behaviour from a direct investor would most likely trigger a Suspicious Transaction Report.)

The CDD process is only going to be as strong as the weakest (least diligent) link in the chain and each agency appointment should be supported by due diligence on that agent and additional sub-agents on a Risk based approach.

The Role of the WRAP Provider or Custodian

I am unclear on your reference in Appendix 2 with regards to The WRAP Platform being an "IT Solution" ..."not usually a separate reporting entity" and WRAP Trustee / Custodian being a reporting entity. Is this a company ownership structural consideration, or is this leading to a WRAP Trustee looking to take comfort under the Trust account exemption?

From the perspective of the Fund Manager, the WRAP or Custodian must always be the managing intermediary for any client in their omnibus account and it must always be a reporting entity. This is central to an effective CDD and transaction monitoring regime. The Issuer needs to be confident that any Custodial Intermediary who is in possession of the underlying client transaction flows is performing this function, because any transaction monitoring at an Issuer level would be totally meaningless.

The WRAP Platform, WRAP Trustee or Custodian:

a) Provides a financial service.
b) In the vast majority of cases has signed a bare trustee / custodial appointment contract directly with the underlying client to provide the service.
c) The WRAP has its primary agreement with the Adviser or Advisory Group which has the direct relationship with the underlying client.
d) They act on the instructions of the Advisor or they may be acting off advisor instructions that the Client approves and sends to the WRAP.
e) They receive and pay the funds directly from/to the client nominated bank account.
f) They maintain all the client transaction records.

g) Once they receive the client's funds they are co-mingled:
   - The beneficial owners are indistinguishable to any Fund Manager or any other counterparty dealing with them.
   - The WRAP can simply transfer beneficial ownership of investments within their books without the underlying Issuers knowledge that a transaction has taken place.

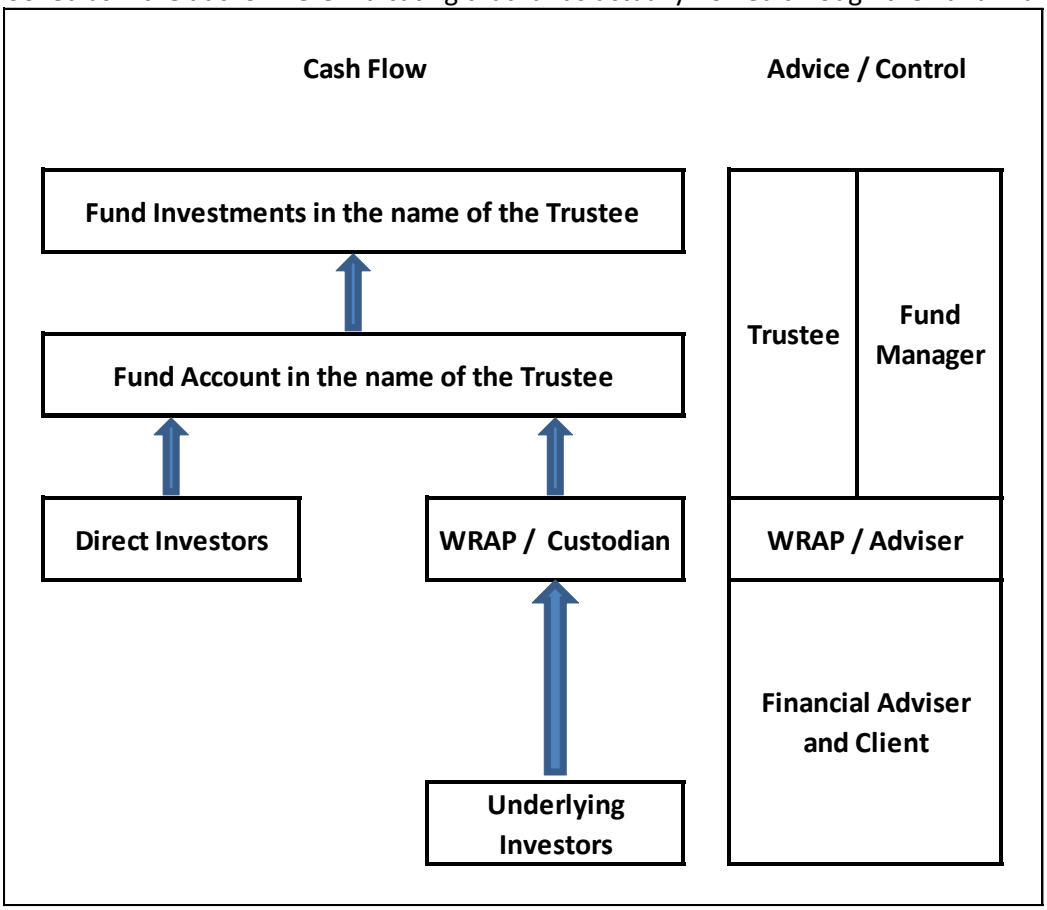
h) An Issuer does not even have visibility of who the underlying advisor might be.

i) If an underlying Client with Advisor A decides they want to change to Advisor B and Advisor B uses the WRAP, then a simple letter from the client authorising the change is sufficient to effect the change. The Client / Advisor nexus is broken and the WRAP relationship can endure and an issuer would be totally unaware.

Given all of the above I think it is a stretch to say it is just an "IT Solution". On this basis you could claim that any online broker was an "IT Solution". Some people might say it would be better described as "New or developing technologies, or products that might favour anonymity".

Cash flows

Below please see my interpretation of the cash flows and associated Advice / Control flows. It looked as if the author were indicating that funds actually flowed through the Fund Managers hands.



Conclusion
There is no debate on the point that the Fund Manager is the Issuer, and as such is a Reporting Entity. It is worth noting that in the case of managed funds, the bank account and the assets are held in the name of the Trustee and cannot therefore be dealt with by the Fund Manager unless it is approved by the Trustee and in accordance with the Trust Deed.

However, in keeping with the intent of the Act, to enhance New Zealand's international reputation and deter AML/CFT, then the Fund Manager needs to accept responsibility for the processing and CDD of direct investors, and should also be entitled to treat the WRAP / Custodian as a single Investor and do their CDD on that entity.

The Fund Manager should have an appropriate "Agency Arrangement" with any WRAP / Custodian facility and be able to rely on the fact the WRAP / Custodian has completed sufficient CDD on the clients that it is acting on behalf of. (This should all fall in within the CDD of accepting the entity as a unit holder.) In the event that either party was not satisfied with the others arrangements they could refuse the business or offer to accept it as a direct investment in the name of the beneficial owner.

The WRAP / Custodian should be responsible for CDD on each Advisor that it allows to use their "IT Solution" and every client that has investments registered in its omnibus account.

The WRAP / Custodian should also be responsible for all transaction monitoring of the funds passing through its hands and the retention of any documents collected on its behalf by its agents.

Operational aspects for inclusion in agency agreements that have not been highlighted:

- Retention of records – An intermediary relationship may extend beyond the Fund Manager or vice versa necessitating a handover of records.
- What do you do if someone goes out of business – take a copy of their files?

I am more than happy to discuss any of the points above and am confident that a practical solution will be achieved which can facilitate the business and support a robust AML/CFT environment.

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