Anti-Money Laundering and Countering Financing of Terrorism

Sector Risk Assessment 2017

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

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Background

The FMA supervises reporting entities (REs) in nine sectors under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act).

Our Sector Risk Assessment (SRA) helps us and the REs we supervise understand the risks of money-laundering (ML) and terrorism financing (TF) in each sector. This SRA replaces our SRA published in 2011 (SRA 2011). See page 3 for details about the differences between the two reports.

This SRA takes into account information from the Financial Intelligence Unit's National Risk Assessment and the SRAs of the other supervisors of the Act – the Reserve Bank of New Zealand and the Department of Internal Affairs. We have also considered national and international guidance documentation and typology reports.

Each of the nine sectors has been given one of the four risk ratings below. The rating is based on the assessment of the inherent risk of ML/TF. These ratings do not factor in the controls REs put in place to reduce ML/TF risks.

Low	Medium–low	Medium–high	High

The rating is based on a risk key which has been applied to the data REs provided in their annual regulatory return, together with other information obtained for the sectors. Although the data available for this SRA is better than in our SRA 2011, we believe REs still need to improve the quality of data provided, to give a clearer picture of our sectors.

Here is a snapshot of risk ratings for the nine sectors we supervise:

Sector	Sector risk 2017	Sector risk 2011-2017
Derivatives issuers	High	Medium-high
Brokers and custodians	Medium–high	Medium
Equity crowd funding platforms	Medium–low	N/A
Financial advisers	Medium–low	Medium-high
Managed investment scheme managers	Medium–low	Medium-high
Peer-to-peer lending providers	Medium–low	N/A
Discretionary investment management services	Medium–low	N/A
Licensed supervisors	Low	N/A
Issuers of securities	Low	Low

Executive summary

Our expectation is that REs:

- Review the revised risk ratings
- Review their risk assessment
- Incorporate any new risks and findings into their assessment.

Purpose of this Sector Risk Assessment (SRA)

The purpose of this SRA is to identify and communicate the ML/TF risks faced by REs in the nine sectors we supervise. Identifying the risks is the first step towards combating ML/TF. This step is integral to putting a risk-based approach in place and to allocate compliance resources effectively.

This SRA is for the following audiences:

REs	The FMA
REs should review and consider this SRA when they prepare or update their risk assessments.	Assessing the risks within each supervised sector enables us to efficiently allocate our limited resources.

Government, Financial Intelligence Unit and other Supervisors	**Other organisations**
To contribute to the New Zealand Financial Intelligence Unit's National Risk Assessment and inform other supervisors – the Reserve Bank of New Zealand and Department of Internal Affairs.	Countries must ensure they have adequate anti-money laundering and countering financing of terrorism supervision in place, as recommended by the Financial Action Taskforce. This SRA contributes towards meeting these obligations.

Key changes between the SRA 2011 and the SRA 2017

Our SRA 2011 was based on the limited information we had available at the time. This SRA replaces the SRA 2011; however, the majority of inherent industry risks identified in 2011 remain the same.

The sectors we supervise changed following amendments to the Act in December 2014. These amendments link the sectors to various financial services in the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

The main changes in the SRA 2017 methodology are:

- A change in focus to inherent sector risks, excluding mitigating factors and control measures
- Risks are now assessed in line with factors set out in section 58(2) of the Act
- Identification of specific 'red flags' that REs should include in their risk assessments
- More detailed analysis of TF.

Changes to the risk ratings

- Derivatives Issuers (DI) – previously called futures and option dealers – are rated as high risk. The rating has increased from a medium-high rating in 2011, as we now have detailed regulatory return data from this sector. The data highlighted previously unknown characteristics about the DI sector such as the high percentage (70%) of non-resident customers
- Brokers and custodians have been rated as medium-high risk. This is an increase from a medium risk rating in 2011 because brokers and custodians operate in a high volume and value environment which increases the risk of ML, and the SRA 2017 has no medium risk rating
- The risk rating for financial advisers risk rating dropped from medium-high to medium-low. This is due to the change in the regulatory environment with the commencement of the Financial Advisers Act regime

Executive summary

The information available on financial advisers has improved significantly since the SRA 2011, allowing us to rate the risks for this sector

- Managed investment scheme managers – previously called collective investment schemes – dropped from medium-high to medium-low. As with financial advisers, this reflects the improved information available for analysis which shows lower ML/TF risks in this sector.

How REs should use the SRA

- Review sections 1 to 7
- Review the section assessing your sector
- Review and update your own risk assessment.

Review sections 1 to 7

All REs would find it helpful to read sections 1 to 7 on pages 7 to 16. This will help you understand the scope of the SRA, its limitations and any key changes to the findings since the SRA 2011 was published.

Review your sector specific assessment

Each sector has a dedicated assessment (in section 8) covering specific risks, red flags and industry characteristics for you to review. We provide a list of common red flags that apply to all sectors, as well as specific red flags for each sector.

Individual REs will vary from the sector average and we provide a number of factors which play a part in lowering or raising the risks for entities in specific areas. This should help you to understand where the FMA has identified higher risk areas within the sector. For more detail, see Section 7 titled *How to interpret the data in this report* on page 16.

If you operate in more than one sector, you should review and apply all relevant risk assessments. The overall risk will depend on a number of factors such as the ML/TF risk present and how much activity is carried out in each category.

Review and update your own risk assessment

We expect you to review and update your own risk assessment with a view to incorporating any new risks identified in this SRA and changes in sector risk ratings. For example, this can be incorporated into the annual review of the risk assessment or carried out as a standalone activity.

In our monitoring, we will look to see if you considered the SRA content, and then factored it into your risk assessment, as required by section 58(2)(g) of the Act.

You need to look at your policies, procedures and controls to examine if you are managing potential ML/TF adequately.

Section 1

Money laundering and terrorism financing risks in New Zealand

The Anti-Money Laundering and Countering Financing of Terrorism Act 2009

The Act came into full legal effect in June 2013. Its main purposes are:

- To detect and deter money laundering and the financing of terrorism.
- To maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force.
- To contribute to public confidence in the financial system.

Under section 131 of the Act, each anti-money laundering and countering financing of terrorism supervisor has to assess the level of risk across all of the REs it supervises.

New Zealand has three levels of risk assessment which review ML/TF risks from different perspectives. Together, the three assessments inform government, supervisors and REs of potential risks to help combat ML/TF. The three risk assessments combined provide a picture of the ML/TF risks New Zealand faces. See the diagram on the right for more detail on how the three assessments inform each other.

The three levels of risk assessments are:

National Risk Assessment (NRA)

The NRA reviews ML/TF issues affecting the whole of New Zealand. It is based on information from suspicious transaction reports (STRs) and proceeds of crime asset recovery data. Information from government organisations, both domestic and international, also contribute to the NRA, and it provides a comprehensive overview of threats and crime trends.

We encourage REs to use the NRA to stay informed about emerging threats and trends. We suggest they share relevant case studies and predicate offences in staff anti-money laundering and countering financing of terrorism training. We found staff who understand the underlying crimes which lead to ML/TF have a greater desire to detect and deter ML/TF.

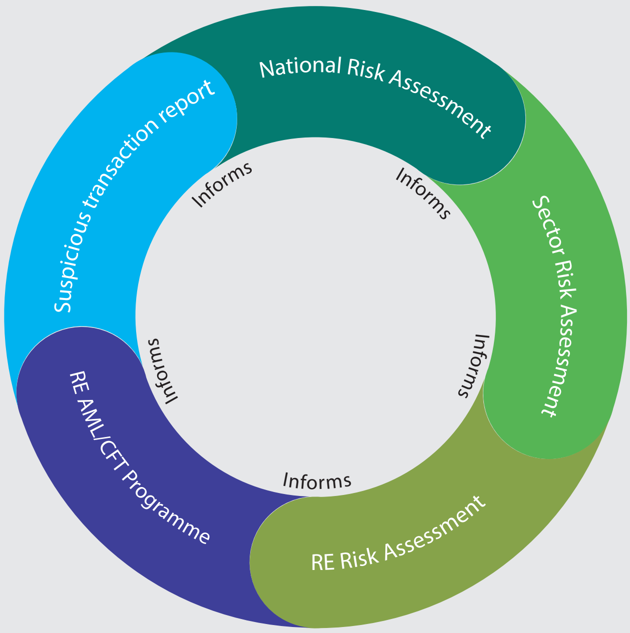
Sector Risk Assessment

The three anti-money laundering and countering financing of terrorism supervisors produce a risk assessment for their sectors. Our ongoing work aims to improve REs' understanding of the ML/TF sector risks, and to inform them of the risk indicators, trends and emerging issues. This SRA will be reviewed from time to time to check how ML/TF risks affect the nine sectors we supervise.

Risk assessments by REs

REs must carry out a risk assessment of ML/TF in their business. Section 58 of the Act sets out what is required in a risk assessment. This risk assessment must also take into account guidance material from their anti-money laundering and countering financing of terrorism supervisor and the Financial Intelligence Unit. The SRA is part of our anti-money laundering and countering financing of terrorism guidance materials. We also encourage REs to access international anti-money laundering and countering financing of terrorism guidance – specifically the material produced by the Financial Action Taskforce and the Asia Pacific Group on Money Laundering.

How the three types of risk assessment inform each other



Section 2

Methodology

This section sets out the type of information we considered, the scope and the limitations of this SRA. Understanding the methodology will help REs review and apply the findings of the SRA to their own risk assessment.

Background information in the SRA

The following information helped inform our SRA:

- The National Risk Assessment
- Other supervisors' risk assessments (Reserve Bank of New Zealand, Department of Internal Affairs)
- National and international guidance documentation
- Typology reports
- Annual anti-money laundering and countering financing of terrorism regulatory reporting
- FMA monitoring and expertise
- RE's risk assessment data
- Discussions with industry representatives and consultants.

Each sector has been assessed against the variables set out in section 58(2) of the Act. This requires REs to assess:

- The nature, size and complexity of their business
- Product and services
- Delivery channel for products and services
- Customer types
- Country risk
- Institutions they deal with.

Scope

We now supervise nine sectors under the Act. These are:

- Derivatives issuers (DI)
- Brokers and custodians
- Equity crowd funding platforms
- Financial advisers
- Managed investment scheme (MIS) managers
- Peer-to-peer lending providers
- Licensed supervisors
- Discretionary Investment Management Services (DIMS), and
- Issuers of securities.

Limitation

For consistency, when comparing sectors, we aimed to determine the likely inherent ML/TF risk. The risks faced by individual REs will vary from the sector average due to business specific characteristics of individual REs.

Risk scale

We applied the risk scale below to all variables set out in section 58(2) of the Act. We have not included a 'medium' risk category to ensure a clear position on the risk rating. For each sector we have rated the ML/TF risk as:

Low	Medium–low	Medium–high	High

Methodology

Inherent risk: The risk that an activity would pose if no controls or other mitigating factors were in place.

The SRA evaluates inherent ML/TF risks.

Inherent risk disregards any controls a RE might have in place. This is deliberate as these will vary significantly from RE to RE, and depend on their available resources and their commitment to reducing ML/TF risks.

Vulnerability: This is described as a weakness that can be exploited for the purposes of ML/TF.

We have considered the key vulnerabilities across the sectors we supervise. This helps identify the sector risk(s). These are:

- Complexity
- Liquidity
- Anonymity.

To see the full list of vulnerabilities, view the risk key on page 10.

We assessed each sector individually by breaking it down into the variables in section 58(2) of the Act to determine the level of exposure to ML/TF risks.

The variables do not have an equal weighting. The overall rating assesses the importance of higher risk factors in the sector. We assumed areas showing a number of, or a particularly strong vulnerability, will have a higher ML/TF risk.

Section 3

Risk key

The risk key below helps determine the main ML/TF vulnerability for each variable set out in section 58(2) of the Act. The vulnerabilities are grouped into factors that may either increase or decrease a particular risk. This helps REs determine if their risk is higher or lower than the overall risk estimate for their sector.

REs need to keep this risk key top of mind when they review the individual sectors outlined in sector risk sections from page 17 onwards.

Variable	What increases the risk?	What decreases the risk?
Nature, size and complexity of business	• Large transactions • High volumes of transactions • Complex transactions • Large entity size can make implementing anti-money laundering and countering financing of terrorism measures difficult • Small-sized entities may have less awareness of ML/TF • Insufficient staff • High staff turnover.	• Low value of transactions • Low volume of transactions • Simple and transparent transactions.
Products /services	• High complexity • Highly liquid products/services • Large volume of products sold • High value products • Third party payments • Commission-based selling, leading to conflicts of interest • Cash-based products and services.	• Low complexity • Low liquidity • Lock in periods • Low volume of products sold • Low value.
Delivery channel for products and services	• Anonymity • No face-to-face identity verification • No direct customer interaction • Due diligence carried out by other institutions • Transactions carried out remotely.	• Regular face-to-face contact • RE carries out customer due diligence.
Customer types	• Trusts and companies with complex structures • High net worth individuals • Foreign Politically Exposed Person (PEPs).	• Stable well-known customer base with ongoing customer due diligence • Simple customer type (mainly individuals).
Country risk	• Customers based in/controlled or owned by persons based in high-risk jurisdictions • Transactions designed for (or coming from) high-risk jurisdictions • Jurisdictions which have sanctions in place against them. • Large overseas customer base.	• Customers based in countries with robust anti-money laundering and countering financing of terrorism systems • Transactions carried out in and/or with countries with sound AML/CFT systems.
Institutions dealt with	• Institutions with weak anti-money laundering and countering financing of terrorism controls • Overseas institutions with unknown anti-money laundering and countering financing of terrorism measures.	• Domestic or overseas institutions with robust anti-money laundering and countering financing of terrorism measures.

Section 4

Potential red flags

Red flags indicate unusual customer activity and should prompt a RE to carry out further investigation. The following red flags come from different sources and could occur in the sectors we regulate.

At the start of the customer relationship

- Customer is nervous and reluctant to provide identity documents
- No connection between customer's place of residence and the financial institution
- The information a customer provided does not align with information from other sources
- Customer has unexplained wealth inconsistent with their economic situation
- A wholesale customer who is an inexperienced investor
- Customer has complex trust or other legal arrangements which aim to hide beneficial ownership.
- Customer resides in a high risk country rated by international sources such as Financial Action Taskforce or Transparency International; and has no logical geographic connection to New Zealand
- Customer seems to be acting for an undisclosed third party.

During the customer relationship

- Unusual or unexplained lump sums added to an account which does not align with the customer's known wealth
- Unusual settlements – such as third parties' cheques sent for no apparent reason
- Transactions that lack economic sense such as buy and sell orders with little gain or loss to give the impression of account activity
- Investments are quickly followed by sales or transfer of assets
- Customer who keeps losing money and replenishes the account in excess of their known wealth
- Customer's investments are inconsistent with their investment profile
- Previously dormant accounts suddenly have unexplained wire transfer activities
- A new customer who introduces other high-net worth customers shortly after onboarding
- Cash is added to an account and withdrawn shortly after, with no trading
- Customer age does not align with the investment or trading behaviour – they could be used as a mule (very young or older customer)
- Customer's wealth is not aligned with their known background.
- Customer makes large or structured cash deposits into the RE bank account to facilitate investment.

Ending a customer relationship

- An account is only used for one transaction, contrary to its normal use
- Customer closes their account after requesting additional customer due diligence documents (like source of funds)
- Customer requests funds to be sent to a third party account with no apparent connection or to an overseas account.

Section 5

Money laundering the proceeds of crime

Stages of money laundering

Money laundering (ML) involves concealing the origins of funds or assets. There are three recognised stages of ML:

- **Placement:** Criminals introduce proceeds of crime into the financial system
- **Layering:** This occurs when the proceeds of crime are in the financial system. It can involve numerous transactions designed to confuse the tracing of funds to their original source
- **Integration:** This occurs when the funds become legitimate.

The sectors we supervise are most likely used in the layering and integration stages of ML.

Predicate offences

Every ML offence is preceded by a criminal offence. This is called a predicate offence. Money laundering transactions will be structured to seem like legitimate transactions, even though the origin of the funds comes from criminal activity.

Common predicate offences

The Financial Intelligence Unit publishes a list of predicate offences both domestically and internationally. The full list can be found in the Financial Intelligence Unit's Quarterly Typology Report – Predicate Offence.

Common predicate offences are:

- Fraud: This includes fraud in the wider economy and also in the capital market sector (market manipulation)
- Tax evasion: REs need to send a suspicious transaction report (STR) to the Financial Intelligence Unit for suspected tax evasion
- Drug offences.

Offences can be carried out either domestically or internationally or both. In its Quarterly Typology Report on Predicate offences, the Financial Intelligence Unit estimates that each year $1.35 billion of proceeds generated from domestic predicate offences are laundered in New Zealand.

REs do not have to identify or investigate the predicate offence when reporting a STR. If a RE suspects a predicate offence is the source of the funds, this is enough to file an STR.

White collar crime

The sectors we supervise are generally expected to be the target of more sophisticated money launderers. These criminals are often familiar with capital markets and their products, involved in elaborate fraud or could be employees of financial institutions. Even though the criminal offending is more elaborate in these cases, the illegally-obtained funds still require layering to appear legitimate.

Potential white collar crime indicators which warrant further investigation by REs are:

- The known source of income contrasts with the person's known lifestyle.
- Unusual 'lump sum' payments described as bonuses.
- Businesses succeeding in sectors which are declining or not scalable.

Money laundering the proceeds of crime

The use of cash in money laundering

Many believe the offence of ML requires cash to be put into the financial system. However, depending on the stage of the process (placement, layering or integration) the proceeds of crime are often already in electronic form. Examples of this would be market manipulation, tax evasion and fraud.

The absence of cash does not lead to a lower ML risk. Some REs may see receiving funds electronically as low risk because the funds would originate from another financial institution such as a bank who will deposit the funds into the REs or their custodian's bank account. When they receive funds electronically, REs cannot rely on other financial institutions to carry out their customer due diligence - unless an explicit arrangement was agreed.

We expect our REs to be used in the layering and integration stages of ML, where there was no placement of cash.

Predicate offence	Placement	Layering	Integration
Drug offences	Cash proceeds	Non-cash	Non-cash
Fraud	Non-cash	Non-cash	Non-cash
Tax evasion	Non-cash	Non-cash	Non-cash
Other	Cash and non-cash	Non-cash	Non-cash

Section 6

Terrorism financing

Overview

Terrorists require funding to achieve their goal of carrying out terrorist acts and to fund their operations. These activities can be as simple as food or rental payments for terrorist fighters. The characteristics of terrorist financing are similar to ML in many respects. However, TF has a different focus on preventing the criminal activity from occurring.

TF, by its nature, can be difficult to identify. The source of funds can be both from legitimate and criminal sources, and often involve a low value of transactions. TF is therefore concerned with concealing the origin and the nature of the funded activity.

Terrorism financing risk in our supervised sectors

The TF threat faced by New Zealand is rated low by international standards. From 30 June 2013, when the Act came into effect, until 31 December 2015, the Financial Intelligence Unit received a total of 83 STRs which indicated a possible relation to terrorist financing, 0.3% of all processed STRs. However, we still expect our REs to stay vigilant to ensure they don't unwittingly fund terrorism.

In its Quarterly Typology Report Second Quarter (Q2) 2015/2016 the Financial Intelligence Unit has covered a number of TF typologies. The two main threats identified in the report are:

- Financiers of overseas groups in New Zealand
- Overseas-based groups seeking to use New Zealand as a conduit for funds.

It is a criminal offence in New Zealand under the Terrorism Suppression Act 2002 to:

Collect funds to use in a terrorist act or to give to an entity carrying out terrorist acts.

Knowingly deal with any property owned or controlled by a terrorist entity.

Make financial services available to a designated terrorist entity.

Terrorism financing

Key indicators and red flags for terrorism financing

Below we identify some of the red flags that could indicate a link to TF. This list is not exhaustive and as part of their risk assessment we encourage REs to identify any other red flags they see in their businesses.

- A customer making fund transfers to multiple beneficiaries located in high-risk jurisdictions
- Individuals and/or businesses transferring funds to known terrorist entities or entities suspected as having links to terrorism or TF
- Multiple customers using the same address/ telephone number to conduct account activity
- REs or individuals with connections to terrorist groups
- Setting up a New Zealand account with false identification
- Customers in or returning from conflict zones
- A sudden increase in account activity which is inconsistent with the customer profile
- Multiple low-value domestic transfers to one account.

Emerging terrorism financing risk

The Financial Action Task Force recommends a forward-looking analysis for TF because the risks change rapidly.

Areas of potential risk are:

- Foreign terrorist fighters, defined by the U.N. Security Council Resolution 2178 as: *"Individuals who travel to a state other than their states of residence or nationality for the purpose of the perpetration, planning, or preparation of, or participation in, terrorist acts or the providing or receiving of terrorist training, including in connection with armed conflict."*
- Foreign terrorist supporters – an entity or individual who provides financial assistance to, or otherwise supports, terrorists
- Fundraising using social media and new payment products and services

REs need to ensure their anti-money laundering and countering financing of terrorism measures both adequately and effectively cover emerging TF. Their anti-money laundering and countering financing of terrorism documentation should reflect this and include regular testing and validation.

Section 7

How to interpret the data in this report

Inherent risk tables

Individual REs will vary to some degree from the sector, due to them having differing exposure to the factors set out in section 58(2) of the Act.

To allow REs to be flexible with how they apply the sector risk rating to their own business, we have provided a number of factors we think lower or heighten the risk of ML/TF for individual REs. This should provide REs with an understanding where we have identified potential higher or lower risk areas within the sector. It is important for REs to evaluate where their business differs from the sector generally and rate their risks accordingly.

For example: A RE has a large number of non-resident customers from higher risk jurisdictions and the sector in general has little exposure to non-resident customers. Therefore the risk to the specific RE would be heightened in this area and the overall risk rating of the RE could be above the sector rating.

Timeframe

REs are required to file annual reports by August each year, for the year ending 30 June. In this SRA we have used 2015/2016 data provided to us by 30 August 2016. STR data collected and analysed by the Financial Intelligence Unit is for the same time period.

Data collected from previous years has not been taken into account. This is due to our expectation that the sectors supervised by us now better understand their filing obligations than in previous years.

Dataset

A number of larger entities licensed under the Financial Markets Conduct Act 2013 (FMC Act) are naturally excluded from the data as they are supervised by the Reserve Bank of New Zealand. The data in this report is therefore **not to be taken to represent the size of the licensed sector,** but as the size of our anti-money laundering and countering financing of terrorism supervised portion of the licensed sector.

A number of REs operate in multiple sectors that we supervise, such as for example DIMS providers also offering MIS and being a broker. Where REs operate in multiple sectors their information was taken into account in each sector, unless specified otherwise. **The total values contained in this report will therefore exceed the actual total values of the sectors supervised by us.**

Where we found sector data did not align with the other information we hold about REs, such as licensing, we questioned the analysis or in some cases decided to override the data, given our knowledge of the sector.

Whilst we have made an effort to identify where REs have misinterpreted the filing requirements, the data has not been analysed for its validity and we have mostly taken REs to have filed a true representation of their businesses.

For presentation purposes the numbers have been rounded.

Section 8

Sector risks

Sector	customers	gross value of transactions	number of REs	REs with PEPs
Managed investment scheme Managers	1,800,000	$85billion	87	13%
Discretionary investment management Services	960,000	$174billion	57	11%
Brokers and custodians	450,000	$523billion	66	17%
Licensed supervisors	360,000	$96billion	6	13%
Financial advisers	194,000	$12billion	370	5%
Derivative issuers	52,000	$15.7billion	16	14%
Peer-to-peer lenders	14,000	$0.49billion	7	20%
Equity crowdfunding platforms	2,200	$0.017billion	8	0%

Rating: High

Derivatives issuers

Derivatives issuers (DI) sell or trade derivatives. Issuers must be licensed to make a regulated offer of derivatives to retail investors. See section 388 of the FMC Act, for more detail on DI.

16
In the sector

52,000
Customers

3.2million
Transactions

63
Average number of transactions per customer

$5,000
Average transaction value

$15.7billion
Value of transactions

7
STR

$386,000
Average value per STR

71%
REs have no face-to-face onboarding

1%
Customers are trusts or other legal arrangements

70%
Non-resident customers

14%
REs with PEP customers

7% Manual | 7% Electronic
86% Both manual & electronic
Transaction monitoring by REs

At the time of filing, 14 entities had an obligation to file an annual return and their data is reflected above.

Derivatives issuers

Introduction

At the date of the publication, New Zealand has 21 derivatives issuers licensed to offer derivatives to retail investors. Five are registered banks and are supervised by the Reserve Bank of New Zealand for anti-money laundering and countering financing of terrorism. We supervise the remaining 16 REs.

In August 2016, the due date of the anti-money laundering and countering financing of terrorism annual return, 14 REs had a filing obligation. At that time the FMC Act licensing process was not completed.

REs had to describe their business in their licence applications. This information helped us group DIs into the following categories:

- Banks – not anti-money laundering and countering financing of terrorism supervised by us; not included in this report
- Trade related – six REs who transact foreign currency or options
- Speculative – 10 REs who trade derivatives.

The derivatives market is highly attractive to money launderers as it offers:

- High liquidity
- High frequency of trading
- Easy access to the market via online account opening and online trading and
- A global marketplace.

The sector filed 7 STRs last year. This is a surprisingly low number in light of the high number (70%) of overseas customers in the sector and other known risk factors.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and where appropriate file a STR.

These are:

- Frequent trading in and out of positions with little gain/loss
- Using cash accounts to 'park money' (adding funds into an account without trading)
- Adding cash to an account and withdrawing it soon after without trading
- Dormant accounts that become active
- A customer who keeps losing money and replenishes their account, where the amount and frequency is inconsistent with the known wealth of the customer
- Third party payments or deposits
- The age of the customer is not in line with their trading behaviour and could be an indication of someone being used as a mule (very young or older customer)
- Multiple customers signed up from, or registered at, the same IP address.

Derivatives issuers

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	REs aimed at speculative online based trading.	REs offering derivatives for risk management purposes only and to a known customer base.
Products and services	Online accounts for speculative trading. Third party deposits or payments. Acceptance of credit cards for payments.	Fit for purpose information technology systems.
Delivery channel for products and services	No face-to-face onboarding of customers.	Customer relationship model with regular customer contact.
Customer types	REs with large customer base compared to the size of the RE. Foreign PEPs.	
Country risk	Customers based in, controlled by or owned by, people in high-risk jurisdictions. REs with large non-resident proportion of their customer base.	
Institutions dealt with	Unregulated institutions in high risk countries.	

Overall risk	The ML/TF risk of the sector has been rated as high, based on: • The high liquidity of the products offered • The ease of opening accounts • Limited face-to-face customer onboarding • Large number of non-resident customers in higher risk jurisdictions.

Derivatives issuers

Sector specific risks

Nature, size and complexity of business

DIs are required to be licensed under the FMC Act, which has improved the information and oversight we have of the sector. REs in this sector vary greatly in size from small entities to those with a global footprint. Their ownership is often concentrated in a small number of offshore based individuals or entities.

Derivatives markets are characterised by fast-paced transactions with a global reach. The REs we supervise carry out 3.2 million transactions per year.

The sector relies heavily on advanced information technology which is changing rapidly each year. This brings challenges for REs to maintain their compliance capabilities in line with changes to their trading platforms.

Risk rating: High

Products and services

DIs offer a range of derivative products to their customers which are highly complex and often involve leverage. From the licensing applications we saw, the DI sector we supervise falls into two distinct categories:

- REs offering speculative trading, often online with no customer interaction or contact (62%)
- REs facilitating risk management for businesses who mostly have a need to hedge against currency movements (38%).

In our view, allowing speculative trading increases the risk a RE faces because a customer's trading patterns can be unknown and unusual.

The average trading amount of $5,000 appears to be very low when taking into account minimum trade size as well as the use of leverage in this sector. This could be a reflection of a higher involvement of retail investors in the sector than previously estimated which could make it more attractive for ML.

DI trading requires, at least, one account holding cash as collateral. Customers can add or withdraw funds from these accounts, whilst maintaining the required balance – this presents a heightened risk of ML.

Risk rating: High

Delivery channel for products and services

Ten REs indicated they on-board customers using other channels than face-to-face. Three REs told us they use overseas intermediaries. The majority of REs (86%) use both manual and electronic transaction monitoring methods.

Frequently trading is carried out through online platforms which customers access anywhere in the world. We understand that trade-related derivative trading follows a more traditional relationship model and frequent phone contact with customers is common.

Risk rating: High

Derivatives issuers

Customer types

The DI sector mainly transacts with individuals who often engage in speculative trading. The number of trust and other legal arrangements is relatively low at 1.3%. Only two REs indicated to have a PEP as their customer.

Risk rating: High

Institutions dealt with

The DI sector deals with institutions based largely in low-risk countries.

Risk rating: Low

Country risk

The DI sector has 70% non-resident customers – the highest percentage of any of the sectors we supervise. There is a split between REs with fewer than 10% non-resident customers, and the remainder who have close to 100% non-resident customers.

Information on country risk ratings comes from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: High

Rating: Medium–high

Brokers and custodians

Brokers – A broker is a financial services provider who holds, transfers or makes payments with client money or property, for their customers. Client money and property is defined as money and property related to the acquisition or disposal of a financial product.

Custodians – A MIS custodian is a financial service, who holds the property of a managed investment scheme. A DIMS custodian is a financial services provider who holds client money or property for a DIMS provider.

66
In the sector

450,000
Customers

21 million
Transactions

47
Average number of transactions per customer

$24,600
Average transaction value

$523 billion
Value of transactions

22
STR

$750,000
Average value per STR

32%
REs onboard their customers face-to-face

9%
Customers are trusts or other legal arrangements

7%
Non-resident customers

17%
REs with PEP customers

11% Manual | 9% Electronic
80% Both manual & electronic
Transaction monitoring by REs

Brokers and custodians

Introduction

Brokers

A broker is a financial services provider who holds, transfers or makes payments with client money or property for their customers. Brokers are not licensed under the FMC Act. Their business activity itself defines them as brokers.

Brokers can include share brokers, providers of portfolio administration services and financial advisers, who receive property or money from customers.

See sections 77B, 77C and 77U of the Financial Advisers Act (FA Act) for a detailed definition of 'broker' and 'broking services', and who is responsible for broker obligations.

The obligations of brokers apply whether they have retail or wholesale customers; and includes custodians of client money and client property.

NZX market participants are a sub-set of brokers. In addition to being a broker under the FA Act they have an assessment and approval process by the NZX and are subject to their rules. There are currently 21 NZX participants who are, in addition to general broking obligations, subject to the NZX rules and supervision. An NZX market participant is a business accredited by New Zealand's main licensed market operator, NZX Limited, to participate in, and trade listed financial products on, the markets NZX operates. NZX participant types include NZX trading and advising firms and NZX advising firms.

The nature of the broking sector is often fast paced, involved in share trading, initial public offers, bond issues and other financial products. Most brokers appear to offer a mixture of trade execution only as well as a more traditional portfolio management model through Authorised Financial Advisers (AFAs).

The sector has filed 22 STRs with an average value of $750,000 which reflects the high values traded by broking customers. Due to the highly liquid products brokers deal with and the fast-paced nature of the business, we see a heightened risk for ML/TF in this sector.

Custodians

Custodians hold money or property on trust for their customers. Under the FA Act all custodians are brokers, but not all brokers are custodians.

Where a custodian acts on instruction from another financial institution, we see little ML risk. Custodians who take instructions from customers, who are not financial institutions, have the same ML/TF risk as brokers.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and file a STR, where appropriate

These are:

- Unusual settlements, for example, payments requested to third parties with no apparent connection to the customer
- Funds deposited into stockbroker's account followed immediately by requests for repayment
- Frequent changes to customer details
- Securities accounts opened to trade in shares of only one listed company
- Transaction patterns resembling market manipulation or insider trading
- Intra-day trading with no economic benefit
- Transactions outside of settlement systems
- Shares bought with one broker and sold through a different broker.

Brokers and custodians

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	Overreliance on third parties for customer due diligence.	
Products and services	Third party deposits or payments.	Custody for other financial institutions.
Delivery channel for products and services		Face-to-face onboarding of customers.
Customer types	PEPs. Trust and other legal arrangements.	Financial institutions.
Country risk	Non-resident customers.	Domestic customer base.
Institutions dealt with		
Overall risk	The ML/TF risk of the sector has been rated as medium-high. This is a reflection of the liquidity of the products, the anonymity that no face-to-face onboarding brings, as well as the high concentration of trust and other legal arrangements, and non-resident customers.	

Brokers and custodians

Sector specific risks

Nature, size and complexity of business

The size and complexity of the sector ranges from small businesses to entities operating on a global scale.

The transactional volume of the sector is significant at $523 billion for the year ended June 2016. This equates to 322,000 transactions per RE in the sector. We attribute the significant volumes in this sector to custodians. On a customer level this translates to 47 transactions each with an average value of $24,600, which supports our understanding of the fast-paced nature of the sector.

Transaction monitoring is carried out manually by 11% of entities which is surprising given the volume of transactions in the sector.

Risk rating: Medium–high

Delivery channel for products and services

The sector uses both face-to-face (32% of REs) and non-face-to-face onboarding (42% of REs) extensively. The remainder of REs use a combination of both face-to-face and non-face-to-face onboarding methods. We understand that brokers with a customer relationship model are more likely to onboard customers face-to-face. The use of online trading systems is becoming more common which will decrease face-to-face onboarding over time, as seen in other sectors that are based entirely online.

Only one RE in the sector has indicated using overseas intermediaries to on-board customers, with around 20% of entities utilising domestic intermediaries for onboarding.

Risk rating: Medium–low

Products and services

Products and services offered by brokers and custodians are generally highly liquid, such as shares, bonds, foreign exchange, managed funds and distribution of initial public offers. The high liquidity possibility of frequent trading without raising suspicion, makes the sector vulnerable to ML. Individual products or entire portfolios in this sector can be transferred to other institutions both on and offshore which can hinder efforts to trace the source of the funds.

Risk rating: High

Customer types

The sector has a relatively high percentage of trust and other legal arrangements at 9%. Non-residents make up around 7% of the customer base and 17% of REs have reported to have at least one foreign PEP on their books. One-off transactions are not uncommon in this sector, and are a higher risk for ML/TF.

Risk rating: Medium–high

Brokers and custodians

Country risk

The reported 7% of non-resident customers come from a variety of countries. These include: China, United Arab Emirates, Brazil, Bulgaria, Cyprus, Fiji, Israel, Kazakhstan, Marshall Islands, Russian Federation, Swaziland, Ukraine and Uzbekistan.

Information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: Medium–high

Institutions dealt with

Brokers and custodians mainly deal with institutions and intermediaries based in low-risk countries.

Risk rating: Low

Rating: Medium–low

Equity crowdfunding platforms

Equity crowdfunding platforms offer an intermediary service for companies to raise small amounts of capital (up to $2 million a year) from retail investors without the legal requirements for regulated offers under the FMC Act.

8
In the sector

2,000
Customers

1,600
Transactions

1
Average number of transactions per customer

$10,800
Average transaction value

$17 million
Value of transactions

0
STR

$0
Average value per STR

0%
REs onboard their customers face-to-face

2%
Customers are trusts or other legal arrangements

3
Non-resident customers

0%
REs with PEP customers

0% Manual

17% Electronic

83% Both manual & electronic

Transaction monitoring by REs

At the time of filing, six entities had an obligation to file an annual return and their data is reflected above.

Equity crowdfunding platforms

Introduction

An equity crowdfunding service is a RE acting as an intermediary between companies issuing shares and potential investors . The crowdfunder provides the facility (such as a website) for the offer to go public. Charitable or philanthropic fundraising, with no shares involved, is not equity crowdfunding.

Crowdfunding is relatively new and a small sector in New Zealand. For most companies there is currently no secondary market for these shares. This means that liquidity after the initial purchase is close to zero. This feature makes it unattractive to money launderers.

Equity Crowd Funding Platforms have been used to raise a portion of capital in New Zealand for ASX initial public offers by overseas companies. In this situation there is a secondary market which significantly increases the ML risk.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and, where appropriate, file a STR.

These are:

- Borrower and lender share the same address or are somehow closely linked
- Issuers cancel a share issue and return funds to investors
- Browser cookies indicate a customer with a New Zealand address is arranging transactions from overseas
- Many customers sign up from one IP address.

Equity crowdfunding platforms

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business		
Products and services	Offer with short term exit strategy (initial public offers).	
Delivery channel for products and services		
Customer types	Foreign PEPs.	
Country risk	Non-resident issuers/investors. Customers from high risk jurisdictions.	
Institutions dealt with	n/a	n/a

Overall risk	The ML/TF risk of the sector has been rated as medium-low. For most share issues in the sector there is no liquidity after the initial purchase, making it unattractive for ML/TF.

Equity crowdfunding platforms

Sector specific risks

Nature, size and complexity of business

Transaction volumes are low at 1,600 for the year to June 2016. Transaction monitoring is carried out manually by one RE, the remainder of REs have indicated they utilise a combination of both manual and electronic transaction monitoring. This seems to align with the nature of the sector, which is generally a customer making a single investment into an offer. Generally, monitoring would mainly be for customers who make multiple investments into different offers.

Risk rating: Low

Products and services

Equity crowdfunding platforms offer a single service which is to match buyers with entities aiming to raise funds. Customers appear to only transact once, with an average investment value of $10,800. As set out earlier, we see little opportunity to utilise the sector for ML/TF due to its illiquid nature except in the issues which raise funds for an exchange such as the NZX or ASX.

Risk rating: Medium–low

Delivery channel for products and services

Crowdfunders only accept customers via non face-to-face methods because it is based online. Based on the information provided from the sector, we understand that no third party channels are used and all customers interact directly with the REs. While non-face-to-face onboarding facilitates anonymity, in the context of the equity crowdfunding sector and its lack of liquidity, we consider this to only moderately increase the risk of ML/TF.

Risk rating: Medium–high

Customer types

The sector has only a 2% exposure to trust and other legal arrangements and no REs reporting PEP customers.

Risk rating: Low

Equity crowdfunding platforms

Country risk

The sector reports 13% (300) of its customers are non-residents. These customers come from: Australia, United Kingdom, Norway, Portugal, Singapore and United States of America.

More information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: Low

Institutions dealt with

Not applicable in this sector

Rating: Medium–low

Financial advisers

There are currently 6,200 registered financial advisers (RFAs) in New Zealand and 1,802 authorised financial advisers (AFAs) registered on the Financial Services Providers Register (FSPR). RFAs are legally bound by the Financial Advisers Act 2008 which defines financial advice as well as categorising the types of products they sell or advise on.

To be a RE under the Anti-money laundering and countering financing of terrorism Act an adviser has to give advice on a category 1 product, (which is shares, bonds and funds). Only a small number of RFAs and AFAs are not employed by another RE and provide advice on category 1 products. Adviser firms range from individual business owners to REs with multiple branches across New Zealand.

370
In the sector

193,000
Customers

1·5 million
Transactions

8
Average number of transactions per customer

$8,000
Average transaction value

$12 billion
Value of transactions

3
STR

$324,000
Average value per STR

80%
REs onboard their customers face-to-face

5%
Customers are trusts or other legal arrangements

2%
Non-resident customers

5%
REs with PEP customers

14% Manual | 9% Electronic
77% Both manual & electronic
Transaction monitoring by REs

The sector data is influenced by a number of larger entities who also provide MIS, DIMS and broking services. In order to get a clearer understanding of the adviser sector, which mainly consists of small businesses, these 65 REs have been excluded for the purpose of our analysis.

Financial advisers

Introduction

Financial advisers are subject to the FA Act which defines financial advice as well as the product categorisation. To be a RE under the Act an adviser has to give advice on a category 1 product, such as shares, bonds and funds.

There are currently 435 REs who identified themselves as financial advisers in the annual return. The majority of these REs (85%) only provide financial adviser services. The remaining 15% of REs provide a wide range of services and a number of them hold FMC Act licences or are brokers and custodians. This heavily influences the results, which is why we have chosen to base our analysis on the data provided by the 370 REs who only provide financial adviser services.

Where adviser businesses are small we consider the lack of monetary and time resources creates ML/TF vulnerabilities. Lack of resource can lead to reduced awareness of compliance obligations, particularly around customer due diligence requirements, STR requirements and transaction monitoring.

Advisers have filed three STRs in the last year which could either reflect the low risk of ML or a continued lack of awareness of filing obligations in the sector.

AFAs

AFAs appear to be mostly targeting high-net-worth individuals offering financial planning services aimed at establishing a long term wealth management strategy. Whilst high-net-worth customers increase the risks of ML, the requirements for AFAs to know and analyse the needs of their customers as part of their obligations lowers the risk of ML. From engagement with the industry, we understand that AFAs tend to have an established customer base aiming mostly at long term wealth creation/ maintenance.

RFAs

RFAs are captured under the Act when selling category 1 products such as KiwiSaver to their customers. There are some vulnerabilities to the KiwiSaver product which RFAs need to consider. However, we believe KiwiSaver is a low risk product for ML overall due to its long term nature and strict eligibility criteria.

Qualifying financial entities (QFEs)

QFEs are REs in their own right such as banks and other large financial institutions employing financial advisers.

This section does not cover QFEs as they will likely be part of other sectors or are REs supervised by the Reserve Bank of New Zealand. Where a QFE provides financial advice only, the sector risk for financial advisers would apply.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and, where appropriate, file a STR.

These are:

- Reluctance to provide customer due diligence documentation
- Customer investments are inconsistent with the investment profile
- Lump sum additions out of alignment with known source of income.
- Structuring drive to achieve anonymity without clear reasons
- Rapid change of products
- Withdrawals are made shortly after deposits
- A customer who seems to be indifferent to losses.
- A new customer who introduces other high-net -worth customers shortly after onboarding
- No logical geographic connection between where the customer lives and where the adviser is based
- The investor wants to be 'wholesale' but the amount or wealth does not meet the wholesale investor classification.

Financial advisers

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	Dependency on one or several high-value customers. Small entity size leading to lack of ML/TF awareness.	Low volume or value of transactions. Trading through large product providers or investment platforms that have an additional layer of AML/CFT requirements.
Products and services	Commission-based remuneration. Emergence of robo-advice allowing for anonymity. High-net-worth customers demanding complex products. Third party payments.	Providing products with lock-in periods and additional identity verification requirements such as KiwiSaver.
Delivery channel for products and services	Customers accepted via non face-to-face channels. Emergence of robo-advice allowing for anonymity.	Most customer interactions are face-to-face. Stable customer base with customers personally known to the adviser.
Customer types	Trusts and other legal arrangements. Foreign PEPs.	
Country risk	Large number of trust and other legal arrangements. Non-resident customers in jurisdictions with weak AML/CF frameworks. Offshore customers combined with trust and other legal arrangements.	Local customer base with known wealth management requirements.
Institutions dealt with	Unregulated institutions.	
Overall risk	The ML/TF risk of the sector has been rated as medium-low. The sector has a number of vulnerabilities which make it susceptible to ML/TF. These risks are mitigated as AFAs have enduring and in-depth relationships with their customers. This is helped by the information AFAs gather when they onboard their customers. RFAs are captured through selling KiwiSaver which is low risk for ML/TF.	

Financial advisers

Sector specific risks

Nature, size and complexity of business

The REs represented in this sector tend to be small businesses, often sole traders with the number of customers limited by the size of the business. The average number of customers of 524 per adviser appears high. The data suggests that around 20% of advisers sell KiwiSaver products only. This inflates the number of customers who require limited on-going advice due to the long term nature of the product.

The lack of resources of both time and funds can lead to reduced awareness of emerging ML/TF risks within the sector which increases the ML/TF risk and could also be reflected in the low filing of STRs.

We note the transaction speed is relatively low with an average number of eight transactions per customer. This is in line with the long term nature of the products offered by the sector.

Risk rating: Low

Products and services

AFAs provide investment adviser services generally aimed at long term wealth accumulation and retirement savings. The products sold are shares, bonds or funds purchased through investment platform providers or brokers. These products are generally liquid (excluding KiwiSaver and other superannuation products) and, therefore, increase the risk of ML.

RFAs are able to provide class advice on category 1 products. We predominantly see RFAs sell KiwiSaver products rather than other category 1 products.

As stated earlier, we deem KiwiSaver to be a lower risk product due to the requirement to have an IRD number and its long term nature. However, there are some risks which advisers have to consider around withdrawal times (hardship, first home and at retirement) as well as self-employed customers who are more likely to have unusual cash flows such as lump sum investments.

Risk rating: Medium–high

Delivery channel for products and services

Most REs (80%) onboard new customers face-to-face which lowers anonymity and therefore reduces the ML/TF risks. Robo-advice is a factor which could significantly change the way advice is delivered.

Risk rating: Low

Customer types

Financial advisers' customers are often high-net-worth individuals. The data shows that trust and other legal arrangements represent about 5% of customers. This seems quite low, given the number of trusts established in New Zealand.

Only 5% of REs told us they have PEP customers. This is lower than we expected from international guidance material but in line with the low number of non-resident customers.

Risk rating: Medium–high

Financial advisers

Country risk

Customers in this sector are based mainly in New Zealand, with only 2% being non-residents. These appear to be mostly New Zealanders who moved offshore and who have chosen to retain their financial affairs with their New Zealand based adviser. These offshore customers appear to be concentrated in a number of firms who have specialised in servicing offshore customers.

Information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: Low

Institutions dealt with

Financial advisers generally invest through licensed fund managers, NZX-brokers and investment platforms based in New Zealand.

Risk rating: Low

Rating: Medium–low

Managed investment scheme(MIS) managers

MIS manager obligations are defined under the FMC Act and FMC Regulations. Only MIS managers issuing to retail investors require a licence under the FMC Act. The sector has currently around $100 billion of funds under management.

87
In the sector

1.8m
Customers

33 million
Transactions

19
Average number of transactions per customer

$2,500
Average transaction value

$85billion
Value of transactions

34 STR

$223,000
Average value per STR

16%
REs onboard their customers face-to-face

2%
Customers are trusts or other legal arrangements

2%
Non-resident customers

13%
REs with PEP customers

17% Manual | 5% Electronic
78% Both manual & electronic
Transaction monitoring by REs

The numbers reflect only the MIS managers we supervise. A number of larger MIS managers are also banks who are supervised for anti-money laundering and countering financing of terrorism by the Reserve Bank of New Zealand.

Managed investment scheme (MIS) managers

Introduction

There are currently 66 MIS managers licensed to offer funds to retail investors. Both retail and wholesale MIS managers are REs.

A MIS manager pools money from a number of investors who rely on the investment expertise of the scheme manager. These schemes can be structured in different ways, and may invest in a wide range of investments.

They can be open-ended (offered continuously) or close-ended (more equity-like).

Examples include:

- **Open-ended** – Open-ended unit trusts, KiwiSaver, superannuation, workplace savings schemes, and other schemes that invest in relatively liquid assets.
- **Closed-ended** – Forestry partnerships and property syndicates that invest in a single asset class.

The population is dominated by a few large entities, particularly in the unit trust and KiwiSaver categories. It should be noted however that some of the larger MIS managers providing KiwiSaver are registered banks. These entities are supervised by the Reserve Bank of New Zealand and, therefore, not included in this analysis.

MIS managers have filed 34 STRs with an average value of $223,000. We see this both as a reflection of the higher sophistication of REs as well as the way in which STRs are attributed. Sectors that have a higher degree of REs operating across multiple sectors are more likely to have an increased share of the overall STR filings. Whilst it could also be a sign of a higher ML/TF risk, we are of the view that it is more likely attributable to the amount of resources MIS managers have dedicated to their Anti-money laundering and countering financing of terrorism efforts and the access to worldwide databases this provides.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and where appropriate file a STR.

These are:

- Buying and selling units in quick succession that do not align with customers' stated investment purpose
- Large KiwiSaver contributions shortly before reaching retirement age
- Lump sum payments which don't match the customer's profile
- Customer transfers KiwiSaver to another provider when asked for additional customer due diligence information
- Funds introduced from offshore
- Increase of KiwiSaver contributions, particularly lump-sum contributions out of alignment with known customer profile
- Spouse appears to be unaware of an account in their name
- Account in children's names (excluding KiwiSaver)
- Gifting of units
- Third party payments
- Holding a large portion of funds in long term cash portfolios/accounts and/or withdrawal prior to investment.

Managed investment scheme (MIS) managers

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	Asia-Pacific Funds Passport (when introduced).	No cash contributions accepted or no cash withdrawals permitted.
Products and services	Self-managed products. The products can be assigned.	Products with long lock in periods such as KiwiSaver or Private Equity Funds. Employer-offered schemes.
Delivery channel for products and services	Use of third party agents. Use of overseas intermediaries. Third party payments permitted.	Face-to-face onboarding.
Customer types	High-net worth customers. Foreign PEPs.	
Country risk	Customer based in, controlled by or owned by persons in high-risk jurisdictions.	
Institutions dealt with	Unregulated institutions.	
Overall risk	The ML/TF risk of the sector has been rated as medium-low. Funds where no lock in period applies offer high liquidity which makes them attractive to money launderers. The sector has a low number of trust and other legal arrangements. It also has a low number of non-resident customers.	

Managed investment scheme (MIS) managers

Sector specific risks

Nature, size and complexity of business

The sector had $85 billion worth of transactions between June 2015 and 2016. This sector's RE population is split into wholesale and retail funds, with MIS managers requiring an FMC Act licence when offering funds to retail investors.

REs indicate an average of 19 transactions per customer with an average value $2,500 per transaction. We expect these numbers to be somewhat distorted due to KiwiSaver funds which have ongoing contributions throughout the year.

A large proportion of REs monitor transactions both manually and electronically (78%) and the remainder of REs indicate a purely manual monitoring of transactions (17%). We expect this to be REs offering niche products with a low number of transactions.

Risk rating: Medium–low

Products and services

The sector ranges from REs offering multiple products to single product providers. Similarly the services offered by the sector vary greatly from fund managers with sales staff to wholesale fund managers who only engage with one or two customers. Most funds are easy to buy and sell and offer daily liquidity making them an attractive proposition for ML. This is in contrast with superannuation products such as KiwiSaver which is inaccessible to retirement age for customers (with exceptions for situations such as first home withdrawal and hardship claims).

Risk rating: Medium–low

Delivery channel for products and services

A surprisingly high number of MIS managers onboard customers face-to-face (16%). This could be due to REs also providing other services such as DIMS. From our industry knowledge, we understand MIS schemes to be sold mostly non-face-to-face.

Approximately 27% of REs onboard between half and all of their customers through domestic intermediaries. Only 1% of REs onboarding customers through the use of international intermediaries.

Risk rating: Medium–high

Managed investment scheme (MIS) managers

Customer types

REs have indicated a low number of trusts and other legal structures (2%) as well as a low number of non-resident customers (2%). What is of interest is 13% of REs in the sector report having foreign PEPs. Given the low number of non-resident customers we see this as a possible indicator of the sectors more sophisticated screening mechanisms compared to other sectors. Nevertheless PEPs present a higher risk for ML and we expect REs to reflect this in their dealings with these customers

Risk rating: Medium–low

Institutions dealt with

Fund managers mostly deal with other licensed entities, investment platform providers, custodians and registered New Zealand banks who all have their own AML processes.

Risk rating: Low

Country risk

The sector has just 2% non-resident customers. The top five countries are: Australia, US, UK, Canada and Singapore. Information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: Low

Rating: Medium–low

Peer-to-peer lending providers

Peer-to-peer lending providers offer intermediary services to arrange loans between borrowers and lenders, either private individuals or businesses. We licence peer-to-peer providers under the FMC Act.

7
In the sector

14,000
Customers

234,000
Transactions

17
Average number of transactions per customer

$2,000
Average transaction value

$491 million
Value of transactions

2
STR

$9,400
Average value per STR

0%
REs onboard their customers face-to-face

1%
Customers are trusts or other legal arrangements

0.2%
Non-resident customers

1 entity (20%)
REs with PEP customers

0% Manual | 17% Electronic

83%
Both manual & electronic

Transaction monitoring by REs

At the time of filing 5 entities were required to file an annual return and their data is reflected above.

Peer-to-peer lending providers

Introduction

Peer-to-peer lending is a new type of financial market service covered by the FMC Act. The FMC Act enables borrowers to raise up to $2 million in any 12 month period, without having to issue a product disclosure statement.

Currently there are seven licensed peer-to-peer platforms operating in New Zealand. They offer different types of lending such as: secured and unsecured, business or consumer lending. One platform has provided the majority of lending at the date of publication.

The business model of peer-to-peer REs is a simple 'self-service' online model. The information we gathered throughout the licensing process tells us these platforms are well resourced to ensure they meet their compliance obligations.

The sector has filed two STRs, with an average value of $9,400, in the last reporting period ended June 2016.

There are some risks of ML in this sector due to it being based online. Additionally the description of what the lending is used for, such as 'wedding', or 'holiday' can be difficult for REs to verify.

We see the risk of collusion by borrowers and lenders, for example through lending facilitated by the platform to legitimise sources of funds and cash payments changing hands between borrowers and lenders outside the platform. However, the amounts involved in this sector are relatively small at $2,000 on average per customer. This means it does not lend itself to laundering large sums of money.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and, where appropriate, file a STR.

These are:

- Two customers that have the same address/bank account who are on opposite ends of the transaction
- A loan is cancelled within seven days or multiple times within that seven-day period by a customer
- Customer with an excellent credit score seeks repeated loans which do not fit their profile
- Early repayments or repetitive early repayments of loans
- Cookies indicating customer with New Zealand address is arranging transactions from overseas
- Many customers signing up from one IP address.

Peer-to-peer lending providers

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	Lending growth higher than the RE's staffing availability to maintain good levels of compliance.	
Products and services	Third parties allowed to repay loans on behalf of customers.	
Delivery channel for products and services		
Customer types	PEPs.	
Country risk	Customer based in, controlled by or owned by persons in high-risk jurisdictions.	
Institutions dealt with	n/a	n/a
Overall risk	The ML/TF risk of the sector has been rated as medium-low. This rating is because there are small sums of money involved, few non-resident customers and a low number of trust and other legal arrangements.	

Peer-to-peer lending providers

Sector specific risks

Nature, size and complexity of business

REs are required to be licensed under the FMC Act. This provides good quality information of the activities within the sector and regulatory oversight. The sector has a relatively simple business model, matching lenders and borrowers, through an online based platform. REs in the sector are sufficiently well-resourced to carry out the activities that meet their compliance obligations.

In line with its online business model, 17% of REs carried out electronic transaction monitoring only, the remaining 83% use a mixture of online and manual monitoring. Electronic transaction monitoring provides the advantage of monitoring volume and patterns. However, they do depend on continual improvement of the monitoring parameters which represents a risk to REs if these are not reviewed on a regular basis.

Risk rating: Medium–low

Products and services

This sector is involved in peer-to-peer lending services only. We see two types of 'products' in the sector:

- Lending through the platform
- Borrowing through the platform.

At this stage the average transaction value is relatively low at $2,000 per customer which reduces the likelihood of large sums of money to be laundered through the platforms undetected.

Risk rating: Medium–low

Delivery channel for products and services

This sector, being entirely based around online delivery, only accepts customers via non face-to-face methods. From the information provided by the sector we understand that one RE utilises domestic intermediaries to accept new customers. Online onboarding increases anonymity and is therefore rated a higher risk for ML/TF.

Risk rating: Medium–high

Customer types

Peer-to-peer lenders appear to cater mostly to domestic individuals with non-resident customers being a mere 0.2%. Trust and other legal arrangements, which are considered higher risk for ML, make up about 1% of the customers. One RE has a foreign PEP, which is surprising, given the low number of non-resident customers.

Risk rating: Low

Peer-to-peer lending providers

Country risk

The sector has a low exposure to non-resident customers at only 0.2%. Countries in this sector include: China, Fiji, Norway, United Kingdom and the United States of America.

Information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media.

Risk rating: Low

Institutions dealt with

Not applicable.

Rating: Medium–Low

Discretionary investment management services (DIMS)

DIMS is a financial product where a customer authorises an adviser or a firm to carry out investment decisions, in line with a pre-agreed strategy and risk profile, without the requirement to consult the customer on individual transactions.

There are two types of DIMS:

Non-personalised DIMS, not a legal term, resembles a fund management arrangement. However, the customer directly owns the assets, rather than through the structure of a fund. Customers are managed in line with the strategy and risk profile set by the provider.

Personalised DIMS focuses on there being a unique investment strategy per investor using the service.

57
In the sector

960,000
Customers

33 million
Transactions

34
Average number of transactions per customer

$5,000
Average transaction value

$174 billion
Value of transactions

13
STR

$1,226,000
Average value per STR

70%
REs onboard their customers face-to-face

2%
Customers are trusts or other legal arrangements

2%
Non-resident customers

11%
REs with PEP customers

5% Manual | 12% Electronic
83% Both manual & electronic
Transaction monitoring by REs

There are currently 53 FMC Act DIMS licence holders and 9 FA Act licence holders. Not all FA Act licence holders would be REs for the purposes of the Act, due to being employed by a RE.

Discretionary investment management services (DIMS)

Introduction

The regulation of DIMS was formalised with the introduction of DIMS licensing (FMC Act) and reduced authorisation (FA Act) in December 2015. DIMS can be provided under the FA Act and the FMC Act. If a person is authorised to provide DIMS under the FA Act, they can only provide personalised DIMS under that authorisation. If a person has a DIMS licence under the FMC Act, they can provide any form of DIMS.

DIMS providers differ significantly in size and range from large REs with significant funds under management to individual AFAs who sought authorisation to retain a number of established customers.

A number of DIMS providers also hold licences in other areas such as MIS, are brokers or employ a large number of financial advisers who sell DIMS. This overlap is reflected in the data, because the regulatory reporting requires REs to provide information on their entire business rather than separating out activities. However, the data does provide valuable insights into REs' business that provide DIMS and, therefore, their exposure to ML/TF risks.

What all DIMS providers have in common is that the nature of the service is to make decisions on behalf of a customer in line with an agreed strategy. This requires in-depth knowledge of either a customer's personal and financial situation and is generally set out to be a long-term relationship. The requirement for customers to disclose detailed information to an adviser, as well as the involved process to initially enter into a DIMS arrangement, means DIMS appears unlikely to be an attractive proposition for money launderers.

The sector has filed 13 STRs with a value of $1,226,000 on average. The high value of STRs filed is a reflection of the significant portfolio values managed by DIMS providers.

Whilst the sector has been given a medium-low rating there are factors which would significantly increase a REs risk rating, such as a high number of PEPs. These factors appear to be specific to REs, rather than industry wide, so we classed them as factors increasing the risk, rather than increasing the sector risk as a whole.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and, where appropriate, file a STR.

These are:

- A customer requests a transfer of assets or account closure shortly after entering into a DIMS facility
- Lump sum additions out of alignment with known source of income
- Withdrawals are made shortly after deposits.
- A customer who seems to be indifferent to losses
- A new customer who introduces other high-net-worth customers shortly after onboarding
- No logical geographic connection between where the customer lives and where the adviser is based.

Discretionary investment management services (DIMS)

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business		Small customer base personally known to adviser.
Products and services	Commission based adviser remuneration. Non-personalised DIMS.	
Delivery channel for products and services	Non face-to-face onboarding of customers.	
Customer types	Foreign PEPs. High-net-worth individuals.	
Country risk	Customer based in, controlled by or owned by persons in high-risk jurisdictions.	
Institutions dealt with		
Overall risk	The ML/TF risk of the sector has been rated as medium-low. This is mainly due to the ease of entering and exiting the product which is similar to a MIS. Additions and withdrawals of funds that do not align with the known wealth of the customer should be able to be identified quickly and a STR raised accordingly.	

Discretionary investment management services (DIMS)

Sector specific risks

Nature, size and complexity of business

The transaction volumes of $174 billion for the last year in the DIMS sector are significant in value. This equates to an average of 34 transactions per customer with a value of approximately $5,000 each. From the nature of the DIMS sector, we interpret these numbers as transactions within the service rather than customers entering and exiting a DIMS facility. We consider this reduces the ML/TF risks of the sector as the customer has no control over these transactions.

Only around 12% of REs rely solely on electronic transaction monitoring. The 5% of REs carrying out manual transaction monitoring only are assumed to be at the lower end of the DIMS scale, as manual monitoring would be difficult for larger providers.

Risk rating: Medium–high

Products and services

DIMS can be offered either closely resembling a managed fund or as a personalised service which will take into account a customer's preferences and personal circumstances. We think DIMS services that do not involve a personal adviser pose a higher risk of ML because there is less requirement for customers to interact with an actual adviser.

DIMS products are generally comprised of products with high liquidity such as shares, funds and bonds. To exit the service a customer can either ask for liquidation of the underlying assets or request a transfer of assets to his/her name.

We expect unusual lump sums or withdrawals would quickly raise suspicion by advisers due to the detailed information about the customer's financial situation on hand from the account opening stage.

Risk rating: Medium–low

Delivery channel for products and service

A large proportion of REs (70%) onboard customers via face-to-face methods. This is in line with the expectation that advisers need to know their customers circumstances in detail to be able to offer a DIMS service we see. Only 7% of REs onboard their customers using mainly non-face-to-face methods such as electronic, phone, post, which could be a reflection of entities engaged in other sectors.

Risk rating: Low

Discretionary investment management services (DIMS)

Customer types

The sector has a low rate of trust and other legal arrangements of around 2%. The number of REs who reported having foreign PEPs as customers at 11% appears to be very high considering the customer base is predominantly made up of domestic customers. We do not believe this is typical of REs in this sector. Therefore we have not included it as a risk which increases the overall sector risk.

Risk rating: Low

Country risk

As set out above, the number of non-resident customers is relatively low at 2%. The top countries REs are exposed to are: Australia, United States of America, United Kingdom, Canada and Singapore.

Information on country risk ratings can be found from a number of information sources including the Financial Action Taskforce, Transparency International, the United Nations Office on Drugs and Crime and open source media

Risk rating: Low

Institutions dealt with

From information obtained during the licensing process we understand that DIMS providers deal with institutions largely based in New Zealand.

Risk rating: Low

Rating: Low

Licensed supervisors

Supervisors, formerly known as securities trustees are subject to a licensing and monitoring regime under the Financial Markets Supervisors Act 2011 (formerly known as the Securities Trustees and Statutory Supervisors Act 2011). There are currently six licensed supervisors.

6
In the sector

360,000
Customers

16 million
Transactions

45
Average number of transactions per customer

$5,900
Average transaction value

$96 billion
Value of transactions

0
STR

n/a
Average value per STR

57%
REs onboard their customers face-to-face

6%
Customers are trusts or other legal arrangements

1%
Non-resident customers

14%
REs with PEP customers

43% Manual | 0% Electronic
57% Both manual & electronic
Transaction monitoring by REs

Licensed supervisors

Introduction

There are currently six licensed supervisors. A supervisor can be licensed to provide supervision of one, a combination of, or all of the following:

- Debt Securities
- Managed investment schemes (including KiwiSaver schemes)
- Retirement villages.

Supervisors are generally not involved in the day-to-day activities of debt issuers and managed investment schemes, as the name suggests their role is to supervise the activities of their customers.

We rate the supervisory activity as low risk for being subject to ML, as there is no discretion for supervisors to act outside their supervisory role and because of the insights supervisors have into their customer's affairs.

Historically, Statutory Trustee Companies were supervised by us and trust and company service providers were supervised by the Department of Internal Affairs. Changes to the Act for non-anti-money laundering and countering financing of terrorism purposes. One of those changes was removing trustee companies as a sector, effectively replacing it with licensed supervisors. However, all trustee companies supervised by the FMA for anti-money laundering and countering financing of terrorism purposes are now licensed supervisors.

The trustee industry has seen some consolidation in the last years with companies now forming either larger entities or group structures. Trustee companies offer their customers a wide scope of service, in addition to administering estates for which they have initially been set up. This ranges from ad-hoc transactions to managing their customer's financial affairs entirely.

Some of the activities carried out are:

- Broking and custody
- Financial advice (often provided by AFAs)
- Establishing trusts and other legal arrangements.

Our analysis focuses on the activities of a licensed supervisor. Activities carried out by REs outside of their supervisory function must be considered by referring to the relevant sectors in this report, such as broking and custody, financial advice and where applicable, the SRAs of one of the other anti-money laundering and countering financing of terrorism supervisors. For example, the Trust and Company Service Providers risk assessment published by the Department of Internal Affairs.

Red flags

The following red flags are a starting point for REs to consider in their risk assessment and compliance programme. It should not be seen as an exhaustive list of unusual customer activity. Red flags should trigger a RE to investigate its customer activities further, and, where appropriate, file a STR.

Debt security

- Raised debt funds are co-mingled with other funds for investment. There is either no reasonable explanation or there are concerns about the source of the equity funding
- Debt is retired, with no reasonable explanation for the source of the new funding
- Debt issuer is making unusually high profits relative to its peers or historical profit levels
- Retirement village occupational right agreement deposits
- An individual purchases an occupational right agreement for a retirement village and departs soon after. There is no reasonable explanation and the individual is prepared to accept the lower capital repayment sum.

MIS

- Unusual related party transactions
- Investments appear to be made outside of a fund's mandate.

Licensed supervisors

Inherent risk summary

Variable	Factors increasing risk	Factors decreasing risk
Nature, size and complexity of business	Insufficient compliance resources. Related party transactions between trust structures, companies and other entities. Poor record keeping.	Information technology systems that are fit for purpose.
Products and services	Escrow accounts. MIS custody.	
Delivery channel for products and services		
Customer types		
Country risk		
Institutions dealt with		
Overall risk	We rate licensed supervisors who only provide supervisory functions as low risk. There is no discretion for supervisors to act outside their supervisory role and they are not involved in the day-to-day activities of the schemes they supervise.	

Licensed supervisors

Sector specific risks

Nature, size and complexity of business

With the introduction of FMC Act licensing requirements, new obligations have been placed on supervisors. This has the potential to put some strain on both human capital and infrastructure, which increases the risk of ML due to human or system errors.

Risk rating: Medium–low

Products and services

There are two main products/services offered by licensed supervisors which are:

- Acting as a supervisor
- MIS custody

As set out earlier, we rate the supervisory activity as low risk due to the nature of the activity. Supervisors who also act as a MIS custodian have a heightened risk profile which is in line with the broking and custody sector for this activity. REs who offer MIS custody should refer to the section to ensure a full understanding of their ML risks.

Risk rating: Low

Delivery channel for products and service

Onboarding of customers is carried out face-to-face and is part of commercial negotiations with each MIS manager.

Risk rating: Low

Customer types

Customers of REs in this sector, MIS managers, are REs in their own right. The risk rating of medium-low is a reflection of the risk rating assigned to this sector.

Risk rating: Low

Institutions dealt with

There is no indication that REs in this sector interact or deal with institutions in high-risk jurisdictions or with low anti-money laundering and countering financing of terrorism standards.

Risk rating: Low

Issuers of securities

Issuers of securities captured by the Act are considered to be 'participating in securities issues and the provision of financial services related to those issues'.

Before the FMC Act the types of securities covered by the sector were:

- Equity securities
- Debt securities
- Interests in unit trusts
- Interests in KiwiSaver Scheme
- Interests in contributory mortgages
- Participatory securities such as bloodstock schemes
- Interests in registered superannuation schemes and life insurance policies.

With the introduction of the FMC Act, all types of securities mentioned above have been included in other sectors except for issuers of debt securities that are not banks, and not non-bank deposit takers and also provide financial services in relation to the debt securities issued.

In the data submitted by REs we note that a large number of entities indicated to be issuers who would no longer be classed in this category as they were captured in other sectors. We have therefore not provided a breakdown of the data.

Risk rating: Low

Appendix 1: Glossary

AFA	Authorised Financial Adviser
AML/CFT	Anti-Money Laundering and Countering Financing of Terrorism
Custodian regulation	Financial Advisers (Custodians of FMCA Financial Products) Regulations 2014
DI	Derivatives issuer
DIMS	Discretionary Investment Management Service
FA Act	Financial Advisers Act 2008
FMC Act	Financial Markets Conduct Act 2013
FMC Regulations	Financial Markets Conduct Regulations 2014
MIS Manager	Managed Investment Scheme Manager
ML/TF	Money Laundering and Terrorism Financing
NRA	National Risk Assessment
PEP	Politically exposed person
QFE	Qualifying Financial Entity
RE	Reporting entity for the purposes of the Anti-Money Laundering and Countering of Financing of Terrorism Act
RA	Risk Assessment
SRA	Sector Risk Assessment
SRA 2011	The FMA's Sector Risk Assessment prepared in 2011
STR	Suspicious Transaction Report
The Act	Anti-Money Laundering and Countering of Financing of Terrorism Act 2009

FMA
FINANCIAL MARKETS AUTHORITY
TE MANA TATAI HOKOHOKO - NEW ZEALAND

AUCKLAND

Level 5, Ernst & Young Building
2 Takutai Square, Britomart
PO Box 106 672, Auckland 1143

Phone: +64 9 300 0400 Fax: +64 9 300 0499

WELLINGTON

Level 2, 1 Grey Street
PO Box 1179, Wellington 6140

Phone: +64 4 472 9830 Fax: +64 4 472 8076