Regulatory Impact Statement (RIS):

The supervisory structure of the anti-money laundering and countering financing of terrorism system

Purpose of Document	
Decision sought:	Agreement to create a single supervisor for reporting entities that are regulated under the Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) Act 2009. Agreement that the Department of Internal Affairs be the single supervisor.
Advising agencies:	Ministry of Justice
Proposing Ministers:	Hon Nicole McKee, Associate Minister of Justice
Date finalised:	26 September 2024

Problem Definition

Supervisory powers under the AML/CFT Act 2009 (the Act) are split between three supervisors. Each supervisor is a different type of legal entity and each has a different source of funding. This fragmentation has led to a regulatory system that does not support an integrated approach to risk-based regulation across our economy.

The split supervisory model negatively affects the provision of advice to reporting entities and has not been effective in minimising the impacts of AML/CFT obligations on business.

Effective risk-based regulation for AML/CFT is also essential to meeting international standards and avoiding counter-measures being put in place against New Zealand.

Executive Summary

The AML/CFT Act 2009 (the Act) plays a pivotal role in New Zealand's effort to combat serious and organised crime as well as terrorism by making it harder for illicit financial activity to occur. Where undetected, money laundering enables and incentivises offending that impacts the wellbeing of our communities and threatens our international reputation.

Three supervisors are currently empowered under the Act. The duties of each supervisor are the same but relate to different sectors of 'reporting entities'. Each supervisor must:

- assess risks across its reporting entities;
- provide guidance on how its reporting entities should meet AML/CFT obligations;
- monitor compliance of its reporting entities in meeting their obligations; and
- investigate and act where obligations are not met.

Each supervisor is a different type of legal entity and each has a different source of funding. Two of the supervisors are legally independent from the Crown and operate with a great deal of autonomy. This fragmentation has led to a regulatory system that does not support an integrated approach to risk-based regulation across our economy.

Criminals are taking an increasingly sophisticated approach to the laundering of money. The risk this presents New Zealand will increase as criminal groups take advantage of new digital technologies. Mitigations, and guidance on meeting obligations, must continue to be

updated in response to this changing environment. This will require the system to move even further towards risk-based supervision, rather than additional prescription, in the Act.

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An ineffective AML/CFT regime will also impose unnecessary costs on domestic businesses and consumers. Some compliance requirements are inconsistent or duplicative. Guidance does not necessarily allow for risk-differentiated implementation of obligations. Opportunities, such as those provided by digital identity and open banking, will not be taken advantage of to improve competition and other consumer outcomes.

This RIS considers different options for structural change to our supervisory model. There has been a substantial amount of public and industry consultation on the issues raised in this RIS and how they might be resolved. The options developed following extensive public consultation and targeted engagement with industry representatives included:

- empowering an oversight committee to direct the regulatory work programme;
- introducing a new entity to direct resource use by the current supervisors;
- reducing the number of supervisors from three to two; and
- implementing a single supervisor model.

The preferred option is a single supervisor model. The changes are consistent with the approach already taken in Australia and international movement towards consolidated AML/CFT supervisors in the United Kingdom and other jurisdictions.

After considering the entities currently involved in the regulatory system, we recommend the Department of Internal Affairs be the sole supervisor for AML/CFT. This will maximise anticipated benefits and minimise transition costs and risks.

Limitations and Constraints on Analysis

Consultation with industry did not include the identity/location of a single supervisor.

Transition costs have not been assessed in detail.

The proximity to our next mutual evaluation by FATF in 2028 limits the time available for additional analysis and consultation to better inform decision-making in respect of legislative and funding changes. Changes must be in effect by 2026 to be considered in the 2028 review as a demonstrable improvement.

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FMA and the RBNZ do not support the recommendations of this RIS and their comments are included in section 2(5) of this paper.

Responsible Manager(s) (completed by relevant manager)

Rajesh Chhana

Deputy Secretary - Policy

Ministry of Justice

26 September 2024

Quality Assurance (completed by QA panel)

Reviewing Agency:	Ministry of Justice
Panel Assessment & Comment:	**Document meets RIS quality assurance criteria** A Regulatory Impact Analysis Quality Assurance Panel from the Ministry of Justice reviewed the Regulatory Impact Statements for the supervisory structure and the funding model for the AML and CFT system. The Panel also reviewed the associated Stage 1 Cost Recovery Impact Statement. The Panel considers that the information and analysis *meets* quality assurance criteria. The Impact Statements are clear, comprehensive and make good use of the available evidence to build a convincing case. The Panel noted there were some limitations on consultation about the options for both the supervisor model and the funding model. However, consultation was undertaken on the broad approach and, within the constraints clearly outlined in the Impact Statements, the analysis can be relied on for decision-making. • All documents appear to be complete and have a clear problem definition. • The analysis is extremely thorough and the conclusions are supported by evidence or sound logic. Efforts have been made to address uncertainty. • All three documents are extremely technical and can be difficult to follow. However, this reflects the nature of the subject matter and the authors have attempted to address it to the extent possible. • There were some limitations on consultation about the options for both the supervisor model and the funding model. However, good consultation was undertaken on some options as well as the broad approach.

Acronyms used in this paper

ACT	The AML/CFT Act 2009
AML/CFT	Anti-Money Laundering and Countering the Financing of Terrorism
APG	Asia/Pacific Group on Money Laundering
AML/CFT SUPERVISORS	The Department of Internal Affairs, the Financial Markets Authority, and the Reserve Bank of New Zealand, are the entities which regulate reporting entities covered by the Act
DIA	The Department of Internal Affairs
DNFBPS	Designated Non-Financial Businesses and Professions
FATF	Financial Action Task Force (intergovernmental AML/CFT body)
FATF RECOMMENDATIONS / STANDARDS	The international standards on combatting money laundering and the financing of terrorism and proliferation
FIS	Financial Institutions
FIU	New Zealand Police Financial Intelligence Unit
FMA	The Financial Markets Authority
GREY LISTING	Subjected to enhanced supervision by FATF member countries
MER	Mutual Evaluation Review (undertaken by the FATF)
MBIE	Ministry of Business, Innovation, and Employment
MFAT	Ministry of Foreign Affairs and Trade
ML/TF	Money Laundering/Financing Terrorism
MOJ	Ministry of Justice
NCC	National Coordination Committee established under the Act
PF	Proliferation Financing
PHASE 2 REPORTING ENTITIES	Additional entities that became subject to the Act over a period from 2015 to 2017, all reporting to DIA.
PTR	Prescribed Transaction Report
RIS	Regulatory Impact Statement
RBNZ	The Reserve Bank of New Zealand
SAR	Suspicious Activity Report
STATUTORY REVIEW	2022 Statutory Review of the AML/CFT Act 2009
TCSP	Trust and Company Service Provider
TFS	Targeted Financial Sanctions
VASPS	Virtual Asset Service Providers

Section 1: Diagnosing the policy problem

1) What is the context behind the policy problem and how is the status quo expected to develop?

Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT)

1. Money laundering enables and incentivises offending that impacts the health and wellbeing of New Zealand communities and threatens New Zealand's international reputation. Further, while the risk of large-scale terrorism financing in New Zealand is low, the consequences of lone actors self-raising funds can be devastating.

2. The AML/CFT system plays a pivotal role in detecting and deterring ML/TF and as such plays a key role in New Zealand's effort to combat serious and organised crime as well as terrorism by making it harder for illicit financial activity to occur.

3. AML/CFT surveillance occurs to ensure that industry is providing the necessary financial intelligence to law enforcement to enable detection of ML/TF, and that the controls industry implement are a sufficient deterrence of ML/TF. Effective supervision links equally to industry and the criminal justice system. Supervisors also facilitate industry compliance with AML/CFT obligations through the provision of intelligence on risks and guidance on the requirements of the regime.

4. The AML/CFT system is mostly set out in the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act). The Act is intended to be an inherently risk-based regime, in that efforts by government and businesses should be prioritised to areas of highest risk. The purposes of the Act are outlined in section 3 to:

   a) detect and deter money laundering and the financing of terrorism,

   b) 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 (FATF), and

   c) contribute to public confidence in the financial system.

The 'split supervisor' model used for AML/CFT in New Zealand

5. Different models were considered in the process of developing the Act. It was determined that using government agencies with existing regulatory relationships with reporting sectors was the best approach in the New Zealand context. This was seen to be cost effective and would allow supervisors to leverage the existing knowledge and relationships agencies had developed through their prudential or conduct regimes.

6. That analysis led to the establishment of three AML/CFT supervisors. The Department of Internal Affairs (DIA), Financial Markets Authority (FMA), and Reserve Bank of New Zealand (RBNZ) are empowered as AML/CFT supervisors under Sections 131 and 132 of the Act. The legal functions of each are set out to be to:

a) monitor and assess the level of risk of money laundering and the financing of terrorism across all of the reporting entities that it supervises;

b) monitor the reporting entities that it supervises for compliance with this Act and regulations, and for this purpose to develop and implement a supervisory programme;

c) provide guidance to the reporting entities it supervises in order to assist those entities to comply with this Act and regulations;

d) investigate the reporting entities it supervises and enforce compliance with this Act and regulations; and

e) co-operate through the AML/CFT co-ordination committee (or any other mechanism that may be appropriate) with domestic and international counterparts to ensure the consistent, effective, and efficient implementation of this Act.

7. The FMA and RBNZ both have specialist financial sector regulatory knowledge and experience. They use information from their prudential, conduct, and licensing regimes to aid in setting the risk status of individual reporting entities. Intelligence and assessments within FMA and RBNZ are shared between teams that interact with the same entities. These benefits are outlined in more detail in Annex A.

Table 1: The Split Supervisor Model

AML/CFT Supervisor	Reporting Entities – Q1 2024
Reserve Bank of New Zealand	27 Registered Banks, 14 NBDT, 4 Life Insurers, 19 Designated Business Group members.
Financial Markets Authority	66 providers of client money or property services, 3 Crowd Funding Providers, 13 Derivative Issuers, 47 DIMS Providers, 451 Financial Advisors, 147 Fund Managers, 109 Issuers of Securities, 7 Peer to Peer Lenders, 5 Trustee Licensed Supervisor, 136 other REs.
Department of Internal Affairs	Over 5,300 REs across 22 sectors.

The approach to resourcing supervisory functions has varied

8. DIA, FMA, and RBNZ each have dedicated AML/CFT resourcing/team for supervision while their other AML/CFT functions (operational policy, intelligence, and enforcement) are carried out by teams also working in other regulatory systems (such as gambling within DIA and prudential within RBNZ).

9. RBNZ and FMA's dedicated AML/CFT supervision teams were established in 2021 and 2023 respectively. Prior to this date both entities employed specialist AML/CFT resources in shared teams and developed their overall resource to support their AML/CFT supervision.

10. DIA set up a fully integrated AML/CFT function in 2017 when its supervision was extended to Designated Non-Financial Businesses and Professions (DNFBPs). DIA had no pre-existing regulatory relationship with most of those reporting entities. Crown funding was appropriated for supervision, policy, intelligence, and engagements teams. This model changed in 2024 to aggregate some support functions with other regulatory areas to take advantage of specialisations and realise efficiencies.

11. Each supervisor also has different funding sources. The corresponding Funding Model RIS sets out their funding sources in more detail; however, in summary:

a) DIA is wholly Crown funded for its AML/CFT function,

b) FMA as a whole is approximately 83% funded through a levy that is not specifically for AML/CFT and 17% Crown funded, and

c) RBNZ is wholly funded by a five-year funding agreement with the Minister of Finance.

The risk-based supervision of AML/CFT obligations

AML/CFT supervisors are expected to apply a risk-based approach

12. A core component of the AML/CFT regime is that it needs to enable effective supervision and regulation of businesses. The supervision and monitoring of businesses should address and mitigate ML/TF risks in the economy, in part by promptly identifying, remedying, and sanctioning (where appropriate) businesses that do not adequately comply with their obligations.

13. A risk-based approach requires a regulator to allocate their resources to the issues that pose the greatest risk to the achievement of their legislative objectives. Risk-based frameworks require a regulator to use their judgement to apply different types of intervention activities (e.g. education or enforcement action) to different situations and to promptly address any significant changes or elevation in risks. This requires a regulator to have a good understanding of their sector(s) and the entities within it.

14. Elements of a supervisory work programme include:

    a) gathering sufficient intelligence to inform a risk-based approach at strategic, operational, and tactical levels;

    b) developing supervisory systems and processes;

    c) both offsite and onsite monitoring of their reporting entities;

    d) investigating non-compliance and taking enforcement action as appropriate; and

    e) legal support for the above.

15. There is also an expectation that supervisors will support policy-related issues and undertake industry engagement that is broader than guidance on interpretation of the Act.

FATF has expectations of what good risk-based supervision should look like

16. The FATF definition of 'risk-based supervision' involves implementation of a sound risk assessment system that enables the identification, measurement, control and monitoring of ML/TF risks, as well as a risk-based supervisory approach that enables timely supervisory intervention.

17. More specifically, FATF requires supervisory actors to:

    a) Develop and maintain a good understanding of ML/TF risks at the sector as well as entity level, based on an assessment of inherent risks and quality of mitigation measures, and informed by national ML/TF risk assessment;

    b) Develop and implement a strategy that effectively directs supervisory focus to higher or emerging ML/TF risks while ensuring that there are appropriate strategies in place to address lower risks effectively and efficiently without impacting unnecessarily on access to and usage of financial services;

    c) Positively influences entities' behaviour by ensuring they have effective AML/CFT policies in place and where issues are identified, providing targeted guidance and feedback, directing and/or overseeing remedial actions and exercising enforcement powers in a dissuasive and proportionate manner;

d) Monitor the evolving risk environment and stay agile to identify emerging risks and respond promptly;

e) Be equipped with the expertise, powers, discretion, and tools needed and adequately resourced to perform their functions; and

f) Coordinate with other competent domestic authorities including intelligence, law enforcement, and other supervisory agencies as well as foreign counterparts by sharing information, prioritising risks, and carrying out joint supervisory activities.

There is an expectation of cooperation and alignment amongst AML/CFT entities

18. The administration, application, and enforcement of the Act involves six agencies:

a) Ministry of Justice (MoJ) is responsible for administration of the Act. The role of the Ministry is set out in Section 149 and includes advising the Minister of Justice as to whether any changes should be made to the regime.

b) The three supervisors as set out above.

c) New Zealand Police is responsible for a variety of financial intelligence functions under the Act (set out in Section 142) and powers (set out in Section 143), including receiving Suspicious Activity Reports (SARs) and disseminating financial intelligence.

d) The Crown also separately funds the Financial Intelligence Unit (FIU in NZ Police) to co-operate with the supervisors, MoJ, New Zealand Customs Service (Customs) and any other relevant agency to help ensure the effective implementation of the requirements under this Act and regulations.

e) Customs does not explicitly have its functions outlined in the Act, but it is responsible for managing and reporting movements of cash across New Zealand's borders.

19. The three supervisors are amongst the members of the National Coordination Committee (NCC), a body established under Section 150 of the Act. Section 151 of the Act outlines:

> The role of the AML/CFT co-ordination committee is to ensure that the necessary connections between the AML/CFT supervisors, the Commissioner, and other agencies are made in order to ensure the consistent, effective, and efficient operation of the AML/CFT regulatory system.

20. Section 152 continues with the functions of the NCC being to:

a) facilitate necessary information flows between the AML/CFT supervisors, the Commissioner, and other agencies involved in the operation of the AML/CFT regulatory system:

b) facilitate the production and dissemination of information on the risks of money-laundering offences and the financing of terrorism in order to give advice and make decisions on AML/CFT requirements and the risk-based implementation of those requirements:

c) facilitate co-operation amongst AML/CFT supervisors and consultation with other agencies in the development of AML/CFT policies and legislation:

d) facilitate consistent and co-ordinated approaches to the development and dissemination of AML/CFT guidance materials and training initiatives by AML/CFT supervisors and the Commissioner:

e) facilitate good practice and consistent approaches to AML/CFT supervision between the AML/CFT supervisors and the Commissioner: and

f) provide a forum for examining any operational or policy issues that have implications for the effectiveness or efficiency of the AML/CFT regulatory system.

The 2021 FATF Mutual Evaluation Report (MER) and 2022 Statutory Review

21. New Zealand is a member of the FATF, which is the global money laundering and terrorism financing watchdog. This inter-governmental body has produced a set of standards that all countries are expected to apply when establishing their AML/CFT regimes, known as the FATF Recommendations.

22. New Zealand underwent an assessment by the FATF between 2020-21, known as a Mutual Evaluation, which assessed the extent of our compliance with the FATF Recommendations - as well as the extent to which the regime was effective. The FATF MER considered the period between 2015 to 2020.

23. A comprehensive Statutory Review of the AML/CFT regime was then undertaken over 2021 to 2022.[1] The Statutory Review considered the period between 2017 to 2021.

24. The ongoing relevancy of the recommendations of the Statutory Review (and need to implement them) was recently highlighted by the Commerce Commission in its study of competition in personal banking services.[2]

AML/CFT is working in a rapidly changing and challenging environment

25. S9(2)(f)(iv)

[1] Ministry of Justice (2022) *Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009*.

[2] Commerce Commission. *Personal banking services*, Final Competition Report 20 August 2024. Page 295.

27. To summarise, it is being seen globally that ML/TF/PF is becoming more sophisticated and therefore harder to detect, deter, and ultimately prevent. The role and outputs of the AML/CFT system will need to grow and adapt to this change.

28. In addition, the banking and financial sector is also undergoing a period of rapid change globally with the introduction of new forms of payments (such as the digital currency) and open banking. Financial technology (FinTech) will require higher levels of reliance by its users being placed on other parties meeting their AML/CFT obligations.

29. Ongoing FinTech advances will also erode traditional boundaries between reporting sectors. Barriers to international investment also continue to reduce. Organised criminal groups are considered early adopters of digital technology to aid their money laundering across national borders.

30. New opportunities for reduced AML/CFT burden are also emerging, such as increasing use of digital identities which brings significant opportunities for more effective and efficient identity verification (a core part of an AML/CFT compliance program).

31. It is likely that supervisors will need to provide more support to business and will need to build and maintain a specialist AML/CFT workforce to manage new and emerging risks and opportunities. VASPs are an example of emerging risk that the system will need to better resource itself to manage.

32. The MoJ considers that the AML/CFT system will need to extend further into the application of risk-based regulation in response to these changing AML/CFT needs.

2) What is the policy problem or opportunity?

Issues in respect of AML/CFT supervision have been well-traversed

33. As noted above, New Zealand's AML/CFT system has recently undergone two thorough reviews, the:

    a) FATF Mutual Evaluation of New Zealand over 2020-2021 (the MER), and

    b) 2022 Statutory Review of the AML/CFT System, led by the Ministry of Justice in collaboration with DIA and NZ Police.

34. The MER found that New Zealand's efforts to combat money laundering and terrorist financing were delivering good results, but more was needing to be done on improving the availability of beneficial ownership information, strengthening supervision, and on the implementation of additional legislation for Targeted Financial Sanctions (TFS) and Proliferation Financing (PF).

35. Mutual Evaluations do not consider how the structure of the AML/CFT regime affects its findings – it is left to each country to decide its regulatory model. For supervision as an output, New Zealand was given a rating of moderate (on a scale of low, moderate, substantial, or high). This rating is defined as meaning 'major improvements' are needed. MER findings and recommendations for supervision are outlined in Annex B.

36. The need for improved supervisory effectiveness is common across reviewed jurisdictions, and many of our international partners are making significant reform and investment in their AML/CFT regimes because of identified weaknesses.

37. S9(2)(d)

S9(2)(d)

38. New Zealand will next be assessed by FATF in 2028/2029. S9(2)(d)

Supervisors have not been set up to take a systematic approach to AML/CFT

39. The Statutory Review aligned with the MER recommendations and additionally found that there was not enough support for businesses to implement their obligations. This was particularly the case for smaller and lower-risk businesses who, with less resources and/or less familiarity with AML/CFT, are more reliant on supervisory support. It also found that some AML/CFT compliance costs were not necessary.

40. Supervision was identified in the Statutory Review as a critical factor underlying both the issues outlined by FATF and its own findings. Although the supervisory functions set out in paragraph 6 align with the FATF definition of risk-based supervision set out in paragraph 16, they were found to focus supervisors on their individual sectors.

41. We consider that the explicit statutory requirements of each supervisor to manage their own reporting entities necessarily takes precedence over the activity required to optimise the system as a whole. The Statutory Review found that:

> the current model can sometimes result in inconsistencies of approaches, interpretation, and guidance between the three supervisors. While some inconsistency may be justified due to the inherent differences in the nature of the sectors being supervised, submitters indicated that there are some instances (e.g., prescribed transaction reporting) where the inconsistency is unwarranted. [SR 349]

42. The NCC is empowered to facilitate good practice and consistent approaches to supervision, however the Statutory Review noted:

> this power has not been sufficient to overcome situations where the AML/CFT supervisors are applying differing interpretations of the Act with some sectors being required to comply (or not) with an obligation by virtue of who they have as an AML/CFT supervisor. [SR 349]

43. Changes to form, function, and funding have also been undertaken by each supervisor in isolation from regime partners. In addition there is:

> no cross-agency workforce plan, and inconsistent pay bands between supervisors, meaning that the AML/CFT supervisors can sometimes compete with one another (and the private sector) for the same people. [SR 348]

44. The legal and institutional independence from Ministers of the FMA and RBNZ makes smoothing over differences of opinion more problematic.

Supervisory resource allocation occurs within individual supervisors

45. Similarly, there is no entity with the authority (or practical ability) to reallocate resources from one part of the supervisory system to another. Funding comes from different sources and is not fungible or readily transferable.

46. S9(2)(d)

> this structure can make it difficult to ensure that supervisory resources are allocated in accordance with a risk-based approach, as there is no ability to direct how resources are

> allocated between AML/CFT supervisors... can result in some medium risk sectors being supervised more intensively than higher risk entities. [SR 348]

The current supervisory structure is also inefficient…

47. In a split model, each agency needs to ensure adequate communication channels both between its supervisors and support functions, and also between supervisory teams in different agencies. This extends to the output of support teams, for instance legal guidance needs to be consistent across the agencies if supervisors are to agree a common approach to implementing an obligation.

48. The Statutory Review found that: "having multiple AML/CFT supervisors necessarily results in duplication of corporate functions and requires additional resource to be used for coordination". [SR 349]

49. As a result, regulatory outputs that require coordination become higher cost than alternative outputs a supervisor can internalise, especially where there is disagreement on legislative interpretation or level of delegation of powers.

50. In the introductory paragraphs of its report, the Select Committee on the original AML/CFT Bill went outside its remit to express concern about intelligence and supervisory arrangements:

> we note that Australia has a single supervisory agency, the Australian Transactions Reports and Analysis Centre (AUSTRAC). We think this arrangement is preferable to the situation applying in New Zealand where four entities, the Reserve Bank of New Zealand, the Securities Commission, the Department of Internal Affairs, and Police are all involved. Consideration should be given to consolidating supervision arrangements in one body which has a close relationship with AUSTRAC. The proposed arrangement seems administratively untidy.[3]

…with AML/CFT activity further dispersed within each supervisor

51. Each supervisor is expected to allocate adequate resources to address or mitigate ML/FT risks identified in their reporting sectors. At the same time, the level of priority given to AML/CFT can change relative to other areas within a supervisor without a corresponding change in the AML/CFT risk environment.

52. The Statutory Review found that:

> AML/CFT supervision is resourced within existing agency priorities, which may make it difficult for AML/CFT supervisory functions to be given enough resource as they compete with other functions, including prudential supervision. [SR, 348]

53. There is no requirement for dedicated AML/CFT resources within each supervisor. As outlined above, supervisory teams share support functions with other parts of their respective agencies. Effective regulation necessitates subject matter knowledge across different elements of the regime. For instance, policy teams need to understand supervisory operations. Supervisors need to keep abreast of policy and standards development by the FATF.

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[3] *Anti-Money Laundering and Countering Financing of Terrorism Bill*, as reported from the Foreign Affairs, Defence and Trade Committee on 14 September 2009: https://www.legislation.govt.nz/bill/government/2009/0046/19.0/096be8ed804522d5.pdf

Issues have persisted since the Statutory Review was completed….

54. In its final report on competition in retail banking, the Commerce Commission noted the considerable overlap of its own findings with those of the Statutory Review, and the lack of progress on its recommendations.[4] Competition in banking is unlikely to increase due to digital innovation without improvement to the AML/CFT regime.

55. Since the Statutory Review was concluded in July 2022 (tabled in Parliament November 2022), we have seen the impacts of our fragmented model continue. In particular:

    a) The Statutory Review made 30 operational recommendations, none of which have been completed. Consultation with the supervisors indicates disagreement with some of the recommendations and of the level of urgency to implement others. Recommendations requiring legislative change are being progressed by MoJ.

    b) Some actions from the AML/CFT Strategy have not been undertaken or implemented, despite Cabinet agreement to the strategy in October 2019 and sign-off by NCC.

    c) Guidance on the 2023 regulations was not commenced until 6 months after the first tranche of regulations had come into effect (July 2023) and not completed until one month before the second tranche came into effect (June 2024).

    d) Industry feedback on the 2024 guidance was that it was too late (requiring supervisors to implement an "assisted compliance" period), and that it did not meet the needs of non-bank entities.

    e) A significant difference between the FMA and DIA in interpreting the scope of an exemption, which led to delays to its renewal, as well as requiring a legal opinion from Crown Law.

    f) Reduced AML/CFT resources for DIA, despite the increased levels of risk identified in respect of VASPs and remitters.

56. Resourcing constraints have contributed to these issues. There is however a continued underlying inability to resolve differences of opinion or commit/deliver a system-wide work programme. For instance, there is disagreement:

    a) Between the supervisors and MoJ, and amongst supervisors, on the extent to which primary legislation and secondary/tertiary instruments should be used to define aspects of the supervisory approach to AML/CFT and resolve ambiguity.[5]

    b) S9(2)(d)

…and MoJ expects these issues to worsen under the status quo

57. MoJ considers that the status quo will lead to:

    a) Increasing fragmentation of guidance and approaches to supervision as the operating environment for the supervisors increases in complexity and speed of change.

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[4] Commerce Commission. *Personal banking services*, Final Competition Report 20 August 2024. Page 295.

[5] In particular what constitutes significant policy and what is mechanics or desirable flexibility as discussed in Legislation Design and Advisory Committee (2021) *Legislation Guidelines*. Crown Law advice has been required and was not able to bridge ongoing differences in opinion.

b) Inadequate supervision of new high-risk areas, as the level of resources allocated to an issue will depend upon who the responsible supervisor is, or potentially fall into supervisory gaps.

c) Relatively lower risk areas receiving higher than warranted levels of supervisory resource due to separate prioritisation/resource allocation by each supervisor.

d) Reporting entities not receiving required guidance, at all or in sufficient detail for new risks and opportunities, or at the boundaries of current areas of supervision.

e) Costs of compliance remaining unnecessarily high as new opportunities are not quickly adopted into the regime (as supervisors will not update Codes of Practice at the pace at which new opportunities emerge).

f) Ongoing inability of the regime to provide the levels of coordination expected under the Act in areas outside direct supervision (such as an AML/CFT strategy).

58. The issues arising from the speed of change in ML/TF environment are likely to be compounded by:

a) increasing requirements of FATF standards and

b) decrease in time for our regulatory actors to respond to a MER before the subsequent evaluation (down to every 7 years from the current 10).

S9(2)(d)

59. The assessment for a country being Grey-listed due to failing technical criteria required under FATF standards is now more difficult. FATF previously required 20 of 40 criteria to be fully met. FATF now require 26 of 40 evaluation criteria to be fully met for a country to avoid being Grey-listed and having counter measures put in place against it.

60. Finally, supervisory effectiveness is now considered in not one but two of the eleven FATF “immediate outcomes”, one for the reporting entities and supervision of financial institutions and another for the reporting entities and supervision of DNFBPs.

3) What objectives are sought in relation to the policy problem?

1) The AML/CFT system is effective at detecting and deterring ML/TF by applying risk-based supervision across the economy

61. Risk-based supervision is applied consistently across every part of our economy. Refer paragraph 13 for a description of risk-based supervision, including resource-use.

62. Emerging opportunities for AML/CFT are developed and implemented in a timely way.

2) Reporting entities are supported to meet their AML/CFT obligations

63. “Responsive regulation” sets out a model for regulatory effectiveness and efficiency. Under this model, regulatory responses are calibrated to regulated entity’s attitude to compliance.[6]

[6] First set out comprehensively in Ayres, I. and Braithwaite, J. (1992) *Responsive Regulation: Transcending the Deregulation Debate, Oxford University Press* but revised and updated many times since then.

64. The model sets out that most entities in a regulated sector want to comply but may need guidance and support to do so. As the behaviour and actions of an increasingly small number of regulated entities deviate away from compliance, regulatory responses become more coercive and interventionist. There is a deterrent effect in enforcement, but the costs of intervention mean it is in many cases less effective given the majority of regulated entities want to comply.

65. Unless there are unusual circumstances, proactive measures taken by the supervisor to promote regulatory success therefore tend to have the greatest impact on positive system outcomes. This model suggests the AML/CFT system in New Zealand has placed relatively more focus on detection and deterrence, and less on capability and capacity building. We have therefore set an objective that will help rebalance this.

3) Efficiencies for both reporting entities and government are maximised

66. The delivery of risk-based supervision for AML/CFT is as efficient as possible so that the level of 'regulatory service' is maximised within the funding envelope available.

67. The cost of compliance to a reporting entity is proportional to the risk created by it (and its customers). Most reporting entities should be able to understand and appropriately manage their obligations without external assurance (consultants and lawyers).

Section 2: Deciding upon an option to address the policy problem

1) Table 2: Criteria for Option Assessment

Criteria	What this means
The AML/CFT system is **effective** and **enduring**	**Effective** - The extent to which the option enables AML/CFT supervision to be risk-based across the economy through: • Optimising allocation of supervision resources across all activities supporting or giving rise to ML/FT. • Providing supervisory input into system level work (AML/CFT strategy, guidance, codes of practice, work programmes etc). • Connections to be built with other regulatory systems mitigating emerging related risks or creating opportunities. • Swift resolution of inconsistencies experienced by reporting entities. **Enduring -** The extent to which supervision across the regime will be able to adapt as the risks of ML/TF change (and change quicker) and as new opportunities for AML/CFT emerge. Including: • System-wide regulatory skills to be built and maintained. • Work programme able to change without amending legislation. • Swift consideration and response to MER findings and recommendations on supervision and related issues.
Efficient for both industry and government	The extent to which the option reduces cost of compliance, reducing duplication or creating other procedural efficiencies for industry, or creates efficiencies or reduces the cost of coordination for government. This would include: • Advice and guidance is timely, sufficiently detailed, and promotes voluntary compliance by reporting entities. • Lowest feasible coordination costs while undertaking risk-based supervision and compliance. • Less reliance by reporting entities on external advice to assure compliance with their AML/CFT obligations (lawyers/consultants). • No regulatory arbitrage. Maintain current efficiencies/links in the system and minimise regulatory touchpoints for reporting entities. Minimise the extent of required government and/or levy funding while still achieving the purpose of the regime.
Feasibility	Is available funding able to meet expected costs, is there time to implement changes before our next MER?

2) What scope will options be considered within?

Options used in this RIS were developed as part of the Statutory Review

68. MoJ asked for public submissions in 2021 on whether there was support for the status quo supervisory model, or whether a change in structure should be considered (refer Annex C). Many submissions were received, while some expressed support for the status quo, all submissions noted issues with the split model that were consistent with this RIS.

69. If the model were to change, most submitters supported having a single supervisor responsible for all entities. Submitters considered this model would make the regime more consistent, clear, and efficient and it would lead to higher quality supervision and guidance. A significant proviso for this was that the supervisor be sufficiently resourced.

70. Alternatively, some submitters suggested retaining three supervisors but having an additional agency responsible for oversight, administration, and interpretation of the Act (and functions of the supervisors) and developing joint supervisory plans. Others suggested narrowing supervision to two agencies rather than three.

71. After additional workshops on this issue with an industry advisory group, six potential arrangements were identified for structural changes that might address the issues identified in the review (including enhancing the status quo), specifically:

    a) creating an oversight body;

    b) creating a central administration body;

    c) centralising administration and policy in one agency;

    d) combining policy, administration, and the FIU in one agency;

    e) having a single supervisor; and

    f) combining supervision and the FIU in one agency.

72. These six options were then used as the basis for further engagement with an industry advisory group in April 2022. During these follow-on workshops, industry participants refined three models that they considered could provide a range of benefits over the status quo. Consistent with feedback about the complexity of the regime, the private sector's preferences leaned towards models that simplified and brought together different functions of the regime. Those four options are used in this RIS.

73. As well as considering different structural arrangements, this engagement included the consideration of how different resourcing models and private sector engagement could feed into each structure. While resourcing and sector input could be progressed without changing supervisory arrangements, the greatest impact was felt to be likely to come from aligned decisions.

Resourcing and industry involvement

74. We are progressing the Funding Model RIS in parallel to this RIS, and that includes an option focussed on industry involvement in setting and resourcing the wider AML/CFT regulatory work programme.

75. Regardless of decisions on regime funding model, resources will and should be constrained. The options in this RIS are therefore considered in terms of efficiency and effectiveness irrespective of the amount or source of funding for supervision.

Options considered out of scope

Changing the functions of the supervisors

76. Structural change could also be undertaken with the current split model. This could occur through a substantive redrafting of the powers and obligations of the supervisors under the Act. New requirements could include the development and regular updating of a joint supervisory strategy and work programme, with particular attention to issues or activity that cross supervisory boundaries.

77. This option was ruled out for four reasons:

    a) Compelling the FMA and RBNZ is inconsistent with their overarching model of regulatory independence. The level of 'voluntary' coordination/agreement required to implement a consistent risk-based regulatory model for AML/CFT across our economy will continue to inhibit its effectiveness and efficiency.

    b) It would still require an entity or body empowered to resolve differences of opinion.

    c) The different legal forms of the supervisors and their governance models limit the ability to efficiently move resources between them to give effect to a joint work programme across the economy, or for any other body to make this decision.

    d) The level of fragmentation in AML/CFT activity, contributing to capacity and capability issues, would remain. Economies of scope in AML/CFT activity by separate regulators would remain lesser than economies of scale with deeper change.

Setting up processes to manage issues of coordination within the NCC

78. An interim solution was also considered and recommended by the Statutory Review. Recommendation 22 was for the exploration of options to ensure that the NCC is able to resolve issues of inconsistency and decide how the law should be applied given its statutory responsibility of facilitating good practices and consistent approaches to AML/CFT supervision (section 152(e)).

79. While this option would, in the short term, allow the NCC to best work to its mandate under section 152 of the Act, this option does not address the fundamental challenges faced by the NCC in not having a legal (or accepted) mandate to resolve issues.

80. Rather, this relies on each agency in the NCC agreeing to a particular process on how to manage such issues, and then adhering to it when it is their opinion that is 'overruled' or leadership teams wish to reallocate resources to other areas within the agency.

81. There has been no progress made on this recommendation since the report was issued in 2022 and it is unlikely to progress.

Moving/consolidation supervision with other functions in the AML/CFT system

82. A popular model in several comparator countries is to have not only have a single supervisor, but to combine supervision with intelligence into a single standalone unit. Primary examples are AUSTRAC in Australia and FINTRAC in Canada. In some instances, policy roles are also combined into that entity.

83. In considering regime structure, the broader options consulted on over the course of the Statutory Review included combining other functions in the AML/CFT system with supervision. While the Statutory Review showed there were issues within all of the

functions in the system, it was also clear that most of the issues industry provided feedback on stemmed from supervision.

84. This RIS is therefore focussed on the supervisory system as the highest priority step. The options analysis notes which options bring opportunities for further consolidation if this was to be considered and agreed at a later date. There would be additional risks to implementing a supervisory option that also integrated intelligence within the timeframes we have available, that outweigh potential benefits given relatively less concern with it.

International models for AML/CFT supervision

85. In preparing this advice, MoJ officials engaged with colleagues overseas, including:

    1. Australia & Canada – a single supervisor, combined with intelligence functions. AUSTRAC in Australia and FINTRAC in Canada. Both making significant investments in improving their regimes, but no structural change, following their last FATF MERs.

    2. UK – a highly split model, with two supervisors for FIs and self-regulating bodies as supervisors for Designated Non-Financial Businesses and Professions (DNFBPs). This is currently going through consolidating of supervision following deficiencies in effectiveness identified in its last FATF MER.

    3. Chinese Taipei – a central administration agency model with a number of entities sitting under it. The effectiveness of the supervisory model is yet to be reviewed through a MER.

    4. Ireland – with a dual supervisory model, split between Financial Institutions (FIs) and DNFBPs. The model is considered substantially compliant with FATF standards.

3) What options are being considered?

86. The options considered were designed during the Statutory Review with industry and public sector engagement. The objectives for supervision (refer paragraphs 61 to 67) are to ensure:

    1. The AML/CFT system is effective at detecting and deterring ML/TF by applying risk-based supervision across the economy.

    2. Reporting entities are supported to meet their AML/CFT obligations.

    3. Efficiencies for both reporting entities and government are maximised.

Option One – *Status Quo*

87. The status quo is the current supervisory model of three AML/CFT supervisors – the FMA, RBNZ and DIA. Refer section 1(2) above for issues in respect of the status quo and Annex A for its benefits. Options analysis is of change compared to the status quo.

88. As outlined in paragraph 5 above, it was anticipated by MoJ in its advice on the AML/CFT Bill that combining AML/CFT with other regulatory touch points in a split supervisory model would be cost effective and leverage the existing knowledge and relationships of agencies. The intent was for combined teams within each supervisor that were more effective than the sum of their parts.

89. We now consider the intended benefits of the split model are outweighed by the coordination costs it creates and negative impact it has had on system-wide AML/CFT activity and prioritisation. There is a tension between moving further towards risk-based regulation to best give effect to the AML/CFT system, and the split supervisory model.

Option Two – Single AML/CFT supervisor

90. This option has just one AML/CFT supervisor for all reporting entities. This could be done through establishing a new entity, or moving all supervision into a single existing entity (whether currently a supervisor or not).

91. This option would meet the criteria set out in Table 2. A single supervisor would be making risk-based decisions in respect of all reporting sectors, and in any newly identified risk areas in the rest of the economy. Of particular importance, a single supervisor will be best placed to move resources/focus between reporting sectors as residual risks change. A common methodology would also be used to assess levels of inherent and mitigated risk for different reporting sectors and the entities within them.

92. A single supervisor would be able to deliver core regulatory work, like fit-for-purpose industry guidance and maintain the currency of that guidance as risks change and new opportunities arise. Differences of opinion in interpretation or application of the Act would be resolved 'in-house' to enable consistent interactions with reporting entities.

93. This would enable the single supervisor to readily adapt as the ML/TF environment changes; particularly as it is likely to have sufficient size/scale to establish dedicated AML/CFT teams in operational policy, intelligence, enforcement, and other support (e.g. legal and finance). AML/CFT will be their focus and these teams will develop and retain relevant specialism/expertise (capability) as well as providing dedicated capacity.

94. Lower coordination costs would also make a single supervisor more efficient in carrying out its regulatory functions, the savings of which could be applied to additional regulatory services or reduced costs (in line with the agreed work programme). There will similarly be lower coordination costs for other entities within the AML/CFT regime.

95. A single entity could establish information sharing mechanisms with other regulatory systems (like prudential within RBNZ), as DIA have done with The Financial Service Providers Register (FSPR). This is demonstrated overseas by AUSTRAC and FINTRAC. There will be an initial cost to establishing formal mechanisms, but once established they can be more systematic and effective in operation and reduce the potential for missed communication/opportunities, miscommunication, or disruption to information exchange as key personnel change.

96. There are multiple ways in which a single supervisor could be established: a new departmental agency, a branded unit within an existing agency; or amalgamating supervision within an existing agency (whether an existing supervisor or not).

97. This option could support consolidation of supervision with other functions in the AML/CFT system (such as intelligence) if this were to be considered and agreed in future. As noted in paragraph 69 above, industry workshops undertaken during the Statutory Review were generally supportive of options for regime structure which had more consolidation of functions. A single supervisor was one of the 'top three' options selected by industry as an alternative structure for the regime (another top three option also consolidated the FIU with the single supervisor - per AUSTRAC and FINTRAC).

98. Subsequent engagement by MoJ with the Industry Advisory Group suggests a single supervisor remains a strong preference with many in industry (particularly smaller to medium sized businesses, and DNFBPs).

99. In summary, this option would positively impact reporting entities, as it provides more support for them in meeting their AML/CFT obligations. It provides better risk-based

supervision across the economy, by enabling consistent and integrated risk assessment and response planning. It will enable the AML/CFT system to detect and deter ML/TF effectively and efficiently. This benefits society, as better detection and deterrence of ML/TF reduces the profitability of crime and disincentivises criminal activities by organised crime. Less criminal activity leads to proportionately fewer victims of crime.

Option Three – Central Administration Agency

100. This option would see the creation of a new entity that sits above the existing three supervisors. This new entity would be the central administration body for AML/CFT supervision: they would hire supervisors and second them into FMA/DIA/RBNZ (duration depending on their assignment and particular skill set).

101. The body could also produce guidance and other forms of advice/support for reporting entities, and resolve differences in interpretation (noting there would be limits to this). It could also be responsible for strategies and work programmes for supervision, and be the 'voice' of supervisors at the NCC, and to Ministers.

102. This option meets the criteria of providing risk-based supervision at a system level. However, in contrast to Option Two, this adds an additional entity into the system, making it inherently less efficient. There would be considerable coordination costs from the entity having to work with the three existing supervisors to work through resourcing (noting their different structures and governance mechanisms).

103. Although this option would address coordination and resource allocation issues, it does not address the broader issue of fragmentation and lack of focus in operational policy, intelligence, enforcement, and other support (e.g. legal and finance).

104. Assuming coordination and prioritisation issues were resolved, there would be a benefit to industry resulting from this model in terms of more effective guidance and potentially reduced compliance. The system would be able to adapt more effectively to a changing ML/FT environment and opportunities in the regulatory space, but not to the extent of Option Two and will likely be less enduring as a result.

105. It is unlikely this option would be feasible in the absence of additional Crown funding, or the introduction of a 'new' levy. There is unlikely to be efficiency savings able to be repurposed even if the system overall is more effective. Additional Crown funding would be inconsistent with cost-recovery principals as set out in the companion Funding Model RIS. At a minimum this option would require legislative changes to the funding mechanisms for RBNZ and FMA.

106. This option was one of the 'top three' identified by industry representatives during the Statutory Review. This option could also be used to allocate resources for the FIU.

Option Four – Shift of current split of supervisory responsibilities

107. This option would see two supervisors: one for DNFBPs, and one for FIs. This is the model used in Ireland.

108. This option would see an improvement in risk-based supervision and improved consistency in interpretation/application of supervision, as there are distinct differences in the risks between DNFBPs and FIs. However, this effect is limited since both DNFBPs and FIs are still (broadly) subject to the same obligations under the AML/CFT Act. There would still be a need for 'whole of system' products like guidance, codes of practice, workforce plans, and supervisory strategies.

109. There are also limits to the distinction in risk between FIs and DNFBPs. While there may be some cases requiring a different supervisory approach, this option has the potential for the supervisors to take different interpretations of the Act and approaches to supervision in similar circumstances. Methods and tools for risk assessment may also remain different and affect the accuracy of the resulting allocation of resources.

110. This option does reduce some of the inefficiency compared to the status quo, and will increase supervision effectiveness, but inefficiencies remain as there will still need to be coordination and agreement on key supervisory outputs like guidance and codes of practice. This cost of coordination will, similar to the status quo, incentivise individual supervisor work over system supervisor work. The level of independence of the remaining two supervisory entities may be an aggravating factor for potential cooperation.

111. This option does consolidate supervision to a degree, which industry showed support for in the Statutory Review, but this option was not one of industry's 'top three'. Reporting entities would likely see more risk-based supervision within their sector of DNFBP or FI respectively. There may be increased levels of support as the cost of coordination has reduced from coordinating 3 entities to 2, and the resourcing for supervision will be relatively more concentrated (potentially allowing for dedicated AML/CFT teams and higher levels of workforce specialisation).

112. The improvements to risk-based supervision at a system level, and reduced inefficiencies, should benefit society as (in line with Options Two and Three above) this should flow through to better tackling organised crime. Respective supervisors would need to set up information sharing mechanisms due to other regulatory splits in relation to financial institutions (currently across FMA and the RBNZ).

113. This option is unlikely to be able to support further consolidation with other AML/CFT functions. There will be additional coordination/transaction costs for other parts of the AML/CFT system in having two supervisors rather than a single supervisor.

114. The feasibility of this option depends upon whom the two supervisors are and any decision in respect of levy funding. RBNZ and DIA are the entities with the greatest regulatory roles in respect of FI and DNFBP respectively. The introduction of a levy would make DIA a possible option for DNFBP. It would be unnecessarily complex/costly to implement other options.

Option Five – Enhanced Powers for NCC

115. This option would enhance the current coordination function in the NCC, by providing the NCC with (in relation to supervision):

a) a specific AML/CFT appropriation to fund supervisory work;

b) legislative powers to direct allocation of resources within each supervisor; and

c) legislative powers to resolve any differences in interpretation or application of the Act.

116. This option is similar to Option 3 in terms of powers but does not set up a new body with those powers. It instead empowers the existing NCC.

117. A key difference is that the NCC would not be employing the supervisors – it would simply allocate funding for supervision to each supervisor. Taking a more involved role and having it deploy staff would effectively be setting up a new entity.

118. This option fundamentally changes the role of the NCC. The Act currently sets up the NCC to be a coordination body; it has no decision-making powers or funding to independently provide coordination and facilitation.

119. There is also an issue of whether the current members of the NCC are best placed to decide on the allocation of supervisory resource. In particular:

a) Whether members like Inland Revenue, the Ministry of Foreign Affairs and Trade, and MBIE should have power to decide allocation of supervisory resource, and

b) Whether effective system-level decisions will be taken if all three supervisors are involved in the decision-making of their own resource allocation.

120. It is not clear that this option will lead to improved resource allocation or effectiveness. It will draw upon and reallocate existing resources, without necessarily resolving the issues that have caused current differences of opinion amongst the supervisors or that are impeded joint work being undertaken in a timely or effective way.

121. In order to increase its prospects of success, this option would require a legislative mechanism to circumvent the level of independence deliberately instilled in both the RBNZ and the FMA. This would need to include a power to direct the use of staff and resources in a way that clearly cuts across the lines of accountability both within the entities and from each entity to their respective boards.

122. In the absence of increased Crown funding, it would also require change to the funding mechanisms for both the RBNZ and FMA. A new levy as outlined in the Funding Model RIS would resolve this issue.

123. This option was identified by industry representatives during the Statutory Review but was not considered by them to be a ‘top three’ candidate.

4) Table 3- How do the options compare to the status quo/counterfactual?

	Option One – *Status Quo*	Option Two – Single AML/CFT supervisor	Option Three – Central Administration Agency	Option Four – Two supervisors	Option Five – Enhanced Powers for NCC
Effective and **enduring**	0	++ A single supervisor would be making decisions for all reporting entities, and allocating resources to their best-assessed use to manage risks. System level supervisory decisions will be made in a unified management chain. More capable of coordinating with other stakeholders on supervisor strategy, work programme, industry guidance, codes of practice. Most likely to be dedicated AML/CFT teams in roles supporting supervision.	+ Essentially acts as a single supervisor, making all system level decisions. Less ability to control actual supervisory decisions (such as enforcement) given these would be taken by the supervisory agency, rather than the CAA.	+ Improved risk-based supervision with the two categories of FI and DNFBPs (and allocation of resource to risk within those categories), but still possible to have unnecessarily inconsistent approaches between the two. Challenges will remain in shifting resources between the two supervisors as risks between DNFBP and FI change. Marginally more likely to get some system level decisions, with only two entities needing to agree and prioritise rather than three.	- Limited ability for NCC to act as an effective decision maker for AML/CFT without legislative change to the RBNZ and FMA.

	Option One – *Status Quo*	Option Two – Single AML/CFT supervisor	Option Three – Central Administration Agency	Option Four – Two supervisors	Option Five – Enhanced Powers for NCC
Efficient for both industry and government	0	++ Single decision maker is the most efficient way to effectively apply risk-based AML/CFT regulation to industry. Some establishment costs to initially setting up information sharing mechanisms with other regulatory systems that are currently informally done within FMA and RBNZ. Formal mechanisms can be more efficient once established.	0 Efficiency in decision making on system level products such as guidance, code of practice and interpretation of the Act. Creates an additional entity in the AML/CFT regime that would have to undertake significant coordination with the existing three supervisors to put secondments into place. These balance each other out.	+ Some efficiencies from reducing from 3 supervisors to 2.	- Membership of NCC would need to be reconsidered in light of new powers and functions. May be a less efficient decision maker than the status quo.
Feasibility	0	0 Multiple options for form. Could be some establishment costs depending on form, but these could (potentially) be resolved through decisions taken on the corresponding Funding Model RIS.	0 Multiple options for form. Could be some establishment costs depending on form, but these could (potentially) be resolved through decisions taken on the corresponding funding model RIS.	- Dependant on funding model and which two entities are selected.	-- Inconsistent with funding model and statutory form (and independence) of RBNZ and FMA.
Overall assessment	0	++	+	+	-

5) What option is likely to best address the problem, meet the policy objectives, and deliver the highest net benefits?

Option Two is our preferred model for AML/CFT supervision

124. Option Two is the only option that we are confident will address the problems identified with the status quo and meet our criteria for a national approach to risk-based supervision, support for reporting entities, and efficiency.

125. Option Two meets the efficiency criteria particularly well, both because it will eliminate many transaction/coordination costs within supervision, and that it will provide sufficient depth in required regulatory skills and expertise for AML/CFT.

126. This improved structure will also reduce or eliminate the inefficiencies currently seen in collaborative work between the AML/CFT supervisors and other parts of the AML/CFT system (such as with the FIU and MFAT).

127. While it is likely that information sharing agreements and coordination of on-site visits with the former supervisors will require some upfront cost to establish, it may also be more efficient in the long run than current informal arrangements. A formal mechanism endures when people move on and can lead to more 'systematic' engagement.

A single supervisor will strengthen a risk-based approach in the AML/CFT Act

128. Legislation for a risk-based approach by supervisors should set clear objectives and avoid complexity. The regulator develops a risk-based framework to give effect to those objectives as discussed in section 1(1) above. Setting detail in legislation removes flexibility and can inhibit an effective approach.[7]

129. A key design question for any regime is "where the detailed requirements get set" in the system. These choices have implications for certainty compared to flexibility, risk tolerance, and who ultimately decides what it is that is required to comply.[8]

130. The anticipated environment for ML/FT is one of increasing complexity and speed of change. This is better addressed in the supervisory programme than primary or secondary legislation as it will be risk-based and need to adapt. The split supervisory model is not able to effectively manage the level of delegation required (less rather than more prescription)intended for the system without requiring more prescription than MoJ considers desirable to address section 1(2) of this RIS.

Consolidating resources will result in better AML/CFT outcomes

131. The benefit of focussed supervisory resourcing is illustrated by the capabilities demonstrated by DIA since 2017/18:

a) regularly able to prioritise and produce sector-specific guidance;

b) system leadership beyond supervision (e.g. Statutory Review input);

c) participation in policy development and regulatory reform;

d) collaboration with other AML/CFT agencies on improving intelligence tools; and

e) active engagement with intergovernmental bodies and international peer-review.

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[7] OECD (2010) *Risk and Regulatory Policy: Improving the Governance of Risk*. Chapter 6.

[8] Legislation Design and Advisory Committee (2021) *Legislation Guidelines*. Introduction and chapter 6.

132. These capabilities were developed and applied despite DIA not having any prior regulatory touch points with many of its reporting entities. DIA has also shown that coordination and collaboration will occur with other regulatory functions in FMA/RBNZ as shown in the example below:

> DIA used information from the Financial Service Providers Register (FSPR, which is administered by MBIE) to identify unregistered remitters (alongside the FIU in terms of information sharing of relevant SARs).
>
> Although this work was recommended by the FATF and committed to in the AML/CFT National Strategy, the AML/CFT National Coordination Committee could not drive this work forward. It was progressed under the Transnational Organised Crime Strategy.
>
> As a result of this information sharing New Zealand received an upgrade by the FATF on a key technical compliance matter (the key material provided to the FATF was an information sharing agreement, with case studies on how it had been used).
>
> Since October 2022, DIA's intelligence team has utilised review of SARs, information received from other agencies and review of the FSPR, as well as tip offs and open-source inquiry more broadly to identify unregistered money remitters.
>
> Following investigations by DIA's operations team, five referrals were made to the FMA/MBIE and one to the NZ Police for investigation.
>
> The five referrals to FMA/MBIE were made as MBIE is the agency responsible for ensuring entities registered on the FSPR comply with registration requirements and the FMA in respect of Financial Service Provider Act requirements. The referral to the NZ Police was made due to significant potential criminality.

Options Three to Five do not provide sufficient improvement over the status quo

133. The objectives used to set the criteria for evaluating the options are almost an antonym for the problem definition. Status quo AML/CFT supervision is not sufficiently coordinated, resources and capabilities are unduly fragmented amongst other regulatory systems, and it has an inherently inflexible resourcing model due to the different structures of the three supervisors.

134. The split model that would remain under options Three, Four and Five would partially address the issue of fragmentation, and may have varying degrees of success in increasing coordination given the independence of the FMA and RBNZ. Effectiveness will increase from the status quo but there will likely be little impact on efficiency.

135. Option Three, if able to be implemented, is the only other option that could clearly address status quo constraints on resource allocation and substantially improve the development of industry guidance.

Statement by the RBNZ on the recommended changes to the supervisory model

136. The RBNZ does not agree with the problem statement and has concerns with the depth of the analysis completed. The RBNZ does not support the preferred option of making DIA the single supervisor.

137. The RBNZ is of the view that S9(2)(d) improvements to the legislative framework should be the priority, rather than costly and disruptive structural changes.

138. The RBNZ believes that the criticisms of supervisors are often caused by ambiguous and poorly drafted legislation rather than the multi-supervisory structure. Finally, the RBNZ's position is that a change in the structure of the supervisory model is not necessary in order to impose a levy.

Statement by the FMA on the recommended changes to the supervisory model

139. It is FMA's view that the work programme for AML/CFT legislative improvement should be prioritised over any changes to the structural model for supervision. It will also provide more time to consider and reflect the value offered by housing AML supervision of financial institutions within regulators that have specialist financial sector expertise.

MoJ response to RBNZ and FMA statements

140. MoJ has proposed legislative changes in the AML/CFT work programme. S9(2)(f)(iv) Consultation by MoJ with international peers has also informed the advice in this RIS.

141. The MoJ considers legislative improvement and structural changes to be mutually supportive rather than in tension with one another. A single supervisor will enable efficient and enduring legislative change to be implemented. A single supervisor will also allow for guidance and industry good activity to be accelerated ahead of the next MER. Transitional planning for the move to the single supervisor can mitigate any impacts on the proposed legislative improvement programme.

142. The improvements set out in this RIS S9(2)(d) they seek a risk-based model for AML/CFT supervision in New Zealand that is fit for purpose and will endure - without the need for repeated legislative or regulatory amendments as the risk environment across our economy changes.

143. While it is possible to implement a levy without structural change, the additional complexity inherent in doing this is outlined in the Funding Model RIS. The proposed changes to AML/CFT funding complement the proposed structural change.

6) Table 4 - What are the marginal costs and benefits of the option?

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Regulated groups	0	0	0
Regulators	Establishment/ transition costs	Less than $2 million one-off, no ongoing cost.	Similar consolidation of functions in forming the Ministry for Regulation saw a capital injection of $2m provided, which was not completely spent. Transition costs would differ depending on who became the single supervisor and in what form (these are outlined below in the implementation section), but reasonable to assume less than $2 million.
Others	N/A	0	
Total monetised costs		<$2m	Medium as a level of assumptions have been made and actual costs may vary considerably depending upon related Ministerial decisions.
Non-monetised costs	Key supervisor staff are lost, negative impact on attracting new staff	Medium	• Current supervisors may try to retain talented staff for use in other areas. • Potential recruits may be less willing to join a new regulator. • There may be a higher than usual level of staff turnover amongst supervisors during the transition period, people tend to not like change or uncertainty
	Disruption to current supervisory work programmes	Low	May be temporary impact on staff and process efficiency as transition occurs. A phased transition programme may mitigate disruption.
	Better regulation doesn't necessarily mean lower cost to reporting entities	Low	Any impact is likely to be outweighed by other change occurring as a result of work programme and resource allocation, rather than moving to a single model per sae.
Additional benefits of the preferred option compared to taking no action			
Regulated groups	More risk-based supervision	High	Medium certainty, based upon findings and recommendations of the Statutory Review and consistent with recent recommendations/observation by the Commerce Commission on personal banking. Better guidance and support from the supervisor. Issues are addressed and opportunities considered in a timely manner as they arise. The impact will vary between different reporting sectors and the entities within each as risk assessment and level of regulatory attention will change from the status quo. There will be less direct compliance cost for some, potentially more for others, but set on a risk-appropriate basis.

Affected groups	Comment	Impact	Evidence Certainty
Regulators	More risk-based supervision	High	More time/resource to do supervision rather than coordination, can build up specialist skills. Benefits evidenced when DIA had a dedicated supervision function.
Others	Society	Medium	S9(2)(d) Beter risk-based supervision will result in better detection and deterrence of ML/TF - reduce organised crime and TF and result in fewer victims of crime.
Total monetised benefits	N/A		
Non-monetised benefits		High	

Section 3: Delivering an option

1) How will the new arrangements be implemented?

144. The problem definition and objectives set in this RIS outline what a single supervisor needs to achieve. Any move to a single supervisor will require additional transition funding, as well as a reassessment of current funding arrangements.

145. The key implementation question is therefore what form the single supervisor should take. There are broadly three options for organisational form:

a) empower an existing AML/CFT entity/agency to be the single supervisor;

b) create a new departmental agency; or

c) create a new Crown entity.

146. Within each option there are alternatives for locating/monitoring the supervisor. Funding decisions will also affect the level of independence under each option. Empowering a new departmental agency or Crown entity both come with establishment, transitional, and ongoing costs that are likely to be higher than establishing a new business unit.

147. The summary of our delivery option analysis is presented in the table on the following page. The best option would be for a single supervisor to be legislated for within DIA as a new business unit. Moving the function to any other agency or a new entity would entail much greater transition costs and risks.

148. The next best option would be a departmental agency to deliver an integrated supervisor, providing it additional independence, and at reasonable cost. This could also be a longer-term option once the single supervisor has been established and our next MER completed.

Table 5 - New structure options for single AML/CFT Supervisor			
	Business unit	**Departmental agency**	**Crown entity**
Effective and enduring as sole AML/CFT supervisor	**0** Neutral as there is inherent flexibility in this model, but uncertainty over level of priority and security of ongoing/adequate funding.	**+** Positive as the sole focus of the entity will be AML/CFT, the model is flexible, and funding is more likely to be ring-fenced.	**0** S9(2)(d)
Transition risk	**+** Positive under recommended location of DIA. Main remaining risk is ability to retain sufficient financial sector expertise.	**0** Neutral, as this will take more time and effort, limiting ability to undertake positive actions ahead of next MER – but manageable if hosted by DIA.	**-** Negative, as ability to undertake positive change will be limited until new entity is established, and there will be much greater transfer of ongoing activity.
Transition cost	**+** Positive under recommended location of DIA. Relatively small teams to transition and no specialist systems identified at present.	**0** Neutral, as this will take more time and effort – but manageable if hosted by DIA.	**-** Negative, due to amount of activity to be transferred and new entity establishment costs.
Ongoing cost	**+** Positive under recommended location of DIA. Able to share management and support system costs.	**0** Neutral, as would require independent management structure and potentially more supporting systems.	**-** Negative, as this would require board, independent management structure, and maintenance of required supporting services.
Overall rating	**Positive**	**Neutral**	**Negative**

A) Establishing a business unit in an existing agency or entity in the AML/CFT system

149. The value in this option varies significantly dependent on which actor is empowered to be the sole AML/CFT supervisor. We have conducted suitability analysis across the primary actors in the AML/CFT regime: the three current supervisors, MoJ, NZ Police, MFAT, and MBIE. Annex E provides a summary of our analysis. We reviewed the following four criteria:

a) **Likelihood the actor would support AML/CFT as a prioritised function.** To be effective and efficient in maintaining a fit-for-purpose AML/CFT system there will likely need to be a dedicated AML/CFT function. This will become increasingly important as due to anticipated changes in the international AML/CFT system and its expansion to proliferation and targeted financial sanctions. This criterion was heavily weighted.

b) **Whether the actor operates other regulatory systems that would provide a beneficial connection to AML/CFT.** This was weighed less heavily given the experience of DIA that co-location isn't necessary to connect regulatory systems when it comes to information sharing, but could be beneficial for other types of connections such as ease of doing joint work.

c) **Experience as a risk-based supervisor.** Requires a different approach from rules-based, transactional, or market regulation.

d) **Ability to work across the AML/CFT system.** An effective AML/CFT supervisor will need to work in close collaboration with the FIU and MoJ to conduct operational supervisory work and provide input into policy and regulatory change.

150. In summary, our analysis is that DIA is the best option to stand-up a single AML/CFT supervisor. The other entities each had relative strengths but also weaknesses. Utilising the existing capabilities and capacity within DIA will also allow for a more rapid implementation of measures needed to achieve FATF Standards in our next evaluation and reduce regulatory burden on reporting entities.

151. Funding decisions can give a business unit an equivalent level of focus/independence to a departmental agency, but this would not automatically occur under the status-quo. There will however be a funding issue to address with any Crown agency being the sole supervisor as current funding from FMA/RBNZ is not specifically for AML/CFT and is not readily transferable. S9(2)(g)(i)

A business unit in DIA as the single supervisor

- *Experienced AML supervisor with lowest transition costs and risks*

152. As a Crown agency, DIA is well placed to work with the other agencies in the system. It also operates other regulatory systems which could link well with AML/CFT (most notably in digital identity).

153. DIA would have the lowest transitional costs and operational risks of any option as they already have established AML/CFT supervision functions, as well as offices with supporting functions in major urban centres (and a wider operational footprint in the rest of New Zealand).

154. The transition to DIA would include the movement over time of dedicated AML/CFT supervision staff from the FMA (4 FTE) and RBNZ (6 FTE) and the migration of related data, models, and any specialist systems/software not already present. No technical issues have been identified that would significantly impede either transfer.

155. The capacity of supporting services within DIA would need to be increased both during the period of transition, and on an ongoing basis to compensate for organisational support currently provided to supervision teams within FMA and RBNZ. There will also be parallel transitional costs at FMA and RBNZ to give effect to their end of the transfer of their respective supervisory functions.

156. As DIA is already a supervisor, they would be able to commence system-level work and engagement with industry on their regulatory approach, guidance, and other industry-good activity. This could deliver significant regulatory relief ahead of other options for a single supervisor. For example, with adequate resources DIA could begin the development of new Codes of Practice before the Act is amended.

157. It would be much more difficult under other options to allow this supervisory work to be undertaken in the short term. Most other options would likely entail a substantial pause (even after the Act is amended) as the new supervisor would be focused on transition and putting monitoring and enforcement capabilities in place.

158. The concern with DIA as single supervisor is that it may not be able to adequately prioritise AML/CFT in the absence of new/ringfenced funding. Under a status-quo shift/amalgamation the supervisory team would be highly reliant on shared support teams and AML/CFT would be underfunded (with RBNZ and FMA unable to transfer funding currently spent on their supervisory functions).

A business unit in MoJ as the single supervisor

- *Prioritised function, knowledge of and connection with criminal justice*

159. MoJ is well placed to jointly work with the other agencies in the system and is well connected into the criminal justice system. It can ensure the AML/CFT system remains focused on detecting and deterring ML/TF and maintaining/facilitating intelligence flows.

160. The key weakness of MoJ is that it does not have experience as a supervisor (for AML/CFT or equivalent regimes). Operational knowledge and experience would need to be bought into MoJ as the existing supervision is transferred from DIA, FMA, and RBNZ.

161. Compared with existing supervisors, there would be higher transition and establishment costs – greater movement of staff from DIA, RBNZ and FMA to MoJ. The risks of losing key personnel and supervisory knowledge are higher than in moving to a current supervisor or potentially with creating a new stand-alone entity. All relevant AML/CFT data, models, and specialist systems would need to be migrated to MoJ. MoJ would likely need to expand its office footprint (outside Wellington) to accommodate AML/CFT supervisory teams (likely renting shared public sector premises).

162. Without access to additional transitional funding, it would be difficult for MoJ to establish a sole supervisor function. Ongoing funding would also need to be resolved given the lack of dedicated AML/CFT funding at the RBNZ and FMA. Ongoing funding needs are likely to be higher than at an existing supervisor or other options considered.

A business unit in MBIE as the single supervisor

- *Knowledge of financial markets, a centre of regulatory policy and operations*

163. As with DIA and MoJ, MBIE is well placed to jointly work with the other agencies in the system. It operates a broad range of regulatory systems, some of which have links to AML/CFT (markets and consumer protection, intellectual property, and labour) and is the monitor of FMA and the Commerce Commission.

164. The operation of registers by MBIE, most notably through the Companies Office, and licensing roles will also be useful in the future, and MBIE will undertake the primary regulatory role for the forthcoming Consumer Data Right (commencing with open banking) which will become both a key risk and a key opportunity for AML.

165. MBIE would have lower transition costs than MoJ and more than DIA, due to their national footprint and regulatory capabilities but no AML/CFT supervisory staff or systems.

166. With MBIE as single supervisor support for AML will likely be distributed into its wider regulatory operations. The lower starting base of knowledge/expertise would put any regulatory relief measures at risk in the short to medium term while other aspects of the regime were stood-up. Under a status-quo shift/amalgamation the supervisory team would be highly reliant on shared support teams rapidly coming up to speed on AML/CFT.

B) Establish a new Departmental Agency to be the single supervisor

167. The problem definition for AML/CFT supervision in section 1(2) above included difficulties in coordination and implementation from financial intelligence, through supervision, to related strategy and policy development. If resolving these issues were prioritised over transitional risks and costs, a departmental agency would be the best implementation option. This dedicated function would also best enable supervision to be done in collaboration with policy and financial intelligence. The focus provided through a departmental agency will help it to adapt and change as ML/TF does.

168. PSC summarise the purpose of departmental agencies:

> In the New Zealand system, departmental agencies are used to reduce fragmentation and cost in the public sector. They are also used to improve system coherence and consolidation.[9]

A departmental agency is operationally independent from its host agency.

169. Annex D outlines our analysis of why AML/CFT supervision meets the criteria for being a departmental agency outlined by the PSC in their guidance note on departmental agencies. In particular the supervisor will be of a suitable size to be a departmental agency, S9(2)(d) merits a separate chief executive holding accountability to Ministers. The functions of AML/FT supervision are suited to being conducted by a departmental agency - ring fenced operations but not carried out by an entity separate from the legal Crown.

170. We looked across the spectrum of existing departmental agencies to identify whether AML/CFT supervision would be comparable to them in terms of size (expenditure and

[9] PSC *Background and objectives for departmental agencies* https://www.publicservice.govt.nz/guidance/supplementary-guidance-note-departmental-agencies, retrieved August 2024.

FTE) and functions. The analysis suggests that it is comparable in functions (particularly to that of NEMA) and would be a medium-sized departmental agency. Annex D also sets out this comparison in size to existing departmental agencies.

171. We expect that the AML/CFT system will need to grow over the coming years to be able to effectively detect and deter ML/TF and meet FATF standards and other international obligations. Cabinet will soon be asked to consider expanding the role of AML/CFT supervisors to include TFS and PF, as well as new regulatory functions such as a licensing system for high-risk sectors (VASPs, Trust and Company Service Providers, Remitters) and a Trust Registrar.

172. If all were agreed to, the size of the departmental agency would significantly increase. These requirements will soon be an accepted cost of the international finance and trade systems that New Zealand relies upon (and will need to accommodate).

173. The best location for the departmental agency to be hosted would depend on:

a) Connections a host provided into related regulatory regimes or policy areas;

b) Any difference amongst alternatives in their cost of hosting; and

c) Ability of the department to otherwise successfully fulfil its role as a supportive host.

C) Establish a new Crown Entity to be the single supervisor

174. Supervisors have a key function of making investigations, and where merited, taking enforcement action for non-compliance with the AML/CFT regime. Sanctions available under the regime include financial and criminal penalties and would also result in significant reputational damage for any parties sanctioned.

175. In New Zealand laws are set by Parliament and interpreted/applied by an independent judiciary. The potential for perceived political interference in the application of criminal laws in particular, has resulted in a general policy of supervisory and enforcement agencies having operational independence from the Government. The FMA's supervisory role for AML/CFT provides a good example of this in practice.

176. AML/CFT supervisors have seldom used their power to seek punitive penalties from the Courts for non-compliance, however, there remains a case to have such decision-making powers placed in an autonomous Crown entity to reduce the risk (perceived or actual) of Ministerial influence in decision making.

177. However, it is not considered essential for supervision to be undertaken by an independent Crown entity. AML/CFT again provides a good example with DIA, a Crown agency that has successfully bought multiple enforcement actions for non-compliance without any suggestion of Ministerial influence in that decision making.

178. The role of the supervisor in AML/CFT is also slightly anomalous in that it is focussed on the generation of information to be used for criminal intelligence elsewhere in the regime - and supervisors are in turn recipients of intelligence products. The economic activity that gives rise to ML/FT is also difficult to categorise due to the broad parts of the economy it encompasses.

179. The problem definition in section 1(2) above identified structural and practical issues with Crown entities being able to work very closely with Crown agencies – with MoJ and NZ Police being Crown agencies responsible for key AML/CFT regulatory functions. These issues can relate to the difference in decision-making of a Crown entity (with a

Board) as opposed to a Crown agency (responsible to a Minister). Aside from the additional complexity for a cohesive AML/CFT regime, we do not consider the establishment and ongoing cost of an independent board necessary.

180. If this option was progressed a decision would need to be made on who the Crown agency responsible for monitoring the Crown entity should be. Selecting a monitoring agency depends on a variety of factors, including the monitoring capability of the Crown agency, any specialised skills required, and where related policy functions sit.

2) How will the new arrangements be monitored, evaluated, and reviewed?

181. The Statutory Review identified a series of problems within the Act and wider system as well as opportunities to improve both. This RIS is a key part of the response to the Statutory Review.

182. The companion Funding Model RIS recommends that a 3-yearly National Strategy and regulatory work programme be developed and reported against. If adopted, we would expect that reporting will incorporate progress on issues and opportunities related to supervision.

183. The AML/CFT supervisor would also be subject to the accountability regime for a departmental agency or a Crown agent.

Annex A: Benefits of split supervisory model

Each of the current supervisors understand their respective reporting sectors and take a risk-based approach to detecting and mitigating ML/TF in their reporting entities.

FMA and RBA use information from their licensing and prudential and conduct systems to aid in setting the risk status of individual reporting entities. Intelligence and assessments are shared between teams that interact with the same entities.

An example from RBNZ is information about the functionality of bank risk committees who handle risks in respect of both prudential and AML/CFT regulatory regimes. Another is including prudential in preparations for on-site evaluations and in respect of the results.

FMA is able to undertake combined conduct/AML assessments of some of its reporting entities, creating an efficient monitoring approach and reducing burden.

As an indication of sector support for the split supervisory model, RBNZ has requested page 16 of the 2021 Statutory Review submission of the New Zealand Bankers Association (NZBA) be included in this RIS[10]:

> NZBA supports the current three supervisor model.
>
> NZBA considers that, overall, the current model with three supervisors works well. We make the following comments:
>
> - A challenge with this model is the time it can take for any triple branded publications to be released, given the complexities involved in all three supervisors 'signing off'. We note that this challenge may be mitigated if the decision-makers are changed from the Ministers to the Chief Executives of the Supervisors. We wonder if a further solution would be for guidance to address where there might be differences for different sectors, instead of all supervisors having to align on each point of the guidance.
> - There can sometimes be inconsistencies in approach and the standard different reporting entities are held to.
> - Supervisors may be under-resourced relative to the job they are expected to do, which we note was also reflected as part of the Financial Action Task Force (FATF) Mutual Evaluation Report.

DIA has not commented on the benefits of the current split supervisor model and is supportive of a single supervisor model.

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10 *Submission to the Ministry of Justice on the Review of the AML/CFT Act Consultation Document,*17 December 2021. To avoid misunderstanding we note the error in the submission on how triple banded guidance is agreed - Ministers have no role in issuing guidance.

Annex B: MER Recommendations and New Zealand response to date

Action Recommended in 2021	Progress made & remaining
New Zealand should address the shortcomings relating to licensing and registration of Financial Institutions (FIs) and Designated Non-Financial Businesses and Professions (DNFBPs). New Zealand should consider setting up a registration regime specific to the Act to ensure the completeness of reporting entities being supervised.	S9(2)(d)
Sanctions available to AML/CFT supervisors should be enhanced to ensure there is a sufficient range of proportionate and dissuasive sanctions. This should include increasing the range of pecuniary penalties for non-compliance and providing AML/CFT supervisors with powers to impose administrative sanctions.	
New Zealand should ensure the appropriate scope and depth of supervision for all the different categories of its supervisory population taking into account the sector-specific vulnerabilities, particularly the higher risks of the banking sector, and provide appropriate levels of resourcing to RBNZ.	
Supervisors should continue to deepen their understanding of the ML/TF risks within the sectors and institutions that they supervise by extending the data sources (e.g. SAR statistics) used for the risk assessments. DIA should also further develop its understanding of risks relating to Phase 2 reporting entities and VASPs.	
An appropriate agency or agencies should be given clear powers and mandate to supervise and enforce TFS obligations, including establishing clear supervisory expectations for preventive measures to avoid TFS contraventions (e.g. timing and frequency of customer and transaction screening) and conducting outreach to reporting entities about these expectations.	
Supervisors should continue to provide up-to-date guidance and feedback to reporting entities and ensure that this is timely and fit-for-purpose to enable them to apply AML/CFT measures, particularly with regard to PTR requirements. DIA should strengthen sharing of supervisory information with the licensing bodies of DNFBPs.	

Annex C: Key findings and recommendations on Supervision, in 2021 FATF MER

Key Findings

a) New Zealand has three AML/CFT supervisors (RBNZ, FMA and DIA). However, no agency has a mandate to supervise reporting entities for their implementation of TFS obligations.

Financial institutions and VASPs

b) New Zealand authorities generally apply effective licensing/registration measures, albeit some technical deficiencies were identified. Most FIs are required to register on the FSPR but current measures to ensure the completeness of the FSPR are insufficient. This is a particular issue for detecting unlicensed Money or Value Transfer Services (MVTS) providers.

c) The supervisors maintain an overall good understanding of the inherent ML/TF risk profiles of their respective sectors, through their Sector Risk Assessments, and individual FIs through their risk profiling models. The understanding of risks relating to VASPs is still developing. The scope and depth of supervision for each financial sector are broadly commensurate with their respective risk levels, except for the banking sector which is due in part to insufficient resources in RBNZ's AML/CFT supervision function.

d) The supervisors generally take remedial actions in an effective manner. However, the range of sanction powers available to the supervisors under the AML/CFT Act is inadequate, particularly the low range of pecuniary penalties available and the lack of administrative penalties. The sanctions that have been applied do not appear to be fully effective, proportionate and dissuasive.

e) FIs generally have good communication and working relationships with the supervisors. Training, outreach and the provision of feedback and guidance is generally strong, although some guidance could be updated. Case examples indicate that actions taken by supervisors have had a positive impact on AML/CFT compliance.

DNFBPs

f) Licensing bodies of DNFBPs apply licensing and screening measures to a varying degree. TCSPs, High Value Dealers (HVDs) and some accounting practices are not subject to licensing or registration requirements, which impacts DIA's ability to supervise these sectors.

g) DIA has a sound understanding of ML/TF risks of casinos and TCSPs. DIA is developing a more comprehensive understanding of ML/TF risk for the Phase 2 sectors, as the AML/CFT regime for these sectors is nascent.

h) DIA applies the same risk-based supervisory framework to DNFBPs as it does to FIs under its supervision. AML/CFT supervision for Phase 2 sectors is at an early stage. This has been conducted in an effective and well-managed way, but in the future DIA will need to progressively shift its emphasis from education towards supervision and enforcement.

Recommended Actions

a) New Zealand should address the shortcomings relating to licensing and registration of FIs and DNFBPs. New Zealand should consider setting up a registration regime specific to the AML/CFT Act to ensure the completeness of reporting entities being supervised.

b) Sanctions available to AML/CFT supervisors should be enhanced to ensure there is a sufficient range of proportionate and dissuasive sanctions. This should include increasing the range of pecuniary penalties for non-compliance and providing AML/CFT supervisors with powers to impose administrative sanctions.

c) New Zealand should ensure the appropriate scope and depth of supervision for all the different categories of its supervisory population taking into account the sector-specific vulnerabilities, particularly the higher risks of the banking sector, and provide appropriate levels of resourcing to RBNZ.

d) Supervisors should continue to deepen their understanding of the ML/TF risks within the sectors and institutions that they supervise by extending the data sources (e.g. SAR statistics) used for the risk assessments. DIA should also further develop its understanding of risks relating to Phase 2 reporting entities and VASPs.

e) An appropriate agency or agencies should be given clear powers and mandate to supervise and enforce TFS obligations, including establishing clear supervisory expectations for preventive measures to avoid TFS contraventions (e.g. timing and frequency of customer and transaction screening) and conducting outreach to reporting entities about these expectations.

f) Supervisors should continue to provide up-to-date guidance and feedback to reporting entities and ensure that this is timely and fit-for-purpose to enable them to apply AML/CFT measures, particularly with regard to PTR requirements. DIA should strengthen sharing of supervisory information with the licensing bodies of DNFBPs.

Annex C: Statutory Review Consultation on AML/CFT Supervision

The problems with system-level decision-making and guidance came through strongly in industry submissions to the Statutory Review

The Statutory Review conducted two rounds of industry consultation. The first round was a consultation document asking industry various questions about the system and how well it was functioning, to identify key issues to work through in more detail within the review.

One of the questions posed was:

> Is the AML/CFT supervisory model fit-for-purpose or should we consider changing it?

Overall, even submitters who supported the current model outlined issues and concerns with the current model that were consistent with the problem identification in this RIS (slow, leads to inconsistent approaches and regulatory arbitrage, is not sufficiently risk-based,

Those who did not support the current model additionally focussed on duplicated efforts, and insufficient collaboration between agencies supervising similar sectors resulting in different approaches being taken with respect to interpretation and regulatory action.

A less prevalent but nevertheless recurring theme was the identification of insufficient resourcing limiting the extent to which supervisors could engage with, and properly understand, their sectors or take a strategic approach to the regime.

Only a few responses raised the more positive view that the current model allowed each supervisor to focus on their specific sectors and build a better awareness of how their areas of responsibility operated. A small number of submitters thought the supervisors did apply the Act consistently, with others noting there are areas where a consistent approach is not appropriate due to different sectoral needs and issues.

As a result, the Statutory Review proposed action be taken to consider in more detail whether the structure of the regime should be amended to be more effective and efficient. The resourcing of the system is considered in the corresponding Funding Model RIS, but the ability to share resources between supervisors and efficiency of use are considered in this RIS.

The Statutory Review also canvassed options for structural change to supervision

Industry was also asked:

> [I]if it were to change, what supervisory model do you think would be more effective in a New Zealand context?

Responses to this question identified six potential models, which workshops with industry over the course of the review narrowed down to three. Industry submissions and the resulting three alternative options are outlined in section 2(3) of this RIS.

Annex D: Analysis of match of AML/CFT supervision with departmental agency form

In the New Zealand system, departmental agencies are used to reduce fragmentation and cost in the public sector. They are also used to improve system coherence and consolidation.

The activities best suited to the departmental agency model tend to be regulatory, service delivery, or other ring-fenced operations that do not need to be carried out by an entity separate from the legal Crown and that can be accountable directly to a Minister (rather than come under the authority of a governance board). A policy role that is clearly identifiable and separately accountable can also fit in the departmental agency model.

Departmental Agency Functions: ...	Alignment of AML to the Departmental Agency Functions
are readily identifiable and measurable, and therefore lend themselves to ring-fenced, transparent funding and reporting arrangements.	AML/CFT functions are all prescribed in the Act, section 131. They are identifiable and measurable. Decisions in respect of funding are yet to be made.
are cohesive and/or fall within a clearly defined area.	All fall within the area of AML/CFT supervision, as outlined in section 131.
have relatively stable policy settings.	Yes, as with any policy area they will change over time, this is the first major change since 2015.
have low levels of operational connection with other functions of the host department.	As shown in the RIS, strong need for a whole AML/CFT dedicated supervision function, which implicitly means low (if any) levels of operational connection with other functions of the host department. A key objective of having a departmental agency is to have AML/CFT supervision a discrete operational function.
have clearly identifiable staff (employees or secondees) who come within the employer responsibilities of the departmental agency chief executive.	The teams carrying out the AML/CFT supervisory work (all functions of).

It is also important to consider whether the relative size (employees and/or expenditure), and/or the nature of the substantive functions warrant the creation of a new entity and appointment of a public service chief executive.

	National Emergency Management Agency (hosted in DPMC)	**Independent Children's Monitor** (hosted in the Education Review Office)	**Social Investment Agency** (hosted in MSD)	**AML/CFT supervisory entity**
Expenditure	$42.6 million (2023/24)	$11.568 million (2023/24)	$6.8 million (2023/24)	Circa $15m, but requested increase of $5-10 million subject to funding decisions.*
FTE	162 (end of 2023)	60	41	50+ current FTE
Functions	Stewardship, operator, and assurer of the emergency management system.	Monitor of National Care Standards Regulations.	Sets standards for social investment practice (including creating data and analysis) and provides advice on the social investment approach.	Operational Policy, Supervision, and input into System Stewardship for AML/CFT.

*Noting the AML/CFT system will likely grow significantly in coming years S9(2)(d) S9(2)(f)(iv)

Annex E: Analysis of which actor could be the single supervisor

Entity	Priority of AML/CFT function*	Other connecting regulatory systems	Experience as (risk-based) supervisor	Ability to work across system
DIA	**Medium** AML/CFT was originally set up as a consolidated function in DIA, has now moved to a more distributed model - retains a high profile. Without changes to the funding model AML/CFT will compete with a wide range of other regulatory functions.	**Medium** Has regulatory systems connected to some predicate offences (OCSE, Scams, VE), that cover relevant entities (Gambling, Charities), and emerging opportunities (Digital Identity).	**High** The dedicated structure originally set up for AML/CFT in DIA, and early results from it, were highly praised by the FATF and other jurisdictions have since replicated it. While DIA has the shortest amount of time as an AML supervisor, it has shown good results from it. The recent restructure will affect these results.	**High** Crown agency, no structural barriers. Experience working cross-agency in AML and partnered with MoJ on the Statutory Review. Would be able to progress regulatory relief at a much more rapid rate than other options.
FMA	**Medium** FMC system may diminish focus on AML/CFT. AML/CFT not specifically funded.	**Medium** Has regulatory systems that can act as preventative measures in AML/CFT (FMCA, enforcement arm of FSPR) for some reporting entities (not for DNFBPs).	**High** Significant regulatory experience, with analogous regulatory principles (with harm-based thinking in the FMCA).	**Medium** As shown in the problem definition, there are structural barriers that affect the extent to which a Crown entity can/will collaborate with Crown agencies. Provided input into the Statutory Review.
RBNZ	**Low-Medium** Prudential system regulation and other regulatory roles can diminish focus on AML/CFT. Only passing references to AML/CFT in the current funding	**Medium** Has regulatory systems that can act as preventative measures in AML/CFT (licensing and prudential) for those reporting entities that RBNZ is already the supervisor for.	**High** Long time as an AML supervisor.	**Low** As shown in the problem definition, there are structural barriers that limit the extent to which a statutory entity can/will collaborate

Entity	Priority of AML/CFT function*	Other connecting regulatory systems	Experience as (risk-based) supervisor	Ability to work across system
	agreement despite extensive discussion of bank priorities, including prudential supervision.			with Crown agencies.
MoJ	**Medium** A relatively discrete number of regulatory roles would enable reasonable profile of AML/CFT. Without changes to the funding model AML/CFT will compete with judicial system.	**Medium/Low** No related regulatory systems, but a core agency in the justice sector (on the JSLB along with Police, SFO, Customs). Has other roles in the AML/CFT system and leads the delegation to the FATF and APG. Administrator of Crimes Act and Criminal Proceedings (Recovery) Act – two key supporting pieces of legislation of the AML/CFT system.	**Low** No supervision experience, but has operational experience with the judicial system.	**High** Crown agency, no structural barriers. Good experience working cross system on AML with delivering the Statutory Review in partnership with DIA and NZ Police. Opportunity to bring MoJ's policy/stewardship role under the Act into alignment.
NZ Police	**Medium** Would likely see supervision combined with the FIU (as per FINTRAC and AUSTRAC). Experience of those two jurisdictions is that combining these two functions can see the FIU element swamp the supervision.	**Medium** No other regulatory systems, but similar to MoJ has other core roles in the AML/CFT system: the FIU, ARU, ML investigations and working with prosecutors.	**Low** No significant supervision experience, but does have significant operational experience in AML/CFT.	**Medium/High** Crown agency, not as much focus on this as the other Crown agencies considered. Experience working cross-agency in AML and partnered with MoJ on the Statutory Review.

Entity	Priority of AML/CFT function*	Other connecting regulatory systems	Experience as (risk-based) supervisor	Ability to work across system
MFAT	**Low-Medium** Unlikely to be a priority given unconnected to much else of the Ministry's work.	**Low** Autonomous sanctions.	**Low** Supervisor of autonomous sanctions, new to this.	**Medium** Crown agency, no structural barriers. Would take more time than other options to progress regulatory relief due to relatively low level of involvement to date.
MBIE	**Medium - Low** The amount of other (and larger) regulatory systems within MBIE suggests it would be unlikely to support AML as a priority.	**Medium/High** Operates analogous functions (licensing, register, monitoring), links into many parts of the economy both through policy and monitoring roles.	**Medium** Has supervisory experience, but not analogous to AML.	**High/Medium** Crown agency, no structural barriers. Would take more time than other options to progress regulatory relief due to relatively low level of involvement to date.

* This does not reflect the organisational model of the entity. Some may have specialist regulatory support teams that enable AML/CFT supervision without this being their sole purpose, others may have AML/CFT resources in more consolidated/centralised teams. As discussed in the Statutory Review, this reflects the level of priority the entity as a whole would provide an AML/CFT function, especially in the absence of additional funding (refer paragraph 52).

Stage 1 Cost Recovery Impact Statement

Levy proposal for the part-funding of the Anti-Money Laundering (AML) and Countering Financing of Terrorism (CFT) system. This CRIS should be read in conjunction with the Regulatory Impact Statement (RIS) for the AML/CFT Funding Model (Funding Model RIS).

Status quo

The purpose of regulating AML/CFT

The purpose of AML/CFT intelligence gathering and supervision is to reduce the occurrence of money laundering and increase the probability of detection where it is still attempted. Where detected, appropriate investigation and enforcement occurs to punish offenders and deter future attempts to money launder.

The outcome sought is an effective and efficient AML/CFT regulatory system, which takes a national risk-based approach and gives effect to our international obligations. Regulatory activity should enhance the ability of reporting entities to comply with AML/CFT obligations and reduce compliance.

S9(2)(d)

here is a related priority of ensuring we have an efficient and effective system that is able to adapt to a changing AML/CFT environment.

Activity necessitating an AML/CFT system

The objective of the AML/CFT system is to detect and deter illegal financial flows whenever:

1. A criminal (or those under their direction) introduces funds earned through criminal activity to the financial system. **Placement**
2. A money launderer (or the criminal themselves) engages in a series of transactions to create layers between the illegal source of the cash they control. **Layering**
3. The criminal moves laundered money back into the financial system. **Integration**

Money laundering can involve layering and integration across different regulated activity types and may include international flows. The risk of a successful initial placement can be assessed and mitigated sector by sector, but organised or complex money laundering can cross various areas of regulation, making detection during the layering process difficult.

As was noted in our last National Risk Assessment[1]:

> the more layers money passes through, the harder it becomes to connect the funds to criminal activity… [i]n New Zealand layering is typically non-cash transactions..., [t]he more countries the money enters and leaves, the harder it is to uncover the 'dirty' source of the money.

For instance, the proceeds of illegal activity overseas might be placed in an offshore bank account, used to purchase real estate in New Zealand, then the proceeds of sale of the real estate are used to invest in the domestic sharemarket. Dividends might then be cashed out for various purposes or returned to the country of origin via a remittance payment.

[1] New Zealand Police Financial Intelligence Unit (2020) *National Risk Assessment of Money Laundering and Terrorism Financing*.

For the financing of terrorism, similar techniques can be used to hide the source and end use (terrorism or weapons proliferation) of the layered funds.

Why does the government need to be involved in AML/CFT?

The government is a monopoly supplier of AML/CFT investigation and enforcement - even where some of that work is contracted to third parties to undertake. Government supply is required both due to the criminal activity at issue and the sanctions available, and for international recognition to enable unhindered participation in international trade and finance.

Surveillance for AML/CFT is undertaken and directed by government, because of the nexus with criminal investigation and enforcement, government ability to operate across different entities and areas of activity, and government interests in meeting international expectations/obligations.[2]

The AML/CFT system is funded from a variety of sources and surveillance is undertaken primarily on a sector-by-sector basis. Any regulatory changes agreed by Government to improve supervisory system effectiveness and efficiency that affect levy calculations will be considered in the Stage 2 CRIS.

Current regulatory roles in the AML/CFT system

Intelligence for the AML/CFT system is gathered both sector-by-sector by supervisors, and across the economy by the New Zealand Police (Police) and its Financial Intelligence Unit.

At present, supervisory activity for sectors incurring AML/CFT obligations is spread across three entities. These supervisors are the Department of Internal Affairs (DIA), Reserve Bank of New Zealand (RBNZ), and the Financial Markets Authority (FMA).

The Ministry of Justice (MoJ) leads regulatory policy development for the AML/CFT system and has overall responsibility for system stewardship.

The FMA is majority levy-funded with supplementary Crown funding, with RBNZ funding set by agreement with the Minister of Finance, and DIA, Police, and MoJ by Crown appropriation.

Analysis in this paper provides a gross estimate of required AML/CFT funding, not a net amount deducting current funding sources. Current funding sources are described in the Funding Model RIS.

[2] Refer Supervisory Model RIS for definitions of supervisors and other regulatory roles under the AML/CFT Act.

Policy Rationale

Why a user charge?

Reporting entities facilitate the system that gives rise to negative spillovers
Law enforcement in the United Kingdom has found that "in nearly all money laundering cases, criminal money passes through the AML-regulated sector at some point to obtain legitimacy". It was considered fair that "those whose business activities are exposed to money laundering risk pay towards the costs associated with responding to and mitigating those risks".[3]

Reporting entities themselves are not the source of the underlying illegal activity, and in almost all cases try to comply with the requirements of the AML/CFT system. However, many of the positive characteristics of regulated activity, which underpin legitimate economic activity, also allow for flows of value that are either illegal in origin or intended use. Reporting entities are risk exacerbators.

The externalities created are negative for society, but where undetected allow additional profit to regulated entities (albeit an involuntary gain). Placement of illegal funds into the real estate sector provides a good example of this, as do fees and service charges for domestic and international money transfer. Advances in the digital economy will accelerate processes used for ML/TF. The negative externalities caused by ML/TF cannot be allocated to individual reporting entities.

Effective and efficient regulatory systems are an industry good
Much of the activity required of our AML/CFT system by FATF does not have direct line of sight to the use or benefit of individual reporting entities. For instance, it would be inefficient to identify the amount of regulatory 'service' an entity or group of regulated entities receives from the National Risk Assessment (NRA) or improvements to the regulatory system.

In comparable regulatory systems in New Zealand, a strong case is made for the operational costs of a well-regulated market to be recovered from the industry that benefits from it. In the AML/CFT context, regulation enables ready access to global capital markets, and for offshore banking accounts to be held by New Zealand trading entities. It is considered reasonable to recover the cost of maintaining that access for those entities (and their customers) who benefit most. Without the AML/CFT system the costs of accessing overseas markets would increase.

In setting and expanding the FMA's levy in 2021, MBIE considered supervision of the conduct of financial institutions was primarily a private rather than public benefit, noting it was a:

> [g]eneral benefit attributable to financial institutions through these entities holding conduct licences and being able to provide products and services to consumers, receiving guidance, support and engagement from the FMA. Increased consumer trust in financial institutions and reduced consumer harm as a result of the FMA's activities will result in benefits to both the industry (from confident consumers being more likely to engage with the industry and use financial products and services) and the general public (confidence in financial markets and well-functioning financial markets generally).

The same can be said of an AML/CFT system.

Why is a levy appropriate?

The AML/CFT regulatory system operates across reporting sectors

[3] HM Treasury (2020) *Economic crime levy: Funding new government action to tackle money laundering. 5.*

Our AML/CFT system will need to pass our next FATF mutual evaluation as a whole. The nature of ML/TF means that the regulatory chain for AML/CFT is only as strong as its weakest link. Identified vulnerabilities in any part of our financial system or broader economy will be taken advantage of.

Publicly stated intentions for the New Zealand financial sector and payments systems are to increase the speed and ease with which transactions can occur – both domestically and internationally – while also supporting a much larger ecosystem of value-adding services and service-providers.[4]

The Government is also focused on reducing the costs of doing business, and the digital economy is expected to play a role in this. Digital Identity and Consumer Product and Data Rights are two related programmes. Without mutual confidence in the AML/CFT system there will be duplication of due diligence and administration costs for participants in digital systems and their consumers. Much of the service provided by the AML/CFT system is therefore akin to a club good rather than being able to be attributed directly to any one type of regulated activity or reporting entity within it.[5]

As technology and regulation come to enable greater levels of domestic and international financial system integration (and a broader ecosystem of related service providers), the levels of inter-dependency will result in AML/CFT becoming even more of a club good across reporting sectors.[6]

An unclear interface between different types of regulated entities in either digital or traditional business systems can result in similar duplication and inefficiency for industry and consumers.

Fees and service charges have been looked at but are not supported for AML/CFT
Fees for the provision of individual AML/CFT services have been looked at domestically and in the United Kingdom, and initially used in Australia. An example of a fee would be for individual entities to pay the cost of any on-site activity by a regulator. Another would be a charge for the cost of any review/investigation of activity at a reporting entity by a regulator.

It was found overseas, and we consider it would be the case here, that charging fees for regulatory services unnecessarily disrupts cooperation from reporting entities and adds unnecessary complexity and uncertainty to the ongoing funding of the system. Negative incentives would also arise if there were charges for reviewing suspicious activity or transaction reports or for other regulatory interactions with/by reporting entities. The impact on small and medium enterprises (SMEs) may also outweigh benefits.

What would the levy be used for?

We intend for the levy to be non-discretionary and allow for the funding of both policy and operational activity. Operational activity would cover intelligence and surveillance activity and also include educational initiatives, the issuing of guidance, and similar industry-good activity. Transition and transformation costs would be included within scope of operational activity but may also be funded by Crown appropriation. Policy activity will have both a domestic and an international focus, ensuring the system remains fit for purpose and that we meet our international obligations.

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[4] Refer RBNZ *Future of Money*, 27 July 2023 https://www.rbnz.govt.nz/money-and-cash/future-of-money/payments; Payments NZ *Payments Direction* https://www.paymentsnz.co.nz/our-work/payments-direction/ retrieved September 2024.

[5] An example is the EU. The free movement of goods, services, and capital are nonrival in consumption but other countries are excluded from them. Adding extra countries and types of exchange increase the benefits. [Adapted from https://en.wikipedia.org/wiki/Club_good].

[6] As AML/CFT mitigation becomes increasingly digitized, it can be excludable but is non-rivalrous. People and firms can be excluded from the benefits of an AML/CFT compliant ecosystem (e.g. open banking) but their use of it does not constrain other consumers.

This is consistent with the approach to levy-setting taken for the FMA.[7]

How should the levy be set and apportioned?

Public/private split *of regulatory burden and benefit of the AML/CFT system*

As with the FMA, we expect that those parts of the AML/CFT regulatory system that cannot be attributed to negative externalities that are created or enabled by industry, or that do not confer an industry-specific benefit, will not be cost recovered. This includes prosecution and asset recovery.

We also consider there is a public good component to the national gathering of intelligence and maintaining the fitness for purpose of the AML/CFT system. This is both in terms of reducing criminal offending (and avoiding victimisation) and New Zealand playing its role as a good global citizen. There is widespread economic and public benefit from an efficient and effective system for financial transactions and the trading of goods and services.

Due to the public nature of the benefit of some AML/CFT activity, we are proposing partial cost recovery for the regulatory system rather than full cost recovery. Setting the level of public benefit in the Stage 2 CRIS will only be possible in generalised terms, as noted by MBIE:

> It is not possible to make direct and isolated correlations between the benefit derived by particular participants or the public. Indeed, unlike a fee, a levy can factor in benefits shared between groups or benefits that cannot be specifically assigned to individual groups.
>
> Accordingly, we cannot establish percentages or proportions for the level of private and public benefit. Instead, our allocations and assessment of benefit are constrained to the more general explanations.

A differentiated levy is ***equitable*** *as risks and returns across sectors vary widely*

A risk-based approach initially identifies sectors or activities of interest, then individual entities within that area of interest are assessed in more detail. It is not practical to charge individual entities for this intelligence and surveillance, but the NRA and Sector Risk Assessments (SRA) provide generic levels of risk that can help inform a levy. Both the NRA and SRAs are clear that the level of risk created by different areas of regulated activity (potential for illegal value transfer), and different types of entity within those areas, varies widely.

We therefore consider a higher levy from the sub-sectors that create the greatest negative spillovers to be appropriate. AML/CFT measures support these same entities maintain their social license to operate and benefit from efficiencies in international and domestic transactions. Revisions of the NRA and SRAs can be used to help recalibrate the levy over time.

The draft AML/CFT National Risk Assessment 2024 noted “banking is colossal in contrast to other higher-risk sectors and is complex due to its broad range of products and services”. An equitable apportionment of costs to the banking sector will be considered in more detail in the Stage 2 CRIS.

The levels of financial and economic benefit also vary widely between and within classes of regulated entity/activity. Profitability and size of reporting entity is not necessarily a proxy for their creation of negative externality, or ‘consumption’ of regulatory services. However, this is relevant as a starting point both to the efficiency of any levy system and the equity within it. Within a sector it is also likely to be indicative of the volume of activity, and therefore AML/CFT risk, created.

This also reflects the outcome of a wider study of potential AML levy metrics in the United Kingdom:

[7] Sections 68 and 69 of the Financial Markets Authority Act 2011.

> No one metric can satisfy all the levy principles. It is therefore a case of evaluating which metric can best meet the principles while resulting in the fewest drawbacks. Against these criteria, the government currently assesses revenue as the most desirable levy base.
>
> Revenue provides proportionality as it relates to the scale of the activity undertaken and is broadly (although not entirely) approximate to a business' ability to pay. It is a metric business can readily report (for the purposes of calculating the levy), is simple and transparent, and is familiar to nearly all businesses. Using revenue would also lead to fewer unintended consequences than the other options considered, as it should not incentivise businesses to change their behaviours.[8]

*A levy differentiated by type of activity and entity is also **efficient***

We are proposing consultation on splits in the amount of levy charged similar to those set out in Table A. Overseas jurisdictions have found there to be diminishing and then negative benefits to setting very granular bands for levying reporting entities. There is a reasonable degree of overlap in the reported risk of sectors as set out in Table A and the ability of the sector to pay, so differentiation at sub-sector level seems appropriate. Smaller money remittance providers may be an exception to the link between ability to pay and risk.

A minimum size/revenue threshold is also applied in overseas jurisdictions that apply a levy - to offset undue AML/CFT compliance costs for SMEs and administration costs for collection. We consider the same approach would be justified in New Zealand.

Additional considerations will be identified through industry consultation and included in analysis for the Stage 2 CRIS. In particular, we expect that further sub-groups will be delineated based on industry feedback in the accounting, legal, real estate, and payments sectors.

The proposed levy will provide incentives for both the regulator and regulated entities to streamline and integrate AML/CFT activity within and across different sectors. Further, incentives will improve within a sector as the levy set is differentiated by sub-groupings of regulated activity and based on residual risk levels (i.e. the ML/TF risk remaining after mitigations are considered).

Competition and consumer impact of the levy

The Commerce Commission has noted the unintended effects of the AML/CFT system in increasing the costs of retail bank account and financial product searching and switching, and in some instances contributing to financial exclusion, especially for owners of Māori freehold land or where a person is unable to verify their identity.[9]

This is in part due to the system not taking a risk-based approach to different entities with the same legal structure (e.g. Māori land trusts), and deficiencies and duplication that have been identified in respect of the current system. Inadequate identification by customers is more difficult to resolve.

Competition and access issues were similarly identified by a market study in the United Kingdom, the response to which was a regulatory system for open banking. An improved AML/CFT system needs to work hand-in-glove with similar efforts here, such as the Customer and Product Data Bill and Digital

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[8] HM Treasury (2020) Economic crime levy: Funding new government action to tackle money laundering. Page 13. Australia also uses an adjusted business and activity metric to charge their AML levy. Refer https://www.austrac.gov.au/business/core-guidance/industry-contribution-levy Work is still underway in Canada on applying levies to cost-recover regulatory activity. Refer https://www.canada.ca/content/dam/fin/programs-programmes/fsp-psf/rs-sr/rs-sr-eng.pdf

[9] Commerce Commission *Personal banking services,* Final Competition Report 20 August 2024.

Identity Services Trust Framework, that will reduce barriers to competition in retail banking and increase consumer choice. The possible impact of these schemes and efforts to reduce the "bluntness" of the AML/CFT system was noted by the Commerce Commission.

We have not identified a case for any other potentially negative impacts upon industry or consumers that may result from the imposition of a levy as outlined in Table A. Further analysis is required of any competition impact on remittance providers as costs might be passed on to low-income or otherwise vulnerable consumers.

How would the levy be monitored?

The entity/ies utilising the proceeds of the levy will all have performance measures and report publicly against them. Accountability, implementation review, and ongoing monitoring will be agreed in the Stage 2 CRIS and related Cabinet decisions. This will include giving effect to any requirements of the levy option selected from the Funding Model RIS.

Irrespective, we anticipate that the regulatory work programme for AML/CFT will be developed in close consultation with industry over a 3+ year horizon and reviewed annually, taking into account the need to respond to the 7-year cycle for FATF mutual evaluations.

Source data

Source information for Table A on the following page:

1. Reserve Bank of New Zealand (2017) *Sector Risk Assessment for Registered Banks, Non-Bank Deposit Takers and Life Insurers*
2. Reserve Bank (2024) *Registered banks financial statistics* https://www.rbnz.govt.nz/statistics/series/registered-banks retrieved July 2024
3. Bank profit and asset data derived from Reserve Bank register of disclosure statements, retrieved July 2024
4. Financial Markets Authority (2021) *Anti-Money Laundering and Countering Financing of Terrorism: Sector Risk Assessment 2021*
5. Department of Internal Affairs (2019) *Designated Non-Financial Businesses and Professions (DNFBPs) and Casinos Sector Risk Assessment*
6. Department of Internal Affairs (2019) *Financial Institutions Sector Risk Assessment*
7. Department of Internal Affairs *Gambling expenditure* https://www.dia.govt.nz/gambling-statistics-expenditure retrieved July 2024
8. Commerce Commission (2024) *Retail Payment System Costs to businesses and consumers of card payments in Aotearoa New Zealand: Consultation Paper*
9. TAB NZ (2024) *Annual Report 2023*
10. Australasian Legal Practice Management Association (2024) *FY2023 New Zealand Financial Performance Benchmarking Report* [Law firms]
11. Sunday-Star Times (2020) *NZ's top accounting firms: How they rank*
12. IBISWorld (2023) *Real Estate Services in New Zealand - Market Size, Industry Analysis, Trends and Forecasts (2024-2029)*
13. NBR (2024) *The Accountants 2024: The $2.1b business of complexity.*

Table A: Preliminary analysis of levy cost allocation (indicative only)

S9(2)(f)(iv)

S9(2)(f)(iv)

High level cost recovery model

We do not have a detailed or consistent cost model for the AML/CFT system, in part due to its dispersed nature across a range of entities. Information received by the MoJ indicates a full cost-recovery levy based on current regulatory costs would be in the order of $23 million dollars (refer accompanying Funding Model RIS), with approximately $7 million of that spent on intelligence, $14 million on domestic supervision, and $2 million on policy, regulation, and international coordination. Enforcement, asset recovery, and non-supervisor costs for investigation are not included.

A cost model tailored to Cabinet decisions on supervisory structure, level of expenditure to be cost-recovered, and major components of the work programme will be prepared for the Stage 2 CRIS.

Individual levy amount would be set by revenue/risk band, rather than a fixed percentage of revenue being levied. The levy collected in Table A would exceed S9(2)(f)(iv) if the total amount were to be collected from each reporting/regulated entity identified. However, many entities will fall under an income threshold. If higher levies are set in some sub-sectors this may allow a higher income threshold for smaller reporting entities to be excluded from the levy.

Supervisors take different approaches to rating ML/TF risk and accounting for mitigations in their publicly published SRAs. The RBNZ's 2017 SRA does not take into account the adequacy or effectiveness of any ML/TF controls, whereas these are considered by FMA in their 2021 SRA (residual risk assessment) and in part by DIA in their 2019 SRAs. In the absence of more detailed information, Table A has been prepared based on publicly available information.

Further analysis is therefore needed by MoJ on the relativity of the risk-adjusted amount allocated to each levy grouping in Table A, and in the further disaggregation of each group in terms of equity of payment given financial and economic considerations. In the United Kingdom, residual risk was identified as the basis for levy apportionment. We expect this analysis will need to draw on the risk-assessment used internally by the supervisors in undertaking their work in each sub-sector.

Although there are many similarities across sectors of regulated activity on the basis of firm size, ability to pay, and consumption of regulatory services (reflected by sector risk), we expect consultation on the levy will confirm some differences. For instance, the level of profitability amongst law firms can vary widely irrespective of firm size and areas of practice. Small or medium sized firms can be very profitable and operating in areas of particular complexity that are inherently linked with activity at risk of ML/TF (for instance trust and property services).

If community distributions were not considered, gambling entities would face a higher levy on the basis of their risk profile and financial returns. More consideration needs to be given in the Stage 2 CRIS to how the economic/wellbeing impacts of any levy is taken into account.

Consultation

Key AML/CFT agencies such as the FMA, RBNZ, DIA and Police were consulted in the development of this CRIS. Industry has not been consulted specifically on this levy proposal. The concept of introducing a levy has been discussed with industry in the past, with a varied response that was generally negative. Industry was more open to a levy where/when they are involved in setting the regulatory work programme. Refer to Funding Model RIS for more detail on industry consultation.

Agency feedback on the CRIS:

- **Police** consider the risks posed by Virtual Asset Service Providers (VASPs) are significantly understated and that a higher levy apportionment would better reflect their risk level and likely consumption of regulatory services.
- **RBNZ** has pointed out the range of other compliance costs faced by financial and non-financial reporting entities, including Conduct of Financial Institutions, Credit Contracts and Consumer Finance Act amendments, Deposit Takers Act implementation, Insurance (Prudential Supervision) Act review, S9(2)(f)(iv)

MoJ response to feedback - Police

The issue of relativity between different reporting sectors will be worked through for the Stage 2 CRIS as MoJ does not have sufficient information to undertake this analysis at present.

Further input on the proposed levy will be requested from sector supervisors and Police. Targeted consultation will then be undertaken with industry prior to the development of the Stage 2 CRIS. Subsequent consultation prior to implementation will be dependent upon timeframes available.

This consultation will be used to inform our advice on the split between Crown funding (public good) and the partial cost-recovery levy, and apportionment of the levy.

MoJ response to feedback - RBNZ

Table A indicates financial service provision under current levels of compliance cost remains profitable. S9(2)(f)(iv)

One or more levies may also be enabled through the Customer and Product Data Bill, but details on potential size and scope are yet to be developed by officials.

Analysis of impact of the proposed AML/CFT levy on the banking sector in this RIS is consistent with that undertaken for the Depositor Compensation Scheme (DCS). Refer Annex 1.

Annex 1: Depositor Compensation Scheme Levy

The DCS levy will be charged to a deposit taker or group of deposit takers according to the risk they pose to the insured deposits. See the Reserve Bank's consultation document, *Levy framework for the Depositor Compensation Scheme* for further information.[10]

The impact of the proposed $1 billion insurance fund was considered by RBNZ analysis of registered banks in July 2023 and found to be "generally not significant even if the cost is fully absorbed by firms' profits".[11] The proposed levy in Table A of this CRIS is unlikely to have a material impact, either compared to the $1 billion fund to be established for the DCS, or in absolute terms given the level of profit currently being made by registered banks in the sector (also shown in Table A).

For 60% of NBDTs it was found that the level would be less than 10% of annual profits. However the RBNZ also found that "a number of other firms have low profits or recent losses, so levies will be more material to their profitability outlook".[12] This is consistent with the approach in this CRIS, its caveats, and the recommended approach to the Stage 2 CRIS. The proposed levy is lower for the smaller deposit-taking entities we are yet to see profitability data on.

[10] https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/consultations/deposit-takers-act/levy-framework-for-depositor-compensation-scheme-consultation-paper.pdf
[11] Ibid.
[12] Ibid.