Hon Nicole McKee
Associate Minister of Justice

Proactive release – AML/CFT Reform

Date of issue: 05 February 2025

The following documents have been proactively released in accordance with Cabinet Office Circular CO (23) 4.

Some information has been withheld on the basis that it would not, if requested under the Official Information Act 1982 (OIA), be released. Where that is the case, the relevant section of the OIA has been noted and no public interest has been identified that would outweigh the reasons for withholding it.

No.	Document	Comments
1.	**Proposals for an AML/CFT legislative work programme** Cabinet paper Office of the Associate Minister of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand
2.	**Appendix – AML/CFT work programme reforms** Cabinet paper appendix Office of the Associate Minister of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand
3.	**ECO-24-MIN-0220 Minute** Cabinet Minute Cabinet Office Date: 25 September 2024	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand • section 9(2)(f)(iv) to maintain the constitutional convention which protects the confidentiality of advice tendered by Ministers of the Crown and officials
4.	**AML/CFT Supervisor Model and Levy** Cabinet paper Office of the Associate Minister of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand • section 9(2)(j) to enable a Minister of the Crown or any public service agency or organization holding the information to carry on, without prejudice or disadvantage, negotiations (including commercial and industrial negotiations) • section 9(2)(f)(iv) to maintain the constitutional convention which protects the confidentiality of advice tendered by Ministers of the Crown and officials
5.	**Appendix – Initiatives in my work programme** Cabinet paper appendix Office of the Associate Minister of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand

No.	Document	Comments
6.	**ECO-24-MIN-0228 Minute** Cabinet Minute Cabinet Office Date: 16 October 2024	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand
7.	**AMLCFT funding model** Regulatory Impact Statement Ministry of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(f)(iv) to maintain the constitutional convention which protects the confidentiality of advice tendered by Ministers of the Crown and officials • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand
8.	**AMLCFT supervisory model** Regulatory Impact Statement Ministry of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(f)(iv) to maintain the constitutional convention which protects the confidentiality of advice tendered by Ministers of the Crown and officials • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand • section 9(2)(a) to protect the privacy of natural persons, including that of deceased natural persons
9.	**AML/CFT Stage 1 CRIS** Cost Recovery Impact Statement Ministry of Justice	Some information has been withheld in accordance with the following sections of the OIA: • section 9(2)(d) to avoid prejudice to the substantial economic interests of New Zealand • section 9(2)(f)(iv) to maintain the constitutional convention which protects the confidentiality of advice tendered by Ministers of the Crown and officials

In Confidence

Office of the Associate Minister of Justice

Cabinet ECO Committee

Proposals for an AML/CFT legislative work programme

Proposal

1 This paper:

1.1 S9(2)(d)

1.2 seeks endorsement of my proposed improvements to the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regime to ensure it is both workable and effective.

Relation to Government priorities

2 These proposals relate to the Government's commitments in the National and ACT parties' coalition agreement, specifically:

2.1 the National Party's 100-point economic plan, including developing protocols to allow simplified verification to comply with anti-money laundering requirements, including the use of biometric authentication and blockchain;

2.2 a commitment to review and reform key sectors where the cost of regulations is overly burdensome for businesses; and

2.3 providing better tools for law enforcement to tackle organised crime.

3 This Cabinet paper fulfils action 27 of the Coalition Government's Q3 Action Plan: "take Cabinet decisions on proposed improvements to the Anti-Money Laundering and Countering Financing of Terrorism regime to ensure it is both workable and effective."

Executive Summary

4 The AML/CFT Act (the Act) provides a framework for the detection, deterrence and combatting of money laundering, terrorist financing, and serious and organised crime by making it harder for illicit financial activity to occur. These outcomes are achieved by imposing obligations on businesses that provide specific financial and non-financial services.

5 Recent reviews of the Act have identified amendments to deliver regulatory relief, better tackle organised crime, address many concerns raised by business, and improve international compliance. In 2021, the FATF identified[1] deficiencies in New Zealand's

[1] In New Zealand's Mutual Evaluation, conducted by the FATF. The resulting Mutual Evaluation Report informed the Statutory Review of the AML/CFT Act.

system including improving the availability of beneficial ownership information, strengthening supervision and implementation of targeted financial sanctions.

6 In 2028-2029, the FATF will conduct an evaluation of New Zealand's AML/CFT system. S9(2)(d)

7 The FATF identified New Zealand's key deficiencies were the lack of transparency around beneficial ownership information, strengthening supervision, and implementation of targeted financial sanctions.

8 S9(2)(d)

10 I am seeking Cabinet's agreement to an AML/CFT legislative work programme to deliver on coalition commitments to deliver regulatory relief S9(2)(d) . Improvements to the AML/CFT regime will also support law enforcement activity to tackle organised crime and help restore law and order. In particular, improving the AML/CFT system is a key component to increasing recovery of criminal proceeds leading to further contributions to the Proceeds of Crime Fund. The work programme will be delivered in three parts:

10.1 Workstream 1: immediate regulatory relief via changes progressed in two regulatory amendment bills; (the Regulatory (Systems) Justice Amendment Bill and the Statutes Amendment Bill);

10.2 Workstream 2: structural changes to improve system efficiencies and create a sustainable funding model; and

10.3 Workstream 3: changes to regulatory settings S9(2)(d) and deliver further regulatory relief to New Zealanders.

11 Immediate relief in workstream 1 includes relaxing address verification requirements, extending reporting timeframes, and addressing overly burdensome obligations for low-risk trusts. Making the regime more risk-based reduces the regulatory burden for those who currently have undue obligations, saving time and money.

12 This work programme is pragmatic. S9(2)(d)

S9(2)(d)

this package delivers within existing baselines and funding.

13 Changes to the system structure and funding model must be progressed before substantial legislative changes are made in workstream 3. Supervisory model changes provide important efficiencies, and a levy sets up a sustainable funding mechanism in line with cost recovery principles. A more efficient supervisor and a sustainable funding model enables implementation of workstream 3 initiatives.

Background

What is money laundering, terrorist financing, and proliferation financing?

14 Money laundering is a process that criminals use to 'clean' money that has been obtained through crime. This process allows criminals to amass illicit wealth and furthers the cycle of criminality by making funds available for reinvestment in crime. Conservative estimates suggest NZD $1.35 billion is generated annually for laundering in New Zealand[2], excluding transnational laundering of overseas proceeds.

15 Terrorism financing refers to how funds are raised, moved, or used, through legitimate and illegitimate sources, to facilitate the planning, preparation, or commission of a terrorist/criminal act. Financing of terrorism within New Zealand is likely to be small scale and involve low value of funds[3]. However, the potential consequences are significant.

16 Proliferation financing refers to proliferation of weapons of mass destruction, trading in proliferation-sensitive goods and technologies, and the financing or revenue-raising activities to support these activities. Comprehensive sanctions regimes and the AML/CFT framework work to combat this threat. New Zealand is considered low risk in facilitating the evasion of sanctions. However, deficiencies and vulnerabilities in our AML/CFT systems (such as poor transparency of companies and trusts beneficial ownership) as well as economic attributes (such as our trade relations with Asia), do create risks of sanctions evasion occurring through New Zealand.

The AML/CFT Act plays a pivotal role in tackling serious and organised crime

17 The AML/CFT regime makes it harder for criminals to profit from their offending. It also disrupts the funding of terrorist activities. The Act is the central plank of this regime, and many agencies play a role in this cross-government system.

18 As the Associate Minister of Justice responsible for AML/CFT, it is my responsibility to administer the Act and regime and assess performance. I will therefore be progressing legislative change to improve performance across the regime.

19 The Ministry of Justice (the Ministry), with the Department of Internal Affairs (DIA) and Police, concluded a Statutory Review of the Act in 2022 to assess the Act's performance. The resulting report (the Report) was heavily consulted on with other Crown agencies and entities (such as RBNZ and FMA), and with the private sector.

[2] As estimated by Police's Financial Intelligence Unit in the 2019 National Risk Assessment
[3] As assessed at page 17 of Police's 2019 National Risk Assessment

The Report estimated that the AML/CFT regime has disrupted NZD $1.7 billion worth of illegal drugs and fraud and NZD $5 billion of broader criminal activity since 2013.

20 The AML/CFT regime results in wide ranging benefits, such as: improving protection of markets from distortion; maintaining the reputation of New Zealand businesses; enhancing national security; combatting terrorism; disrupting and dismantling serious and organised crime (including transnational organised crime); protecting New Zealand from bribery, corruption, and foreign interference; and retaining criminal assets. Making crime less profitable also reduces future victimisations.

21 The benefits of the regime are achieved by imposing obligations on businesses that provide specific financial and non-financial services, known as reporting entities. At a very high level, the Act requires reporting entities to assess their money laundering and terrorist financing risks, identify and know their customers, report suspicious activities and certain transactions, and maintain various records.

22 The AML/CFT system generates the largest and most detailed financial intelligence available to the government and law enforcement agencies. Improvements that make the AML/CFT regime more risk-based can contribute to the Government's law and order objectives.

The AML/CFT system needs to be more efficient, effective, and risk-based

23 The Report found that existing efforts by agencies and businesses are not always being prioritised towards areas of highest risk. This makes the regime overly burdensome on business[4], and less effective at tackling organised crime. I consider making the system properly risk-based would resolve these issues, from legislation through to the delivery/operational level. This is supported by my officials' analysis, the statutory review, industry, agencies, and the FATF's conclusions in New Zealand's latest Mutual Evaluation Report.

24 The Ministry issued regulations in 2023 to address some immediate concerns, deliver relief and remedy numerous technical deficiencies. However, the scope and potential impact of these changes was inherently limited by the nature of secondary legislation.

25 Substantive legislative change will be required to tackle the significant regulatory burden remaining, and to ensure law enforcement agencies have the tools they need to effectively tackle organised crime.

S9(2)(d)

New Zealand's AML/CFT regime is assessed against international standards

26 The Financial Action Task Force (FATF) sets international standards and monitors countries' AML/CFT systems to ensure they are compliant. All countries undergo evaluation and follow-up monitoring is applied dependent on results.

27 Countries found to have significant strategic deficiencies are placed on a public grey-list and intensively monitored to ensure deficiencies are addressed. Grey-listing is a

[4] Making AML/CFT less burdensome for industry will improve efficiency and effectiveness of the system, and address the Commerce Commission's concerns by improving competition and Māori access to capital.

significant step, which will trigger other jurisdictions to impose restrictions on financial dealings with the grey-listed country.

28 The Minister of Finance recently reaffirmed, at a FATF Ministers meeting in Washington DC earlier this year, New Zealand's commitments to support the FATF and combat financial crime, implement and be assessed on the FATF standards, and hold countries accountable that do not.

S9(2)(d)

29 The FATF identified a range of deficiencies in New Zealand's AML/CFT system. Key deficiencies identified were the lack of transparency around beneficial ownership information, strengthening supervision, and implementation of targeted financial sanctions.

30 S9(2)(d)

31 S9(2)(d)

32 How the FATF will assess New Zealand following any domestic changes is uncertain as the evaluation will be in a new round, with unestablished precedent, and there is an element of subjectivity dependent on the assessors assigned.

33 S9(2)(d)

34 As a FATF member, we are not immune to grey-listing, as shown by other FATF members such as Iceland, Türkiye and South Africa who were recently grey-listed.

S9(2)(d)

S9(2)(d)

S9(2)(d)

I propose a 3-stage AML/CFT work programme

40 There is a significant potential regulatory reform programme. However, the Ministry does not have the available capacity to deliver the necessary reforms within baselines, without compromising the delivery of Government priorities (such as coalition commitments and Targets).

S9(2)(d)

41 I initially sought additional funding to support a comprehensive regulatory package S9(2) delivered further regulatory relief to New Zealanders and helped tackle organised crime, but was advised funding was not available to support this work.

42 I have therefore designed a revised package that can be delivered within Ministry of Justice baselines, supported by Justice Cluster underspends and the input of other AML/CFT agencies. I consider that this package strikes an appropriate balance between delivering regulatory relief, tackling organised crime S9(2)(d)

The link between initiatives and goals are set out in the appendix. Further reprioritisation would require trade-offs against other priority projects in the Justice portfolio, which I consider to be undesirable as it risks undermining coalition commitments and policy priorities.

43 I have taken a pragmatic approach to complying with the FATF standards and have targeted those initiatives which both aim to address FATF deficiencies and also meet coalition goals of providing regulatory relief and supporting tackling organised crime. I have prioritised initiatives that serve a dual purpose.

44 My proposed work programme will address many, but not all, existing deficiencies identified by the FATF's Mutual Evaluation of New Zealand. It will integrate counter-proliferation financing into the AML/CFT system, strengthen supervision of reporting entities, improve transparency of beneficial ownership of trusts, address offence and penalty deficiencies, and improve customer due diligence (CDD) settings.

45 Further deficiencies and potential improvements will need to be addressed later, such as insufficient preventive measures for key money laundering channels in virtual asset service providers and remittance networks (resolved by licensing). Appendix A sets out the next phase of priorities.

46 The priorities broadly fall into three workstreams.

Workstream 1 – Immediate relief to business via amendment Bills

47 Workstream 1 is currently well underway and will provide business with immediate relief from compliance burdens and reduce compliance costs through the Regulatory Services (Justice) Amendment Bill (RSJAB), and a Statutes Amendment Bill (SAB).

48 Changes in these Bills will reduce regulatory burden on New Zealanders by:

48.1 removing the obligation to verify the address of all customers. Most people will not need to provide information to prove their address, which is important for vulnerable members of society who do not have the documentation currently required. This will improve financial inclusion in New Zealand;

48.2 extending reporting timeframes for suspicious activity reports for lawyers and prescribed transaction requirements; and

48.3 removing mandatory enhanced customer due diligence requirements for low-risk trusts. Most trusts would not have to provide nearly as much information to financial service providers. In particular, information on source of funds, which

makes accessing and changing financial services much easier for most trusts and removes the significant burden for financial service providers.

49 I have heard from industry these changes will make a difference to business and provide immediate regulatory relief.

50 The Commerce Commission reported friction for customers when switching financial service providers due to identification checks to meet AML/CFT[8]. The report recommended prioritising competition concerns when reforming the AML/CFT regime. It states reducing address verifications, as is in workstream 1, could help vulnerable customers and reduce switching barriers. This would benefit financial inclusion and help reduce barriers to accessing basic banking services.

51 The Commerce Commission report also recommended the unjustified level of scrutiny on Māori land trusts should be reduced. It reported that relaxing mandatory requirements to conduct CDD, as is in workstream 1, would work towards this. The report also considers this change would help reduce barriers to lending for housing on Māori freehold land.

52 The SAB is currently on track for introduction on 17 September 2024, with enactment on 28 April 2025. The RSJAB is currently on track for introduction S9(2)(f)(iv)

Workstream 2 – Effective and efficient structures

53 This workstream considers two significant structures in the system: the supervisory structure and the funding model. Reforming the supervisor structure and funding model will allow the system to be more responsive to industry and community needs, more focused on risks, and more agile. The new proposed changes would empower businesses to relax mitigations in low-risk settings, and give the private sector a role to participate in driving ongoing system change.

54 The statutory review considered whether an alternative approach to supervisory arrangements could better deliver risk-based supervision, supervisory consistency, support efficient implementation of obligations, and provide more support to businesses to comply with their obligations. Moving to a single supervisor will streamline decision-making to allow for a real risk-based approach and the required support for businesses. I have heard from industry this could deliver substantive regulatory relief. Analysis indicated that a single supervisor is a better structure than the current model which splits supervision across three agencies (DIA, FMA, and RBNZ).

55 The AML/CFT system is currently predominately Crown funded, but is not a pure public good.9 A new funding model, which better aligns with cost recovery principles could deliver significant savings to the Crown. These savings would come from current Crown funding provided to the Ministry, DIA, and the Financial Intelligence Unit in Police which would no longer be required if the funding model saw the industry regulation component of the system levy-funded, whilst the criminal justice component

[8] In the Commerce Commission New Zealand's 'Personal banking services' final competition report.
[9] RBNZ and FMA are not fully crown funded – RBNZ is wholly funded by a five-year funding arrangement with the Minister of Finance, and FMA is predominately levy funded with some crown funding. All other agencies involved in AML/CFT are crown funded for their AML/CFT work.

remained Crown funded. Tying in the levy to industry involvement in the national strategy would further involve the private sector and enable input on system direction.

56 I intend to seek Cabinet's agreement to the system-level changes in the coming weeks. These changes are necessary to implement and fund other changes I am proposing. Much of the opportunity for regulatory relief sits at the operational level. In considering how to improve the supervisory model, I am looking at how this change could be implemented so the positive effects can be felt as soon as possible, such as ensuring work on guidance for industry and codes of practice are commenced promptly.

57 I have made it clear to officials that the introduction of any levy should not place an undue financial burden on New Zealand's low-risk small businesses. A new funding model will mean better and more efficient regulation, supervision and support. I have seen this hybrid-funding model used in Australia, Canada and the United Kingdom to deliver good support to business.

58 A levy will ensure the system has sufficient resources in 2026/2027 to be able to do more work in advance of the FATF evaluation. Without agreeing to a levy, Crown funding will be required to implement the broader regulatory package and establish a single supervisor.

Workstream 3 – Enhanced regulatory settings and mitigating grey-listing risk

59 Workstream 3 contains changes to regulatory settings that provide benefits for tackling organised crime, provides regulatory relief, S9(2)(d)

60 My proposed workstream contains initiatives that come from statutory review recommendations, which was informed by the latest FATF evaluation. Changes include:

60.1 changing the settings for business groups so the expectation is for compliance by groups rather than individual businesses;

60.2 bringing in proliferation financing and targeted financial sanctions to the supervised regime so businesses have clear obligations and are supported;

60.3 developing a closed trust register;

60.4 reforming offence and penalty settings; and

60.5 improving customer due diligence settings.

61 This workstream also provides regulatory relief through simplifying customer due diligence settings. This initiative reduces duplication of customer due diligence requirements and obligations. Other regulatory relief initiatives include a closed trust register and group wide compliance changes.

62 This workstream supports law enforcement and assists in tackling organised crime by providing better tools and financial intelligence. Areas of reform such as a beneficial ownership register for trusts, and tightening up controls for terrorist financing and proliferation-financing are examples of improvements to support law enforcement. Making beneficial ownership information more available would make police

investigations easier for companies and trusts. A beneficial ownership register is also an important component of countering foreign interference.

63 Further information on these initiatives, and what they work towards, are contained in the appendix.

64 Delivery of this workstream is dependent on funding via a levy in workstream 2. Alternative funding would need to be sought to implement these initiatives without levy funding.

65 I intend to introduce a Bill containing the initiatives in workstream 3 by April 2026.

This AML/CFT work programme has some risks

66 My officials have identified the most significant policy interventions to achieve my objectives. Due to resource constraints, my proposed legislative work programme has been significantly scaled from all possible changes that could be made to improve the system, deliver on the coalition agreement, S9(2)(d)

67 While this work programme is necessarily limited in scope, I consider it takes a pragmatic approach, and balances the current fiscal management approach with the economic risk and economic gain of improvements. What is progressed this term is a matter of priority. However, due to the importance of the work, I will continue to look at opportunities to expand my work programme as other priorities are delivered. Some key initiatives that could be progressed next are included in the appendix.

68 S9(2)(d)

Next Steps

69 Following Cabinet's agreement to my proposed work programme, I intend to:

69.1 Continue to progress workstream 1 through a Statutes Amendment Bill (SAB) and Regulatory Systems Justice Amendment Bill (RSJAB). These Bills are well advanced so we will be able to deliver regulatory relief to business quicker;

69.2 Seek policy decisions in coming months on proposed changes to the supervisor and funding models, with the view to introduction of a Bill by March 2025; and

69.3 Immediately commence targeted consultation during September and October 2024 to progress workstream 3 with the aim to seek policy decisions by Cabinet in April 2025 and ultimately see introduction of a Bill by April 2026.

Implementation

Cost-of-living Implications

70 AML/CFT regulation impacts New Zealand customers. I expect that improving the regime would flow to benefit everyday New Zealanders, such as improving financial

inclusion. Bringing New Zealand into international compliance further aligns New Zealand with key trading partners. In providing relief, I will make the system more risk-based and efficient which will flow through to the customers of reporting entities.

71 Providing information to help providers meet their AML obligations can be time consuming and prohibitive for customers. This is bad for competition, and flow on effects of poor competition may be felt by consumers. Reform can reduce this friction.

72 Cost-of-living implications for the levy will be considered in a future Cabinet paper.

Financial Implications

73 There are no immediate financial implications arising from this paper. Financial implications associated with structural and funding changes will be set out in a future Cabinet paper.

Legislative Implications

74 This paper does not seek any legislative decisions.

75 Four Bills have been included in the Government's 2024 Legislation Programme:

75.1 Workstream 1 – Immediate relief via SAB: with priority 5;

75.2 Workstream 1 – Immediate relief via RSJAB: with priority 5;

75.3 Workstream 2 – effective and efficient structures: with priority 5;

75.4 Workstream 3 – enhanced regulatory settings S9(2)(d)

Impact Analysis

Regulatory Impact Statement

76 As no regulatory decisions are being sought, a RIS is not required.

Climate Implications of Policy Assessment

77 There are no climate implications associated with this policy.

Population Implications

78 There are no populations implications associated with this policy.

Human Rights

79 There are no human rights implications associated with the policy agreed to in this paper. Any implications of the individual initiatives will be considered in further Cabinet papers where agreement to policy is sought.

Use of external Resources

80 No external resources were used.

Consultation

81 The following agencies were consulted on this Cabinet paper: New Zealand Treasury, Department of Internal Affairs, Financial Markets Authority, Reserve Bank of New Zealand, New Zealand Police, New Zealand Customs Service, Ministry for Business, Innovation and Employment, Ministry of Foreign Affairs and Trade, Inland Revenue, Public Service Commission, Office of the Privacy Commissioner, Ministry for Regulation, the Department of Prime Minister (Policy Advisory Group) and the Parliamentary Council Office.

Police's comment

82 Police considers these workstreams have been prioritised incorrectly and we are concerned the proposed work programme does not sufficiently focus on tackling organised crime. We recognise that a levy is important for resources however it risks disruption to workstream three through a focus on reorganisation of the supervisory model versus legislative change and will have less impact on tackling organised crime.

83 Workstream three is missing two significant elements critical to the integrity of the AML/CFT regime and protecting New Zealand against emerging threats in the area - preventative measures for money laundering through virtual asset service providers and agency powers (including freezing powers for Police). These are necessary to tackle organised crime. Police considers these pieces of work should be prioritised and implemented as soon as possible.

84 I have considered Police's comments. I have taken a pragmatic approach to an AML/CFT work programme and consider my proposed work programme strikes an appropriate balance between S9(2)(d) , delivering regulatory relief, and supporting tackling organised crime. As signalled earlier, as further resources become available I will continue to seek opportunities to make system improvements such as those noted by Police as other priorities are delivered.

Communications

85 I will consider any announcement in due course.

Proactive Release

86 I propose to release this paper and supporting material, subject to redactions as appropriate and consistent with the Official Information Act 1982.

Recommendations

The Associate Minister of Justice recommends that the Committee:

1 S9(2)(d)

2 **Note** my proposed work programme fulfils the Government's commitments in the National and ACT parties' coalition agreement;

3 **Note** I have proposed an AML/CFT work programme that can be achieved within Ministry of Justice baselines, supported by Justice Cluster underspends and the input of other AML/CFT agencies, S9(2)(d) and delivers some regulatory relief while considering other government priorities in the portfolio;

4 **Agree** the AML/CFT legislative work programme include the following three components:

4.1 Delivering immediate relief to business via amendment Bills, to be introduced in September S9(2)(f)(iv)

4.2 Effective and efficient structures, with the view to introduce a Bill by March 2025; and

4.3 Regulatory setting changes that both meet coalition commitments and mitigate grey-listing risks, with a view to introduce a Bill by April 2026;

5 **Note** that I intend to seek Cabinet's agreement to changes to the supervisor structure and to establish a sustainable funding model shortly; if a levy is not agreed, Crown funding will be required to implement the broader regulatory reform package;

6 S9(2)(d)

7 S9(2)(d)

8 **Note** that I will continue to seek opportunities to deliver further relief for businesses and make system improvements as other priorities are delivered.

9 **Note** that Justice officials will work with the AML/CFT Industry Advisory Group to identify further opportunities to improve effectiveness and efficiencies in the AML/CFT regime to progress as future work.

Hon Nicole McKee

Associate Minister of Justice

Appendix

Appendix – Legislative Initiatives

Appendix: AML/CFT Work Programme reforms that will deliver regulatory relief, support tackling organised crime and S9(2)(d)

Structural reforms (Table 1) will improve the efficiency and effectiveness of the AML/CFT system, supporting better analysis of risk and reducing costs for business.

Table 1: Structural reforms

Proposed reform	Workstream	How reform delivers Government priorities
Changing the supervisor model	Workstream 2 (Structural reform)	**Regulatory relief:** This work responds to industry feedback that the current three-supervisor model is slow and leads to inconsistent regulation. A single supervisor will reduce duplication of expenditure and improve the provision of advice and support for business.
Establishing an AML/CFT Strategy and work programme as part of introducing a levy	Workstream 2	**Regulatory Relief:** The Strategy will be developed in partnership with industry. This will support the development of an ongoing programme of work that will include a strong focus on identifying opportunities for regulatory relief.

The risk-based AML/CFT system enabled by these structural reforms will in turn enable the effective implementation of a wider programme of regulatory reforms that will provide business with regulatory relief (see below).

Table 2: Regulatory reforms

Proposed reform	Workstream	How reform delivers Government priorities
Address verification requirements	Workstream 1 (Amendment Bills)	**Regulatory relief:** This work will remove the obligation to verify the address for most customers. This will both reduce obligations on business and help vulnerable members of society who do not have the documentation currently required.
Timeframe for suspicious activity reports	Workstream 1	**Regulatory relief:** This will extend reporting timeframes for suspicious activity reports for lawyers and prescribed transaction requirements.
Removing mandatory enhanced customer due diligence (CDD) requirements	Workstream 1	**Regulatory relief:** This work will reduce the amount of information that most trusts would have to provide to financial service providers. This will make accessing and changing financial services easier for most trusts and reduces the burden for financial service providers.
Establishing a Beneficial Ownership Trust Register	Workstream 3 (Statutory reform work programme)	**Regulatory relief:** Businesses often need to undertake extensive processes to gather beneficial ownership information needed for CDD. A central beneficial ownership register for trusts would reduce compliance costs and duplication of CDD activities for business.

		Tackling organised crime through better financial intelligence to law enforcements agencies. S9(2)(d)
Simplifying standard CDD requirements	Workstream 3	**Regulatory relief:** This will progress a range of technical amendments that will simplify business CDD requirements and focus them more closely on actual risk. CDD is the largest cost driver for businesses when complying with their AML/CFT requirements.
Group wide compliance/reliance	Workstream 3	**Regulatory relief:** This work will review the application process for establishing designated business groups (DBGs). Reporting entities are only permitted to share customer due diligence information within a financial group if they apply and are approved to form as a DBG. The application process is resource intensive and costly. S9(2)(d)
Proliferation Financing Risk Assessment	Workstream 3	**Tackling organised crime by** creating further mitigations to avoid proliferation financing risks. S9(2)(d)
Targeted financial sanctions	Workstream 3	**Tackling organised crime** by protecting NZ economy through more mitigations in place to avoid sanctions breaches
Offences and penalties	Workstream 3	**Tackling organised crime** through ensuring offences and penalties are proportionate and dissuasive. S9(2)(d)
Exemptions	To be progressed as part of workstream 3 resources become available	**Regulatory relief:** This work will review the potential to expand the range of exemptions from AML/CFT requirements and amend the application process to make it more available to small and medium enterprises. This will reduce costs for exempt businesses.
Licensing of High-Risk Sectors	To be progressed as part of workstream 3 as resources become available	**Regulatory relief:** This work will involve the design of an AML/CFT licensing system for the highest-risk sectors that are not currently licensed. Currently these sectors struggle to gain approval to business with financial institutions. Licensing would mean that the AML/CFT system wouldn't prevent these businesses from receiving financial services. **Tackling organised crime** through preventive measures in vulnerable sectors to money laundering in New Zealand.

		S9(2)(d)
Agency Powers	To be progressed as part of workstream 3 as resources become available	**Tackling organised crime** through ensuring law enforcement and intelligence agencies have the powers they need to prevent illicit finance transactions.

ECO-24-MIN-0220

Cabinet Economic Policy Committee

Minute of Decision

Proposals for an Anti-Money Laundering and Countering Financing of Terrorism Legislative Work Programme

Portfolio **Associate Justice (Hon Nicole McKee)**

On 25 September 2024, the Cabinet Economic Policy Committee:

1 S9(2)(d)

2 **noted** that the work programme proposed in the paper under ECO-24-SUB-0220 fulfils the Government's commitments in the National and ACT Parties' coalition agreement;

3 **noted** that the proposed AML/CFT work programme can be achieved within Ministry of Justice baselines, supported by Justice Cluster underspends and the input of other AML/CFT agencies, S9(2)(d) and delivers some regulatory relief while considering other Government priorities in the portfolio;

4 **agreed** that the AML/CFT legislative work programme include the following three components:

4.1 delivering immediate relief to business via amendment Bills, to be introduced in September S9(2)(f)(iv)

4.2 effective and efficient structures, with the view to introduce a Bill by March 2025;

4.3 regulatory setting changes that both meet coalition commitments S9(2)(d) with a view to introduce a Bill by April 2026;

5 **noted** that the Associate Minister of Justice (Hon Nicole McKee) (the Associate Minister) intends to seek Cabinet agreement to changes to the supervisor structure and to establish a sustainable funding model, and that if a levy is not agreed, Crown funding will be required to implement the broader regulatory reform package;

6 S9(2)(d)

7 S9(2)(d)

8 **noted** that the Associate Minister will continue to seek opportunities to deliver further relief for businesses and make system improvements as other priorities are delivered;

9 **noted** that Ministry of Justice officials will work with the AML/CFT Industry Advisory Group to identify further opportunities to improve effectiveness and efficiencies in the AML/CFT regime to progress as future work.

Rachel Clarke
Committee Secretary

Present:
Hon David Seymour
Hon Chris Bishop (Chair)
Hon Shane Jones
Hon Brooke van Velden
Hon Dr Shane Reti
Hon Simeon Brown
Hon Paul Goldsmith
Hon Louise Upston
Hon Mark Mitchell
Hon Todd McClay
Hon Tama Potaka
Hon Matt Doocey
Hon Simon Watts
Hon Nicole McKee
Hon Melissa Lee
Hon Andrew Bayly
Hon Andrew Hoggard
Hon Mark Patterson
Simon Court MP

Officials present from:
Office of the Prime Minister
Office of Hon Mark Mitchell
Office of Hon Andrew Bayly
Officials Committee for ECO

In Confidence

Office of the Associate Minister of Justice

Cabinet Economic Policy Committee

Anti-Money Laundering and Countering Financing of Terrorism: reforming the supervisory model and establishing a sustainable funding mechanism

Proposal

1 This paper seeks agreement to reform two components of the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regulatory system to support compliance with Financial Action Task Force (FATF) standards: the supervisor model and the funding model.

Relation to government priorities

2 These proposals relate to the Governments' commitments in the National and ACT parties' coalition agreement, specifically the commitment to review and reform key sectors where the cost of regulations is overly burdensome for businesses.

Executive Summary

3 The Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (the Act) establishes a model for supervising businesses with obligations under the Act (reporting entities). The Act establishes the Department of Internal Affairs (DIA), the Financial Markets Authority (FMA) and the Reserve Bank of New Zealand (RBNZ) as supervisors of their respective reporting sectors[1].

4 In 2021, the Financial Action Task Force (FATF)[2] identified several deficiencies in New Zealand's AML/CFT system. S9(2)(d)

5 Cabinet has recently agreed an AML/CFT work programme [CAB-24-MIN-0381 refers] to S9(2)(d) , and deliver regulatory relief. To ensure that the AML/CFT system can effectively implement legislative reforms, we need:

5.1 a risk-based supervisory programme across our economy - that focuses on our highest risks and lowers unnecessary compliance costs elsewhere, and

5.2 greater flexibility in how resources are allocated, and reallocated, across our economy to implement that plan and respond to changes in risk.

6 The current supervisor model is inconsistent with effective risk-based regulation of the system. The absence of a single decision-making authority makes transferring supervisor resources to areas of greatest risk difficult. It also results in inefficient development of guidance for industry, inconsistent application of rules, and

[1] RBNZ supervises banks, FMA supervises financial services and DIA supervises a variety of reporting entities designated non-financial businesses and professions (e.g. law firms), casinos, the TAB NZ and remitters.

[2] FATF is the inter-governmental body which produces global standards for AML/CFT regulation.

S9(2)(d)

duplication of expenditure. Most like-minded jurisdictions (including Australia and Canada) have established a single supervisor to monitor AML/CFT compliance.

7 I am seeking Cabinet's agreement to amend the Act to establish DIA as the single supervisor of the AML/CFT System. This will improve efficiency, support more effective allocation of resources to risk, enable more timely provision of guidance and support to industry, and thereby support the realisation of opportunities that reduce costs and barriers for business and consumers.

8 I am also seeking Cabinet's agreement to introduce a levy-making power into the Act. This will help ensure the AML/CFT system is adequately resourced to respond to emerging risks and provide support for reporting entities. A levy on reporting entities is consistent with cost-recovery principles, and the approach taken by like-minded jurisdictions. The Act will require that the levy's development be contingent on the creation of an AML/CFT National Strategy and work programme to ensure that costs are equitable and reasonable.

Background

Compliance with the AML/CFT Act is currently monitored by three supervisors

9 The Act establishes a model for supervising reporting entities to ensure their compliance with the AML/CFT system.

10 The Act deliberately describes the obligations of reporting entities in a high-level and non-prescriptive manner. Detail is intended to be provided in regulations and interpretation set out in guidance provided by the supervisors.

11 The Act establishes three supervisors: the RBNZ, the FMA and DIA. DIA is Crown funded. The majority of the FMA's supervisor activities are levy funded (83%), with the remainder Crown funded. The RBNZ is funded from revenues generated from its operations.

12 The Act also establishes an AML/CFT National Co-ordination Committee (NCC) comprising of representatives of the three supervisors, the Ministry of Justice (MoJ), Customs New Zealand and New Zealand Police, to ensure the consistent, effective, and efficient operation of the AML/CFT regulatory system.

Reform to the supervisor and funding model is necessary to support wider legislative reform

13 New Zealand underwent an assessment of our compliance with FATF standards in 2020-21, known as a Mutual Evaluation review (MER). The MER identified several issues, including the need for significant improvement to our supervisor model, and insufficient resources to carry out necessary regulatory functions. S9(2)(d)

14 S9(2)(d)

15 The Cabinet agreed AML/CFT work programme [ECO-24-MIN-0220 refers] will require decisions on the AML/CFT supervisor model and funding scheme because:

15.1 the supervisory model needs to apply a single risk-based supervisory programme across our economy, that focuses on our highest risks and lowers unnecessary compliance costs elsewhere, and

15.2 there needs to be much greater flexibility in how resources are allocated across our economy to implement that plan and respond to changes in risk.

System change: the supervisor model

A 2022 statutory review found that the current supervisory model is not well-placed to ensure effective and efficient compliance with AML/CFT requirements

16 Following the MER, MoJ undertook extensive engagement with industry and government agencies as part of the 2022 Statutory Review of the Act. In assessing the current supervisor model, the review identified that:

16.1 supervisor resources are not allocated to areas that represent the highest risks,

16.2 the supervisory model results in duplication of spending and requires additional resource to be used for coordination,

16.3 there can be inconsistencies between the supervisors' interpretation of the Act and the provision of guidance, and

16.4 reporting entities receive insufficient support resulting in overly prescriptive measures that increase costs and raise barriers for business and consumers.

17 The AML/CFT system requires that the three supervisors work together to meet the objectives of the legislation and implement a system-wide approach to supervision. In practice, the existence of three supervisors, two of whom have a high level of independence from the Crown, makes the delivery of system-level work costly and difficult. The different funding models for each supervisor also inhibits effective resource sharing and adequate prioritisation of emergent issues.

I am seeking Cabinet's agreement to a new single AML/CFT supervisor model

18 Officials have assessed a variety of alternative models for supervision with significant industry input (see the Regulatory Impact Statements in the **Appendix**). I agree with the approach, co-developed with industry of amending the Act to establish a single AML/CFT supervisor. This will:

18.1 **Tackle system level challenges** by:

18.1.1 moving resources as opportunities and risks change,

18.1.2 delivering core regulatory work (including workforce and planning) and build the necessary specialist capability to carry it out,

18.1.3 delivering a guidance work programme that ensures consistent interpretation and approaches to supervision across the sector.

18.2 **Deliver efficiencies in government** by removing duplication of corporate functions and making coordination across the AML/CFT system easier.

18.3 **Support industry and consumers** by providing consistent and up-to-date guidance and support, reducing compliance costs, and realising opportunities (such as digital identity and open banking).

18.4 **Adapt to an evolving AML/CFT risk environment** by establishing AML/CFT as a dedicated function (without the distraction of competing regulatory functions in other areas) with sufficient expertise and capability.

18.5 **Align our regulatory approach with that of our international partners** (a single supervisor model is utilised by Australia and Canada).

19 The financial intelligence function would remain with New Zealand Police and the policy and stewardship function for the AML/CFT system would remain with MoJ.

20 I also recommend updating the functions of the supervisor, MoJ and the Financial Intelligence Unit to reflect New Zealand's FATF obligations and to enable a risk-based supervisory approach that supports timely supervisory intervention.

I recommend that DIA become the sole supervisor and that the NCC is removed from the Act

21 In my view, establishing the single supervisor within an existing supervisor will deliver the benefits while minimising implementation costs and transition risks. Based on advice from my officials (see the attached *Regulatory Impact Statement: The supervisory structure of the AML/CFT system*), I recommend that DIA be established as the supervisor for AML/CFT compliance. I have engaged with the Minister of Internal Affairs who agrees with establishing DIA as the single supervisor.

22 If you agree to establish a single-supervisor, I recommend removing references in the Act to the NCC. The level of specificity regarding the NCC in the Act is not consistent with Legislation Design Advisory Committee (LDAC) Guidelines and is not required by the FATF Standards. Most of the functions of the NCC relate to coordinating between the supervisors, which will no longer be required.

23 If the NCC is removed from the Act, I propose giving MoJ a general direction to establish committees as required to give effect to the Act. Officials have discussed this proposal with the NCC and its members signalled that if a single-supervisor is established, they support the NCC's removal from the Act.

DIA agrees to becoming the single supervisor, subject to an analysis of the costs and risks

24 While DIA has indicated agreement to becoming the single supervisor for the AML/CFT regime, they have concerns that the practical costs and risks are not fully understood. They consider there is a good case for change, but it is not yet clear whether financial efficiencies are significant (or when they will be delivered), and what level of costs would need to be passed on to regulated parties.

25 DIA propose that officials report back to Ministers within six months on the findings of a due diligence process. This process will help to build DIA's understanding of the practical challenges in transition (e.g. ICT transition costs and data migration) and an

indicative cost burden on regulated parties. DIA has no objection to the policy and legislative work associated with a single supervisor progressing ahead of due diligence based on decisions from Cabinet in this paper, subject to final Cabinet approval of the financial arrangements by the time legislation is introduced.

26 MoJ officials consider that potential transitional costs can be met without fiscal impact if Cabinet agrees to implement a levy for AML/CFT. MoJ is also confident that financial risks can be sufficiently mitigated now by related decisions on transferring Crown funding. MoJ will provide support to DIA in identifying financial risks and can provide advice to Ministers on how to front load the levy.

RBNZ does not support the single supervisor model

27 RBNZ has concerns with the depth of the analysis completed and considers a case for change to the existing supervisor model has not been made. It does not support the preferred option of making the DIA the single supervisor. Its view is that S9(2)(d) – improvements to the legislative framework should be the priority, rather than costly and disruptive structural changes.

28 It believes that the criticisms of supervisors are often caused by ambiguous and poorly drafted legislation, rather than the multi-supervisory structure. Its position is that a change in the structure of the supervisory model is not necessary in order to impose a levy. It believes that the banking industry (the largest and highest risk sector) is highly likely to have concerns with the preferred option, DIA as the single supervisor.

FMA and New Zealand Police recommend that the AML/CFT legislative programme be prioritised over structural reform

29 It is FMA's view that the work programme set out in *Proposals for an AML/CFT legislative work programme* should be prioritised over any changes to the structural model. This work would improve S9(2)(d) and would be the most impactful workstream to address the most immediate AML/CFT system needs. 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.

30 New Zealand Police has also expressed their preference that the legislative suite of work outlined in *Proposals for an AML/CFT legislative work programme* should be prioritised over structural reform. Its view is that structural reform risks disrupting the AML/CFT system, which could delay the benefits of the legislative work programme, S9(2)(d)

Reform to the supervisor model to establish a risk-based AML/CFT system is based on robust analysis and is required to support the delivery of wider legislative reforms

31 The decision to establish a single supervisor has been considered through the Statutory Review, consultation with international peers and extensive analysis. During the Statutory Review the Ministry received 220 submissions, including banks, law firms, real estate agencies, financial services, retirement villages and virtual asset service providers. There was strong support overall for a single supervisor. I have also

encountered a desire for reforming the supervisor model in my personal discussions with industry stakeholders.

32 The Statutory Review also did not recommend change to the high-level drafting of the Act. The Act was drafted this way to allow the AML/CFT system to be responsive to changing risks, and to empower supervisors to issue guidance. This is consistent with LDAC guidance and international best practice.

33 While I note FMA and the New Zealand Police's concerns, structural reform is required to ensure the AML/CFT legislative work programme is effectively implemented and funded. I therefore do not agree with the comments of agencies expressed above.

Introducing a sustainable funding system

Crown funding is not suitable for all aspects of the AML/CFT system

34 In comparable regulatory regimes in New Zealand and overseas, the operational costs of a well-regulated market are 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. Without the AML/CFT regime the costs (and outright barriers) to overseas trade would also increase. I consider it reasonable to recover the cost of maintaining ready access to international trade and investment from those entities who benefit most.

35 The AML/CFT regulatory system is also responding to a negative externality (i.e. money laundering) enabled through the operation of reporting entities and their customers. Under cost recovery principles, responses to such negative externalities are usually funded by the businesses that cause, exacerbate or can otherwise manage the harm (e.g. by putting in place systems to detect and report suspicious activity).

I recommend Cabinet create a transparent funding model that enables an integrated approach to AML/CFT supervision and intelligence

36 I recommend introducing a hybrid-funding model to fund the AML/CFT system consisting of an AML/CFT levy and Crown funding.

37 A hybrid funding model enables the recovery of regulatory costs from those entities that are at greatest risk of being used for money laundering or terrorism financing (ML/TF), and therefore benefit from the AML/CFT system. At the same time, it will still provide Crown funding to reflect the public-good aspects of the system. The levy would be designed to ensure the system is resourced in proportion to the changing risk environment for ML/TF.

38 My preferred option would involve the levy being paired with the delivery of a National AML/CFT Strategy and work programme (the Strategy). This model has already been successfully used to fund problem gambling services through the Problem Gambling Levy.

39 The levy would cover the cost of the single supervisor, MoJ and the Financial Intelligence Unit in giving effect to their functions, powers, and duties under the Act. Integrating funding for all the functions of the AML/CFT Act will result in a more

cohesive and coordinated AML/CFT system. This approach is consistent with cost-recovery principles as it will support risk-based regulation, and more effective detection and deterrence of ML/TF. Additional detail will be provided to Cabinet before decisions are made on the size, timing, and apportionment of the levy.

40 I propose that the Act require the development of the Strategy (to be updated every three years and approved by Cabinet). I also recommend the establishment of a new Oversight Committee, to be accountable to the Minister of Justice, the Minister of Police and the Minister of Internal Affairs for the delivery of the Strategy.

We consider that the levy can be designed to ensure that costs are equitable and reasonable

41 I recommend the Act be amended to provide a regulation-making power to make, implement and collect a levy to recover costs of the functions, powers, and duties under the Act (see the attached *Regulatory Impact Statement: AML/CFT Funding Model* for further details).

42 Primary legislation will set out what categories of cost can be recovered by the levy, and whom the levy is to be paid by. The legislation will allow levy payments to differ between reporting entity types to reflect the nature of the risks associated with their activities, and other matters (e.g. ability to pay).

43 The levy regulation-making power will require that consultation with reporting entities and other industry stakeholders be undertaken before setting the levy. It will set out what factors that the Minister may consider when recommending a levy, sanctions for non-payment of the levy, and the power to enforce payment. The legislation will also allow levy exemptions or waivers by the Secretary for Justice.

44 Officials have conducted a preliminary analysis on the impact of an AML/CFT levy applied through regulation (see attached Stage 1 Cost Recovery Impact Statement for details). In line with international experience, but depending on the weightings set, my expectation is that:

S9(2)(d)

While industry was initially generally opposed to a levy, they showed more support for it if accompanied by the development of a collaborative supervisory work programme

45 During the Statutory Review, stakeholders were consulted on the option of introducing a flat fee largely opposed a levy because:

45.1 Some businesses already pay licensing fees to another system

45.2 A flat fee would be disproportionate to the risk in some sectors, and

45.3 AML/CFT outcomes are a public good, and so the costs should be borne by Government.

46 To respond to these concerns, officials held a series of targeted engagement workshops with sector stakeholders in April 2022. Attendees expressed more support for the introduction of a levy, if it was based on a collaborative work programme that would better respond to the needs of reporting entities (e.g. guidance, codes of practice, new risk assessments). We will continue to work with industry during the levy's development to ensure cost-recovery is equitable and risk-appropriate.

Next Steps

47 The implementation of the new single supervisor and funding models will require amendments to the Act and promulgation of new supporting regulations. If the recommendations in this paper are accepted, I will direct MoJ to issue drafting instructions for the Bill to the Parliamentary Counsel Office.

48 Officials will then consult with industry on the structure of the levy. I will return to Cabinet in May 2025 to seek your agreement on the content of the levy regulations. This paper will set out the full costings of the AML/CFT system that will be met from the levy and the amount that the Crown will continue to fund.

Cost-of-living implications

49 It is unlikely that an AML/CFT levy would lead to an increase in the cost of living. There may be an outsized impact on investors in speculative virtual assets (e.g. cryptocurrencies) and very high-risk sub-sectors that are comprised of small and medium sized enterprises. There will, in time, be cost of living benefits through related government programmes, such as open banking and digital identity, and reducing the compliance costs for many New Zealand businesses.

Financial Implications

50 Currently, the Crown appropriates around $17 million per annum for the parts of the AML/CFT system. I intend to fund this by introducing a hybrid funding model. Another $2.4 million is spent by supervisors on AML/CFT from other sources (FMA funding and RBNZ's operating revenues). Introducing the levy will likely reduce the level of Crown funding required for the AML/CFT system on an ongoing basis.

51 However, I expect that the costs of the AML/CFT system in coming years will be greater than our current levels of expenditure. This will be required to meet the increasing expectations and standards of FATF and therefore for our continued access to international markets for trade and investment.

52 Amendments to FMA and RBNZ's funding to reflect the transfer of their AML/CFT functions to DIA will be decided by the agencies responsible for their funding (MBIE and the Treasury) when the law comes into effect in July 2026.

53 Officials will need to work through advice on the optimal level of funding for the AML/CFT system, and the split of Crown and levy funding within that as part of a Stage 2 Cost Recovery Impact Statement.

54 I also intend for any transitional costs that cannot be met from within baselines to be covered by a fiscally-neutral transfer from already appropriated funding (front loading). The levy will be introduced to make up any funding shortfall in future years.

Regulatory Impact Statement

55 Two Regulatory Impact Statements (one for the supervisor model and one for the funding model) and a Stage 1 Cost Recovery Impact Statement have been completed (see Appendix). MoJ's Regulatory Impact Assessment quality assurance panel has reviewed the Regulatory Impact Statements. It found that they meet the quality assurance criteria and that the analysis can be relied on for decision-making.

Climate Implications of Policy Assessment

56 The Climate Implications of Policy Assessment (CIPA) team has been consulted and confirms that the CIPA requirements do not apply to this proposal as the threshold for significance is not met.

Legislative Implications

57 If the recommendations in this paper are accepted, I will direct MoJ to issue drafting instructions to the Parliamentary Counsel Office for a Bill to enact the policy proposals outlined in this paper.

58 I also seek authority to decide minor and technical policy issues that arise during the drafting of the proposals outlined in this paper (e.g. to remove references to multiple supervisors).

59 MoJ has made a bid for the Bill to be included on the 2025 Legislation Programme with a priority 5 categorisation.

Table 1: Timeline for the implementation of reforms to AML/CFT funding and supervision

Milestone/Activity	Timeframe
April 2025	LEG and Cabinet approval to introduce the Bill
April 2025	Introduction
April – July 2025	Select Committee
Q4 2025	Primary legislation passed
TBC	Cabinet approval of levy settings
TBC	Secondary legislation comes into effect

Population Implications

60 The proposals contained in this paper will primarily impact on reporting entities, through their contribution to the levy, and their engagement with the AML/CFT regulatory system.

61 The new levy and supervisor models will support the AML/CFT system to effectively tackle organise crime. These proposals should therefore benefit those (disproportionately in disadvantaged communities) harmed by organised crime.

62 System-level supervision should also lead to better identification of the unintended consequences of the AML/CFT regulatory system, including those that have potential Treaty of Waitangi implications. One example of this is the extent to which the Act supports or inhibits the ability of Māori to engage with the formal financial system.

Human Rights

63 There are no immediate impacts on human rights arising from the proposals outlined in this paper.

Consultation

64 MoJ sought public submissions on the AML/CFT supervision and funding models as part of the 2022 Statutory Review. The resulting report was heavily consulted on with Crown agencies and entities, and with the private sector. MoJ then undertook iterative consultation with targeted groups of private sector stakeholders, including an Industry Advisory Group to develop recommendations for change.

65 The following agencies were consulted in relation to this Cabinet paper: DIA, FMA, RBNZ, New Zealand Police, New Zealand Customs Service, the Treasury, Ministry of Business, Innovation and Employment, the Inland Revenue Department, the Department of the Prime Minister and Cabinet (Policy Advisory Group), the Ministry of Foreign Affairs and Trade, the Office of the Privacy Commissioner, the Public Service Commission, the Ministry for Regulation and the Parliamentary Counsel Office.

Communications

66 I intend to publicly announce these proposals in due course.

Proactive release

67 As per Cabinet Office Circular CO (23) 4: Proactive Release of Cabinet Material – Updated Requirements, this Cabinet paper will be proactively released subject to any redactions that may be warranted under the Official Information Act 1982.

Recommendations

The Associate Minister for Justice recommends that the Committee:

1 S9(2)(d)

2 **note** that S9(2)(d) and providing regulatory relief to business, will require reforms to the AML/CFT supervisor and funding models because:

2.1 the funding model must support risk-based AML/CFT supervision across our economy and be consistent with cost recovery principles; and

2.2 we need a more efficient and effective supervisor model to allocate resources across our economy, as needed, to respond to risk;

3 **agree** to amending the AML/CFT Act 2009 (the Act) by:

3.1 replacing the three-supervisor model with a single AML/CFT supervisor;

3.2 establishing the Department of Internal Affairs (DIA) as the single supervisor;

3.3 updating the functions of the supervisor, the Ministry of Justice and the Financial Intelligence Unit to reflect New Zealand's FATF obligations and to enable risk-based supervision and effective collection of a levy;

3.4 introduce a levy-making and collection power:

3.4.1 to be given effect through secondary legislation;

3.4.2 on reporting entities under the AML/CFT Act;

3.4.3 to recover costs incurred by the Crown in giving effect to functions, powers, and duties under the Act, including levy collection costs;

3.4.4 tied to the development of a National Strategy and work programme for AML/CFT, agreed by Cabinet (to be updated every three years);

3.4.5 that allows the levy to be differentiated so that sub-groupings of reporting entities are prescribed different levy amounts;

3.4.6 that requires consultation with reporting entities and other industry stakeholders to set the levy;

3.4.7 factors (if any) that the Minister must or may take into account when recommending a levy, including when setting differentiated levy amounts for reporting sectors or any sub-groups;

3.4.8 sanctions for non-payment of the levy by a reporting entity;

3.4.9 power to enforce the payment of a prescribed levy;

3.4.10 power for the Chief Executive of the Minister of Justice to waive (in total or part) payment of the levy by any one or more reporting entity or reporting sector;

3.4.11 any transitional arrangements, if needed for New Zealand's next FATF Mutual Evaluation Review, for the initial setting of the levy;

3.5 remove references to the AML/CFT National Co-ordination Committee from the Act (including sections 150, 151 and 152), and

3.6 give the Ministry of Justice the power to establish an oversight committee for the AML/CFT National Strategy and work programme related to the levy, and such other committees as are required to give effect to the Act;

4 **note** that officials intend to report back to Ministers within six months on the findings of a due diligence process to assess the practical challenges in transition to a single supervisor and an indicative cost burden on regulated parties;

5 **note** that any transition costs that cannot be met from within baselines will be funded by a fiscally neutral front-loading of spending from existing departmental output expense appropriations, subject to joint-Minister approval;

6 **invite** the Associate Minister of Justice to issue drafting instructions to the Parliamentary Counsel Office for a Bill that amends the Act as outlined in recommendations 3;

7 **authorise** the Associate Minister of Justice to decide minor policy and technical issues arising during drafting, that align with the overall policy intent;

8 **invite** the Associate Minister for Justice to report back to the Cabinet Legislation Committee with the draft Bill by March 2025;

9 **invite** the Associate Minister for Justice to report back to Cabinet to seek approval for the AML/CFT levy regulations.

Hon Nicole McKee

Associate Minister of Justice

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

[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.

ECO-24-MIN-0228

Cabinet Economic Policy Committee

Minute of Decision

Anti-Money Laundering and Countering Financing of Terrorism: Reforming the Supervisory Model and Establishing a Sustainable Funding Mechanism

Portfolio **Associate Justice (Hon Nicole McKee)**

On 16 October 2024, the Cabinet Economic Policy Committee (ECO):

1 S9(2)(d)

2 **noted** that S9(2)(d) and providing regulatory relief to business, will require reforms to the AML/CFT supervisor and funding models because:

2.1 the funding model must support risk-based AML/CFT supervision across the economy and be consistent with cost recovery principles;

2.2 a more efficient and effective supervisor model is needed to allocate resources across the economy, as needed, to respond to risk;

3 **agreed** to amend the AML/CFT Act 2009 (the Act) by:

3.1 replacing the three-supervisor model with a single AML/CFT supervisor;

3.2 establishing the Department of Internal Affairs (DIA) as the single supervisor;

3.3 updating the functions of the supervisor, the Ministry of Justice, and the Financial Intelligence Unit to reflect New Zealand's FATF obligations and to enable risk-based supervision and effective collection of a levy;

3.4 introducing a levy-making and collection power:

3.4.1 to be given effect through secondary legislation;

3.4.2 on reporting entities under the AML/CFT Act;

3.4.3 to recover costs incurred by the Crown in giving effect to functions, powers, and duties under the Act, including levy collection costs;

3.4.4 tied to the development of a National Strategy and work programme for AML/CFT, agreed by Cabinet (to be updated every three years);

3.4.5 that allows the levy to be differentiated so that sub-groupings of reporting entities are prescribed different levy amounts;

3.4.6 that requires consultation with reporting entities and other industry stakeholders to set the levy;

3.4.7 factors (if any) that the Minister must or may take into account when recommending a levy, including when setting differentiated levy amounts for reporting sectors or any sub-groups;

3.4.8 sanctions for non-payment of the levy by a reporting entity;

3.4.9 power to enforce the payment of a prescribed levy;

3.4.10 power for the Chief Executive of the Ministry of Justice to waive (in total or in part) payment of the levy by any one or more reporting entity or reporting sector;

3.4.11 any transitional arrangements, if needed for New Zealand's next FATF Mutual Evaluation Review, for the initial setting of the levy;

3.5 removing references to the AML/CFT National Co-ordination Committee from the Act (including sections 150, 151 and 152);

3.6 giving the Ministry of Justice the power to establish an oversight committee for the AML/CFT National Strategy and work programme related to the levy, and such other committees as are required to give effect to the Act;

4 **directed** officials to report back to the Minister of Finance, Minister for the Public Service, Minister of Internal Affairs, Associate Minister of Justice (Hon Nicole McKee) (the Associate Minister) and the Minister of Commerce and Consumer Affairs by June 2025 on:

4.1 funding transfers;

4.2 implementation details of a single supervisor, including a detailed timeline for development of the AML/CFT National Strategy, levy policy, and levy regulations;

4.3 an indicative cost burden on regulated parties;

5 **noted** that any transition costs that cannot be met from within baselines will be funded by a fiscally neutral front-loading of spending from existing departmental output expense appropriations, subject to joint Minister approval;

6 **invited** the Associate Minister to issue drafting instructions to the Parliamentary Counsel Office for a Bill to amend the Act as outlined in paragraph 3 above;

7 **authorised** the Associate Minister to decide minor policy and technical issues arising during drafting, that align with the overall policy intent;

8 **invited** the Associate Minister to report back:

8.1 to the Cabinet Legislation Committee with the draft Bill by March 2025;

8.2 to ECO to seek content approval for the AML/CFT levy regulations by May 2025.

Rachel Clarke
Committee Secretary

Present:
Hon David Seymour
Hon Nicola Willis (Chair)
Hon Chris Bishop
Hon Brooke van Velden
Hon Simeon Brown
Hon Erica Stanford
Hon Paul Goldsmith
Hon Louise Upston
Hon Todd McClay
Hon Tama Potaka
Hon Simon Watts
Hon Nicole McKee
Hon Melissa Lee
Hon Penny Simmonds
Hon Nicola Grigg
Hon Andrew Bayly
Hon Andrew Hoggard
Hon Mark Patterson
Simon Court MP

Officials present from:
Office of the Prime Minister
Department of Internal Affairs
Ministry of Justice
Officials Committee for ECO

Regulatory Impact Statement: AML/CFT Funding Model

Purpose of Document	
Decision sought:	Implement a levy to partially recover the costs of the regulatory system for Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT).
Advising agencies:	Ministry of Justice
Proposing Ministers:	Hon Nicole McKee, Associate Minister of Justice
Date finalised:	26 September 2024

Problem Definition

The funding model for AML/CFT does not support an effective or efficient regulatory regime and is not aligned to cost-recovery principles.

Executive Summary

This Regulatory Impact Statement (RIS) should be read in conjunction with document "The supervisory structure of the anti-money laundering and countering financing of terrorism system" (Supervisory Model RIS). The Supervisory RIS sets the context for this paper and outlines how efforts to launder money and finance terrorism are expected to become more complex over time and require risk-based supervision across the economy.

The funding model for AML/CFT is currently uncoordinated and inflexible to new and emerging issues and opportunities. This has contributed to a regulatory system that is unable to take a whole of system approach to risk-based regulation.

The AML/CFT system is only able to apply a risk-based approach within the separate bounds set for each of the three current supervisors. Resourcing levels are similarly set within the bounds of each actor in the regulatory system, and their individual funding sources, rather than based upon the national risk environment.

Our funding model is also inconsistent with comparator countries, where cost-recovery typically funds most AML/CFT intelligence and supervisory activity. Only a relatively small proportion of our supervisory system is cost-recovered and the intelligence system is largely Crown funded.

The structural changes sought in the accompanying AML/CFT Supervisory Model RIS would best be supported by a funding model that is:

a. stable enough to implement a multiple-year risk-based work programme
b. flexible enough to reallocate resources anywhere in the AML/CFT system as national and sector risk assessments for ML/TF are updated
c. able to realise opportunities identified by industry and minimise compliance.

The model should also be consistent with principles for cost recovery and incentivise efficiencies by both reporting entities and government while achieving (a) to (c).

The work contributing to this RIS considered various options to unify the funding model for the regulatory system, including additional Crown funding or utilising the Proceeds of

Crime Fund. Those and other options were ruled out, with this RIS focussing on a pair of options based on cost recovery.

Options analysis in this RIS has found partial cost recovery through a levy provides the best way forward. This would part-fund the AML/CFT regulatory work of the Financial Intelligence Unit, Department of Internal Affairs, and the Ministry of Justice.

Based upon current regulatory expenditure, an upper limit for an AML/CFT levy for the preferred option is $23 million per annum. Ongoing Crown funding of public good aspects of the system would decrease this amount.

There are many details to work through with industry before the Stage 2 CRIS, but initial analysis is that the proposed levy would be able to be implemented without significant impact on industry. Industry reaction to the proposed levy is likely to be negative, however, an enhanced level of industry involvement in setting the levy-funded work programme could mitigate the level of negative reaction.

Limitations and Constraints on Analysis

The proximity to our next mutual evaluation (ME) by the Financial Action Task Force (FATF) in 2028 limits the time available for additional analysis and consultation to better inform decision-making in respect of legislative and funding changes.

High level costings for current regulatory services have been provided to inform this RIS, more detailed information will be needed to establish the amount to be cost-recovered.

The Ministry of Justice has not received requested qualitative risk assessment or quantitative information on reporting entities from supervisors that could be used to calibrate a levy. Reliance on publicly available information has an impact on the level of confidence able to be given in the CRIS on how the levy should/could be apportioned.

Industry have been consulted on the possibility of a levy for the AML/CFT regime, but this was limited and focussed on a flat fee rather than a differentiated levy. There are proposals to add levies on AML/CFT reporting entities for other regulatory regimes. These are at varying levels of certainty and design, so the cumulative impact is difficult to assess.

Responsible Manager(s) (completed by relevant manager)

Rajesh Chhana

Deputy Secretary - Policy

Ministry of Justice

26 September 2024

Quality Assurance	
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.

Section 1: Diagnosing the policy problem

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

Current state

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

1. 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. Undetected money laundering enables and incentivises offending that impacts the wellbeing of New Zealand communities and threatens New Zealand's international reputation.
2. 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. There is also the risk that New Zealand becomes a conduit for layering or transferring funding for large-scale terrorism or proliferation in third countries.
3. The broader legislative framework and roles of the agencies involved in the regulatory system are set out in Annexes A and B respectively.

Resourcing of the system

4. Table 1 summarises information on current regulatory expenditure for AML/CFT. The AML/CFT regulatory system is majority Crown funded.

Table 1: System Resourcing 2024/25 (000's)

Agency	Funding source	Direct AML/CFT spend	Indirect AML/CFT spend[1]
Ministry of Justice (MoJ)	Crown funding	1,085	0
Department of Internal Affairs (DIA)	Crown funding	10,336 combined direct/indirect spend	
Financial Markets Authority (FMA)	Levy and Crown funding[2]	635	142
Reserve Bank of New Zealand (RBNZ)	RBNZ Funding Agreement	1,277	422
Financial Intelligence Unit (FIU)[3]	Crown funding	5,600	0
Total current spend		19,497	

Analysis has been limited to core AML/CFT regulatory entities.

[1] Indirect means supporting functions for the obligations under the Act, such as legal and communications teams. DIA has provided a combined estimate (only total costs).

[2] Approximately split of 83% levy and 17% Crown funding with a separate Crown-funded litigation fund which includes AML enforcement.

[3] The Financial Intelligence Unit is housed within NZ Police and is funded out of the broader Financial Crime Group. As its functions are distinct from wider Police work, and under international standards the FIU should be set up as an independent entity, we have looked at its resources separately from that of NZ Police.

2) What is the policy problem or opportunity?

The funding model does not support an effective or efficient regulatory regime

5. The funding model for AML/CFT is uncoordinated and inflexible to new and emerging issues and opportunities. This is flowing through to a regulatory system that is increasingly driven by operational silos and unable to take a whole of system approach to risk-based regulation.

6. Changes to Crown-funding also has an uneven impact across reporting sectors depending on who the supervisor is, rather than on a risk-based approach. The negative impact on system effectiveness of inconsistent funding settings was noted in the Regulatory Maturity Survey.[4]

7. The majority Crown-funding for a system that benefits industry or addresses an externality is also inconsistent with cost recovery principles. See problem definition in CRIS Stage 1 and Annex D for more detail on this issue.

The status quo will lead to negative economic impacts for New Zealand

8. The corresponding Supervisory Model RIS outlines in more detail the current state of ML/TF and how AML/CFT is expected to develop in New Zealand. To summarise, it is expected that ML/TF (and related proliferation financing) will become more sophisticated and outputs of AML/CFT system will need to adapt to this.

9. S9(2)(d)

10. S9(2)(d)

11. There are also wide-ranging economic impacts from an ineffective AML/CFT system.

The status quo will increase compliance costs and not realise opportunities

12. The level of mutual reliance by reporting entities and consumers in different AML/CFT reporting sectors is expected to increase. Digital enablers are rapidly evolving to increase payments and financial services flexibility, and we continue to reduce barriers to international investment and trade with key partners.

13. The system is not able to keep up with desirable change in the economy. This increases compliance burdens for legitimate business activity and impedes positive consumer outcomes. For instance, the Commerce Commission's study into retail banking competition found AML/CFT measures and their implementation detrimental to personal banking competition and financial inclusion. Its final report notes the considerable overlap of its own findings with those of the Statutory Review of

[4] Undertaken for the Act as part of a Statutory Review published in 2022Ministry of Justice (2022) *Report on the review of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009*.

AML/CFT, and the lack of progress on its recommendations despite the competition and consumer benefits they would realise.[5]

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

14. The funding model for AML/CFT should be:
    a. stable enough to implement a multiple-year risk-based work programme
    b. flexible enough to reallocate resources anywhere in the AML/CFT system as national and sector risk assessments for ML/TF are updated
    c. able to realise opportunities identified by industry and minimise compliance.
15. The model should also be consistent with principles for cost recovery and incentivise efficiencies by both reporting entities and government [while achieving (a) to (c)].

[5] Commerce Commission. *Personal banking services,* Final Competition Report 20 August 2024. Page 295. Refer to the accompanying Supervisory Model RIS for more detail on the Statutory Review.

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

1) What criteria will be used to compare options to the status quo?

Table 2: Criteria used to compare alternative options with the status quo

Criteria	What this means
Funding enables a risk-based approach.	The amount and allocation of funding for AML/CFT can change in line with the national risk environment.
The AML/CFT system aligns with cost-recovery principles.	At a system level, this would require efficient allocation of resources across the public and private sector and equity between the two (i.e. role of cost recovery in the system).
Feasibility.	Feasibility analysis will consider whether the option can be implemented: 1) within the current structure of the AML/CFT system, and 2) if the preferred option from the corresponding Supervisory Model RIS is progressed in tandem. Feasibility primarily relates to the need to implement improvements to our AML/CFT regime before our next ME by the FATF, in the context of resources at the Parliamentary Counsel Office and limited House time. Changes must be in place for two years for their effectiveness to be demonstrated and therefore considered as part of a ME by the FATF.

2) What scope will options be considered within?

Some funding models/options were ruled out

16. Cost recovery for the AML/CFT system is considered appropriate for three reasons:
    a. industry benefits from a well-regulated market that mitigates the impact on industry and its customers of the impacts of fraud in an effective and efficient manner,
    b. industry is enabling/creating a negative externality through their ordinary course of business, which should be mitigated and then any remaining cost internalised; and
    c. meeting FATF standards is a requirement for international financial and trade systems that provide direct benefits to reporting entities and their customers.
17. Additional Crown-funding was not evaluated as an option to cover the ongoing costs of supervision as it would not be consistent with cost recovery principles or provide desired incentives on industry or supervisor(s) to pursue efficiencies. The current model of majority Crown-funding of intelligence and supervisory functions is inconsistent with comparable countries as set out in paragraphs 28 to 32 below.
18. A levy-based funding model was given limited consultation through the Statutory Review. The Statutory Review model was based on each reporting entity paying $1,000 per annum. Industry feedback was that a flat fee would not reflect the difference in risk of ML/TF and benefits of AML/CFT across different reporting sectors and the entities within them. A flat fee or levy was therefore ruled out, and options for this RIS

were developed on the assumption that any payment would be weighted by relevant considerations to differentiate levy payers.

19. Cost recovery to provide a service to industry, or address a negative externality, can also be distinguished from cost recovery for a service that provides a discrete benefit to an identifiable person or entity (individual). Fees, rather than a levy, are not considered a viable option for substantive AML/CFT regulatory funding as they would create an incentive for reporting entities to avoid their AML/CFT obligations. This was also based on the experience in Australia, where a fees-based funding model was found to be impractical for reporting entities and had an excessive administrative cost. It created uncertainty of funding on a year-to-year basis and introduced additional complexity to setting cost recovery targets.

20. The use of Proceeds of Crime to fund the regime was discounted because of the incentives it would place upon a supervisor to seek 'revenue', and the level of uncertainty this would place on funding available for the regulatory work programme.

Extent of possible cost recovery

21. A key scope decision relates to the extent of public good funding that will continue to come from the Crown. In looking at the whole of the AML/CFT system, we consider that the roles of the supervisors, Financial Intelligence Unit, and the Ministry of Justice are responding to the negative externality enabled/created by industry, provide a service to industry, and are therefore within scope of cost recovery.

22. The roles of Police and the Ministry of Justice relating to other legislation within the AML/CFT system, most notably the Crimes Act and Criminal Proceeds (Recovery) Act, are criminal justice matters that are public goods not within scope of cost recovery.

23. The cost of prosecutions is similarly a criminal justice matter and any penalties awarded through the courts are returned to the Crown. The public/private split in terms of benefits of the AML/CFT regime, and how its costs should be borne, is discussed in more detail in the accompanying CRIS and will be better developed for its Stage 2.

Recent funding decisions on supervision for analogous regulatory functions

24. The Customer and Product Data Bill (CPDB) will give individuals and businesses greater choice and control over their data. It will require a 'designated' business to share customer data in a prescribed manner with accredited businesses. The CPDB will be introduced sector by sector, starting with the designation of banking products and data. The Bill allows for the introduction of a levy for each sector designated for inclusion in the scheme. It is proposed that levies will reflect the benefits or risks of operating in the designated sector. Some cost recovery may also occur through accreditation fees (accreditation is like licensing and involves registration).

25. The FMA also recovers the bulk of its funding from levies. In determining how to design its levy model, MBIE identified the following objectives:

    a. The cost of the levy for market participants is consistent with the benefits they receive from a well-regulated financial market;

    b. The levy will not discourage some classes of entity from supplying financial products or services; and

    c. The levy is practical in respect of its implementation, collection, and also avoids large over or under-collection.

26. All registered financial service providers (FSPs) must pay FMA levies annually. The FMA levy a FSP must pay depends upon the services it provides, and 'classes' of

service are then further delineated by either assets held, or revenue/fees received. A FSP must pay the full fee applicable for each class it is registered for (additive).

27. Recent funding decisions for both the External Reporting Board[6] and the Companies Office[7] have also implemented cost recovery from regulated entities on the basis that each provides a regulatory service for industry.

Relevant experience from other countries

28. Since the conclusion of the Statutory Review, which recommended looking into cost recovery options, the Ministry of Justice has undertaken consultation with Canada, the United Kingdom and Australia to better understand how cost recovery in their AML/CFT system works. The paragraphs below summarise the different systems, and commonalities across them. Annex C provides more details on the systems.

29. Canada's combined supervision and intelligence unit (FINTRAC) is entirely funded through cost recovery. The Department of Finance Canada and FINTRAC established guiding principles for FINTRAC's funding model, the first of which is that the funding model must generate sufficient funding for FINTRAC to administer its compliance program and the enabling internal services that support it.[8]

30. Australia's combined supervision and intelligence unit (AUSTRAC) is also entirely funded through cost recovery. Additionally, AUSTRAC undertakes some policy work (such as developing regulations) and provides Australia's delegation to the Asia-Pacific Group on Money Laundering (APG).

31. The United Kingdom recently implemented an Economic Crime Levy. This is an annual charge that levies entities (organisations) who are supervised under the Money Laundering Regulations and whose UK revenue exceeds £10.2 million per year. Funds raised through the levy do not go to specific regulators in set amounts, but instead to planned activities as outlined in the Economic Crime Strategy.

32. Key commonalities between overseas funding models were:

    a. Use of hybrid funding model to reflect creation of risk/vulnerability,
    b. Weighting of payments in accordance with risk, complexity, and profitability/revenue of payers,
    c. Accountability to industry on use of payments for support to industry in meeting their obligations, and
    d. Balancing fairness in apportioning costs and risk to reporting entities against administrative simplicity and efficiency in collection.

3) What options are being considered?

33. The Statutory Review (SR) considered the introduction of a hybrid public/private funding model for the regime through a 'flat fee' levy. A hybrid model was seen by the SR as having potential, as an industry contribution model would enable the regime to be more dynamic and responsive without being dependant on Crown appropriations.

34. Increased responsiveness could help ensure the regime would address compliance challenges at a faster rate, produce more comprehensive guidance, and make it easier for businesses to comply - and potentially reduce overall compliance costs.

35. Given existing compliance costs for industry, a levy was considered to need to demonstrate good value for money and deliver more responsive guidance, supervision,

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[6] https://www.xrb.govt.nz/

[7] https://www.companiesoffice.govt.nz/

[8] Development and administration of the assessment of expenses funding model (canada.ca)

support, and regulatory reforms. The SR proposed that this could be achieved by basing any contribution from industry on a forward workplan agreed to between the private sector and public sector.

36. Most submitters to the SR opposed cost recovery. As mentioned above, there was particular opposition to a flat fee as the basis for cost recovery. Other points raised against cost recovery were that many reporting entities already paid a licensing fee, and that AML/CFT outcomes are a public benefit and the costs should be borne by government through general taxation. Similar arguments have been raised by a minority of industry stakeholders when the FMA levy is updated/increased.

37. Workshops conducted as part of the SR expressed less opposition to the proposal for a levy if it was determined by/for a collaborative work programme. The findings of the SR, and subsequent developments through targeted consultation with industry, have led to the development of two cost recovery options:

    1) Only cost of AML/CFT supervision, or
    2) Covering the AML/CFT cost of supervisors, FIU, and MoJ.

Two key assumptions have been made throughout these options:

38. **Assumption One:** any levy would be risk-based, with payment per entity within a levy band or grouping dependant on a range of criteria likely to encompass risk, complexity of supervision, and profitability/ability to pay. Size of entity would relate both to ability to pay and use of regulatory services.

39. **Assumption Two:** any levy for regulatory functions would replace rather than supplement current resourcing for that regulatory function. Crown-funding will be appropriated for the public good element of the AML/CFT regime. We have not assumed current expenditure at FMA/RBNZ would reduce on a 1:1 basis.

40. We note that this RIS is limited to an initial estimate of costs to be recovered under different levy options to understand potential (maximum) financial impacts on industry. If a new levy option is progressed, the level of 'sufficient' resources for cost-recovery would be more accurately calculated and consulted through the CRIS Stage 2 process.

41. In addition, the level of sufficient resources for supervision will be impacted by any decision to change the supervisory model or add to its work programme.

Option One – *Status Quo*

42. The status quo option sees the AML/CFT system being majority Crown-funded and subject to individual departmental/agency prioritisation. No additional Crown funding is anticipated as being available in the short-medium term.

43. The status quo does not meet criteria for enabling a national risk-based approach to resourcing or align with cost-recovery principles. The issues outlined in section 1(2) above will remain and objectives in section 1(3) will not be realised. The status quo funding model remains feasible with no structural change but, without additional Crown funding, would limit the progress of other options in the Supervisory Model RIS.

Option Two – *Levy for cost of supervision*

44. Option Two would see the cost of the supervisors delivering their regulatory functions under the Act as being majority levy funded. It would encompass direct supervision, enable functions (such as use of supporting intelligence, legal, and communications teams), and the supervisory component of international coordination.

45. This option would better enable risk-based supervision, but not address resource allocation across the wider regime. There would be a benefit to industry in terms of

improved support and reduced compliance as supervision has the most direct impact on reporting entities. Option Two will partially enable a national risk-based approach.

46. Recovering the costs of supervision would align with cost recovery principles as supervision is wholly responding to the externality of ML/TF and the service provided thorough the AML/CFT system. If risk-weighting of cost recovery through the levy is based upon residual risk, it also provides an incentive on industry to improve coordination and risk mitigation through new or improved systems/processes. Large banks would pay the largest individual fee, although the levy would apply across all high and medium risk sectors (refer attached CRIS for an illustrative table).

47. The three supervisors estimate current spend as just under $13 million per annum:

Table 3: Current AML/CFT Supervisory Annual Cost Estimate (000s)

	Direct AML spend	Supporting AML spend
DIA	10,336 direct and supporting spend	
FMA	635	142
RBNZ	1,277	442
TOTAL		**12,832**

48. To estimate what 'sufficient' resources for supervision might be, we have drawn upon the research undertaken when DIA became the supervisor for Designated Non-Financial Businesses and Professions. This costed both direct supervision and supporting spend, and included capacity to develop guidance for new sectors. For the RBNZ and FMA there is no research we can draw on to estimate sufficient resources, so have applied a 20% increase across supervisors to indicate approximate cost. This uplift would enable ongoing activity identified in the SR as required but not provided.

49. Total levy collection for Option Two on that basis would be approximately **$15.5 million per annum**. There may be a component of public good funding to be deducted from this amount (in the Stage 2 CRIS), so it provides an upper bound of cost impact for industry under this option with current cost data and stated assumptions as above.

50. Introducing the levy within the current structure of the AML/CFT system would necessitate amendment to legislation and regulations for the FMA and RBNZ. A suitable mechanism would need to be developed and implemented to allow for the raising and allocation of funding between the supervisors.

51. Ministers also have limited ability to direct the FMA and RBNZ on spending their allocated budgets or what work they are to produce in a specified time. Governance issues may preclude this option from being effectively implemented.

52. Unless there are changes to the supervisory structure, this levy will have a diminished impact on supporting good regulatory outcomes. The introduction of a levy would be consistent with, and support, a single supervisor model. It could be readily included alongside the legislative and regulatory changes that would be required to give the new structure legal effect.

Option Three - *Levy for cost of supervision, policy, and the FIU*

53. Option Three builds from Option Two, additionally including the costs of the MoJ and FIU in delivering their functions under the AML/CFT Act.

54. In addition to producing the National Risk Assessment, the FIU also provides support to industry through targeted guidance, briefings, and other information sharing. Legislative and regulatory change could also be better aligned with industry needs.

55. Integrating funding for the major functions of the AML/CFT Act would result in a more cohesive and coordinated approach to risk-based regulation – it will enable a national

risk-based approach to setting funding envelopes and allocating resources. Regulators and reporting entities will more effectively detect and deter ML/TF.

56. This option aligns with cost-recovery principles. It would also be applied on the basis of sector risk and firm size/ability to pay. The nexus of policy and the FIU with industry is lesser than with supervision but remains valid in the context of a cohesive regime providing risk-based regulation of AML/CFT.

57. Option Three will better enable the sort of differentiated and risk-based approach desired by the Commerce Commission in its market study of competition in retail banking. Similar benefits will be seen for other reporting entities and their consumers.

58. However, this option would require a higher amount of levy to collected. Estimated current expenditure is set out below.

Table 4: Current Annual FIU and MoJ Spend on AML/CFT (000's)

	Direct AML/CFT spend
Financial Intelligence Unit	5,600
Ministry of Justice	1,085
Total additional spend	**6,685**

59. In addition to the current costs outlined for Option Two and in Table 4:

    a. For the MoJ we estimate that resources of approximately $1 million per annum would be required to carry out all of these functions.
    b. For the FIU: a 20% uplift, in line with the estimate for supervisors.

60. Total levy collection for Option Three would be approximately **$23 million per annum**. There will likely be a component of public good funding to be deducted from this amount so it provides an upper bound of cost impact for risk-creating industry under this option with current cost data and stated assumptions as above.

61. This option was not specifically consulted on during the Statutory Review. Submitters were more receptive to a levy if it led to more support for them - which as outlined in section 1(2) is more likely to be delivered on by improved resourcing and integrated work planning across all of the functions that impact industry.

62. As with Option Two, introducing the levy within the current structure of the AML/CFT system would necessitate amendment to legislation and regulations for the FMA and RBNZ. A suitable mechanism would need to be developed and implemented to allow for the raising and allocation of funding between regulatory functions. Governance issues may preclude this option from being effectively implemented. The addition of MoJ and FIU will increase coordination costs and efficiency of implementation, but not detract from overall feasibility given their status as Crown agencies.

63. The introduction of a levy would be consistent with a single supervisor model and the changes that would be required to give the new structure legal effect. There will be

some additional complexity with the addition of MoJ and FIU but this will be required in any case to implement an effective national risk-based regime.

4) How do the options compare to the status quo?

	Option One – [*Status Quo / Counterfactual*]	Option Two – Levy for supervision as outlined in the Act	Option Three - Levy for supervision, FIU, and MoJ as outlined in the Act
Funding enables a national risk-based approach.	0	+ A single source of funding can be used as leverage to require higher levels of coordination and collaboration in supervision. Supervision will have sufficient funding flexibility to implement a risk-based approach. Other key functions will be subject to ongoing Crown funding decisions.	++ A single source of funding can be used as leverage to require higher levels of coordination and collaboration amongst AML/CFT regulators. Funding across the system will be able to adapt to a changing environment for ML/TF. Support for industry can be improved through the regulatory requirements for consultation on a levy.
The AML/CFT system aligns with cost-recovery principles.	0	+ Only applies to supervision, but supervision is the main point of interaction with industry. The closest direct connection/nexus with managing negative externalities and providing regulatory services.	++ The link of industry to other regulatory functions is not as close as with supervision, but that can be reflected in ongoing Crown funding. However, the other regulatory functions in AML/CFT are key elements of a risk-based approach to meeting the negative externalities created by industry and meeting FATF requirements, thereby still providing value to reporting entities and their customers.

	Option One – [*Status Quo / Counterfactual*]	Option Two – Levy for supervision as outlined in the Act	Option Three - Levy for supervision, FIU, and MoJ as outlined in the Act
Feasibility of implementation prior to next MER.	0	+ No barriers were identified to partial cost-recovery within required timeframes. The change in funding would need to be legislated and incorporated into the next funding agreement for the RBNZ and for the FMA in terms of both its Crown funding and levy collection. As there are existing mechanisms for both of these changes, the challenge will be in respect of structural issues as outlined in the Supervisory Model RIS.	+ Similar feasibility to Option Two. Drafting legislation and regulations will be slightly more complex than under Option Two. New appropriations may need to be added into Vote Police and Vote Justice.
Changes in analysis if single supervisor model adopted	0	++ Feasibility is improved under a single supervisor model and the legislative changes that will be needed to give it effect. A single levy for cost recovery would assist the implementation of a single supervisor.	++ Feasibility is improved under a single supervisor model and the legislative changes that will be needed to give it effect. A single levy for cost recovery would assist the implementation of a broader risk-based approach.
Overall assessment under status quo supervisor structure	0	+	++
Overall assessment with single supervisor	N/A	+	++

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

64. Option Three best meets the criteria set in this RIS for an AML/CFT funding model under either the status quo structure or a single supervisor model. It is therefore the preferred option of the Ministry of Justice to enable a national approach to risk-based regulation that can adapt to changes in ML/TF and endure.

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

65. The impact of non-monetised benefits has been determined from research undertaken and industry consultation during the Statutory Review. Following the Statutory Review, 6 months of co-design occurred with industry to understand the potential impacts on industry of options for legislative change.

66. This led to the finding that a lot of the impact/compliance cost comes from the lack of regulatory work in the areas that best support reporting entities and minimise unnecessary impacts on industry. A key example is the inability for the Ministry of Justice to process exemptions or more regularly review regulations to ensure opportunities for regulatory exemptions are being sought.

67. A key uncertainty in this analysis is exactly how the ML/TF environment will develop over the coming years. Whilst we expect the current trend towards increased sophistication of ML/TF, and therefore increased need of the AML/CFT system, this trend is difficult to predict. It is therefore uncertain how much the demands on the system are likely to change in coming years. Additional flexibility to the national funding of the AML/CFT system will help manage this uncertainty.

Table 5: Marginal costs and benefits of the preferred option

Affected groups	Comment	Impact	Evidence Certainty
Additional costs of the preferred option compared to taking no action			
Reporting entities	Public good component will be deducted from this amount	$23 million	Medium
Total monetised costs		$23 million	
Non-monetised costs	S9(2)(d)		
Additional benefits of the preferred option compared to taking no action			
Regulated groups	Additional support will be provided, an inherently more risk-based system that differentiates between reporting entities. Expected result is reduced compliance costs.	Medium/High	Medium – evidence from industry submissions and analysis in the Statutory Review, as well as looking at international experience, especially improved regulatory services in Australia once the work programme became levy funded.
Regulators	Levy-funded activity would otherwise be funded by regulators (avoided cost).	$23 million	Medium – expenditure impact on RBNZ and FMA not able to be determined at this point.
New Zealand	Sufficiently resourced system able to better detect and deter ML/TF, keeping New Zealanders safe from crime. Also reduced taxpayer burden.	Not monetised	Medium due to limitations in being able to estimate impact of AML/CFT on reducing crime beyond operational outputs, but can estimate current amounts of ML/TF (See 2024 NRA).
Total monetised benefits	Monetised costs and benefits are assumed to broadly offset		
Non-monetised benefits	Significant impact of an improved regulatory system	Medium	Medium

Section 3: Delivering an option

1) How will the new arrangements be implemented?

Legislation to enable levy setting and collection

68. Legislative amendment will be needed to provide the powers to set and collect an AML/CFT levy. Secondary legislation will also need to be passed to set more specific details of the levy and whom it will be collected from.

69. Consultation with industry on the best and fairest way to calculate payments will take place through the remainder of 2024 and potentially into 2025, with a Stage 2 CRIS bought to Cabinet in 2025.

70. This consultation would also include the best way to charge – whether through setting of transparent bands (like the UK) or charging individual invoices 6 months before payment is due (like Australia).

71. Industry have indicated a strong preference for a higher level of involvement in the setting and use of any AML/CFT levy than would be typical under standard levy settings. This is considered in more detail below.

72. S9(2)(f)(iv)

73. S9(2)(f)(iv)

74. There will also need to be a power to require reporting entities (some, or all) to declare financial details to the supervisor if relevant to the levy calculation.

Industry consultation and work programme reporting

75. We prose that the levy regulations specify how industry is to be consulted via two mechanisms – a National Strategy for AML/CFT, and a regulatory work programme.

    a. The National Strategy would outline trends in risks and direct existing resources to areas of highest risk and opportunity. It would include action items that are not levy funded – such as the target for asset recovery set in the last National Strategy.

    b. A regulatory work programme would be set to underpin the National Strategy. It would also be consulted with industry and publicly reported upon. This would include all relevant regulatory activities in the system, not just levy funded activity.

76. The National Strategy and regulatory work programme will inform decisions on the levy and Crown funding of AML/CFT. They will not change or set the level of levy being collected. Where the work programme requires a significant increase in work related to a regulatory function, agencies would need to outline the cost of that increase and corresponding impact on levy payers. Any changes in funding would need to be consulted on and approved through Cabinet (as with other levies).

77. The National Strategy should be revised every three years. This would allow the National Strategy to be set following a FATF Mutual Evaluation Report (MER), and give the regulatory work programme time to address its recommendations (and demonstrate effectiveness) in advance of the next MER.

78. Aligning levy collection with the delivery of a National Strategy means that the cost of compliance and need for adequate industry guidance will be factored into the regulatory work programme. However, the nature of the government role in AML/CFT

outlined in Section 1(1) means that it would not be feasible for industry to have veto powers over the work programme.

Giving effect to legislative changes

79. As the Ministry of Justice is already prescribed the role of advising on system outcomes and objectives, and its performance in achieving those, it would be a natural fit for the Ministry of Justice to be the agency responsible for developing the two levy mechanisms set out in paragraphs 75 to 78 (as per existing section 149 of the Act, in consultation with other agencies and with additional requirements on industry input).

80. The Ministry could also have a specified role to maintain an AML/CFT industry advisory group, including its amendment to ensure it remains representative across reporting entities, and that smaller reporting sectors can provide input. This would in the first instance be based on the existing industry advisory group, which has already conducted significant consultation and co-design work with the Ministry of Justice through the Statutory Review and development of legislative reform.

81. The mandate for coordination currently in the Act is too prescriptive and circumscribed. It is not flexible enough to be used for levy-making processes or reflect changes in the AML/CFT system or broader criminal justice sector. There is therefore a need to revise the mandate to:

    a. reflect the simplified operating environment enabled by a single supervisor,

    b. enable resource allocation across the AML/CFT system, and

    c. improve the ability of the coordination function to adapt and evolve.

Table 6: Outline of delivery timetable

Date	Milestone
October 2024	Cabinet agreement to cost recover
October – March 2025	Drafting of Bill
Commencing after November 2024	Consultation with industry on levy settings
August 2025	Bill enacted
TBC	Secondary legislation comes into effect (i.e. levy due for payment)

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

82. As outlined above, the National Strategy and Annual Reports will provide ongoing monitoring, evaluation, and review of the AML/CFT system. This would include whether the agreed action items of the strategy are being met, as well as performance of core regulatory functions, and be a key input into any decisions on altering the levy.

83. The FATF will review the performance of New Zealand's AML/CFT system against the FATF standards every 7 years, with the next MER due in 2028-2029.

Annex A: New Zealand's AML/CFT regulatory regime

The AML/CFT Act 2009 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.

In addition to the AML/CFT Act, the Crimes Act and Criminal Proceeds Recovery Act form the basis of the AML/CFT system. The AML/CFT Act sets out the broad system and its purpose, while the Crimes Act contains the offence of money laundering and CPRA provides ability for law enforcement to recover the proceeds of crime – including money laundering and any illegal activity undertaken to establish the funds to be laundered.

The AML/CFT system covers industry regulation (to deter ML/TF from occurring but also to detect and report suspicions of it occurring) through to criminal justice with investigations and prosecutions.

The administration, application, and enforcement of the of the AML/CFT system directly involves six agencies:

1. Ministry of Justice is responsible for administration of the AML/CFT Act 2009 (the Act). The role of the Ministry is set out in Section 149 of the Act and its stewardship responsibilities include advising the Minister of Justice as to whether any changes should be made to the regime.
2. The Department of Internal Affairs, Financial Markets Authority, and Reserve Bank of New Zealand are designated as AML/CFT supervisors. The functions and powers of the supervisors are set out in Sections 131 and 132 of the Act.
3. New Zealand Police is responsible for a variety of financial intelligence functions (set out in Section 142 of the Act) and powers (set out in Section 143 of the Act), including receiving reports from the financial industry [primarily Suspicious Activity Reports (SARs)] and disseminating financial intelligence products.
4. 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.
5. Customs does not explicitly have its functions outlined in the Act, but it is responsible for receiving reports of large movements of cash (over NZD 10,000) across New Zealand's borders.

The Ministry of Justice also forms the delegation to the Financial Action Task Force (FATF) and Asia-Pacific Group on Money Laundering (APG). The FATF is the inter-governmental body that produces a set of binding standards that countries are expected to apply when establishing their AML/CFT regimes, known as the FATF Recommendations. In addition to their other obligations under the Act, all agencies who form the regime are jointly responsible for making sure New Zealand fulfils its obligations as a member of the FATF and APG.

Annex B: Functions of agencies in the AML/CFT Act

Entity	Role in the AML/CFT system	Relevant Minister
Ministry of Justice (Public Service Agency)	Stewardship of the AML/CFT regime. Administers the Act, regulations and class exemptions. Leads engagement with the Financial Action Taskforce.	Minister of Justice
Department of Internal Affairs (DIA) (Public Service Agency)	Jointly responsible for supervision (including issuing jointly developed guidance, codes of practice).	Minister of Internal Affairs
Financial Markets Authority (FMA) (an independent Crown Entity)		Minister of Commerce and Consumer Affairs
Reserve Bank of New Zealand (RBNZ) (a statutory corporation)		Minister of Finance
New Zealand Police (Non-Public Service Agency)	Investigations, asset recovery.	Minister of Police
Financial Intelligence Unit (independent unit, housed in Police)	Receipt of Suspicious Activity and Prescribed Transaction Reports. Provision of Financial Intelligence to law enforcement and other agencies. Leads the National Risk Assessment.	Minister of Police
New Zealand Customs (Public Service Agency)	Receipt of Border Cash Reports.	Minister of Customs
Inland Revenue (Public Service Agency)	Key law enforcement partner.	Minister of Revenue
Serious Fraud Office (Public Service Agency)	Key law enforcement partner.	Minister of Police
Ministry of Foreign Affairs and Trade (Public Service Agency)	Administer autonomous sanctions, which put obligations onto AML/CFT reporting entities.	Minister of Foreign Affairs and Trade
Ministry of Business, Innovation and Employment (Public Service Agency)	Companies Registry, also Crown entity monitoring agency for FMA.	Minister of Commerce and Consumer Affairs

Annex C: AML/CFT cost recovery overseas

Australia[9]

Australia first introduced a levy to fund most of the work of AUSTRAC in 2011. AUSTRAC is a combined intelligence and supervisory entity (e.g. our FIU and three supervisors in one).

The structure of the levy has changed over time, following substantive reviews

Australia originally levied providers of designated services on a deemed-value 'user-pays' basis – calculated on factors including earnings and transaction values and volumes.

A new levy structure was applied to contributions in 2015. Compared with the original levy legislation, the 2014 amendments provided greater flexibility to change the levy structure by allowing more parameters (such as limits and thresholds) to be set via an annual Ministerial Determination. The amendments also required that the levy be independently reviewed four years after the amendment. None of the submissions to that review mounted substantial or substantiated arguments in favour of major changes to the levy arrangements.

In its present form, the Australian Levy Act does not prescribe any particular structure of, or basis for, the levy. However, the effect of the new structure was to shift more of the financial burden of the levy onto the largest reporting entities.

As a consequence of the combination of the adoption of a $1,000 minimum payment and the concentration of transactions reporting in a small percentage of reporting entities, the levy (at the time of the review in 2019) was paid by only 561 of the more than 14,000 entities reporting to AUSTRAC, compared with a total of 4,667 under the original levy regime.

Details on the current levy structure

The structure and details of the levy are set each year by a Ministerial Determination, following consultation between AUSTRAC and industry stakeholders. AUSTRAC initially publishes a stakeholder consultation paper that contains draft rates and thresholds within the levy structure that are expected to raise sufficient revenue to match the agency's cost recovery target. These rates and thresholds are refined on the basis of data received from reporting entities at the time of the annual census day.

The levy is not thought of as cost recovery, in the sense of a set of individual fees for service based on, or related to, identifiable costs of provision of that service. Rather, it is analysed as an industry-specific tax, calculated to recover AUSTRAC's operating budget. There is the significant caveat that, in meeting its revenue target, the levy should also be designed to minimise its regulatory burden (compliance costs).

As mentioned above, levy charges depend on entity earnings and the number and value of transactions reported by the entity to AUSTRAC. We understand from AUSTRAC that the latter is becoming an increasingly smaller factor in determining total payment amounts.

[9] Review of AUSTRAC Levy Arrangements

Coverage of the current levy

The result is that usually, only medium to large businesses are required to pay the levy. These are businesses with one or more of the following:

- earnings of A$100 million or more,
- a large number of transaction reports relative to other entities, and/or
- a high total value of transaction reports lodged with AUSTRAC during a calendar year, relative to other entities.

The distribution of the current basis for the levy (reported earnings and transactions report volumes and values) are highly concentrated in a small percentage of reporting entities. Modelling of revenue-neutral alternative levy parameters in the 2019 review demonstrated that there is considerable scope to redistribute the burden of the levy, albeit largely between currently liable entities. However it was also found that a more wide-spread distribution of levy contributions is likely to significantly increase total administrative and compliance costs.

United Kingdom[10]

The United Kingdom introduced an Economic Crime (Anti-Money Laundering) Levy (ECL) in 2021. The ECL was part of the government's wider objective to develop a long-term sustainable resourcing model to tackle economic crime. The ECL is an annual charge on entities who are supervised under the Money Laundering Regulations (MLR) and whose UK revenue exceeds £10.2 million per year (an estimated 4,000 businesses).

The ECL aims to raise £100 million per year from the MLR sector to pay for government initiatives outlined in the Economic Crime Plan (to help tackle money laundering). The Economic Crime Plan itself acknowledges the need for a long-term and sustainable resourcing model to transform the UK's response to economic crime.

As outlined in the Plan, the government believed that the resourcing model should comprise contributions from both the public and private sectors that participate in, and benefit from, the agenda to reduce economic crime. The ECL was seen as being fair and proportionate; as the firms most exposed to money laundering risk will be the principal financial contributors to the reform initiatives that will benefit them and help make the UK a safer place for them to do business.

The ECL is paid as an annual fixed fee. The amount of the fee is determined by which band the entity's UK revenue places them within. There are 4 band sizes:

ECL band size	UK revenue
Small	under £10.2m
Medium	£10.2 million to £36 million
Large	£36 million to £1 billion
Very large	more than £1 billion

[10] Levy_Consultation_Document_-_FINAL_.pdf (publishing.service.gov.uk)

The fee for each entity within an income band is as follows:

ECL band size	ECL fee
Small	No ECL liability — not required to register with HMRC
Medium	£10,000
Large	£36,000
Very large	£250,000

Canada

Canada recovers the costs of supervision within its AML/CFT regime.

Recovering costs involves FINTRAC (our FIU and three supervisors in one) forecasting the full costs of its compliance program for the upcoming 3 fiscal years for inclusion in its Departmental Plan. This includes the costs of the enabling internal services that support the program such as human resources, information management/information technology (IM/IT), and communications, among others. This forecast then informs the estimated total cost that FINTRAC charges to reporting entities for the upcoming year.

FINTRAC holds a dedicated annual meeting with key stakeholders where it presents the key compliance program plans included in its most recent Departmental Plan. During this meeting, reporting entities can ask questions and seek clarifications on FINTRAC's forward-looking compliance agenda.

Every year, FINTRAC also produces an annual report which outlines how funds were spent against plans and priorities during the previous fiscal year. This information is included in FINTRAC's Departmental Results Report.

Guiding principles for the funding model

The Department of Finance Canada and FINTRAC established guiding principles for FINTRAC's assessment of expenses funding model:

- **Self-sufficient:** The funding model must generate sufficient funding for FINTRAC to administer its compliance program and the enabling internal services that support it.
- **Proportionate:** Reporting entities that have the greatest business volumes and are the most complex to supervise should be responsible for the majority of the cost.
- **Fair:** Charges for reporting entities with similar revenues and supervisory requirements should be consistent across sectors.
- **Efficient:** Administrative and information costs to calculate and collect charges should be minimized for reporting entities and FINTRAC.
- **Transparent and predictable:** Reporting entities should understand how the funding model works and the amounts they may be expected to pay.

Annex D: Regulatory Economics

A negative externality is the imposition of a cost on a party as a result of the actions of another party. In economics negative externalities arise when one party, such as a business, makes another party worse off, yet does not bear the costs from doing so. A negative externality may also arise from the consumption/use of a good or service. Pollution is often used to demonstrate both types of negative externality.

Using a motor vehicle as an example, pollution separately occurs in its creation ranging from mining raw materials through to powering the manufacturing plant that finally assembles it, then additional emissions and discharges over the use/life of the vehicle, and finally additional pollution in its dumping/recycling at end of life. The negative externalities follow the vehicle through its lifecycle, affecting a range of other parties to greater or lesser extents. Different regulatory regimes will often apply to the individual instances/sources of pollution.

In regulatory economics the government is considered to have a role to play in designing goods or services (and the associated charges) in a way that discourage actions with negative externalities. This includes things like ensuring a business is operating in accordance with regulations. Government intervention typically focusses on two groups:

1. people who benefit from the output of the regulated activity; and
2. risk exacerbators (that is, the individuals or organisations whose actions make it necessary for the government to become involved).

In this RIS, the primary activities under regulation are financial services, designated non-financial services, and other forms of value storage and transfer (domestic and international). Both consumers and providers benefit from the provision of these services. Providers are also risk exacerbators – their actions or inactions directly influence ML/CF outcomes for criminal and terrorist organisations and individuals.

Criminals undertaking predicate offending are targeted through the wider criminal justice system. The focus of the AML/CFT regime is on value flows after offending has occurred (provision and use). If value flows are successful criminal activity is incentivised, both through ability to reinvest in crime, and through the benefit of being able to realise and enjoy the profits of crime in the legitimate economy. For terrorism this allows the financing of terrorist activity.

In the case of incentivising crime and enabling terrorism, the negative externality affects the:

1. public through the occurrence of crime and terrorism
2. direct victims of crime and terrorism
3. legitimate businesses and consumers who may face increased sanctions/compliance
4. ability of service providers and industry to access international markets.

The AML regulatory regime is in place to allow legitimate value flows domestically and internationally while minimising illegal flows in as efficient and effective manner as possible.

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.

S9(2)(d)

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.

S9(2)(d)

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.

[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.

[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

[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.