



cutting through complexity

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The FATF Mutual Evaluation of Australia: Are there lessons for New Zealand's reporting entities?

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THE FATF MUTUAL EVALUATION OF AUSTRALIA: ARE THERE LESSONS FOR NEW ZEALAND'S REPORTING ENTITIES?



The Financial Action Task Force (FATF)¹ published the Mutual Evaluation Report of Australia² on 21 April 2015 which provides valuable insight for those involved in New Zealand's Anti-Money Laundering and Countering the Financing of Terrorism (AML/CFT) regime. In this update, we provide a summary of the key findings from the FATF's report and explore what lessons could be learned for New Zealand's reporting entities.

As the leading intergovernmental body for AML/CFT, the FATF sets the global AML/CFT standards in its 40 Recommendations. The FATF mutual evaluation is a year-long 'peer review' by a panel of international experts from other FATF member countries which undertake an independent assessment of a country's AML/CFT system as a whole. Australia is one of the first countries to be assessed under the FATF's fourth round of evaluations.³ The new evaluations under the 2013 Methodology see a significant shift in the way the FATF assesses a country.⁴

The FATF continues to assess the technical compliance with the 40 Recommendations, but there is now a substantial focus on effectiveness where assessors seek to answer one key question: how well does a country's AML/CFT measures work in practice?⁴

As with New Zealand, Australia's AML/CFT framework has significantly changed since its last FATF evaluation in 2005. With New Zealand scheduled to be assessed by the FATF in 2018-19, the FATF's evaluation of Australia is a valuable opportunity for policy makers and reporting entities to learn lessons from 'across-the-ditch'. For reporting entities, it is useful to consider future developments and trends, as well as how their efforts may be benchmarked against international best practice.

"AUSTRALIA IS A VALUABLE OPPORTUNITY FOR POLICY MAKERS AND REPORTING ENTITIES TO LEARN LESSONS FROM ACROSS-THE-DITCH."



¹ The Financial Action Task Force (FATF) is the intergovernmental policy-making body which sets the international standards to combat money laundering, terrorist financing and the financing of proliferation.

² The 2015 FATF Mutual Evaluation Report of Australia is available in full at the FATF website at: <http://www.fatf-gafi.org/countries/a-c/australia/documents/mer-australia-2015.html>

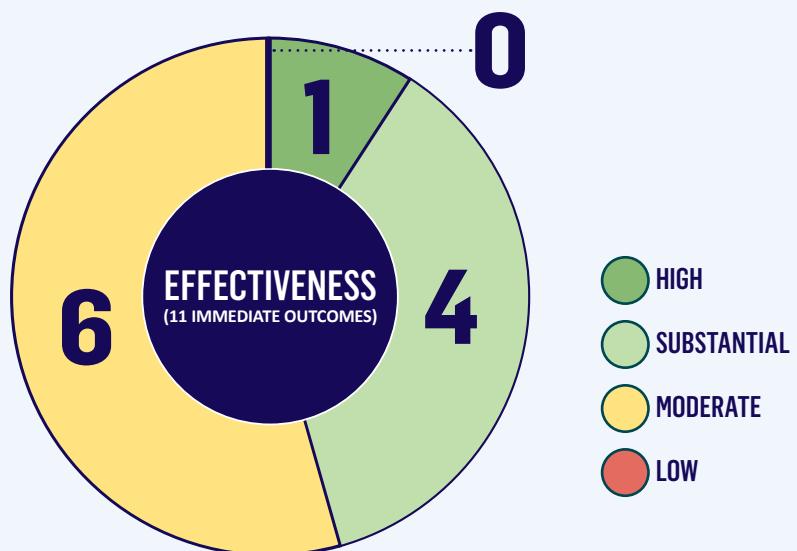
³ The other countries that have been evaluated in the fourth round are Norway (2014), Spain (2014) and Belgium (2015).

⁴ FATF Methodology for assessing technical compliance with the FATF Recommendations and the effectiveness of AML/CFT systems (2013), FATF, Paris, France

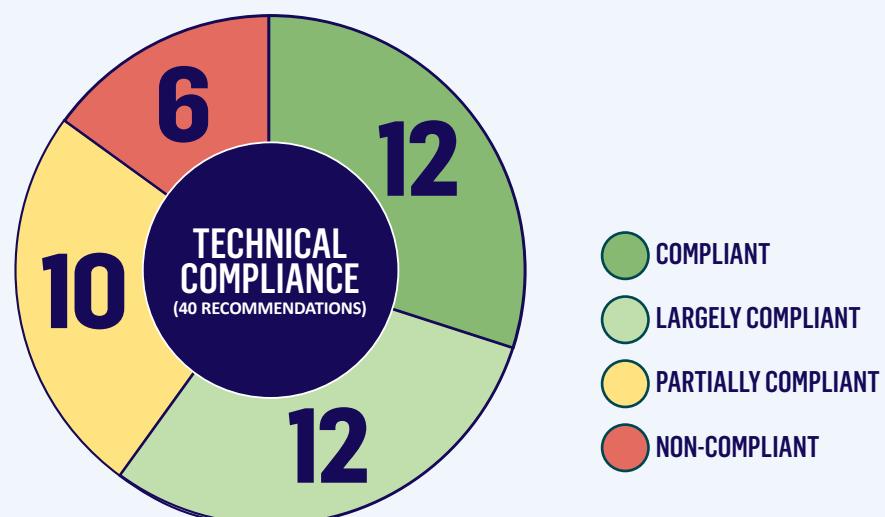
⁵ FATF 2013. The Methodology comprises two components: technical compliance assessment of the FATF Recommendations and the assessment of effectiveness of their implementation. The effectiveness assessment is based on a defined set of 11 Immediate Outcomes.

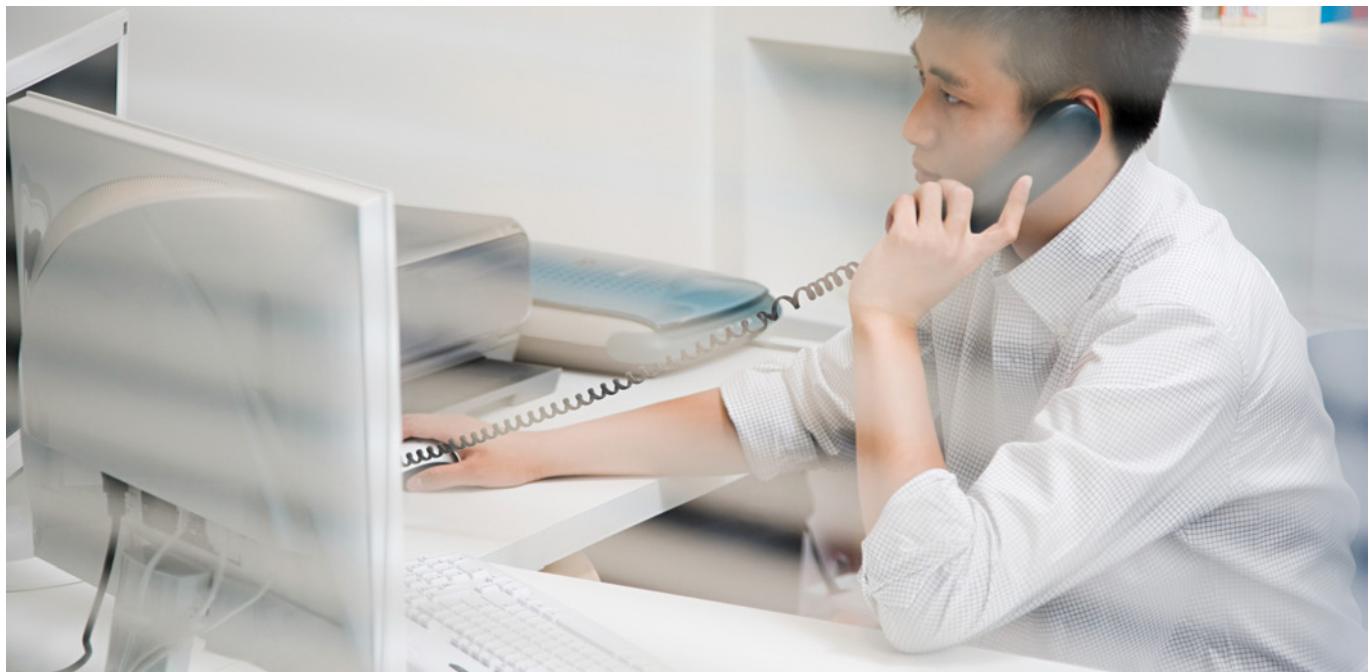
KEY FINDINGS

MUTUAL EVALUATION REPORT OF AUSTRALIA: RESULTS



The FATF report contains some positives for Australia, yet also found some deficiencies in key areas. For the effectiveness assessment, Australia was rated as having high or substantial level of effectiveness (generally considered a 'pass mark') with 3 of 11 Immediate Outcomes. For the technical compliance assessment, Australia was rated as being compliant or largely compliant (the 'pass mark') with 25 of 40 Recommendations. The FATF found that while Australia's legal, law enforcement and operational measures are particularly strong, some improvements are needed for AML/CFT controls and supervision in the private sector. These results show that there is a way to go to meet the international expectations.





The FATF's key findings include⁶:

- Australian authorities generally have a good understanding of Money Laundering (ML)/Terrorist Financing (TF) risks and have strong operational coordination.
- Australia develops and disseminates good quality financial intelligence.
- Australia cooperates well with its international partners on AML/CFT issues.
- While Australia's law enforcement focus on disrupting and deterring crime is positive, it should expand its focus to ensure a greater number of money laundering cases. Australia has successfully prosecuted TF and taken steps to disrupt TF activities.
- Australia has a strong legal framework to implement targeted financial sanctions which is considered best practice. However, the financial sector is not adequately supervised for compliance with the sanctions regimes.
- Australia is praised for their supervisory efforts to promote AML/CFT compliance by reporting entities. However, the FATF is concerned that a focus is needed on effective supervision and enforcement of individual reporting entities' compliance. In particular, the FATF concludes that the limited number of enforcement actions, and the lack of monetary penalties, mean that they have had a minimal impact on reporting entities not directly sanctioned.

- Australia's rules for Customer Due Diligence (CDD) and correspondent banking were found to be deficient. The CDD rules were rated as partially compliant, with key reasons including the shortcomings in the obligation to identify the nature of their business and ownership structure for trusts and companies and the absence of a requirement to carry out enhanced CDD when there were doubts about customer information. The correspondent banking requirements were rated as non-compliant as the key obligations only apply based on risk determined by the bank.
- Implementation by reporting entities varies across sectors. Banks and other large institutions have a good understanding of the requirements, but small to medium reporting entities can improve.
- Reporting entities are currently implementing the new requirements on CDD, including beneficial ownership and politically exposed persons (PEPs), which came into force on 1 June 2014, in line with the transition period. In this transition period until 1 January 2016, AUSTRAC will only take action against a reporting entity if it fails to take reasonable steps to comply with the new rules.
- Most designated non-financial businesses and professions, including lawyers, accountants, real estate agents and trust and company service providers, are not subject to AML/CFT controls.
- The existing mechanisms do not provide Australian authorities with access to information on the beneficial owners of companies and trusts in a timely manner.

“BANKS AND OTHER LARGE INSTITUTIONS HAVE A GOOD UNDERSTANDING OF THE REQUIREMENTS, BUT SMALL TO MEDIUM REPORTING ENTITIES CAN IMPROVE.”

⁶This list of key findings is based on the report and is not exhaustive. For the complete list, see the FATF Mutual Evaluation Report of Australia. <http://www.fatf-gafi.org/countries/a-c/australia/documents/mefr-australia-2015.html>

KPMG INSIGHT

ARE THERE

LESSONS FOR

NEW ZEALAND'S

REPORTING

ENTITIES?

The FATF Mutual Evaluation of Australia shines a spotlight on a number of ongoing issues facing reporting entities in New Zealand. The AML/CFT regime of Australia is different to that of New Zealand – however, there are enough similarities for New Zealand's reporting entities to recognise the key themes in the FATF's assessment. Below are some of the themes to emerge from the report that are more relevant in the New Zealand context.

Customer Due Diligence: Politically Exposed Persons (PEPs) and beneficial ownership remain under focus

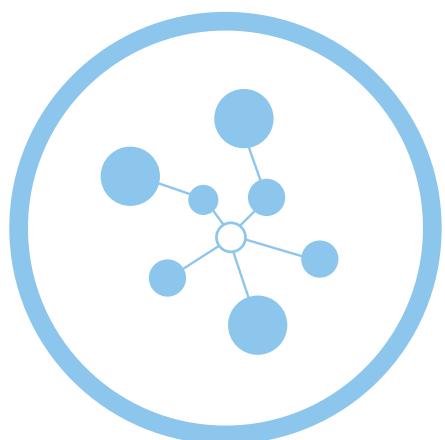
The FATF found that Australia's reporting entities are in the process of implementing the new Customer Due Diligence (CDD) rules on beneficial owners and PEPs which were introduced in June 2014, in line with the transition period Australia adopted.

To avoid supervisory action from AUSTRAC⁷, reporting entities must take reasonable steps to comply with the new rules (which included establishing a transition plan by 1 November 2014) and must be in full compliance by 1 January 2016. The FATF found that reporting entities are not yet in compliance with the new rules but they are using this transition period to enhance their systems and practices to align with the new rules.

The FATF's concern with the late adoption in Australia of these requirements is consistent with the international concern with these issues. KPMG's 2014 Global Anti-Money Laundering Survey found that PEPs remain an area of focus globally, which is gaining attention from senior management.⁸ 80% of respondents stated that PEPs are required to provide documents to evidence their source of wealth and/or income. In relation to the beneficial ownership requirements, respondents to that survey found that identifying complex ownership structures was the most challenging area in the implementation of a risk-based approach to Know-Your-Customer (KYC) collection.

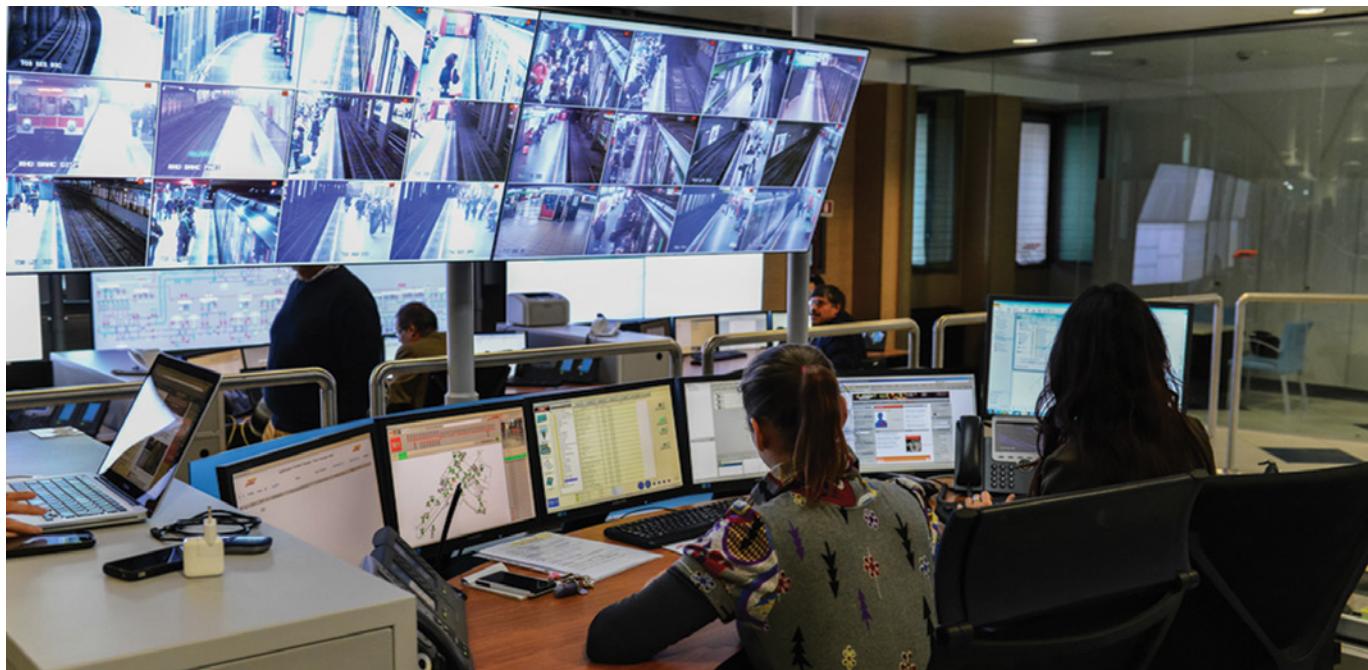
In New Zealand, the CDD rules introduced in 2013 set out new requirements on beneficial owners and PEPs which are broadly similar to the new rules in Australia. However, the requirements are complex and, as we have seen from our work with clients, they are challenging to implement. For example, understanding complex entity structures and meeting the verification requirements for the source of wealth of PEPs remain challenging issues. As Australian reporting entities develop their CDD systems to meet the new requirements for PEPs and beneficial owners during the transition period, New Zealand entities may be able to share their experience and learn from the Australian context as they refine their systems.

“UNDERSTANDING COMPLEX ENTITY STRUCTURES AND MEETING THE VERIFICATION REQUIREMENTS FOR THE SOURCE OF WEALTH OF PEPs REMAIN CHALLENGING ISSUES.”



⁷ Australian Transaction Reports and Analysis Centre-

⁸ <http://www.kpmg.com/NZ/en/IssuesAndInsights/ArticlesPublications/Pages/Anti-Money-Laundering-2014.aspx>



Coverage of the high risk businesses and professions

The FATF is critical of Australia's lack of coverage of high risk businesses and professions in its AML/CFT regime, including lawyers, real estate agents, and trust and company service providers. This places an additional burden on financial institutions as the gatekeeper to the financial system in Australia. The FATF concludes that 'the preventive measures in the financial system as a whole and Designated Non-Financial Businesses and Professions (DNFBPs) is hence called into question to some extent'.

While the regime in New Zealand extends beyond the Australian system through its coverage of trust and company service providers, other businesses and professions remain outside the scope. The Ministry of Justice has stated that lawyers, accountants, conveyancing practitioners and real estate agents will be considered in a second phase of AML/CFT reforms. The timing for this is yet to be determined.⁸ The FATF's criticism of Australia may lead to a renewed push in both Australia and New Zealand to extend AML/CFT regulation to cover these businesses and professions.

From the international perspective, coverage of the businesses and professions required by the FATF varies. Countries such as the United Kingdom and other European Union members capture all the required businesses and professions. Other countries remain in a similar position to Australia and New Zealand as they continue to extend their AML/CFT regimes to cover all the businesses and professions, such as the United States and Canada.

Resourcing challenge

The FATF concludes that while the larger entities have a good understanding of the AML/CFT requirements, small to medium entities find it challenging. A driver of this is the complex nature of the risk-based requirements and the resources required to implement effective systems which puts pressure on small to medium sized entities. This challenge is highlighted further by the findings of the 2014 KPMG Global Survey⁹ in which 82% of respondents in the Asia-Pacific region mentioned the pace and impact of regulatory change as their top concern.

Our observation is that we are experiencing a similar situation in New Zealand. While the risk-based approach delivers many benefits to smaller reporting entities as they can tailor their programme to meet their circumstances, it increases the complexity. From our work reviewing risk assessments and AML/CFT programmes, it can be challenging for small to medium sized reporting entities in New Zealand to comply with the obligations.

“COUNTRIES SUCH AS THE UNITED KINGDOM AND OTHER EUROPEAN UNION MEMBERS CAPTURE ALL THE REQUIRED BUSINESSES AND PROFESSIONS.”

⁸ <http://www.justice.govt.nz/policy/criminal-justice/aml-cft/information-for-businesses>

⁹ <http://www.kpmg.com/NZ/en/IssuesAndInsights/ArticlesPublications/Pages/Anti-Money-Laundering-2014.aspx>

Supervisory approach

The FATF report continues the international debate on the appropriate use of sanctions for non-compliance with AML/CFT laws. The FATF expresses concern that the number of enforcement actions in Australia does not convincingly demonstrate that reporting entities are subject to effective and proportionate sanctions for non-compliance. The FATF concludes that the limited use of enforceable undertakings has 'a minimal impact on reporting entities not directly affected by the sanction'.

An important component of the work of New Zealand's supervisors since the introduction of the AML/CFT Act has been to educate reporting entities on expectations and consequences of future non-compliance. Our view is that this approach is likely to develop and shift over time as the AML/CFT system matures and the expectations on reporting entities to have adequate programmes increase. The FATF's concern with the Australian approach adds weight to this view.

Sanctions compliance

The FATF expressed concern that the financial sector is not adequately monitored or supervised for sanctions compliance. In Australia, the monitoring of financial institutions for sanctions compliance is undertaken by the Department of Foreign Affairs and Trade rather than AUSTRAC which is the AML/CFT supervisor. A similar approach is adopted in New Zealand where the Ministry of Foreign Affairs and Trade plays an important role to monitor compliance.

The FATF called on Australia to actively supervise financial institutions for sanctions compliance. Given the international spotlight on this issue, this may signal an increase in monitoring of financial institutions and enforcement in Australia and New Zealand. The 2014 KMPG Global AML Survey found that while sanctions compliance shows signs of improving, there is still some room for improvement, particularly when it comes to validating screening systems. Reporting entities in New Zealand should continue to ensure compliance with sanctions regimes and consider ways to test their screening systems for effectiveness upon implementation.

"THERE IS STILL SOME ROOM FOR IMPROVEMENT, PARTICULARLY WHEN IT COMES TO VALIDATING SCREENING SYSTEMS."



CONCLUSION

The FATF Mutual Evaluation Report of Australia is a useful opportunity for reporting entities to take stock of their AML/CFT controls and New Zealand's AML/CFT regime in comparison to international standards. It highlights a number of issues that are gaining global attention, including PEPs, CDD on beneficial ownership and sanctions compliance.

The dynamic nature of the AML/CFT environment means that reporting entities cannot sit back once their risk assessment and programme are drafted and rolled out. They should monitor transactions within their business and risks within the industry generally to ensure their programme manages the ML/TF risks it faces. This will be particularly important as supervisors in New Zealand adopt a more 'forensic' approach to test the effective implementation of reporting entities' programmes and policies.

**"REPORTING ENTITIES
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THEIR RISK ASSESSMENT
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If you have any questions on New Zealand AML/CFT Compliance, our team would be happy to help.

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