Response to part 3 of MBIE Options Paper, "Review of the Financial Advisers Act 2008 and the Financial Service Providers (Registration and Dispute Resolution) Act 2008", issued December 2015.

Part 3 of the December 2015 MBIE Options Paper, pp 51-54, proposes ways to address misuse of the Financial Service Providers Register by offshore entities. Responses are requested by 29th January 2016. The response template referenced in the document (www.mbie.govt.nz/what-we-do/faareview) is at a dead link; this author will simply walk through the proposed options in sequence.

The responder, Richard Smith, is a UK-based blogger at Naked Capitalism who has been covering New Zealand's travails with offshore finance companies since 2011.

Background

The 2014 reforms to FSP registration gave FMA discretionary powers over FSP registration and deregistration. The reforms introduced a 'natural justice' approach, giving registrants the right to appeal both denial of registration and deregistration.

So far, this right of appeal has merely opened up a whole new form of abuse: offshore FSPs can now challenge FMA in the courts, as illustrated by the Vivier and Excelsior appeals. It is particularly alarming that the appeal by Vivier, convincingly alleged to be a vehicle covertly controlled by the notorious British tax fraudster Ian Leaf (now known as Ian Andrews), has succeeded. FMA are appealing the Vivier decision on 10th February.

Win or lose, FMA are in a tight spot with the legislation as it stands. In its latest estimate of the amount of money laundered worldwide, the United Nations comments:

> The estimated amount of money laundered globally in one year is 2 - 5% of global GDP, or $800 billion - $2 trillion in current US dollars. Though the margin between those figures is huge, even the lower estimate underlines the seriousness of the problem governments have pledged to address.

Meanwhile FMA has a total budget of around $30Mn per annum. If one accepts the lower UN figure, $30Mn is just 0.00375% of the financial firepower commanded by the offshore forces now arrayed against FMA, thanks largely to the natural justice approach newly enshrined in New Zealand law. FMA seem unlikely to win that confrontation if there is sustained recourse to the NZ courts.

Abandoning the 'natural justice' approach again would be immoral and unwise. Exhilarating though it was, back in 2012, to see Companies Office rampaging through the FSPR deregistering dodgy offshore entities by the hundred, unchallenged, one could never quite get rid of the sense that the cries of massacred innocents, if there were any, would be going unheard.

Nevertheless, FMA urgently needs a less sticky wicket on which to bat. As Part 3 of the Options Paper puts it:

> Steps have been taken to reduce misuse of the FSPR (including use of the de-registration powers), but misuse remains an ongoing challenge and the de-registration powers have not proven to be fully effective.

Option 0 – MoJ and AML (p. 51)

Closure of the gaping territorial loophole in NZ's AML laws is not formally one of the options, but highly desirable. The Options Paper simply has this to say

> We will also be working with the Ministry of Justice to consider how the preferred option would work alongside anti-money laundering and countering financing of terrorism legislation, and whether any changes to that legislation would assist with resolving the misuse issues.

One would like to see the AML law change followed up and sorted out once and for all.

Option 1 – Stronger registration requirements (p.51)

This looks like a no brainer:

> "Regulations could be made requiring applicants to confirm and provide proof that they are licensed and/or supervised in their home jurisdiction and in any jurisdiction that they are proposing to provide services to."

...but there is a snag: not all jurisdictions are equally reliable regulators. The prospect of a sudden influx of FSPs purporting to be regulated in Panama (a favourite location of NZ FSPs back in the heady days of Michael Magnusson) or North Korea, or some daft little tropical island (Vanuatu, say) ought to be cause for concern.

In other words, this option is very attractive, but there would also need to be backup, for instance in the form of a public list, maintained by FMA, at their discretion, of home jurisdictions that *wouldn't* smooth the way to FSP registration. If need be, the list can be empty, to start with, though one could visit the FATF for initial ideas about blacklists. The overhead of maintaining a similar list in NZ would not be huge. New arrivals on the list would trigger investigation of already registered FSPs having that home jurisdiction. That's a pain, but desirable when keeping track of the cockroaches.

Next:

> Other changes could include requiring a level of indemnity cover or bonding for offshore-controlled entities providing services to New Zealand retail consumers to ensure compensation funds are available in the event of a dispute.

The clients (or victims) of offshore FSPs are usually not NZ residents, and dodgy offshore FSPs have no intention of participating in any meaningful way in a dispute resolution scheme. The NZ registration has typically been nothing more than a flag of convenience. To the extent that this change would impose a capital requirement on fly by night operators it is another useful feature. If FMA feel they can monitor it cheaply enough, it should be adopted.

Option 2 – Amend the grounds for deregistration (p.51)

This proposed new criterion may turn out to be hard to apply unambiguously (especially in court) and gives FMA additional expensive investigative duties:

> The grounds could include where an entity does not provide a substantive amount of services from a place of business in New Zealand...

So: over to FMA to judge whether this can be made to work and fit a budget. They seem to have had a great deal of difficulty proving this sort of proposition about Vivier, yet much less with Excelsior (two different firms, judges and investigative teams). It might be best to wait until the Vivier appeal outcome is known and digested before deciding whether to adopt this idea.

On the other hand this idea

> ...or are a 'repeat offender' that has previously been de-registered

is so obvious that one can't quite understand why FMA isn't applying it already. If legislation really is required to back up common sense, this proposal should certainly be adopted.

Lastly this proposal merely highlights the underlying ingrained eccentricity of the NZ approach to FSP registration:

> The legislation could... provide that if firms wish to refer to their registered status, they must accurately describe that status and its limitations (and could provide standard wording, such as "registered in New Zealand but not licensed or subject to active supervision or oversight"). Failure to comply could then be a ground for de-registration.

This seems unlikely to have much effect. I'd comply, and carry on laundering money, if I were a running a dodgy FSP. Nevertheless, it might trip up a few linguistically-challenged cowboys, so why not implement it?

Option 3 – require a legitimate connection to NZ

This idea may need to be made much more specific otherwise it has the potential to leave FMA in more expensive fog in the courts. One idea: require the wannabe FSP's business, or the bulk of it, to go through company bank accounts located in NZ.

This natural definition of 'place of business' could help quite a lot with AML investigations, though only if you assume that the FSP's business actually does all go through NZ bank accounts. In the end, few legislative proposals are robust against abuses by liars.

Option 4 – require TCSPs to register

This is a no-brainer. This provision should have been in place long ago. Something similar, requiring TCSPs to be based onshore, was considered in NZ in 2011-2013 in the last round of Companies Act reforms, but, inexplicably, dropped.

Many jurisdictions make a mess of their thinking in this area, notably the UK, which has muffed the registration of TCSPs active in the UK but located overseas, and now has a huge AML problem as a result.

Overseas TCSPs should either be barred from accessing the Companies Office altogether or as a bare minimum, required to register in order to gain access. Repeat or serial offenders or their front persons should be rejected.

Systematic creation of shell companies should be grounds for deregistration and, pending the discovery of new forms of camouflage, can be detected fairly easily even if the creator hasn't identified himself as a TCSP.

GT Group or The Company Net in past times, or Equity Trust International right now, ought to have been chopped off at the knees early in their respective lives. Requiring and enforcing TCSP registration would be an easy way to make it more difficult for this kind of operation to continue.

For a live example of the international mayhem TCSPs can cause, consider Jack William Flader, formerly boss of renowned NZ blogger and anti-FMA campaigner Cathy Odgers at GCSL New Zealand. Flader is currently standing trial in the UK for just one of several multiple hundred-million-dollar money laundering exploits.

Options 5 & 6

Options 5 & 6 address only the superficial aspects of problem and in a hugely complex and opaque manner to boot. They look awful. Don't go there.