VULNERABLE CLIENTS AND AML/CFT

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WHAT IS THE DEFINITION OF A VULNERABLE CLIENT

Definition of a vulnerable client (as per the UK financial regulators definition of vulnerability which the FMA references):

> **"A vulnerable consumer is someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care."**

WHAT IS THE DEFINITION OF A VULNERABLE CLIENT

*A consumer can be considered vulnerable when due to their personal circumstances they are especially **susceptible to detriment** and are therefore at greater risk of experiencing harm.*

Focusing on ‘**circumstances**’ rather than ‘**types’** of people is an important distinction. It shifts the focus from **vulnerability** as something certain ‘groups’ of people **experience** to vulnerability being a **result of a specific event** or set of circumstances which can happen to anyone at any time.

These events or circumstances are known as ‘**drivers**’ of vulnerability.

POTENTIAL RISK FACTORS

Work by the Ministry of Business, Innovation and Employment (MBIE) and the Financial Markets Authority (FMA) has identified a number of potential risk factors. These have been mapped according to **four main drivers of vulnerability.**

1. **Health and physical factors**– health conditions or illnesses that affect the ability to carry out day to day tasks
2. **Life events** – major life events such as bereavement or relationship breakdown
3. **Resilience** – low ability to withstand financial or emotional shocks
4. **Capability** – low knowledge of financial matters or low confidence in managing money

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POTENTIAL RISK FACTORS – IN REALITY

Health and physical factors	**Life events**	**Resilience**	**Capability**
Mental health issues	Recently migrated	Low savings	English as a second language
Physical health issues	Caring responsibilities	Loss of income	Low literacy levels
Addiction issues	Bereavement/ending of relationship	Lack of self-confidence	Lack of knowledge of consumer rights
Learning disabilities	Natural disasters	Over indebtedness	Low level of financial capability
Physical disabilities	Non-standard requirements: women in refuge, ex-offenders, children in care	Lack of time	Digital exclusion

Summary Characteristics of consumer vulnerability:

- Not a static group of people
- Can happen to anyone at anytime
- Can be permanent or transient in nature
- Is a personal experience
- Potential for multiple vulnerabilities being experienced at once
- Results in increased risk to harm
- Can be short or long term

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Recognizing and appropriately addressing the needs of vulnerable clients is crucial to ensuring fair and ethical treatment in the financial industry.

Financial advisers are expected to exercise extra care and sensitivity when dealing with vulnerable clients to protect their interests and avoid any potential harm or exploitation.

PAUSE AND REFLECT ON OUR ENVIRONMENT

- Inflation pressures
- Mortgage interest increases
- Markets dropped
- Long covid – reduced resilience
- Money worries

WHY VULNERABLE CUSTOMERS ARE SUCH A BIG FOCUS FOR US?

As stated in the Code of Professional Conduct

Code Standard 1 – Treat Client Fairly – A person who gives advice must always treat clients fairly.

WHY VULNERABLE CUSTOMERS ARE SUCH A BIG FOCUS FOR US?

CS1 - What is fair depends on the particular circumstances, including the nature and scope of the financial advice. Treating clients fairly should include:

- Treating clients with respect
- Listening to clients, considering their views and responding to their concerns and preferences
- Communicating with clients in a timely, clear and effective manner
- **Not taking advantage of clients' lack of financial knowledge or other vulnerabilities**
- Not applying undue pressure on clients.
- Treating clients fairly does not mean that clients are not responsible for their own decisions or that they are not exposed to risk.

CODE STANDARD 4 - ENSURE THE CLIENT UNDERSTANDS THE FINANCIAL ADVICE

A person who gives financial advice must take **reasonable steps** to ensure that the **client understands** the financial advice.

This standard relates to the financial advice itself.

Understanding the financial advice includes the client having **sufficient comprehension** of the content, risks and consequences of the financial advice, and of the nature of any ongoing and other services related to the financial advice, to be able to make timely and informed decisions about the financial advice,

What amounts to reasonable steps by the person who gives the financial advice will depend on the circumstances, such as the nature and scope of the financial advice, **and the skills, experience and vulnerabilities of the client.**

Note: A client signing off the advice is not proof that they understand the advice which was provided.

EXAMPLE TO THINK ABOUT

James and Joan are newly married. Both are in their early twenties and they have recently taken out a mortgage. Neither of them were able to save for the deposit, as they have both just finished University. The couple's families gifted the couple 10% of the house purchase. While they both have good jobs, with good future earning ability, neither of them really understands about the impact of debt, and saving for their retirement is a long way off. Their focus is on getting used to the responsibilities and costs associated with being homeowners and paying off their student loans. They have come to you for insurance advice. At the interview it became very clear that Joan was not engagement in the process and James is dominating the process.

In fact Joan appears to have very limited financial literacy and James was hung over when they arrived.

It felt like the only engaged person at the meeting was yourself!

QUESTIONS TO THINK ABOUT

- What are the limitations of this scenario and risks and consequences of these?
- What are some of the client considerations?
- What factors are likely to impact on the nature and scope of your advice?

FOUR AREAS YOU NEED TO DEVELOP YOUR THINKING FOR VULNERABLE CUSTOMERS

1. Policies , Procedures and Controls
2. Staff Capability
3. Customer Service
4. Communications

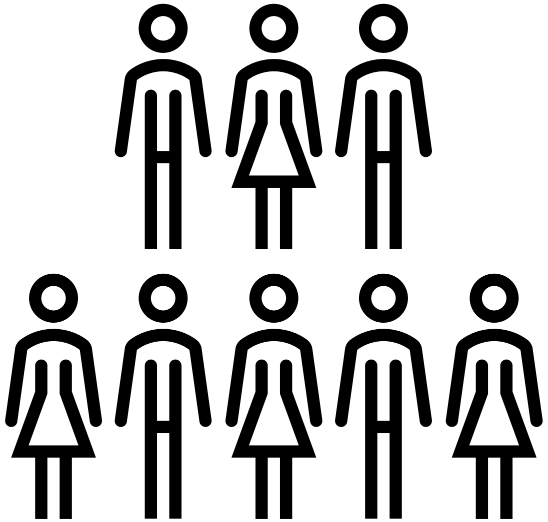
POLICIES, PROCEDURES AND CONTROLS ARE REQUIRED

Central to addressing the needs of customers in vulnerable circumstances is the development and implementation of appropriate policies and procedures across the business.

STAFF CAPABILITY

Ensuring all **customer-facing staff are equipped** with the necessary skills and confidence to **identify, assess and address** customer vulnerability is critical for serving the needs of customers.

A **general understanding** across your organisation of what vulnerable is.



CUSTOMER SERVICE

Vulnerable customers are more likely to have **different service needs**.

For example, they may find **some channels of communication** challenging or stressful, or need more time to understand information and make decisions.

Firms should consider **how their systems, support staff and advisers** are responding to the evolving needs of vulnerable customers.

COMMUNICATIONS

Firms should consider **how they communicate with vulnerable** consumers, taking into consideration the customer's needs.

Where possible, firms could offer **multiple channels** so vulnerable consumers have a **choice.**

Firms are increasingly using **digital communication** channels. These can be both a **benefit and a barrier** for vulnerable customers.

Indirect contact can sometimes make it **harder to identify** lead drivers of vulnerability.

However, this risk can be mitigated by, for example, making it easier for customers to **disclose their needs through online platforms**, or by using data analytics or software to identify drivers of vulnerability.

What policies, procedures and controls can you have in place to ensure you have identified any vulnerabilities and understand the advice which has been provided?

Firms need to embed the fair treatment of vulnerable customers in policies and processes throughout the **whole customer journey**.

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SOME POSSIBLE POLICIES

1. Capacity and Understanding
2. Capacity and Understanding Vulnerability Assessment
3. Duty of Care
4. Establish Trust and Rapport
5. Tailored Communication and Support
6. Informed Consent (enhanced SoA)
7. Recognize Exploitation and Abuse
8. Suitability of Products and Services
9. Regular Review
10. Record Keeping
11. Continuous Training and Education
12. Confidentiality
13. Compliance and Regulatory Obligations

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POLICY: Capacity and Understanding Vulnerability Assessment

Procedure:

- Identify factors that may make the client vulnerable, such as age, health, cognitive ability, or life events.
- Be aware of potential signs of vulnerability, including isolation, dependency, undue influence, debt and financial stress.

POLICY: Capacity and Understanding

Procedure:

- Assess the client's mental capacity to make financial decisions.
- Determine the client's level of understanding of financial matters and terminology.
- Use clear and simple language when communicating financial information.

Remember that each vulnerable client's situation is unique, and the financial adviser should approach each case with sensitivity, empathy, and a client-centric focus.

AML/CFT

ARE FINANCIAL ADVICE PROVIDERS REPORTING ENTITIES?

- Are Financial Advice Providers Reporting Entities? – Yes in many cases they are.
- This includes being an AB in a FAP – AB's are also reporting entities

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TWO WAYS YOU CAN BE AN AML/CFT REPORTING ENTITY

1. Captured as a financial institution
2. Captured by Regulation 16 of the AML/CFT Definitions Regulations 2011.

A FAP can be captured by either or both of these ways.

CAPTURED AS A 'FINANCIAL INSTITUTION'

- Financial advice alone does not make a FAP a 'financial institution’
- Additional activities may lead to Reporting Entity status

CAPTURED AS A 'FINANCIAL INSTITUTION'

Definition of a 'financial institution' in section 5 of the AML/CFT Act.

The definition in the act: financial institution —

a) Means a person who, in the ordinary course of business, **carries on 1 or more** of the following financial activities:

   I. accepting deposits or other repayable funds from the public:

   II. lending to or for a customer, including consumer credit, mortgage credit, factoring (with or without recourse), and financing of commercial transactions (including forfeiting):

   III. financial leasing (excluding financial leasing arrangements in relation to consumer products):

   IV. **transferring money or value for, or on behalf of, a customer**:

   V. issuing or managing the means of payment (for example, credit or debit cards, cheques, traveller's cheques, money orders, bankers' drafts, or electronic money):

   VI. undertaking financial guarantees and commitments:

CAPTURED AS A 'FINANCIAL INSTITUTION'

VII. **trading for, or on behalf of, a customer** in any of the following using the person's account or the customer's account:

a) money market instruments (for example, cheques, bills, certificates of deposit, or derivatives):

b) foreign exchange:

c) exchange, interest rate, or index instruments:

d) transferable securities:

e) commodity futures trading:

VIII. participating in securities issues and the provision of financial services related to those issues:

IX. **managing individual or collective portfolios**

X. safe keeping or administering of cash or liquid securities on behalf of other persons:

XI. **investing, administering, or managing funds or money on behalf of other persons:**

XII. issuing, or undertaking liability under, life insurance policies as an insurer:

XIII. money or currency changing; and

CAPTURED AS A 'FINANCIAL INSTITUTION'

For example, how you can be captured:

An adviser may handle client money or trade on behalf of clients.

These FAPs/AB’s will likely be Reporting Entities as a result of (and in respect of) those additional activities, capturing them as a ‘financial institution’ (see the definition in section 5 of the AML/CFT Act).

CAPTURED BY REGULATION 16

FAPs **arranging** for another **Reporting Entity** to provide **relevant services**

Definition of a **'relevant service'** and **'relevant product'** in Regulation 16(5)

- **Relevant service** – e.g managing funds for customers or trading/transferring securities for customers

- Relevant product – includes managed investment schemes and equity securities

REGULATION 16 IN PRACTICE

Example from the FMA guidelines:

- ABC Limited is a Financial Advice Provider.
  Sandra is a financial adviser for ABC Ltd, engaged to provide advice to clients on ABC Ltd's behalf.
  Sandra advises Cary to invest in the Global Growth Fund, managed by Global Growth Management Ltd.
  In addition to giving Cary that advice, Sandra also fills in the application forms for Cary, and liaises with Global Growth Management Ltd in relation to Cary's investment in the Global Growth Fund.

- By doing this,
  ABC Ltd is **arranging** for Global Growth Management Ltd (**another reporting entity)**
  to provide a **relevant service** (managing funds)
  in respect of a **relevant product** (a managed investment product) to Cary.

  This additional activity makes ABC Ltd a Reporting Entity under Regulation 16.

REPORTING ENTITY EXEMPTION

Examples of products that are not captured include:

- Fire and general insurances
- Life insurance and income protection (however, an investment-linked contract of insurance is captured)
- Mortgage/consumer credit contracts
- A fixed term deposit product issued by a registered bank.

However; investment in KiwiSaver – investment in retirements are exempt to be a reporting entity but have other obligations (conditions to the class exemption S4)

Note that a FAP that only advises on KiwiSaver (and does not arrange for clients to invest in KiwiSaver) will not be a Reporting Entity and will not have any AML obligations in respect of that advice.

THE OTHER OBLIGATIONS AND CONDITIONS UNDER SECTION 8, CLAUSE 4

This exemption is made subject to the following conditions:

a) the relevant financial advice provider has reasonable cause to believe the **manager of the relevant retirement** scheme is **compliant** with its obligations under the Act; and

b) the relevant financial advice provider must, for the purposes of section 34 of the Act, act as an agent of the manager of the **relevant retirement scheme**, and agree to carry out, and carry out, the following obligations on behalf of the manager:

   i. conducting **customer due diligence and obtaining and verifying any information** required under the Act for each customer or intended customer of the retirement scheme introduced by the financial advice provider:

   ii. **reporting to** the manager any suspicious activities or patterns of activities that the financial advice provider becomes aware of in relation to any customer or intended customer introduced to the retirement scheme by the financial advice provider:

   iii. **providing transaction records** and identity verification records to the manager in a timely manner:

   iv. ensuring that any employee engaged in AML/CFT-related duties by the financial advice provider is appropriately vetted and provided with training on the manager's obligations under the Act:

   v. establishing procedures that are consistent with the manager's risk assessment and that are compliant with the Act.

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Also note This exemption comes into force on 30 June 2023 and this exemption will expire on 31 December 2024.

ARE YOU A REPORTING ENTITY?

YES	NO
Transferring money or value for, or on behalf of, a customer	If you **are arranging** for another **reporting entity** to provide a **relevant service** in respect of **a relevant product for**:
Trading for or on behalf of a customer	• Fire and general insurance
Managing individual or collective portfolios	• Life insurance and income protection
Investing, administering, or managing funds or money on behalf of other persons	• Mortgage/consumer credit contracts
	• Fixed term deposit product issued by registered banks
	• Investment in KiwiSaver or invest in retirements

IF YOU ARE A REPORTING ENTITY YOU HAVE A ROLE TO PLAY WHICH MEANS:

- ✓ Understand your AML/CFT Programme – know your policies, processes and controls
- ✓ Do your customer due diligence:
  - ID and address verification
  - PEP checks
  - Business Relationships
  - Verify nominee directors, shareholders and general partners
  - Conducting enhanced due diligence
  - Profile your client
- ✓ Report odd, peculiar and suspicious activity immediately

KEEPING REPORTING ENTITY STATUS UPDATED

- Importance of updating Reporting Entity status on FSPR
- Seeking legal advice if unsure about AML/CFT Act applicability

AML/CFT OBLIGATIONS UNDER FSLAA

- Consider changes in your business offering and risk assessment
- Are you now doing KiwiSaver or managed funds?
- Review your risk assessment to determine if it needs amending and consider if you need to update your AML/CFT programme

OBLIGATIONS FOR NEW REPORTING ENTITIES

Steps for new reporting entities to comply with AML/CFT Act you must:

- ✓ appoint an AML Compliance Officer
- ✓ conduct and document your AML/CFT risk assessment
- ✓ develop, implement, and document your AML/CFT programme
- ✓ file an annual AML/CFT Report to the FMA
- ✓ file Suspicious Activity Reporting to the Financial Intelligence Unit of the NZ Police.

ANNUAL AML/CFT REPORTS

- Submission of annual AML/CFT Reports for all reporting entities
- Deadline and procedure for submitting reports through FMA's Online Services portal
- Due from the **1 July – 31 August – no exceptions**

BIG SIGH - FINES

- **Pecuniary penalties**
  Up to $200k for individuals and $2m for entities
- **Fines**
  Up to $300k and/ imprisonment
  Up to $5m for entities

THANK YOU