11 December 2024

Ministry of Foreign Affairs and Trade
195 Lambton Quay
Private Bag 18 901
Wellington 6001
New Zealand

By email: RSAreview@mfat.govt.nz

RUSSIAN SANCTIONS ACT STATUTORY REVIEW

Introduction

1. Thank you for the opportunity to comment on the Statutory Review of the Russian Sanctions Act 2022 (**Act**). This is a joint Submission from the Government Superannuation Fund Authority, the Accident Compensation Corporation, and the Guardians of New Zealand Superannuation – three of New Zealand's Crown Financial Institutions (**CFIs**).

2. In responding to the issues raised in the consultation document, we have not provided direct answers to the specific questions raised in it. Instead, we have set out our views on the particular position of institutional investors as it relates to the Russian sanctions regime, and the general areas of focus contained in the Ministry's document.

The Submitters

3. The **Government Superannuation Fund Authority** (**GSF**) is an autonomous Crown Entity, established in October 2001. Its functions are to manage and administer the Government Superannuation Fund and the GSF Schemes.

4. As at 30 June, the GSF schemes had 2,965 contributors, 40,786 annuitants, and 1,789 deferred annuitants, paying entitlements of more than NZ$1 billion annually. During the 2023/24 year the GSF achieved returns of 14.3%. Its investment portfolio, as at 30 June 2024, totalled NZ$5.5 billion.

5. The **Accident Compensation Corporation (ACC)** is a Crown entity established to deliver and manage New Zealand's no-fault accident insurance scheme. ACC's operations are funded through a mix of levies, Government appropriation, and investment returns. ACC invests to meet the future cost of accidents that have already happened.

6. Since 1992, ACC's investment reserves have returned 9.2% p.a. (before costs), and 7.6% in 2023/24. As at 30 June 2024 ACC's investment reserves had a value of $48.5 billion.

7. The **Guardians of New Zealand Superannuation** (**Guardians**) is a Crown entity set up in 2003 to manage and invest the New Zealand Superannuation Fund (Super Fund) to help pay for the increased cost of universal superannuation entitlements in the future. A long-term, growth-oriented investor holding a mix of public and private assets around the world, the Fund has returned 10% per annum (after costs, before NZ tax) since inception.

8. The Guardians has operational independence regarding investment decisions, which are made on a commercial basis. The Fund's size is approximately NZ$80 billion; it is projected to total more than NZ$100 billion by the end of the decade.

General Position and Context

9. The Act, Russian Sanctions Regulations 2022 (**Regulations**), and associated guidance are, in our view, primarily framed around conventional business dealings, core banking/finance/asset management activities. As a result of this focus on the relevant characteristics of businesses as opposed to investors, aspects of the regime are overly broad as they relate to the overseas investment activities of large institutional investors (such as the CFIs), holding broad, diversified, and complex portfolios.

10. To understand such issues, it is necessary to also have an understanding of the investments and investment approaches of international institutional investors, their scale, and complexity. New Zealand's CFIs, for instance, involve:

    a. Multi-billion dollar investment portfolios (over NZ$130 billion, as at 30 June 2024, in the case of the submitters combined portfolios), invested in a broad range of local and international investments through a wide range of different strategies, structures and approaches.

    b. These funds are invested through a mix of internal mandates (i.e. managed in-house), and external fund managers. A mixture of strategies and structures are also applied across a range of international jurisdictions.

    c. As a result CFIs hold, directly and indirectly, a significant range of stock and other assets. To illustrate, as at 30 June 2024, the Super Fund held ~NZ$37 billion of equity securities, in just over 1,280 companies with significant diversification across countries and industries. Refer to NZ Super Fund - Portfolio Disclosures for further details.

    d. Depending on the approach taken in relation to a specific investment strategy or vehicle, there are different levels of direct control and capacity to influence involved.

11. From a compliance perspective, it is important to note that the international fund managers used by CFIs tend to be major financial institutions, typically domiciled in the United States, United Kingdom, or European Union. As such, they are highly regulated in their own rights, and subject to sanctions which apply through their domestic jurisdictions, including in relation to Russia.

12. In addition, transactions on listed markets inevitably involve a range of financial intermediaries and market infrastructure entities (e.g. custodians, brokers, managers, index providers). Such organisations implement main sanctions lists, which tend to be broader than New Zealand sanctions.

13. When the Act was passed and the Regulations promulgated, the submitters undertook comprehensive risk assessments, engaged with financial institutions, custodians, and relevant international peer funds to implement the appropriate level of controls, commensurate with our respective activities and risk profiles.

Sanctions and Investment Activities

14. The key restriction of the sanctions regime, in terms of its impact on investors, is a prohibition on dealing with securities of sanctioned persons (Regulation 10A). This includes an extensive list of entities who are specifically listed in the Regulations (i.e. entities that are 'explicitly' sanctioned), together with their "associates" (i.e. entities who are not listed, but 'implicitly' sanctioned by being captured by the definition of "associate").

15. Since the implementation of the Regulations, we have worked constructively with the Ministry to improve the settings as they relate to investment activities. This resulted in some material improvements in the Regulations, which removed some areas that were overly broad and not feasible for investors to comply with, given globally available data sets. We appreciate the Ministry's work in this regard.

16. Despite this, certain aspects of the "associate" test remain overly broad, out of step with main sanctions lists, and challenging (if not impossible) to apply from an investment perspective in the context of sophisticated portfolios such as those we have outlined above. In reality, the risk that this overly broad approach translates into actual sanction breaches is low. Having said that, we submit that it is inappropriate to set a sanction regime which, despite having appropriately robust sanction controls that reflect global good practice, is too broad to possibly comply with.

17. Based on our experience internationally, it is common for sanction regimes to include some form of "associate" test or mechanism to catch controlled entities. Such provisions, however, tend to be confined to entities which are owned/controlled by the sanctioned individual. In an investment context, this is something that can be more readily ascertained and verified from public records – see further under 'Sanction Screening' below.

18. In the case of the current New Zealand test for association, however, the test is much broader. For example, Regulation 5(2)(A) in effect prohibits investors from acquiring an asset – or investing in an entity – which is owned or controlled by a person (Person A), who is acting directly or indirectly on behalf of, or at the direction of, another person (Person C), who is in turn acting directly or indirectly on behalf of, or at the direction of a sanctioned person (Person B). We are unaware of globally available data sets which include this information in a manner that would enable us to effectively screen for, and apply this definition of associate. It is entirely unclear, therefore, how such a requirement could be complied with, or the necessary parties and relationships even identified.

19. We have previously raised this legislative gap with the Ministry, and suggested that it considers amending Regulation 5(2)(a), or confining the instances when it applies so that it is inapplicable to Regulation 10A.

20. Further, the current regulatory approach in naming sanctioned individuals together with their "associates" has the effect of transferring responsibility/risk and compliance costs for identifying "associates" to the market, despite the Ministry potentially having superior access to information/intelligence and resources in respect of identifying these associates. While that may make sense for some situations, such as conventional business dealings with more limited counterparties where extensive due diligence is possible, we query whether this is an efficient approach to regulation in an investment context.

21. We recommend confining the definition of associate to Regulation 5(2)(b), and instead ensuring any other persons intended to be caught are themselves listed explicitly on the sanctions list.

Sanction Screening

22. The regime and guidelines for sanction screening also raise issues for large investment portfolios, such as those managed by the CFIs. Such portfolios make a significant number of trades on a daily basis, in short time frames, and through a range of channels and managers. It is simply not practical to undertake individualised due diligence in relation to each trade. Even if this was practical, both the extent of the compliance costs, and the impact it would have on the efficiency and effectiveness of investment management would be material, imposing significant actual and opportunity costs to both current and future tax and levy payers.

23. This should not be taken as implying that no screening is already involved, as quite the opposite is the case. Investment managers making trades and custodians and other financial intermediaries which complete those trades and hold the relevant securities for investors instead subscribe to sanctions data services. The relevant service providers monitor various sanctions lists and include individuals/entities who are subject to "explicit" sanctions (i.e. specifically listed in the sanctions) in their sanctions database. Some of these screening providers reflect NZ "explicit" sanctions, but many do not.

24. The main value of the screening services is that the providers analyse public and other records to identify any further individuals / entities subject to "implicit" sanctions (i.e. entities that are not specifically listed in sanctions but which are nonetheless caught because they are owned or controlled by one or more explicitly sanctioned individuals).

25. An issue with this often broader, but de facto approach to compliance, from a New Zealand regime perspective, is how it will obviously not provide a New Zealand specific data set but is instead composed by reference to individuals and tests of association which reflect the main global sanction regimes (OFAC, EU, UK). The screening service providers develop their own bespoke methodology for identifying owned/controlled entities, framed around the legal tests used for main sanction regimes and the practicalities of what is possible to determine based on publicly available information. This means that the methodology for compiling the implicit sanctions lists does not perfectly align with the New Zealand legal definition of "associate", which creates a gap that investors are not able to screen against.

26. However, some aspects of the "implicit" sanctions lists that investors can subscribe for are broader than what we would need for NZ compliance purposes. This is because the lists are derived from connections to persons on main sanction lists, which are more extensive – and may have a different geopolitical focus – than NZ sanctions. So, while these lists may provide de facto coverage of NZ implicit sanctions, they also include many other names NZ does not sanction.

27. To illustrate the issue, if New Zealand authorities issue novel/unique sanctions (i.e. persons that are not on main sanction lists), then any entities that sanctioned persons own or control would not necessarily be identified by the sanction screening services despite being subject to NZ implicit sanctions. In that instance, NZ investors would realistically not be able to identify such entities for themselves.

28. Again, however, the capacity exists for the Ministry to effectively mitigate this potential, but not currently applicable, issue. Should the need for unique sanctions arise in the future, the Ministry could consider adding any "associates" (the definition in the Russia Sanctions that frames up implicit sanctions) that the Ministry is aware of to the explicit sanctions lists (rather than rely upon the broad "associate" / implicit sanction provisions), in which case such entities should be included within sanction screening databases. As a more technical point, the sanctions should then be revised so that "associates" of such persons would not be caught, since that would in effect extend the scope of the sanctions (i.e. effectively applying to "associates of associates").

Corporate Actions

29. Aspects of the sanction restrictions regarding dealing in securities do not work for sophisticated corporate actions. As a result, the current approach could have the perverse impact of actually precluding transactions that are desirable from a sanction policy perspective, and would advance the objectives of the regime.

30. A good example of this is a transaction to exit a sanctioned stock via a buyback. In this situation, a sanctioned entity may wish to undertake share repurchases (i.e. where the issuer repurchases shares from investors). This would enable investors to withdraw part of their investments in the sanctioned entity, an outcome which would not otherwise be possible, given they can't trade the stock due to the impact of global sanctions on markets.

31. Such a transaction is consistent with the intent of the sanctions regime, in that it results in a repatriation of funds that would weaken the balance sheet of the issuer and withdraw capital from Russia. Given that, an effective regime would be enabling of such transactions, as opposed to restrictive, as is currently the case. The counter-productive constraint results as, assuming that the transaction involved another entity that was subject to NZ sanctions, then under regulation 10A(2)(b) the ability to sell securities of a sanctioned entity does not apply where that sale would result in a sanctioned person (i.e. the issuer) owning or controlling the security.

Anti-Money Laundering and Countering Financing of Terrorism Interactions

32. The consultation document raises questions relating to increasing the alignment of the sanctions regime with existing anti-money laundering and countering financing of terrorism (AML/CFT) processes. Specifically, it explores whether AML/CFT supervisors should have an explicit role in ensuring duty holders comply with their sanction obligations.

33. Each of the CFIs hold Ministerial exemptions from the New Zealand AML/CFT regime, albeit with slightly differing terms. ACC and the Super Fund, for instance, hold complete exemptions, reflective of the fact that each organisation has other oversight mechanisms, specific statutory functions, and no "customers" in a traditional sense. See for example: https://www.justice.govt.nz/assets/Documents/Publications/Guardians-Ministerial-Exemption.pdf.

34. From our reading of the consultation document, it does not appear there is an intention for amendments to impact on the availability of Ministerial exemptions or otherwise create an obligation to have AML/CFT supervisors oversee sanction compliance of the CFIs. If this was the outcome of the amendments, whether intended or otherwise, we would be very concerned. Such an outcome would result in disproportionate and unnecessary compliance costs, and increased inefficiency, in an attempt to manage risks which are already appropriately managed by the CFI's routine risk management processes.

Conclusion

35. Thank you again for the opportunity to provide our input into the statutory review of the Russian sanctions regime.

36. In general, we believe the Ministry has done an excellent job in developing and implementing the regime. We also acknowledge, and are appreciative of, the efforts taken since the regime's introduction to be responsive to feedback and work to fine tune and improve it.

37. The issues raised in our submission in large part result from the unique and complex requirements of large institutional investors. We would welcome the opportunity to work with the Ministry to improve these aspects of the sanctions and, thereby, the overall effectiveness and efficiency of the regime.

38. Should you wish to discuss our submission further, please feel free to contact:

Adrien Hunter Associate General Counsel Guardians of New Zealand Superannuation	William More Investments Legal Manager Accident Compensation Corporation	Tim Mitchell Chief Executive Annuitas, Government Superannuation Fund Authority
AHunter@nzsuperfund.co.nz	William.More@acc.co.nz	tmitchell@annuitas.co.nz

39. Please note that we may publish this submission on our respective websites.

Guardians of New Zealand Superannuation

Accident Compensation Corporation

Government Superannuation Fund Authority