New Zealand Law Society
Te Kāhui Ture o Aotearoa

Review of the AML/CFT Act

10/12/2021

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Introduction

1 The New Zealand Law Society | Te Kahui Ture o Aotearoa welcomes the opportunity to comment on the Ministry of Justice's (**the Ministry**) review of the Anti-Money Laundering and Countering Financing of Terrorism (**AML/CFT**) Act 2009 (**the Act**).

2 The consultation period specified has been insufficient to allow the Law Society to respond to each of the substantive number of questions posed in the Consultation Document. Instead, we comment on the topics as outlined by the Ministry, where relevant to the legal profession. Except where otherwise indicated, the Law Society's comments relate exclusively to the legal profession.

3 The Law Society is both a regulator and representative body. The majority of this submission is based on the input of practitioners, including the Law Society's Property Law Section, Criminal Law Committee, and contributors from law firms.

General comment

4 The Consultation Document poses some 'overall questions,' which we address briefly below and throughout the substantive submission:

- How is the Act operating? Is it achieving its purposes? Are there any areas of risk that the Act does not appropriately deal with?
- What is working and what is not? Are there areas that are particularly challenging or costly to comply with? How could we alleviate some of those costs while also ensuring the effectiveness of the system?
- What could we do to improve the operation of the Act?
- Is there anything we need to do to "future proof" the Act and ensure it can respond to the modern and largely digital economy?

5 We recognise the importance of an effective regulatory system to support a well-functioning AML/CFT regime and the role that lawyers have in preventing the harms that result from the targeted conduct. However, lawyers are concerned that, whilst the purposes of the Act are understood, the compliance cost and burden that the Act has introduced is, for many practitioners, disproportionate to the risk posed by their activities. The feedback the Law Society has received from many lawyers is that implementing and complying with this regime is perhaps the most difficult thing they have had to cope with during their careers. For some it is prompting early retirement. These lawyers consider they do not have the time, resource, or necessarily the expertise, to meet this compliance burden. They are concerned that the costs are disproportionate to the risks inherent in their business and their client base. We consider the regime needs to balance these compliance costs with the risks relating to lawyers, especially sole practitioners or small legal practices.

6 The main areas of concern for lawyers, which are expanded on throughout this submission, include:

- The cost and time involved with compliance (both initially and on an on-going basis), and whether this is in fact proportionate to the AML/CFT risks inherent in their businesses.
- Lack of clarity around general information sharing, in particular to avoid the duplication of CDD. For example, the extent to which (and in what scenarios) an entity can share

CDD information with another entity, which would not only ease some burden on lawyers, but would also apply to third party electronic verification companies and should decrease the costs of outsourcing CDD.

- While sector-specific guidance has improved, the cross-sector guidance issued is not as helpful. There remain areas where further guidance – so long as it is consistent with a risk-based approach – would be appreciated.
- Clarity is required around terminology such as 'ordinary course of business', 'managing client funds', and 'engaging in or giving instructions'.
- Interpretations which strain the meaning and intention of the legislative and regulatory provisions so that businesses are caught when there is no intent that they should be (and there is no benefit in terms of the purposes of the Act), and which then rely on other mechanisms (e.g., exemptions) to exclude those businesses on a case-by-case basis, should be avoided. Exemptions may be available in some circumstances but there are significant costs of compliance, and time and uncertainty involved for lawyers, DIA, and the Ministry in relation to exemption applications. The need for such processes should be minimised.
- The Act is designed to mitigate ML/TF risk in New Zealand conditions, as emphasised by section 3(1)(b), which provides that one of its purposes is to '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.' Where the Ministry now proposes additional areas of capture, or increased obligations, going beyond the FATF recommendations, there should be a proper cost-benefit justification.

7 Lawyers have a fundamental obligation under the Lawyers and Conveyancers Act 2006[1] (LCA) to uphold the rule of law and facilitate the administration of justice in New Zealand. That obligation is for the benefit of the client, and not the lawyer. The lawyer-client relationship requires a high degree of trust between lawyer and client, as well as the ability for clients to provide their lawyers with information in complete confidence. Any infringement of this may constrain the critical role of lawyers to act as advocates for their clients, as well as access to justice. The Law Society considers that any further changes to the Act (or regulations) must recognise the profession's role and functions.

8 Lawyers view the rapid rise of the digital economy and the related development of technologies favouring anonymity, as important money laundering and terrorism financing (ML/TF) risks. The Law Society considers that any review of the Act must facilitate appropriate management of these risks, but regulators and supervisors need to support the development of appropriate mechanisms to assist with compliance.

9 While a review of the regime is welcomed, the prospect of further change and the potential extension of obligations, is concerning. If obligations on law firm reporting agencies are to increase in some areas, based on the experience of the regime so far and the identified issues and risks affecting law firms, then it is appropriate that this review also consider where obligations can be reduced, similarly based on that experience.

10 The Law Society also encourages the Ministry to undertake a detailed cost benefit analysis of AML/CFT compliance across sectors. As is covered below, the estimates made prior to implementation of 'Phase 2' of the AML/CFT regime do not appear to have proven accurate.

[1] Section 4(a) LCA.

Institutional arrangements and stewardship

Purpose of the AML/CFT Act?

11 The Law Society has always recognised, and accepted, the case for lawyers being reporting entities under the Act, to the extent to which they conduct captured activities. The Law Society accepts there is risk associated with the activities of the sector, and that the New Zealand legal profession is not immune from the mischief which the Act is designed to deter and detect. It acknowledges the legal profession has a responsibility to co-operate in the global response to money laundering and terrorist financing.

12 The Law Society considers that the purposes of the Act remain generally appropriate. The Act is designed to deter and detect ML/TF by providing a framework for reporting entities to protect themselves from exploitation. One way it does this is by placing obligations on reporting entities to make disclosures to enforcement agencies in certain circumstances.

13 As acknowledged in the Consultation Document, the potential impact of an expanded purpose could be significant in terms of the additional compliance burden. It would likely have other unintended consequences, such as further deterring legitimate businesses from participating in the financial system.

14 In addition, the Law Society suggests that it would be inappropriate for the purposes of the Act to be expanded to the active prevention of money-laundering. Reporting entities are not law enforcement agencies. Any change that created further tension between a lawyer's duty to their client and their duties under the Act could further undermine the critical role that lawyers play in the administration of justice.

15 The Act already partially "deputises" reporting entities by requiring them to report certain activities, and to keep records. Lawyers are also already required to disclose confidential information where it relates to the anticipated or proposed commission of a crime punishable by three or more years imprisonment.[2] In the case of lawyers, expanding the purposes of the Act does not appear necessary.

Risk-based approach to regulation

16 The risk-based approach does have some recognition in the Act, for example in the varying intensities of CDD. However, the Act could better support a risk-based approach that recognises different sectors have different ML/FT risks and should therefore have different risk-adjusted requirements.

17 In practice, it is not clear that a risk-based approach is applied. There can be a tendency for supervisors, reporting entities, compliance officers and consultants to assume the most conservative position. Additional guidance could assist with this, making clear that reporting entities have the discretion to determine the risk, and therefore any accompanying obligations. Guidance should be clear, seek to clarify obligations, and should indicate where it is not mandatory.

18 In respect of the compliance burden relative to the benefits of the AML/CFT scheme, in 2016 the Ministry obtained a 'Business Compliance Impacts' report in advance of the Phase 2 reforms. At that time, it was difficult to quantify compliance costs, just as it was difficult to quantify the benefits of implementing Phase 2 of the scheme. The Law Society considers that now, in the context of this full-scale review, it is appropriate for the Ministry to undertake work to identify the true cost of AML/CFT compliance across sectors. This information is

[2] Rule 8.2(a), Rules of Conduct and Client Care.

essential to a review that seeks to understand whether the correct balance has been struck between risk and regulation.

19 The Law Society's Property Law Section has noted that the compliance costs estimated in that 2016 report were likely not accurate at the time, and are incorrect now. For example, the report estimated:

- Conveyancers would incur CDD costs of $37.76 per transaction. The compliance costs for lawyers undertaking conveyancing work are typically a minimum of $250 - $350 plus GST for simple CDD. It can often cost more.[3]
- Real estate agents would incur CDD costs of $355.88. This figure (as observed by lawyers) tends to be a minimum of $500, and can be significantly more.

Information sharing

Direct data access to FIU information for other agencies

20 The Law Society understands the intention behind the proposal that there be some arrangement enabling specific government agencies to query intelligence that the FIU holds. However, such information is likely to be highly sensitive, particularly where it is provided by lawyers. In the Law Society's view, it remains appropriate that such information be shared only on a case-by-case basis.

21 The Law Society notes the administrative burden that this may impose on the FIU but observes that the Act in general imposes a significant administrative burden on all involved, including reporting entities, often for good reason.

22 The Law Society would be concerned if access arrangements for other public sector agencies were to raise risks of inadvertent disclosure. That could easily lead to a loss of public confidence in the system and accompanying loss of public perception of the integrity of the FIU and the AML/CFT regime more generally.[4]

23 The Law Society cannot comment substantively on these proposals without more information regarding which agencies, other than Customs, might potentially have access to data held by the FIU under this proposal, and why that is considered necessary.

Use and disclosure of information ss 137 – 141

24 Section 3(2) of the Act states that the Act '*facilitates co-operation amongst reporting entities, AML/CFT supervisors, and various government agencies, in particular law enforcement and* ***regulatory*** *agencies.*' However, not all regulators are government agencies. Consideration should be given as to whether s3(2) of the Act requires amendment to make it clear it applies to non-government regulatory agencies.

25 Section 139 of the Act allows an AML/CFT supervisor to disclose any information (that is not personal information) obtained by it in the exercise of its powers or the performance of its functions and duties under the Act, to any government agency or regulator, for law enforcement purposes, if it is satisfied that the relevant entity has a proper interest in receiving such information.

26 Subsection (2) allows information sharing between the various entities (if not authorised under any other provision of this Act) for law enforcement purposes, in accordance with

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3 This estimate has been provided by the Law Society's Property Law Section.

4 The risks inherent in information-matching have been commented on in the context of the Privacy Act 2020 by the Privacy Commissioner: https://www.privacy.org.nz/privacy-act-2020/information-sharing/information-matching-overview-2/

regulations made under section 139A. To our knowledge there are no regulations made under s139A in relation to information sharing, but it is a matter within the scope of this review.

27 A regulator is defined in the Act as '*a professional body responsible under any New Zealand enactment for enforcing the regulatory obligations of a particular industry or profession whose members are subject to this Act.'* For lawyers, this is the Law Society, which is the responsible regulatory body under the Lawyers and Conveyancers Act 2006 (LCA).

28 Section 140 of the Act allows a government agency or an AML/CFT supervisor to disclose to any other AML/CFT supervisor or government agency any information supplied or obtained under an enactment listed in subsection (2), if the disclosing entity has reasonable grounds to believe that the disclosure of that information is necessary or desirable for the purpose of ensuring compliance with this Act and regulations.

29 The LCA is one of the enactments included in subsection (2) at paragraph (n). The Law Society, as one of the regulatory bodies under the LCA, is the likely receiver of information supplied or obtained under the LCA, but it is not an entity included in subsection (1) as it is neither an AML/CFT supervisor nor government agency.

30 Accordingly, the Law Society suggests that section 140(1) requires amendment to include non-government regulators, as section 139 does.

31 Unlike section 139, section 140 does not include a prohibition or restriction on the disclosure of personal information. The relevant information privacy principles (IPP) under section 22 of the Privacy Act 2020 are IPP 10 (limits on use of personal information) and IPP 11 (limits on disclosure of personal information).Provided section 140 is amended to include 'regulators', the Law Society would be able to disclose that information pursuant to section 24 of the Privacy Act, which states these IPP do not limit the effect of a provision contained in any enactment that authorises or requires personal information to be made available.

Licensing and registration

32 As noted in the consultation document, 'licensed' means that the business needs to satisfy objective criteria to demonstrate they are suitable to provide the business activity, and requires agencies to actively approve the business to carry out the relevant activity. It can also allow the licensing agency to impose limits or conditions on how the business operates. Registered, by contrast, usually does not require the business to satisfy various criteria, except that they intend to provide the relevant activity and potentially satisfy a fit-and-proper test.[5]

33 Not all law firms are reporting entities under the Act. A law firm is a reporting entity if "in the ordinary course of business" it carries out one or more of the captured activities listed in the definition of a designated non-financial business or profession (DNFBP).

34 There does not appear to be justification for an AML/CFT levy to fund the regulatory and/or administrative work in this area. Lawyers and consumers already bear AML/CFT compliance costs more extensive than estimated prior to the implementation of Phase 2. AML/CFT is, in this sense, a 'public good'. It should be publicly funded.

35 There could be justification for a levy where it related to cost-recovery for funding of central AML services such as centralised Politically Exposed Persons (PEP) checking and ID verification, or an accessible register of Beneficial Owners – none of which are presently provided.

Registration

36 The Law Society supports an AML/CFT-specific registration regime which complies with international requirements. It considers that the most appropriate agency to be responsible

5 *Review of the AML/CFT Act Consultation Document,* Ministry of Justice at page 15

for its operation is the applicable supervisor (for lawyers, DIA). Providing section 140 is amended to allow information sharing between DIA as supervisor and the Law Society as the regulator for lawyers, the Law Society could provide the registration information it already holds, to avoid duplication and reduce the cost and administration involved. This would also ensure consistency of information between the two registration systems.

37 Lawyers are required when renewing their annual practising certificate, to complete 'fit and proper person' declarations, and the Law Society may make its own checks. Again, provided it is allowed for under the Act, and that the Law Society explained to lawyers that the information would be used for this purpose (where applicable), this information for registered reporting entities could be provided to DIA.

Licensing

38 As noted in the consultation paper, a licensing framework would involve agencies (e.g. AML/CFT supervisors) making a positive assessment about whether a business should provide particular services. The licensing authority could also impose conditions through a license which manages or restricts activities in certain circumstances, or more generally impact how the business operates. However, licensing frameworks tend to be expensive and administratively burdensome for both the applicant and the licensing authority.

39 The Law Society is of the view that a separate AML/CFT licensing regime for lawyers is unnecessary and would involve disproportionate costs and administration for the following reasons:

- Lawyers are required to undergo 'fit and proper person' and compliance checks on an annual basis in order to renew their practising certificate.
- A law firm as defined in the Act refers to lawyers practising on own account. To be approved to practise on own account, lawyers go through a robust process, which includes looking at their suitability to undertake work in particular areas of law without supervision, and their business plan for operation of their practice.

Scope of the AML/CFT Act

Challenges with existing terminology

40 The Law Society considers that rather than attempting to legislate what is meant by "ordinary course of business" (which could create further interpretative difficulties), it would be more useful and carry less risk of unintended consequences if supervisors were instead to provide more comprehensive commentary and guidance on the point. This would allow greater flexibility and responsiveness to changes in business practices and technologies and assist law firm reporting entities with compliance through the "safe harbour" provisions.

41 The words "only to the extent that" in section 6(4) appear intended to ensure that reporting entities are captured only in respect of the captured activities that they conduct, and not more generally. As implicitly acknowledged in question 2.5, they prevent legislative "creep" – the inadvertent and inappropriate expansion of the application of the Act. Removing those words would create difficulties for law firm reporting entities, given the tension between their role in the legal system and their obligations under the Act. It could lead, for example, to a law firm engaged in litigation (not captured) becoming aware in the course of proceedings of an offence committed by a third party, and then having an obligation to disclose that offending in circumstances which could seriously compromise the proceedings. This is an untenable outcome, and likely to have serious implications for the administration of justice.

42 As set out in previous submissions,[6] the Law Society disagrees with the view taken by DIA that "fees for professional services" in the context of the exclusion from activities constituting "managing client funds" set out section 5(1) refers only to a business's own fees. The Law Society supports legislative clarification to resolve the matter. The definition of "professional fees" in this context should specifically include the fees of a third party (including the exemption for barristers' fees currently contained in regulation 24AB(1)(d) of the Anti-Money Laundering and Countering Financing of Terrorism (Exemptions) Regulations 2011), as well as disbursements incurred or recoverable alongside such fees, and amounts/retainers on account, whether for the fees of the recipient business or a third party.[7] Such amounts are received for a pre-designated purpose associated with the provision of legal services, so that the recipient of such funds cannot be said to control the flow of them. Only if the payer subsequently attempted to direct any amount of the funds other than for that purpose should AML/CFT obligations apply.

43 The Law Society agrees that the meaning of the phrase "engaging in or giving instructions" in part (a)((vi) of the definition of "designated non-financial business or profession" in section 5(1) of the Act could be clarified. However, the suggested solution of changing "engaging in" to "assisting a customer to prepare for" would make the definition less clear ("engaging in" is at least a bright line of activity and therefore easier to identify). More significantly, it would potentially and unjustifiably broaden the definition by catching advisory or other preparatory activities in a context where the ML/TF risk is posed by the actual implementation or transaction. The Law Society considers that the definition should read "carrying out or giving instructions on behalf of a customer to another person to carry out".

44 There are also issues of terminology and scope which could be addressed by sector-specific guidance. This includes guidance on the definition of 'customer' and captured activities for lawyers. These areas of guidance should be developed in consultation with the profession and would assist in reducing the need for each firm to undertake their own analysis of which instructions and/or clients are in scope (at least in respect of aspects conducive to guidance).

Potential new activities

Partner in a partnership

45 The Law Society agrees that a situation in which a person acts, or arranges for a person to act, as a partner in a partnership should be added to part (a)(ii) of the definition of "designated non-financial business or profession" in section 5(1) of the Act, consistent with the risk-based approach to AML/CFT. Any change to the definition should be clear about what constitutes a "partnership" for this purpose. It is not clear whether limited partnerships would be included, despite these having been identified by FATF as an area of risk in New Zealand.

Company secretary

46 The Law Society disagrees that "company secretary" should be included in this definition. As identified in the Consultation Document, the Companies Act 1993 does not recognise the concept of "company secretary." It is difficult, then, to see what basis there could be for addressing the concept in the Act. Attempting to incorporate such a concept in the Act without a legislative basis or definition at general law would inevitably create more interpretative uncertainty in the Act.

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6 See the Law Society's submission on the Ministry's paper *Expiring AML/CFT Regulations*, 30 October 2019, at 3 – 4.

7 Regulation 24AB(1)(e) is not sufficient to address this point. It is not sufficiently clear, and is limited to low value transactions.

Criminal defence lawyers

47 The Law Society disagrees that criminal defence lawyers should have AML/CFT obligations.

48 The Consultation Document notes[8] that *"… if we imposed obligations on criminal defence lawyers, we would need to carefully navigate questions of whether these obligations are proportionate, as well as issues of legal privilege, rights to a fair trial, and lawyers' professional obligations…*".

49 The Law Society agrees that placing AML/CFT obligations on criminal defence lawyers raises concerns around the proportionality of compliance obligations, as well as issues around legal professional privilege, fair trial rights, and the professional obligations of lawyers.

50 Criminal defence law, overall, does not deal with the transfer of money other than for the payment of fees by clients who are not legally aided for the work undertaken. Criminal lawyers do not manage client funds or assets in the way that other areas of the legal profession do. In terms of the section 5 definition of a DNFPB, this is why criminal defence lawyers do not attract AML/CFT obligations. Presumably, any decision to place AML/CFT obligations on criminal defence lawyers would require amendment to the captured activities, in order to cover a criminal defence lawyer's receipt of professional fees. However, there appears to be no evidence suggesting that the current position has led to a material risk of laundering of criminal proceeds, or the financing of terrorism.

51 In addition, criminal defence lawyers (like all lawyers) are subject to obligations under the Rules of Conduct and Client Care (ROCCC). Lawyers are not permitted to assist any person in an activity that is fraudulent or criminal, or that conceals fraud or crime.[9] They must take all reasonable steps to prevent a person from perpetrating a crime or fraud through their practice,[10] and must disclose confidential information where it relates to the anticipated or proposed commission of a crime that is punishable by three or more years imprisonment.[11]

52 In terms of the Discussion Document, it is not clear what level of 'suspicion' would be necessary to displace a lawyer's obligations to their client. The discussion document refers to a client who insists on paying their fees in cash, '*which may indicate that criminal proceeds are being used to pay for the legal defence'*. Not only is this unfairly presumptive and a somewhat jaundiced view of criminal defendants, but it also ignores the reality that many vulnerable persons face de-banking and financial exclusion. Defendants not in receipt of legal aid may well be in employment and receiving legitimate funds, and cash payment can be preferred for a variety of reasons.

53 As set out in the general comments, above, absolute trust and confidence between lawyer and client are fundamental to the lawyer-client relationship and to criminal defence in particular. Public confidence in the availability of a proper defence to criminal charges underpins public confidence in access to, and the administration of, justice. Criminal defence lawyers deal with clients who already have low trust in the justice system and a misperception that lawyers are working "for" or "with" police or will provide information to law enforcement agencies. Making that perception a reality subverts the lawyer-client relationship and can only do great harm to justice and access to justice in New Zealand. Further, mandatory reporting requirements could deter an individual from exercising their right[12] to consult a lawyer when arrested, detained, or charged with a criminal offence.

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8 At page 26.

9 Rule 2.4.

10 Rule 10.11.

11 Rule 8.2(a).

12 Sections 23(1)(b) and 24(c) New Zealand Bill of Rights Act 1990.

DNFBP

54 Although not mentioned in the Consultation Document, the Law Society considers that legislative clarification is required in relation to part (a)(vi)(D) of the definition of "designated non-financial business or profession" in section 5 of the Act. It is not clear whether the "buying, transferring, or selling of a business or legal person… and any other legal arrangement" in that context captures the sale of a minority shareholding in a company. The current definition creates uncertainty, and difficult boundary issues, which could be manipulated.

55 In the view of the Law Society, a transaction involving a minority shareholding is equally vulnerable to ML/TF as the sale of a 50% or majority shareholding, so the Act should treat all such transactions equally.

Current and future exemptions

56 The Law Society agrees that legal or natural persons that act as trustee, nominee director, or nominee shareholder, where there is a parent reporting entity involved that is responsible for discharging their AML/CFT obligations, should not be subject to such obligations in their own right.

57 The effective duplication of compliance obligations disproportionately burdens the persons involved, without enhancing the detection and deterrence of ML/TF or contributing to public confidence in the financial system. The Law Society observes that these purposes are served by ensuring that compliance obligations in relation to any particular entity under the Act are satisfied – by whom they are satisfied is irrelevant.

Territorial scope

58 The Law Society agrees it would be useful for the Act to define its territorial scope, and suggests the adoption of the criteria set out in the guidance published by the AML/CFT supervisors.[13] However, those criteria need careful attention to properly align them with the "carrying on business" tests that appear in the Companies Act 1993 and in other similar statutory forms such as the Insurance (Prudential Supervision) Act and the Financial Service Providers Registry regime.

59 Regarding the specific example of an offshore company providing an activity solely online to New Zealanders, the Law Society observes that without some tie to New Zealand, enforcement would likely be difficult, if not impossible, because there is no presence in New Zealand upon or against which enforcement action could be taken. The responsibility for enforcement properly (and practically) rests with the offshore company's jurisdiction of incorporation/origin/location of business. In practice, New Zealand agencies such as the FIU and FMA are quite capable of conveying information to their counterpart agencies in the offshore jurisdiction as needed.

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13 *Territorial scope of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009,* updated November 2019: https://www.fma.govt.nz/assets/Guidance/191122-AML-CFT-territorial-scope-of-the-AML-CFT-Act-2009.pdf

Supervision, regulation, and enforcement

Agency supervision model

60 In its submissions on the Ministry's consultation on the implementation of "Phase Two" of the AML/CFT regime under the Act, the Law Society outlined the work that would be required by the supervisor(s) that came to assume responsibility for the newly captured sectors:[14]

> *The workload of the current supervisors is likely to increase disproportionately if new and disparate sectors are included within the scope of supervision. The nature of work performed by lawyers means that the legal profession does not neatly fit under the umbrella of any of the current supervisors. An existing supervisor would therefore need to invest in developing specialist knowledge relevant to legal practice and law firm administration and gain an in-depth understanding not only of the law but also the practical application of matters such as legal professional privilege. Communication links and vehicles for effective dissemination of information would also need to be established across the supervised sector.*

61 This work is not yet complete, though sector-specific guidance has improved. The Law Society considers that DIA must be adequately resourced to carry out its work as supervisor and must continue to deepen its knowledge of all the sectors it supervises, including law firm reporting entities. The Industry Advisory Group is currently underutilised and could assist in this regard.

Powers and functions

62 The Law Society observes that in exercising the powers of search and removal of documents vested in the Commissioner of Inland Revenue by the Tax Administration Act 1994, a warrant or consent must be obtained in relation to private dwellings. The Law Society considers that any ability of AML/CFT supervisors to enter a private dwelling house should be subject to similar constraints.

Regulating auditors, consultants, and agents

63 The Law Society agrees that there is presently a gap in the Act in terms of who can conduct an audit. The Law Society considers that the issue is not the "standards" applied to auditors, but that anyone can currently set themselves up as an auditor for the purposes of the Act.

64 The Law Society considers that appropriately qualified[15] Lawyers, Chartered Accountants, and persons holding CAMS certification should be able to act as auditors of any reporting entity. In addition, a process could be established by which other persons who may have suitable qualifications through experience (for example, some former police officers) could apply to the DIA to have their qualifications recognised. That recognition could be potentially limited to certain types of reporting entities, within the auditor's demonstrated experience and knowledge.

65 The Law Society observes that businesses already have protections in the form of tortious action against auditors, as well as, potentially, the avenue of complaint to the auditor's professional body. A requirement for auditors to be regulated by a professional body could ensure this protection. The Law Society observes that an audit, although mandated by the Act,

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14 https://www.lawsociety.org.nz/assets/Law-Reform-Submissions-0010-105004-I-MOJ-AMLCFT-Phase-Two-consultation-16-9-16.pdf, at page 15.

15 Criteria would need to be developed for this and could include, for example, that the individual is regulated by a professional body.

is not an enforcement function. Rather, it should assist the reporting entity in assessing and, if necessary, strengthening its compliance programme.

66 The Law Society disagrees that it is necessary to specify the role of a consultant in legislation, including their obligations. Doing so may hinder the compliance efforts of reporting entities. The Act and regulations are extensive, encompass a broad range of sectors and activities and, by design, give reporting entities significant latitude to establish their own risk and related compliance programmes by way of risk management, for which the reporting entities themselves remain responsible. That being the case, the Law Society considers it is best left to individual reporting entities to consider what advice or assistance they might need, and whom best to obtain it from. At a minimum, regulation must not prevent lawyers from providing advice on the law.

67 One issue of great concern to lawyers that does not appear to be raised in the paper is audit frequency. In the view of the Law Society, many law firms (particularly smaller firms or sole practitioners not operating trust accounts) are at very limited real risk of being exploited for ML/TF purposes. The costs for such firms of compliance in general, and of frequent audit in particular, are disproportionate. The Law Society submits that such firms could be required to be audited at longer intervals than currently – potentially five or more years.

Preventative measures

Customer due diligence

General issues

68 A principal challenge faced by lawyers in relation to CDD obligations is that they are imposed with little practical support. The time, cost and resource involved in collecting the information from clients, (particularly in circumstances where there may be multiple reporting entities in a single transaction, all of whom may be required to perform CDD on the client), often seems disproportionate to the real risk posed by any client or transaction and difficult to justify. For example, in a real estate transaction, a person selling and buying a home may be subject to three or more CDD reviews:

- Real estate agent
- Bank or other lender(s)
- Lawyer
- Accountant

69 This creates added cost and delay for the client, with all costs needing to be added to the total cost of doing business. One example provided to the Law Society showed a cost of $875 that had to be passed on by a real estate agent to the client, for AML/CFT compliance and administration on a residential sale. Further costs would then be incurred in the context of CDD that had to be carried out by other reporting entities.

70 The process should be streamlined in terms of who must conduct CDD, who may rely on that CDD without being directly responsible for its accuracy, and (with appropriate privacy protections) making that CDD available to others.

71 The inability to rely on this information without assuming direct responsibility means that the ‘reliance’ methods set out in the Act are unhelpful and do not, in practice, reduce the compliance burden of CDD. Consistent across all feedback to the Law Society was that this burden could be reduced responsibly, without increasing risk. The Law Society considers lawyers should be able to rely on CDD conducted by other New Zealand reporting entities

(particularly 'Phase 1' entities, such as banks) without being required to duplicate or to verify the process or information.

72 This duplication of CDD involves time and cost for both the entity and client, without necessarily furthering the aims of the AML/CFT regime. There are technological solutions that could be facilitated by supervisors/government, such as a centralised identity verification (with customer/client consent or participation) through the RealMe identification service or the proposed Digital Identity Programme.

73 It would not be appropriate to have such information on a widely searchable database for privacy and security reasons, but at the same time, it would significantly aid compliance if the resources presumably available to government/law enforcement in this regard were also available to reporting entities to facilitate their compliance under the Act. In providing any technological solution, it will be necessary to strike a balance between protecting public trust and confidence (appropriate privacy protections) and allowing reporting entities access in a manner that is not excessively 'hamstrung' by restrictions and/or liability.

74 The duration of CDD validity should also be considered, keeping in mind that expired ID does not suddenly undermine or compromise the procedures and protocols adopted in the issuing of that ID. For example, LINZ has accepted an expired passport as acceptable ID. The rationale being that expiration restricts the ability to use the document for travel, but does not alter the veracity and authenticity of that document as confirming the person's identity.

When CDD must be conducted

75 The Law Society expresses caution about further regulation for law firm trust accounts and encourages the Ministry to identify what real – as opposed to theoretical – ML/TF risks there are in relation specifically to trust accounts operated by New Zealand law firms.

76 Feedback from large law firms has also identified the issue of CDD where a firm receives a referral from an offshore office or partner. CDD will have already been conducted by the overseas party, however it must either be done again by the reporting entity, or otherwise a full assessment undertaken to determine whether the overseas AML/CFT scheme and CDD was suitable. A preferable approach would be for clear guidance on which overseas AML/CFT regimes are deemed to be acceptable.

What information must be obtained and verified

77 The Law Society remains of the view expressed in its submissions on the implementation of 'Phase 2' of the Act[16] that the process of verifying a client's source of funds/source of wealth can be very complex or even impossible from a practical perspective. The Law Society encourages consideration of whether there are circumstances in which it is appropriate for there to be an exemption from this requirement, for example where funds are clearly already within the New Zealand financial system, at an entity such as a bank.

78 In such circumstances, the provenance of such funds should have already been subject to AML/CFT checks by reporting entities. Alternatively, a simple self-certification procedure completed by the client should be sufficient and require no further inquiry by the lawyer, absent obvious issues with the information.

79 The Law Society's Property Law Section also noted the example of family trusts, the majority of which in New Zealand are non-trading trusts with the family-occupied home as the only asset. The requirement to obtain 'source of wealth' from the client becomes difficult and somewhat pointless in this scenario. When asking a client, who has owned the family home in the trust for 20 years, to provide the source of wealth, it is frequently impossible for the client

16 Above, n 7.

to 'prove' where the funds were derived other than their personal earnings. Lawyers need guidance on how much information should reasonably be required in such circumstances.

Verifying information

80 In March this year, the Law Society submitted on the Draft Electronic Identity Verification Guidance.[17] In that submission, we explained that IVCOP is impractical and the burden it places on lawyers is disproportionate to the risk of money laundering posed by lawyers.

81 IVCOP is more appropriate for financial institutions. Lawyers (and some other DNFBPs) should have their own code of practice. In many cases the risk of money laundering can be adequately managed by lawyers receiving electronic copies of identity documents – rather than by verifying identity documents face to face or through one of the complex EIV methods.

82 The Law Society remains of the view that sector specific guidance should be issued by DIA, and should not be based on guidance prepared initially for businesses with a completely different customer, product/service offering, and AML/CFT risk profile. This could increase engagement and compliance within the legal profession.

83 The IVCOP is not mandatory (it is a safe harbour) and law firms could then reasonably have regard to their risk assessment and take the view in their compliance programme that, in certain circumstances, they will not require strict adherence. Such circumstances might include where the client is:

- Personally known to a partner of the firm; and
- Residing in New Zealand; and
- A New Zealand citizen; or
- A director and not a beneficial owner of a client entity who is a New Zealand resident and New Zealand citizen.

84 The Law Society observes that law firm reporting entities frequently treat adherence to IVCOP as mandatory and apparently lack understanding that it is simply a safe harbour. This can create difficulties and frustrations for clients. One example of this is where a client does not receive bills, bank statements or other correspondence through the post to their home address in their name, an increasingly common situation as business moves online. Address verification is also not required internationally.

New technologies

85 The Law Society considers that section 30 of the Act requires amendment, as it can be difficult for reporting entities to apply in practice. This is because those entities frequently are neither AML/CFT experts, nor experts in financial crime or the intricacies of emerging technologies. The implicit expectation of section 30, that reporting entities will be able to identify any risks that might be posed by new or developing technologies or products, and ascertain whether they "might favour anonymity", is unrealistic.

86 The explicit expectation of section 30(b) that having identified those risks, financial institutions are capable of identifying appropriate measures to mitigate and manage the ML/TF risks arising from such technologies or products, is also unrealistic. Identifying developing risks and providing guidance to reporting entities on how to mitigate them is properly the role of supervisors and the legislature, not reporting entities themselves.

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17 https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/l-DIA-AMLCFT-Guideline-on-Electronic-Identity_Vicky-Stanbridge.pdf

87 The Law Society notes that the approach taken in section 30 is quite distinct from other areas of the Act, where reporting entities are required to identify and mitigate risk. For example, the risk assessment required by section 58 relates to risks that a) stem from what the reporting entity itself does and b) are risks that only the reporting entity is properly placed to identify in relation to its own business. Section 30 should simply require that reporting entities meet any requirements prescribed by regulations that apply to any particular new or developing technology or product, as in the current section 30(b).

Wire transfers

88 The Law Society observes that at present there is quite significant overlap, particularly in terms of record-keeping, between law firms' obligations under the Lawyers and Conveyancers Act (Trust Account) Regulations 2008 and law firm reporting entities' obligations under the Act. These rules should be harmonised, or an exemption given to law firms already covered by the Trust Account Regulations, to provide clarity and to reduce duplication.

Reliance on third parties

89 One of the most frequently expressed concerns by lawyers is in relation to the cost and time involved with compliance under the AML/CFT regime.

90 One way to address this is through reliance on third parties. However, as noted in the Consultation Document, relying on a third party for AML/CFT purposes is not without risk for the reporting entity. It may reduce their compliance obligations, but it does not remove their obligations completely.

91 Businesses can share their compliance obligations to differing extents depending on the type of reliance employed. For example, businesses outside of a Designated Business Group (DBG) can only rely on other reporting entities or persons in other countries for CDD purposes, whereas DBG members can also rely on other DBG members to make suspicious activity reports (SARs) or conduct risk assessments.

Designated Business Group reliance

92 The creation of DBGs is one mechanism purposed to alleviate some of the compliance burden under the AML/CFT regime. The definition of a DBG allows a group of 'related' DNFBPs, and their subsidiaries, that are reporting entities (within the same sector), to form a DBG with each other.

93 However, the Consultation Document notes that the eligibility criteria set out in section 5(1) of the Act may inadvertently exclude some business relationships from being able to form a DBG and thereby share compliance obligations.

94 The current definition of DBG in the Act is problematic for lawyers:

> *a related law firm, or a subsidiary of a law firm, that is a reporting entity in New Zealand (or the equivalent body in another country that has sufficient AML/CFT systems and that is supervised or regulated for AML/CFT purposes)…*

95 'Related' is intentionally not defined, and DIA as the supervisor has issued guidance to assist DFNBPs in understanding how this should be interpreted. DIA considers that 'related' in this context should be interpreted to mean 'connected' or 'associated', and notes that DNFBPs may only be considered 'related' if they operate in the same sector, i.e. the entities are all law firms.

96 The Law Society's submission on the draft exposure AML/CFT Bill noted in respect of DBGs that:

At this stage, it is uncertain whether the designated business groups exception would provide any practical assistance to lawyers given the structure of legal practice in New Zealand and the fact that client confidentiality and legal professional privilege issues would inhibit the sharing of compliance information by law firms.

97 Under the LCA, a lawyer or an incorporated law firm is prohibited from sharing income with any other person from any business involving the provision of regulated services. There are also restrictions upon who may be a director or shareholder of an incorporated law firm.

98 Only a lawyer practising on their own account and who is actively providing regulated services through the firm may be a director or shareholder of that law firm (certain defined relatives or a qualifying trust may be non-voting shareholders). For this reason, a law firm cannot technically 'own' or be a subsidiary of another law firm. Accordingly, interpretation of the term 'related' taken in the context of the Companies Act 1993 appears to be an impediment to the inclusion of law firm arrangements within the definition of DBGs.

99 The Law Society is of the view that issuing regulations would not address this issue. This appears to be an example of insufficient tailoring of the Act's financial sector language to the needs of all DNFBPs.

Internal policies, procedures and controls

Compliance officer

100 The Act requires an employee (or a partner of a law firm) to be designated as a compliance officer, who will have responsibility for administering and maintaining the AML/CFT Programme. If no employees are available, the business can appoint another person. The Law Society considers that, in practical terms, the selection and appointment of a suitable person as the Compliance Officer is fundamental to the operation of the Act.

101 The Consultation Document notes that while the Act requires the compliance officer to report to a senior manager, this is not consistent with international standards and best practice. For example, the FATF requires compliance officers to be "at the management level". This is best practice because it places the compliance officer in a position where they can influence higher-level decisions within the business and ensures that senior management is involved in the business' AML/CFT programme.

102 The Law Society agrees that a 'compliance officer' should be a person at a sufficient level to understand the requirements and their obligations under the AML/CFT regime. In a large firm, the most suitable person to be the compliance officer may not be a 'senior manager' as defined in the Act. For example, it could be a senior solicitor who practices in this area of law and therefore has special expertise, or a non-lawyer employee such as the Practice Manager. They would still be required to report to the 'senior manager' (partner or director of the firm) who exercises influence over the management of the firm, which provides an additional check.

103 It is also noted that a person practising as a sole practitioner will not have another person within the reporting entity who fits within the senior manager definition, but they may have employees, including a Practice Manager, who could perform the role of the compliance officer. This would allow the sole practitioner (who is the only person exercising influence over management of the practice) to carry out the role of senior manager.

104 Guidance from DIA states that in the case of a sole practitioner, they would expect the sole practitioner to be the compliance officer. If that is not possible, an external person must be appointed as a compliance officer. Clarification is required as to whether a senior manager is also required to provide additional accountability if the sole practitioner is acting as the compliance officer. If so, by definition, the sole practitioner would need to carry out the role of

senior manager, and if they have no employees, an external person will need to be appointed as the compliance officer.

105 The supervisor expects that if the person who is acting as a compliance officer is not part of the business, there should be a justifiable reason, and the reporting entity should be able to demonstrate to the supervisor that the person selected has an appropriate level of access to business information and systems to discharge their duties, and the authority to advise the senior manager of the business about AML/CFT matters. The Law Society notes that in this situation, matters regarding privacy, privileged information, and confidentiality would need to be addressed.

106 A separate issue is that some businesses have appointed legal persons as compliance officers, such as companies, if they have no employees who can fulfil this role. The Law Society agrees that this is not the intention of the Act, and it is important that the compliance officer is a natural, rather than legal, person, so that they can act as a point of contact and drive compliance culture within the business. Therefore, the Law Society agrees the Act should clarify that compliance officers must be natural persons.

Suspicious activity reporting

107 The Law Society considers it would be helpful if the relationship between section 6(4) and section 40 of the Act could be clarified.

108 The Law Society is concerned that unless law firm reporting entities clearly understand the circumstances in which they are obliged to report suspicious activities, those law firms could be breaching their ethical duties of confidentiality under the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008. The definition of "service" in section 39A appears to provide the answer (so that section 6(4) limits the scope of section 40), but this does not appear to be well-understood by many lawyers.

Other issues or topics

Harmonisation with Australian regulation

109 The Law Society observes that Australian lawyers are not currently subject to Australian AML/CFT regulation, due to concerns about impacts on lawyers' role in the justice system, and access to justice more broadly. This issue is currently before the Australian Senate for consideration.

110 One of the challenges faced by New Zealand reporting entities at present is that due to differing requirements between Australia and New Zealand, there is no opportunity for streamlining or finding administrative efficiencies to help reduce the burden of AML/CFT compliance on reporting entities. The Law Society considers that an ideal situation would be one in which a New Zealand law firm accepting instructions from an Australian law firm was able to rely on material already available to that Australian law firm, to the extent that such material satisfies New Zealand CDD requirements.

Privilege and confidential information

111 The Discussion Document asks whether the Act currently provides appropriate protection of legally privileged information.

112 The definition of privileged communication in section 42 is consistent with general legal professional privilege, and specifically recognises applicable provision of the Evidence Act 2006. The exceptions in section 42(2) are consistent with lawyers' obligations under the LCA (including the obligation to uphold the rule of law and to facilitate the administration of justice), LCA (Trust Account) Regulations 2008, and the Rules of Conduct and Client Care.

113 It is for the lawyer to determine whether privilege applies, or whether a prima facie case exists to render it not a privileged communication, based on the particular facts of each case. The Law Society has published a Practice Briefing to assist with this assessment,[18] and lawyers can also seek advice from the National Friends Panel.[19]

114 Section 159A of the Act allows for the Commissioner, and AML/CFT supervisor, or the person refusing to disclose any information or document (on the grounds that it is a privileged communication and that section 132(4), 133(5), or 143(3)[20] of the Act apply) to apply to a District Court Judge for an order determining whether the claim of privilege is valid.

115 This is appropriate as it is consistent with the procedure under rule 8.25 of the District Court Rules 2014 and the High Court Rules.

Conclusion

116 The Law Society appreciates the opportunity to comment on this review and is available to answer queries or provide further information where required. Contact can be directed to Aimee Bryant, Manager Law Reform and Advocacy (aimee.bryant@lawsociety.org.nz).

Arti Chand
Vice President
10 December 2021

18 https://www.lawsociety.org.nz/professional-practice/client-care-and-complaints/anti-money-launderingcountering-funding-of-terrorism/practice-briefings-and-guidance/privilege-confidentiality-and-reporting-suspicious-activities/

19 https://www.lawsociety.org.nz/professional-practice/practising-well/national-friends-panel/

20 Note that the section incorrectly refers to s143 subsection (3) when it should refer to subsection (2).