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MINISTRY OF JUSTICE CONSULTATION PAPER ON PHASE 2 OF THE AML/CFT ACT - SUBMISSIONS IN RESPECT OF EXTENDING AML/CFT REQUIREMENTS TO LAWYERS UNDER "PHASE 2" ("CONSULTATION PAPER")

1. Introduction/Background

(a) This letter is in response to the request for submissions in respect of the consultation paper in respect of the proposed extension of the Anti-Money Laundering and Countering of Financing of Terrorism Act 2009 and related legislation ("AML/CFT Act") to lawyers. Due to the time available to us to make submissions, we have not been in a position to voice an opinion on all the matters raised in the Consultation Paper and have therefore focussed on the practical difficulties we can envisage our firm having as a consequence of extension of the AML/CFT Act, particularly if excessive duplication of effort that other reporting entities have already undertaken is required, which is one of the two key concerns we have.

(b) Subject to two significant issues (elaborated on in more detail later in this letter), we have little difficulty with many of the provisions of the AML/CFT Act being extended to lawyers. Many of these requirements will incur additional cost for us and will cut into our firm's profitability, but can be complied with without the costs being prohibitive or requiring extensive changes to our existing systems. We can clearly understand the rationale behind many of the requirements.

(c) We do wish to note that in the Ministry of Justice consultation paper, there are two examples from the FIU where suspicious transactions were not reported by lawyers and real estate agents involved – apparently to justify extending the scope of the AML/CTF Act to lawyers. Both examples appeared in contexts where there appears to be a clear requirement on the lawyers involved to report suspicious transactions under the Financial Transactions Reporting Act 1996 ("FTRA"). Therefore, we do not think the examples, of themselves, are arguments to more fully extend the AML/CFT Act to lawyers. We also do not consider these two examples demonstrate lawyers trust accounts pose a loophole or that lawyers are often assisting in suspicious transactions and need more legislative requirements imposed on them. Professionals not complying

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with one statute (the FTRA), will doubtless not comply with similar requirements under another one (the AML/CFT Act). The true solution in these examples would be to enforce an appropriate sanction on the lawyers that were not reporting something where they clearly had an obligation to do so under the FTRA.

(d) We have no issue with the requirement for an AML/CFT compliance policy, compliance officers or an audit. We envisage that these will add a reasonably significant additional cost to our risk management systems (particularly the audit) but we accept that our internal risk management and reporting systems already to a large part reflect and are set up to record the same risks. We therefore do not expect the additional cost of this to be prohibitive – although we will need time to properly implement systems that entirely comply with the AML/CFT requirements.

(e) We consider legal privilege rules are sufficient as they stand, but more detailed guidelines would be welcome. We consider privacy act requirements can be adequately covered in lawyers terms of engagement, where clients provide privacy waivers in respect of use of their information for firm compliance with legislation.

(f) We do think that (as per the Shewan enquiry), if transactions go through New Zealand banks, other reporting entities should be focussing on reporting suspicious transactions, rather than wasting considerable resources duplicating the due diligence the bank would already undertake. This would give scope to extending the legislation to reporting all suspicious transactions that do not go through New Zealand banks, although there would need to be considerable guidelines on this to prevent over or under reporting. This is already one of our concerns (guidance on what is likely to be a "suspicious" transaction outside of the areas we have traditionally focussed on under the FTRA,, this concern would be more extensive with extended reporting requirements. Over reporting (which entities' may do for the avoidance of doubt) is very likely to stretch the FIU's resources.

(g) We **do not** consider that fee payments by our clients should be exempt from reporting obligations as appears to be suggested in the Ministry of Justice proposal. We think it is quite possible that a money launderer could pay large legal fees from suspicious or illegitimate sources (in cash for example) in order to acquire a legitimate asset. As we presently have an obligation to report a large cash payment of fees in this way, we see no reason why that should be exempted from the extension of the AML/CFT Act for lawyers. We hope this was not proposed because the Ministry of Justice may have cynically thought exempting legal fees from the requirements may make the legislation more palatable to lawyers, since we consider lawyers (including our firm) are happy to assist with the prevention, detection and reporting of crime. What tends to make legislation particularly unpalatable to lawyers is a lack of logic or efficiency in the legislation or its implementation.

(h) The two significant issues we have with the extension of this legislation are as follows:

(i) More detailed guidance is required as to what constitutes a "suspicious transaction". We consider that, if lawyers and other businesses are to detect and assist to deter crime, much more detail will be helpful to assist us to identify a "suspicious transaction". This is actually reasonably straight forward under the FTRA because deposits with us for deposit or investment purposes is very rare. Conveyancing is common, but the purchase of a property seldom raises issues as we are often faced with funds (even overseas funds) first being

deposited in a New Zealand bank account – the New Zealand bank will have much greater ability than us to assess the payment. Police guidelines to date give some very general (but useful) examples of when a matter may be suspicious, but this is generally said to be a matter of "common sense and intuition". We expect money launderers and terrorists could use some very sophisticated methods to disguise their transactions and in these cases, we expect "experience and fraud investigation training" will be of much more use than common sense and intuition. We do think that a significantly larger amount of training material, guidance, case studies and other information could be made available to assist everyone identify when a transaction is suspicious, particularly since this becomes a very subjective exercise in many cases. In particular, transactions by overseas persons or those using wire transfer payment systems like Western Union are very common and often likely to be completely legitimate, but these types of transfer are also a common way of disguising the source of funds. There is a lot of international commerce in New Zealand and we consider more detailed and useful literature will assist to prevent over reporting (by the risk averse) or innocent under-reporting in these areas.

(ii) The customer due diligence required is in many cases a wasteful duplication of the same due diligence that we will be aware has already been undertaken by larger financial institutions (notably banks). Wasteful duplication takes up significant amount of cost (primarily in time – which is taken away from other more profitable activities). Knowing that we are wasting time and cost in pointless duplication of due diligence that has already been undertaken by another institution takes the focus and enthusiasm away from the real focus of the AML/CT legislation, which we consider is to detect and deter AML/CT crimes. While are positive about providing direct assistance to achieve this latter aim, we are not positive about completing significant costly administration that could be streamlined or avoided where, for example, it is obvious or can be verified that due diligence has already been undertaken by another, larger institution (such as a bank). We believe this part of the AML/CFT legislation can be streamlined to avoid significant cost to business, provided that those businesses can be sure that due diligence has occurred/been completed by another large, reputable and regulated body.

(i) We have expanded on the due diligence issue in the following paragraph of this letter, since that is our single greatest objection to the extension of the legislation and where we can see significant cost and resources being expended for no real benefit. We think this can be streamlined and implemented in a more efficient way. We then discuss our last issue, which is our concern about timeframes for implementation.

2. Customer Due Diligence

(a) We consider the legislation has not been as well-crafted in some areas as we consider it could be to work efficiently and effectively in the New Zealand regulatory environment. We think it could be more cost efficient and effective in a way that places true focus on the harm it is supposed to detect and prevent.

(b) A key factor for us, which we consider has been largely overlooked, is that New Zealand (like many Commonwealth countries) has a centrally regulated banking system

and all banks in New Zealand are required to obtain all of this compliance information from all of their customers. We understand a significant number of other countries have private banks, or mixed State/Nation chartered banks that are not subject central regulation. To us, the legislation appears to be international "one size fits all" statute that has been adopted by a number of countries without some of those countries (including legislators and their advising regulators in New Zealand) actually considering the regulatory and business framework in each country and how that can lead to more efficient and effective regulation in local conditions – and in this area (Customer Due Diligence) less economic impact on business to achieve the same result.

(c) As examples, many large financial institutions in New Zealand (notably banks) and a number of regulatory bodies (such as the Registrar of Financial Service Providers) already gather the same or more information about those same customers as is already required - and has been undertaken by - other reporting entities by the AML/CFT legislation. However, the legislation requires all reporting entities dealing with that same person (and there may be many of them) to duplicate that same onerous due diligence exercise. The duplication of effort is unlikely to result in any detection of suspicious activity, it only identifies the person engaged in it. If it is clear that a large organisation such as a bank has already performed due diligence on that person, then duplicating that effort takes the focus away from analysing the nature of the actual transactions the customer is undertaking. Instead, if lawyers and other reporting entities were able to avoid performing due diligence since it can be established that the same person had already been verified by another reporting entity (such as a bank), the duplication would be unnecessary. This type of due diligence compliance is difficult (from a customer relations perspective) and extremely costly (from a time and human resources perspective) for organisations to undertake on each and every legal person they deal with. This is particularly so where trusts are involved. It is very clear to us that this process could be dealt with more efficiently and with less duplication to save cost to businesses and keep focus on detecting a suspicious transaction, safe in the knowledge that the person engaging in that transaction can be fully identified by (for example) their banking institution.

(d) Put another way, we consider that if a person already has a verifiable New Zealand bank account, and all initial transactions are occurring through that New Zealand bank account of that customer, then it should be able to be safely assumed that the person concerned has already completed the appropriate due diligence required by the AML/CFT legislation, which should not need to be duplicated by us. Likewise, if we are acting for a registered financial service provider, or other governmentally licensed service provider, we should be able to assume that the person has been appropriately vetted by the relevant government body.

(e) If our clients are completing all their transactions through New Zealand bank accounts – as the vast majority of our clients do, and as the banks will have records of all of that customer's transactions as well as having completed due diligence on them, it makes no logical sense to us to require all other legal persons dealing with that same customer (such as lawyers) to perform the same costly and time consuming due diligence exercise.

(f) Our experience is that clients do not welcome having to provide significant paperwork to organisations to verify their identity, source of funds etc., particularly where they already have a New Zealand bank account in their name. Clients do not like to repeatedly prove themselves – it wastes time for them. Some see extensive

information requests as evidencing a lack of trust in them – and trust and confidence is one of the core tenets of a solicitor/client relationship that we need to endeavour to preserve at all costs.

(g) We ourselves have experienced this in respect of our firm trustee companies and in other trustee roles, where we are often subjected to significant and repeated information requests from small finance companies where all transactions concerned are being entirely conducted through a New Zealand bank account in the name of the relevant trust, where the same, or even more detailed due diligence has already been undertaken by the bank. In short, it is not just time consuming for the business requesting the information, but for the customer, who is having to provide due diligence material multiple times to multiple reporting entities.

(h) Our short point in respect of extending the AML/CTF Act to lawyers clients and trust accounts is that there must be a suitable means of verifying a client that will prevent other entities (including lawyers) from having to duplicate the same customer due diligence exercise – and assists the customer from having to duplicate their effort to provide due diligence material, multiple times to multiple parties. This seems to be an enormously wasteful duplication of effort (time/cost) as well as significantly detracting from a focus on suspicious transactions. If a client can provide sufficiently verifiable details of a New Zealand bank account already held in that client's name and being utilised by it for its initial transactions, then that should be sufficient to prove that person's bona fides.

(i) While there will doubtless be a number of better ways a regulator could arrive at in respect of how verification can occur to avoid excessive due diligence, we can think of a number of ways we could immediately verify sufficient information (e.g. a client needing to provide bank account details - and pay a small retainer from that bank account in their name – noting that if the client concerned is fraudulently using that account the photo identification will assist). Once verified, we should be able to assume any other due diligence has been completed by the bank (including in respect of more detailed due diligence on trusts we are not setting up).

(j) We expect that it would be open for the regulator to develop an initiative to "pre-verify" persons (and their accounts) to save other businesses the expense. This could be developed in conjunction (for example) with registered banks, who could verify that customer to other reporting entities (perhaps for a small fee – which is justifiable given the administration duplication efforts that other parties might otherwise need to make). We expect that in time, an appropriate exemption preventing unnecessary duplication of due diligence could be extended (with appropriate enquiry by the Ministry of Justice) to verification of people operating with the use of bank accounts or other government verification in other centrally regulated banking jurisdictions, where the banks comply with substantially similar customer verification procedures (such as Australia, for example). We expect legal persons holding an Inland Revenue tax number could also assist to verify that person and assist to exempt them from any further due diligence/verification exercise, since they are clearly a New Zealand tax resident.

(k) We appreciate that any initiatives like this may take time to consider and develop (certainly more time than we have had to consider the impact on us), but we do think the effort will save a significant cost for businesses and therefore improve their profitability as well as ensure they are focussed on crime detection, rather than become disillusioned and lose focus or otherwise stretch their resources too much by

duplicating paperwork. We consider this exercise is worth taking before extending the legislation. It may also remove a burden from smaller financial institutions that are already burdened with it (and therefore are possibly not as positively engaged with the process as they could be, focussing on paperwork rather than crime detection).

(l) For the avoidance of doubt, we appreciate that in many cases we will be the "frontline" and will still need to complete appropriate due diligence on clients for example:

(a) We are already required under other legislation (such as the FTRA and various conveyancing related legislation) to complete a reasonably detailed verification process in respect of clients that place funds for us for the purposes of deposit or investment (which is exceedingly rare, to the extent we could not quickly find any relevant examples) or for the purpose of settling real estate transactions.

(b) If clients are not transacting entirely through other financial institutions (e.g. New Zealand bank accounts in their name) then we will need to complete the due diligence exercise to the best of our ability; and

(c) Where we are involved in providing registered office services, or formation of trusts, we will need to undertake the due diligence required, although we expect this can also be truncated if settlors, trustees and key beneficiaries (those of age) already had verifiable New Zealand bank accounts and are otherwise New Zealand residents (i.e. they have already completed a due diligence exercise and passed the scrutiny of a centrally regulated New Zealand bank).

(m) Last, if all of our points are rejected, and our suggestions are not accepted for future clients, we would hope that all existing clients that have conducted transactions via New Zealand bank accounts in their name could be exempted from further due diligence requirements **and** that the requirements would only occur for each client as they commence a new instruction. Otherwise we consider that trying to complete up to date due diligence on all our existing clients (or ensuring that we have sufficient information from them to comply with the AML/CTF requirements) could well be prohibitive – if not unachievable for us - in time and cost (we have 90,202 open clients).

Summary:

We think the due diligence requirements of the AML/CTF legislation will be an exceedingly costly exercise for our firm, which we consider is likely to greatly impact on our overall profitability. We think this requirement can be significantly streamlined across all businesses in New Zealand, resulting in a more cost effective, targeted and efficient AML/CTF regime where detection of suspicious transactions is the focus, while the person involved has still been subject to appropriate due diligence scrutiny (although not multiple times).

In our view, the legislation at present, by requiring duplication of due diligence compliance on customers that have clearly already passed scrutiny with larger reputable and regulated organisations (particularly banks) places an unnecessarily onerous burden on small and medium businesses that are out of proportion with the intention of the legislation. The end result, we consider, is that many businesses may well end up (inadvertently or not) focussing on administration and blind legislative compliance that is simply duplicating effort undertaken by larger and more financially pivotal organisations (banks) – and this takes away the focus from actually focussing on truly suspicious transactions or customers or transactions that pose a true risk.

3. Timeframes

(a) Inevitably, endeavouring to comply with whatever the outcome of this review results in will result in some quite substantially different and more extensive compliance obligations for our firm. We would hope that, whatever the outcome of this review is, lawyers will have long period in which to bring in compliance systems and otherwise endeavour to comply with the legislation.

(b) If what we consider are sensible and logical submissions to make the legislation more efficient and less costly for business (allowing focus on the real intent behind the legislation) and there is some significant streamlining of due diligence requirements to avoid inefficient duplication between reporting entities, we would expect a six month lead in period would be achievable, if we did not have to extend any required due diligence on existing clients until they completed their next transaction.

(c) If it is not accepted and we need to perform due diligence on every client of the firm (existing and future), regardless of their bona fides, we would realistically need *at least* 18 months to become compliant, although in fact it may prove prohibitive or even impossible for us to implement in all cases. As noted, we have 90,202 open clients. We engage in a significant number of transactions for clients annually. This will not be a small compliance exercise for us – and as the vast majority of our clients have regularly transacted through New Zealand bank accounts in their names – or have been firm clients for many years, we are already certain of their bona fides, so it is not something we will be approaching with positivity.

4. Summary

In summary, we consider:

(a) With one fairly significant exception, we consider we can comply with the majority of the requirements of the AML/CTF without the costs or timeframes becoming prohibitive and, importantly, we consider those requirements will be positively embraced.

(b) We consider "due diligence" requirements need to be streamlined to prevent small and medium businesses from having to repeat the same due diligence exercise on the same customer that has been undertaken by larger and more pivotal institutions such as banks. We can see that this exercise will be excessive in time, we will not positively embrace it (because it appears wasteful) and this will detract from positive and constructive implementation of the AML/CFT by some firms (and other businesses) and will also seriously detract from targeting resources at detecting and reporting suspicious transactions.

(c) We do think more guidance is required on "suspicious transactions" particularly in an international commerce context. We consider it is much easier to detect a suspicious transaction in an entirely domestic context than it is in an international one. The effect of extending the AML/CFT legislation to lawyers will greatly broaden the scope of the transactions we presently need to review and report (under the FTRA), and the criteria is very subjective. The most useful guidelines are objective ones (such as the FTRA requiring reporting of unexplained cash transactions over a certain level)/. Guidance is needed.

(d) While a cost to us, apart from the above comments, we do not have any logical objection to the other requirements of the AML/CFT being extended to us, other than there will be a reasonable cost incurred by us in time and effort in order to comply. We therefore consider there should be a reasonable "lead in" period to allow lawyers to properly understand the new requirements and to properly implement the changes and systems that will be required to comply with the legislation.

We hope this assists.

Yours faithfully
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