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AML/CFT consultation team
Ministry of Justice
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By email: aml@justice.govt.nz

Re: Consultation on Phase Two of the AML/CFT Act

The New Zealand Law Society (Law Society) welcomes the opportunity to respond to consultation on Phase Two of the Anti-Money Laundering and Countering Financing of Terrorism (AML/CFT) regime.

The consultation paper *Improving New Zealand's ability to tackle money laundering and terrorist financing: Ministry of Justice consultation paper on Phase Two of the AML/CFT Act*, August 2016, has been circulated to the legal profession and to the Law Society's Property Law Section, Tax Law Committee and Commercial and Business Law Committee for discussion and comment. The Law Society's response to the consultation paper has been informed by this discussion and is set out below. There are a range of views in the profession, with some lawyers questioning whether it is necessary for lawyers to be included in the Phase Two reforms, and it is likely there will be submissions directly from firms and individual members of the profession to the Ministry.

The Law Society's submission is structured as follows:

A. Executive Summary

B. Rationale for the AML/CFT reforms

C. The Phase Two proposals in relation to lawyers

D. The Law Society's response to consultation questions:

Part 3: Lawyers

Part 4: Supervision

Part 5: Implementation period and costs

Part 6: Enhancing the AML/CFT Act

A. EXECUTIVE SUMMARY

The AML/CFT regime introduced in New Zealand by Phase One to be enhanced by Phase Two is generally comparable to regimes that have existed in other jurisdictions (including nearly all of New Zealand's major trading partners) for several years. The Law Society recognises the case for lawyers being reporting entities under the AML/CFT legislation. The Law Society accepts that the New

Zealand legal profession is not immune from the mischief which the AML/CFT regime is designed to deter and detect and has a responsibility to co-operate in the global response to money laundering and terrorist financing.

At the same time, it must be recognised that the proposed AML/CFT obligations for lawyers are fundamentally inconsistent with the traditional solicitor/client relationship of trust and confidence. That relationship is based on lawyers' ethical obligations of confidentiality, acting in the client's best interests and protecting privileged communications, which run counter to the proposed AML/CFT monitoring and reporting obligations. There is a significant tension between the role of lawyers as trusted advisers and their role as informants under the regime.

The new obligations will need to be carefully crafted to ensure the solicitor/client relationship is preserved to the greatest extent possible, while still delivering on New Zealand's AML/CFT commitments to the international community. The Law Society considers that the following factors will need to be addressed in order for there to be successful uptake of the Phase Two obligations by the legal profession:

- an appropriately targeted **list of the legal services** subject to the AML/CFT obligations (some changes are suggested to the list provided in the consultation paper at p13)
- the focus remaining on **suspicious transactions**, rather than a wider (and more uncertain) category of suspicious 'activities'
- **clear definitions** of key terms
- greater **clarity as to the thresholds** for monitoring and reporting
- putting in place **measures to ensure privileged information is protected**, including a wider statutory definition of privilege
- minimisation of the impact of AML/CFT monitoring and reporting on lawyers' **ethical duties** so far as possible (in particular, absolute clarity in respect of when lawyers' ethical obligations may or must be overridden by their AML/CFT obligations)
- extensive and clear **guidance to the profession** on the range of scenarios likely to arise in practice (the Law Society intends to prepare Practice Notes and assist in educating the profession on the AML/CFT obligations)
- an **effective and appropriate supervision model**
- finally, provision of **adequate time** for the profession to understand and implement the new obligations in practice.

Supervision

Ensuring the right supervision model for Phase Two sectors will be crucial. The Law Society's preliminary view is that Alternative 2 (multiple agencies with self-regulatory bodies) would achieve the best balance. In relation to lawyers, the Law Society considers it has the necessary experience and capabilities to be the supervisor of the legal profession for AML/CFT purposes, and the supervisor role logically fits with the Law Society's current regulatory responsibilities for the profession. Given its involvement with and understanding of lawyers the Law Society is best placed to perform this role while ensuring the ethical and legal duties of lawyers are respected and protected so far as possible. The Law Society is also the most appropriate body to issue guidance to

assist lawyers to comply with their obligations. A concern raised by the profession is how the Law Society would be funded to carry out the supervisor role.

Timing

As noted above, timing of the reforms will be a crucial consideration. In that regard, the very short time (four weeks) given for the current Phase Two consultation has not been helpful in terms of raising awareness and acceptance within the profession regarding the need for the reforms. The short consultation period is surprising, given that the Phase Two reforms have been in preparation for several years.

The short consultation period has resulted in:

- limited time for the Law Society to consult its 12,500 members,
- limited opportunity for lawyers to engage meaningfully with the issues – many of them complex – raised in the consultation paper, and
- the results of the business compliance cost survey – which is being undertaken concurrently with the consultation, and which is likely to produce valuable data and information – are not available to inform the consultation.

It is clear the Phase Two legislation is on a fast-track: it is expected the Bill will be introduced to Parliament later in 2016 and passed by July 2017.[1] The Law Society questions whether this timeline can be achieved without compromising the buy-in from the affected sectors that will be central to the ultimate success of the reforms.

However, regardless of the timeline, there will need to be adequate consultation with the legal profession (and other affected sectors) on the details of the proposed legislation. Consultation on an exposure draft of the Bill is strongly recommended.

B. RATIONALE FOR THE AML/CFT REFORMS

The background to the Phase Two reforms is helpfully set out in the consultation paper, and is summarised here for ease of reference.

Money laundering and terrorist financing (ML/TF) are recognised risks in New Zealand and globally. New Zealand is a member of the inter-governmental forum that sets global AML/CFT standards, FATF (Financial Action Task Force), and is committed to implementing the FATF recommendations.[2] Failure to implement the recommendations could result in reputational damage to New Zealand and market access being denied. The consultation paper records that ML/TF are significant problems in New Zealand, allowing criminals to hide criminal proceeds and to fund serious crimes such as drug offending, organised crime and tax evasion, with an estimated $1.5 billion being laundered in New Zealand each year.[3]

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[1] Consultation paper, p6.

[2] FATF Recommendations 2012 http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.

[3] Consultation paper, p4.

New Zealand introduced the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (Act), to cover business activities that pose a high risk of being misused by criminals to conduct financial transactions or purchase assets. It requires specific types of businesses carrying out certain types of transactions to comply with measures to detect and deter money laundering and terrorist financing. The measures include:[4]

- developing a risk assessment and compliance programme
- undertaking customer due diligence (CDD) – this involves asking for and verifying customers' identification
- vetting and training staff
- monitoring accounts
- monitoring compliance and audit, and
- reporting suspicious transactions to the Police Financial Intelligence Unit (FIU).

New Zealand's approach is risk-based, namely:

- AML/CFT efforts should be proportionate to the risks, and
- businesses subject to the Act are well placed to assess their risk levels and to focus their attention and resources relative to the particular risks they face (for example, due to the type of products/services they provide).

The Phase One obligations on financial institutions and casinos came into effect in 2013. It was signalled at that time that Phase Two, covering lawyers, accountants and various other sectors, would follow later.

In June 2016 the Government announced it would accelerate Phase Two, with the legislation intended to be passed by July 2017. Officials have advised that "current gaps in coverage are undermining Police efforts to detect and deter criminal activity in New Zealand" and that "professional services (lawyers, accountants) and real estate are high risk sectors for money laundering. Recent Police investigations show that the risk of money laundering from these sectors is rising."[5]

The paper states that "case studies and research here and internationally show that some services provided by legal professionals are attractive to criminals wanting to launder the proceeds of crime and to finance terrorism" and that "while there are some instances of legal professionals being directly involved in money laundering, most lawyers who are exposed to it are not complicit" – namely that their involvement is innocent (no 'red flag' indicators are apparent) or unwitting (basic CDD undertaken; some 'red flags' but missed or significance misunderstood).[6]

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4 Consultation paper, pp7-8.

5 22 March 2016 Aide Memoir to Minister, p1, as reported by the New Zealand Herald, 10 September 2016 http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11706741 (accessed 13 September 2016).

6 Consultation paper, p11. See also New Zealand research (FIU, 2010) cited at p9.

C. THE PHASE TWO PROPOSALS IN RELATION TO LAWYERS

Part 3 of the consultation paper sets out issues and questions relating to specific sectors, including lawyers (at pp11 – 15).

The paper states that "in some circumstances, lawyers will have a fuller picture of their clients' background, circumstances and activities than financial institutions involved in conducting transactions, so a legal professional may be better placed to identify suspicious financial activity".[7]

It is proposed that lawyers will be subject to AML/CFT requirements when providing the following services in the ordinary course of business:[8]

- acting as a formation agent of legal persons or arrangements
- arranging for a person to act as a nominee director or nominee shareholder or trustee in relation to legal persons or arrangements
- providing a registered office, a business address, a correspondence address, or an administrative address for a company, a partnership, or any other legal person or arrangement
- managing client funds, accounts, securities or other assets
- preparing for or carrying out real estate transactions on behalf of a customer
- preparing for or carrying out transactions for customers related to creating, operating or managing companies

The consultation paper notes that lawyers already have obligations under the Financial Transactions Reporting Act 1996 (FTR Act) of identity verification, record keeping and reporting suspicious transactions, but that these only apply in limited circumstances and are not as robust as the AML/CFT obligations.[9] Lawyers' current FTR Act obligations, and the additional AML/CFT Phase Two obligations, are summarised in Appendix 1, **attached**.

The paper acknowledges that "legal professional privilege plays an important role in our legal system and there's no intention to override it in the implementation of Phase Two".[10] This is discussed below.

D. NZLS RESPONSE TO CONSULTATION QUESTIONS

<u>Part 3: Lawyers</u>

Consultation questions

1. How should AML/CFT requirements apply to the legal services sector to help ensure the Act addresses the risks specific to it? For example, which business activities should the

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7 Consultation paper, p13.

8 Consultation paper, p13. The paper notes that it is intended the Phase Two reforms will not include "transactions that are solely for the purpose of paying professional fees or invoices" and will not apply to in-house lawyers "as they do not provide services to external clients".

9 Consultation paper, p9. See also p14.

10 Consultation paper, pp13-14.

requirements apply to? At what stage in a business relationship should checks, assessments and suspicious transaction reports be done?

2. Is the existing mechanism that protects legal professional privilege appropriate for responding to money laundering and terrorist financing, and for the legal profession to comply with its expected obligations under the Act? If not, what else is required?

The consultation paper also outlines related issues, including:

- Whether the legislative protection of legal professional privilege in the Act (which is consistent with the FTR Act) is sufficient, or whether the current provision is too broad and allows claims of privilege in a wide range of circumstances that aren't appropriate; and
- Whether there is a need to consider addressing AML/CFT issues in practising rules, or whether it would help to publish supervisor or industry guidance on the relationship between the Act's requirements and legal professional privilege (as done, for example, in the UK).[11]

Some lawyers have questioned the rationale for including the legal profession in the Phase Two reforms, saying there has been insufficient evidence provided to justify their inclusion. The Law Society notes that the two case studies provided at p12 of the consultation paper in relation to conveyancing transactions would both have been covered by lawyers' existing reporting obligations under the FTR Act and do not demonstrate compelling justification for Phase Two to be extended to lawyers. Nevertheless, the Law Society accepts that the New Zealand legal profession is not immune from the mischief which the AML/CFT regime is designed to deter and detect and has a responsibility to co-operate in the global response to money laundering and terrorist financing.

In the Law Society's view, the aim must be to establish a practical monitoring and reporting regime for lawyers based on proven AML/CFT risks in the New Zealand context.

<u>"Legal services" subject to AML/CFT obligations</u>

- *The proposed list*

The list of services provided by lawyers in the ordinary course of business, which it is proposed would be subject to AML/CFT obligations (listed in Section C above, and at p13 of the consultation paper), is accepted. For the most part it is difficult to argue that it is unreasonable for a lawyer to verify the identity of a client to whom the lawyer is providing such services.

However, the references to "managing client funds, accounts, securities or other assets" (particularly in relation to estate administration matters) and "preparing for or carrying out transactions for customers relating to creating, operating or managing companies" are vague and ambiguous. It is important that it be clear exactly what services are subject to the obligation.

[11] http://www.lawsociety.org.uk/support-services/advice/practice-notes/aml/legal-professional-privilege/

- *Non-lawyer providers of the services*

It is also unclear whether it is intended that non-lawyer providers of the services listed are to be captured by extension of the regime to the *legal profession*.[12] The Ministry will need to consider the coverage of providers of services falling within the scope of 'legal services'.

In New Zealand any individual or entity can provide legal services directly to the public. This is subject to a limited scope of activities that only lawyers may provide. Those activities are the 'reserved areas' of work for lawyers which are generally limited to litigation-related activities and matters that by statute only a lawyer may undertake. Only a lawyer or Licensed Conveyancer (or person acting under their supervision) may provide 'conveyancing services' to the public.[13]

There is therefore a wide range of services within the legal landscape that individuals outside the legal profession can provide.

Those services are not regulated under the Lawyers and Conveyancers Act 2006 and remain largely uncaptured by other regulatory regimes. They include certain activities identified in the Ministry's consultation paper (such as *acting as a formation agent of legal persons or arrangements, arranging for a person to act as a nominee director or shareholder or trustee in relation to legal persons or arrangements, providing a registered or business address for other entities or persons, preparing for or carrying out transactions for customers related to creating, operating or managing companies).*

The wider legal services sector is a growing industry. This growth is likely to continue as technology evolves allowing access to previously untapped legal consumer markets.

There is a concern that currently unregulated providers of legal services (outside the Lawyers and Conveyancers Act 2006 regime) may not be captured in the implementation of Phase Two. If this were the case, unregulated legal service providers may become an attractive option for individuals seeking to avoid the rigours of the AML/CFT compliance regime. Leaving these service providers outside the AML/CFT umbrella could then open a significant loophole ripe for criminal exploitation. This is wholly inconsistent with the Ministry's aim of stopping the "displacement effect" which relates to criminals accessing assistance outside any supervised sector to avoid detection.

- *Definitions and thresholds*

There are also some definitional or threshold issues that need to be worked through. For example:

- "Carrying out real estate transactions" is significantly broader than the FATF's equivalent formulation "buying and selling of real estate".[14] It is unclear whether this is intentional and if it is, what the rationale is for New Zealand taking such a broad approach relative to international recommendations and practice.

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[12] It is noted that there is no definition of 'legal profession' in the current Act. However, reference to 'legal profession' in the consultation paper appears to relate to 'lawyers' regulated under the Lawyers and Conveyancers Act 2006. A 'lawyer' is defined in section 6 of that Act as a person who holds a current practising certificate.[12] Clarification around the definition of 'legal profession' should be considered.

[13] Lawyers and Conveyancers Act section 6 – it is an offence under the Act for an unauthorised person to provide conveyancing services – section 35.

[14] Consultation paper, Appendix 2.

- The triggering services should be entity/form-agnostic, so "preparing for or carrying out transactions for customers related to creating, operating or managing companies" should also (consistent with the FATF recommendations) apply to partnerships, trusts etc.
- Related to the point immediately above, presumably the service relating to the provision of an address would apply to trusts and if so, they should be expressly mentioned for the sake of clarity.
- The scope of the service "managing client funds …" should be clarified. This is the terminology used in the FATF recommendations, but it could usefully be clarified – compare with (x) and (xi) of the definition of "financial institution";[15] "managing" could be interpreted to mean some form of control or discretion is required, but in this context it is probably also intended to apply to simply holding or handling client funds.

In addition, the FATF list of relevant services include the "organization of contributions for the creation, operation and management of companies" and "buying and selling of business entities". It is not clear why these services have been excluded from the proposed list.

The profession will need clarity regarding what is intended to be in scope, and clear definitions in the Bill. The Law Society will want to be consulted on an exposure draft of the Bill before it is introduced.

Including suspicious "activities"

Changes are also being considered to suspicious transaction reporting (STR) requirements under the Act, which would extend them to the reporting of suspicious *activities*.[16] This is prompted by concerns that valuable financial intelligence for detecting crime is not being passed onto the FIU because the suspicious or unusual activities did not involve an actual transaction or a transaction through a local financial institution. It is proposed that all suspicious transactions, including attempted transactions, should be reported regardless of the amount involved.

It is not clear from the consultation paper what "activities" it is envisaged will be covered. If the definition of "transaction" is merely clarified to specifically include transactions that do not go ahead or transactions that do not go through a local financial institution (the concerns of the Shewan report) then this change may raise few concerns. However, the reference to "suspicious activity" suggests a broader extension is envisaged.

Issues may arise in practice if the concept of "suspicious activity" is not clearly defined or understood by the market, leading to confusion around when a report should be made and potential under-reporting. Supervisors would also need to provide clear guidance on this issue, setting out scenarios and circumstances which could indicate suspicious activity, to minimise confusion.

The extension of reporting obligations to include suspicious "activities" also raises particular issues for lawyers. Lawyers are often involved in only part of a transaction or proposed transaction and will

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15 *Financial institution* defined in section 5(a) of the Act means a person who, in the ordinary course of business, carries out 1 or more of the following financial activities: (x) safe keeping or administering of cash or liquid securities on behalf of other persons; (xi) investing, administering, or managing funds or money on behalf of other persons.

16 Consultation paper, p33.

not always have total oversight of all relevant information. It is also important to bear in mind that the role of lawyers is as advocates for clients, not as investigators of their actions. The focus to date on "transactions" has limited the tension with lawyers' duties to their clients and the extent to which issues in relation to privileged information arise. The proposed extension of STR reporting obligations to "activities" has the potential to result in a greater number of cases of lawyers being placed in difficult situations where they are forced to breach the usual ethical duties of confidentiality as well as deal with difficult issues of when they can and should withhold information on the basis of privilege. It raises the prospect of a much more significant erosion of the lawyer's role as trusted advisor with duties of loyalty and confidentiality to the client.[17]

The Law Society considers that if the reporting obligation is to be extended it should only be extended to capture the concerns addressed by the Shewan report (about transactions that do not go ahead and transactions that go through an overseas financial institution).

Key aspects of the regime, including Customer Due Diligence

Brief comments on how the key aspects of the regime should apply to the legal services sector are as follows:

- *Customer due diligence*. CDD should be able to be conducted by legal practices in connection with the relevant services at the same time, and in the same manner and to the same standard, as required for other reporting entities under the Act.

  Verification of identity should be fairly straightforward and could be achieved by taking a copy of a passport or drivers' licence and evidence of address (e.g. a utility bill or copy of a tenancy agreement). In relation to many legal services (such as conveyancing) this is already done.[18] The administrative burden of verifying identity should not be excessive in relation to individual clients and the relevant documentation could be collected at the outset of the engagement. Clients are likely to be increasingly accustomed to providing such documentation due to similar requirements imposed on banks and other financial institutions. It would be helpful if there were a central mechanism (such as REALME) whereby clients could take responsibility for verifying their identity without putting a duplicated burden on banks, lawyers, brokers etc.

  It would, however, be a much greater administrative burden to verify the identities of all beneficial owners, directors, officers and other office holders of corporate clients. In this regard the Bill should exclude beneficial owners holding less than 25% of the issued share capital of a company and a similar threshold for ownership interests in other entities. There should be no requirement to verify the identities of the beneficial owners and officers of clients that are listed companies, government departments, state-owned enterprises and businesses licensed and supervised by recognised regulatory authorities (such as other lawyers, financial institutions, chartered accountants etc).

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[17] See for example *Minter v Priest* [1930] AC 558 (HL) at p573 per Viscount Dunedin "[I]f a man goes to a solicitor, to consult him and does consult him, though the end of the interview may lead to the conclusion that he does not engage him as a solicitor … nevertheless the interview is held as privileged".

[18] When a conveyancing transaction is conducted, solicitors must meet requirements set out in the Property Transactions and e-dealing Practice Guidelines, including identifying the client (current government photo ID is required, such as NZ Drivers Licence or Passport).

Guidance will need to be given on matters such as what could constitute a "material change in the nature or purpose of the business relationship" (which could trigger the need to do CDD on an existing client in accordance with section 14 of the Act). The Law Society anticipates providing such guidance to the profession, for example by way of practice briefings.

- *Enhanced customer due diligence for high-risk transactions*. The process of verifying a client's source of funds is very complex and there should be an exclusion for lawyers in this regard — at least insofar as it is clear the funds are already within the New Zealand financial system. In such circumstances, the provenance of funds should have already been subject to AML/CFT checks by reporting entities such as banks. 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 provided or suspicious behaviour. Again such certificates could be procured at the outset of the client engagement using standard forms. These certificates could be supported by reference letters from relevant third parties.

- *Reliance*. In order to minimise duplication and compliance costs, it should be clear that legal practices can rely on CDD undertaken by other reporting entities, including financial institutions, accountants, real estate agents and other legal practices (who are often referral sources).

- *Suspicious transaction reports*. The key issue here is the interaction with privilege (and confidentiality obligations). This issue is addressed in detail below.

- *Record keeping, risk assessment, AML/CFT programme, staff vetting and training, management of compliance, monitoring etc*. It should be possible for lawyers to comply with these requirements in the same way as other reporting entities are required to do so under the Act. However, the issue of privilege will also need to be considered in certain areas including inspections, audits and annual reports.

Lawyers' ethical duties

Lawyers are subject to a number of unique ethical and legal duties as a result of their role within the justice system and the work they undertake.

The relationship of lawyer and client is recognised as one of utmost trust and confidence.[19] A fundamental precept underpinning the relationship is the concept of absolute confidentiality. This duty is both an equitable and ethical duty. Under the Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 (RCCC) lawyers are required to hold in confidence all information about the affairs of clients. This is subject to limited exceptions provided for in the RCCC.[20]

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[19] Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 5.1 and see also CIR v West-Walker [1954] NZLR 191

[20] One of those exceptions is that a lawyer must disclose if the information relates to the anticipated or proposed commission of a crime that is punishable by imprisonment for 3 years or more and may disclose in circumstances relating to the anticipated or proposed commission of an offence (without any specified imprisonment period) Rules 8.2(a) and 8.4(b).

The lawyer's duty of confidentiality as well as legal professional privilege are necessary and essential conditions of the effective administration of justice[21] as well as aspects of the rule of law.[22]

Equally, a lawyer has a duty of candour to their client. A lawyer is required to promptly disclose to a client all information that a lawyer has or acquires that is relevant to the matter in respect of which the lawyer is engaged.[23] Limited exceptions are provided including if '*disclosure would be in breach of law …*'.[24]

Reporting and disclosure obligations where the thresholds for reporting and disclosure are not consistent with the exceptions that currently apply, are inherently incompatible with lawyers' ethical duties and with the underlying principles those duties serve. The Law Council of Australia has expressed concern in its jurisdiction that the requirement for suspicious transaction reporting (if extended to lawyers) "would impact on the client lawyer relationship, client confidentiality and client legal privilege". This would require lawyers to act as the agent of law enforcement agencies, a role that is inherently inconsistent with lawyer-client obligations.[25]

An area of particular difficulty for lawyers is how to proceed where an STR is made and the lawyer may have to continue acting to avoid tipping off the client even though the lawyer has concerns that he or she is involved in criminal activity.

It is therefore important that the impact of the regime on lawyers' ethical duties be minimised so far as possible and that there is absolute clarity in respect of when a lawyer's ethical obligations may and/or must be overridden by the AML/CFT regime. This is vital not only for the protection of lawyers but also legal consumers relying on their assistance. As noted above, the Law Society submits that any extension of the existing requirement to report suspicious transactions should be as limited as possible, because it already represents a significant erosion of the role of lawyers.

The Law Society wishes to be consulted in respect of any extension or creation of legislative provisions which may impinge on lawyers' ethical and professional obligations.

The Law Society considers that it has an important part to play in providing guidance to lawyers in relation to these matters.

<u>*Legal professional privilege*</u>

The Law Society has identified the following issues which arise in the context of legal professional privilege:

- The wording of the exception related to committing or furthering the commission of some illegal or wrongful act differs from that used in the Evidence Act 2006 and the Search and Surveillance Act 2012.
- Because of the different thresholds that apply to trigger the obligation to report a suspicious transaction and to exempt information from legal professional privilege, lawyers may be

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[21] *Blank v Canada (Minister of Justice)* [2006] 2 SCR 319; (2006) 270 DLR (4th) 257 at [26]; cited in *Bain v Minister of Justice* (2013) 21 PRNZ 625 at [61]. See also *Commissioner of Inland Revenue v West-Walker* [1954] NZLR 191; *Waterford v Commonwealth of Australia* (1987) 163 CLR 54 at 64.

[22] *Three Rivers DC v Bank of England (Disclosure) (No 4)* [2004] 3 WLR 1274 at [34] (HL).

[23] Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 r7.

[24] Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 r7.3(c). An example given in the footnote to the RCCC is that a disclosure is prohibited by law when a lawyer makes a suspicious transaction report under the Financial Transactions Reporting Act 1996 – s20.

[25] 'Anti-Money Laundering Guide for legal practitioners' (updated January 2016) Law Council of Australia.

presented with difficult situations where they have suspicions which trigger the requirement to report a suspicious transaction but are uncertain as to whether they have sufficient information such that the exception to privilege applies.

- It is important that legal professional privilege is protected where the power to conduct on-site inspections of lawyers' offices is exercised.
- The Act should be amended to include litigation privilege in the section 44 definition of legal professional privilege.

Wording of exception

Section 42 provides that an otherwise privileged communication can lose its privilege if it is made or brought into existence for the purpose of committing or furthering the commission of some illegal or wrongful act.

The Evidence Act 2006 provides for a procedure where the Court is required to disallow a privilege claim if satisfied that there is a prima facie case "that the communication was made or received, or the information was compiled or prepared, for a dishonest purpose or to enable or aid anyone to commit or plan to commit what the person claiming the privilege knew, or reasonably should have known, to be an offence."[26] This exception has been treated as the codification of long-standing common law authority.[27] The same language is used in section 136(2), Search and Surveillance Act 2012.

The Law Society submits that it would be appropriate for the wording in section 42(1)(c) to be amended so that it is consistent with the Evidence Act and section 136(2) of the Search and Surveillance Act to ensure that the same test is applied under all three statutes and that there is no uncertainty about the application of other provisions of the Search and Surveillance Act to the exercise of the inspection power under sections 132 – 133 (discussed below).

Potential difficulties where suspicious information is privileged

Suspicious transactions may involve communications which may, on the face of it, be privileged but do not meet the threshold of communications brought into existence for the purpose of committing or furthering the commission of some illegal or wrongful act.

At common law "dishonest purpose" is a high threshold but encompasses things less than, as well as different from, an offence. The dishonest conduct must be stated in clear and definite terms, and be supported by prima facie evidence that the alleged conduct has some foundation in fact.[28]

This does not fit easily with the obligation to report any suspicious activity by lodging a Suspicious Transaction Report (STR).

The STR is the reporting of a suspicious transaction. In other words, the transaction has raised suspicion, but there has been no determination and may not even be any prima facie evidence as to whether or not there has been the committing or furthering of the commission of some illegal or wrongful act.

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26 Evidence Act section 67(1).

27 See e.g. *Icepak Group Ltd v QBE Insurance Ltd* [2013] NZHC 3511 at [44].

28 *Icepak Group Ltd v QBE Insurance Ltd* [2013] NZHC 3511 at [44]–[47].

Power to inspect under sections 132 – 133, AML/CFT Act

The concerns about privilege are particularly acute in the context of search powers such as those provided for in sections 132 – 133 of the AML/CFT legislation. The Supreme Court of Canada held that a similar warrantless search power when applied to lawyers, along with the inadequate protection of privilege, were an unjustified infringement on the right to be free from unreasonable search and seizure.[29] As the Court pointed out, the Canadian provisions implicate lawyers who have home offices. In New Zealand the protection of privilege under section 136 and the procedures to protect privilege under section 145 of the Search and Surveillance Act 2012 would apply. However, if the definition of privilege in the AML/CFT legislation differs from that in the Search and Surveillance Act then this may give rise to uncertainty.

The Law Society submits that, if the definition of privilege is not amended to use the same language for the exception that is used in the Search and Surveillance Act, then section 42 or section 133 should be amended either to make it clear that the Search and Surveillance provisions which protect privilege in the context of warrantless searches apply or to provide that no document or information that is subject to legal professional privilege is required to be provided under section 133(2).[30] It is important that it be clear that information that is subject to both legal advice and litigation privilege can be withheld.

Extension of the definition of legal professional privilege to include litigation privilege

At common law, legal advice privilege and litigation privilege are together referred to as legal professional privilege. However, section 42 only describes legal advice privilege. The definition should include both limbs of this privilege. Litigation privilege is unlikely to be an issue as long as suspicious transaction reporting is limited to "transactions". It is more likely to be an issue if reporting requirements are extended to "activities". As noted above, it is important that both privileges be protected in the context of the exercise of the sections 132 – 133 powers.

The Law Society's role

As noted above, there is an obvious tension between lawyers' obligations to their clients and their obligation to report suspicious transactions. The Law Society will need to provide guidance to the profession on the relationship between the Act's requirements, ethical obligations of confidentiality and legal professional privilege.

Lawyers will want to have some certainty that they are obligated to disclose before disclosing. As to when the obligation to report exists, the Act combines an objective test (i.e. you must report if you have **reasonable grounds** to suspect that the transaction or proposed transaction is or may be [*prohibited*]) and a subjective test (and you are protected from [*sanction*] unless the information was disclosed or supplied in **bad faith**). Add to this the lawyer's duty to withhold privileged information unless it meets the threshold of involvement in an illegal or wrongful act, and lawyers could find themselves in some very difficult ethical situations. For lawyers treading the fine line between their obligations, guidance (including examples) on the meaning in these contexts of reasonable grounds and bad faith will be essential.

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[29] *Canada (Attorney-General) v Federation of Law Societies of Canada* 2015 SCC 7, [2015] 1 SCR 401.

[30] *Chief Executive, Ministry of Fisheries v United Fisheries Ltd* [2010] NZCA 356; [2011] NZAR 54 at [81].

If appointed as AML/CFT supervisor for the profession, the Law Society will be well-placed to exercise powers such as those under sections 132 – 133 in a way that is sensitive to privilege, as well as the other duties owed by lawyers.

Part 4: Supervision

Consultation questions

1. Do you think any of our existing sector supervisors (the Reserve Bank, the Financial Markets Authority and the Department of Internal Affairs) are appropriate agencies for the supervision of Phase Two businesses? If not, what other agencies do you think should be considered? Please tell us why.

2. Are there other advantages or disadvantages to the options in addition to those outlined [at pp29-31 of the consultation paper]?

Overview

Effective supervision and enforcement are essential components of a successful AML/CFT regulatory regime.[31] Getting the right supervision 'fit' for Phase Two sectors will be crucial. For the reasons given below, the Law Society's preliminary view is that:

- Alternative 2 (multiple agencies with self-regulatory bodies) would achieve the best balance for New Zealand. There would be set-up and ongoing costs, and issues to be worked through (as noted in the consultation paper) but, in the longer term, and for the reasons noted in the consultation paper, supervision by appropriate professional associations is preferable.
- The Law Society as AML/CFT supervisor of lawyers: The Law Society considers it has the necessary experience and capabilities to be the supervisor of the legal profession for AML/CFT purposes, and the supervisor role logically fits with the Law Society's current regulatory responsibilities for the profession. Given its involvement with and understanding of lawyers the Law Society is best placed to perform this role while ensuring the ethical and legal duties of lawyers are respected and protected so far as possible. The Law Society is also the most appropriate body to issue guidance to assist lawyers to comply with their obligations. A concern raised by the profession is how the Law Society would be funded to carry out the supervisor role.

The basis for the Law Society's preliminary view is discussed in more detail below.

The Law Society's primary concern is that any supervisory model implemented under Phase Two meets international benchmarks and is fair, consistent and proportionate. Any model must achieve the ultimate goal of protecting the public, supervised entities and New Zealand's international reputation from the immeasurable harm caused by money laundering and terrorist activity.

The Law Society welcomes the opportunity to be further involved in establishing an effective supervision model for the legal profession under Phase Two. It looks forward to engaging with the Ministry and consulting further with lawyers.

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[31] FATF "Guidance for a risk based approach -Effective supervision and enforcement by AML/CFT Supervisors of the Financial Sector and Law Enforcement"

Key factors for successful supervision

The Law Society has identified criteria relevant to the establishment of a successful supervisory model for Phase Two. These are informed by the FATF guidance for effective supervision[32] and include:

- Specialised knowledge and expertise relevant to the supervised sector
- Most efficient use of existing frameworks and expertise
- Effective relationships with the supervised sector (this includes good communication channels in place for the effective provision of information to the supervised sector as well as to provide ongoing guidance and assistance to assist it to meet compliance obligations)
- Consistency of regulation
- Proportionality (the most appropriate regulatory model proportionate to the risk involved)
- Capability to meet the changing risks involved in ML/TF
- Collaboration between supervisors

The Law Society considers its appointment as AML/CFT supervisor for the legal profession would satisfy those criteria.

The current NZ regulatory model for AML/CFT supervision

The current New Zealand AML/CFT (Phase One) model is multi-agency supervision comprised of three supervisors with separate spheres of responsibility:[33] the Reserve Bank supervises banks, life insurers and non-deposit takers; the Financial Markets Authority (FMA) supervises securities, trustee corporations, and entities involved in investment and financial advice; and the Department of Internal Affairs supervises casinos, money changers, trust and company service providers and those reporting entities not falling within the purview of the Reserve Bank or FMA.

The workload of the current supervisors is likely to increase disproportionately if new and disparate sectors are included within their 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. These would provide significant challenges for existing supervisors. Lawyers and most aspects of legal practice are currently regulated by the Law Society as the frontline regulator under the regulatory regime established by the Lawyers and Conveyancers Act 2006,[34] and the Law Society has the significant advantage of already knowing the sector.

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32 Ibid.

33 Consultation paper, p28.

34 The Law Society is presently the primary regulator of lawyers, in a co-regulatory model. (The Legal Complaints Review Office, a tribunal administered by the Ministry of Justice, reviews complaints from Law Society's Lawyers Complaints Service Standards Committees. In addition, the Minister must approve the Rules of Professional Conduct and Client Care.)

The transition and implementation period for Phase Two is likely to be relatively short. Given a short lead-in period, the Law Society as a supervisor with an established knowledge of the legal sector would be effective at an earlier date. In contrast, an alternative supervisor would face a significant challenge in quickly gaining this capability.

Current regulatory models for AML/CFT supervision – single vs multiple supervisor

It is important to consider issues of efficiency and efficacy of multiple supervisors in AML/CFT regulation, and the resulting impact on supervised entities.

The *Single Supervisor* model involves an overarching entity charged with the function of supervising all reporting entities. This is the model currently in place in Australia (AUSTRAC). It is difficult to assess the Single Supervisor model in Australia given that the legal profession is yet to be included under the supervision regime and there has been some resistance to its inclusion.[35] Issues have been raised by FATF around the sufficiency of AUSTRAC's understanding of the ML/TF risks of individual reporting entities within reporting entity groups.[36]

The New Zealand model has to date not been that of a Single Supervisor. There are considerable differences in size and scale between the two jurisdictions. In addition, New Zealand, unlike Australia, does not have the complication of a federal model. In the New Zealand context significant time and resource would be required to amalgamate current supervisors and establish a 'super' regulator.

The legal profession in New Zealand is a diverse sector in terms of its features and geography, comprising large corporate law firms, small to medium enterprises and sole traders as well as barristers and in-house lawyers. The work undertaken by lawyers and their specialist expertise and business practices also vary widely. Despite this diversity, the legal profession is bound together by common ethical and professional obligations. These obligations are unique to lawyers and are required by their role. The challenge for any supervisor of the legal profession will lie in developing an understanding of the make-up and specialised work of this diverse sector.

Based on the concerns and key ingredients for effective AML supervision highlighted above, the Law Society considers Alternative 2 outlined in the consultation paper – *Multi-agencies with self-regulatory bodies* – merits further consideration.

The HM Treasury (UK) has recognised that this model is working well in the United Kingdom, but with room for some improvement around consistency and information sharing.[37] The challenge facing England and Wales is the large number of legal profession supervisors. In New Zealand the problem of multiple regulators does not exist. This is because in New Zealand all lawyers are regulated under the Lawyers and Conveyancers Act 2006 by the Law Society (it performs this function as a co-regulator).

The Solicitors Regulation Authority (SRA), which is the primary professional regulator for solicitors[38] in England and Wales, supervises most law firms and solicitors in relation to AML/CFT. It has found

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35 "Anti-Money Laundering Guide for legal practitioners" (updated January 2016) Law Council of Australia.

36 FATF *Anti-money laundering and counter-terrorist financing measures - Australia (Mutual Evaluation Report,* chapter 6 *Supervision*.

37 "Anti-Money Laundering and counter terrorist finance supervision report 2014-15" HM Treasury (May 2016).

38 Solicitors are also regulated by other legal regulators.

that in general law firms now have the right systems in place to manage money-laundering risks and report suspicious activities.[39] The SRA has been well placed to work closely with the legal profession to achieve this.

In the New Zealand context, this type of model could involve supervision of the legal profession by the Law Society, either under delegation from one of the established supervisors or as a stand-alone supervisor.

The preferred option in the Law Society's view would be as a stand-alone supervisor. This is consistent with the capabilities the Law Society would bring to this role. It also avoids problems of role definition and double handling, as well as providing certainty for the sector.

A preliminary assessment of this model has identified the following potential advantages:

- The Law Society is an established regulator with deep institutional knowledge of the legal sector. It has comprehensive oversight of all lawyers through its existing regulatory role. The Law Society's regulatory framework includes the operation of an established market entry process based on a 'fit and proper' test, a Financial Assurance Scheme through which the Law Society's Inspectorate monitors and enforces compliance with the LCA and LCA (Trust Account) Regulations 2008 and applies a comprehensive risk framework. The Law Society also operates a dedicated consumer complaints and disciplinary process (through the Lawyers Complaints Service).
- Such a model leverages the significant work and investment undertaken by the Law Society in using the Australia/New Zealand Risk assessment framework (AS/NZ ISO 31000 (2009)) as the basis of its trust account inspection work. It also draws on the knowledge that the Law Society is constantly updating from its regulatory work in regard to the risks faced by lawyers in their operating environments.[40]
- The Law Society has significant expertise in focusing on risk prevention and mitigation, and has a good appreciation of the ML/TF risks facing members of the legal profession. It is currently working closely with the profession to provide education and assistance in respect of similar threats such as emerging cyber-security risks.
- Established communication channels with the legal profession already exist.
- The Law Society has extensive experience in providing practical guidance and assistance to members of the legal profession in relation to legislative change and compliance issues. The Law Society expects it will need to provide comprehensive guidance and training to the legal profession in matters related to AML/CFT.
- The Law Society is particularly well-placed to exercise search powers such as those under sections 132 – 133 AML/CFT Act in a way that is sensitive to privilege, as well as the other duties owed by lawyers.
- Established communication channels already exist between the Law Society and international regulatory bodies and domestic agencies such as the Financial Intelligence Unit.

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39 SRA Anti-Money Laundering report (May 2016)

40 For example, key personnel in the Law Society hold membership of the Association of Certified Fraud Examiners.

- It avoids an undue burden on current supervisors through expediting the process involved in accruing specialist knowledge and methodologies.

This model requires further investigation to identify and explore appropriate collaboration and information sharing protocols with the current supervisors. Resourcing is also an important issue for further consideration.

Part 5: implementation period & costs

The consultation paper acknowledges that meeting AML/CFT obligations imposes a compliance burden and costs, and a business compliance cost survey is being undertaken concurrently to help estimate these impacts.

Consultation questions

1. What is the necessary lead-in period for businesses in your sector to implement measures they will need to put in place to meet their AML/CFT obligations?
2. Where possible, please tell us how you calculated how long it will take to develop and put in place AML/CFT requirements.

The AML/CFT regime has been in place for three years for Phase One entities, so there will be some familiarity in the business community regarding the preparation of risk assessments, compliance programmes, CDD, and reporting requirements. However, there will be some unique challenges for the legal sector and getting properly prepared will still be a substantial undertaking. If the process is rushed, it is likely there will be less effective engagement and a consequent increased burden on supervisors. Time also needs to be allowed for professional associations including the Law Society to develop guidance for members and/or assist with codes of practice. There will be a range of complex scenarios in practice that need to be addressed in practice briefings and educational seminars.

It would likely take law firms two to three years to properly implement systems and processes to allow them to comply. Firms would need to develop procedures manuals, run internal training sessions, appoint Money Laundering Reporting Officers, and bed in the new information gathering and filing protocols.

The Law Society considers that a 12-month implementation period would be too short, particularly for small firms which will need to absorb the cost in resources and time of setting up new systems and processes. The Law Society therefore recommends the Phase Two lead-in period should be at least two years, and preferably three.

In particular, it will be important to synchronise the AML/CFT Phase Two reporting obligations with introduction of the FATCA (the United States' Foreign Account Tax Compliance Act) and Automatic Exchange of Information (AEOI) and CRS (Common Reporting Standard) reforms, to avoid duplicate or possibly even triplicate information being gathered. Insofar as a corporate or trust client is a "Financial Institution" for the purposes of FATCA or CRS there will inevitably be some reporting required to Inland Revenue by the relevant entity. Similarly, if a corporate or trust client is a "Passive NFFE" for the purposes of FATCA or CRS there will inevitably be some reporting required to the Financial Institutions with which the entity deals. In some cases, law firms may be responsible for

reporting this information. These Automatic Exchange of Information (AEOI) obligations either exist already or soon will exist regardless of the AML/CFT regime.

More detailed comments on the interaction between AML/CFT, FATCA and AEOI obligations are set out in **Appendix 2**.

<u>Part 6: enhancing the AML/CFT Act</u>

Part 6 of the consultation paper sets out several proposals for amendment of the AML/CFT regime. The Law Society's responses are noted below.

Proposal: extend reporting to include suspicious 'activities'

It is proposed to expand the current requirement to report suspicious transactions to include reporting of suspicious 'activities'. The Law Society's response to this is set out above.

Proposal: information sharing

The consultation paper seeks views on how existing information sharing arrangements could be enhanced. Consultation questions are:

1. Should industry regulators be able to share AML/CFT-related information with government agencies?
2. Should AML/CFT supervisors be able to share customers' AML/CFT-related personal information with government agencies?
3. What are the appropriate circumstances under which the FIU can share financial intelligence with government agencies (such as the sector supervisors, industry regulators, intelligence agencies, IRD and Customs) and reporting entities? What protections should apply?
4. What restrictions should be placed on information sharing?

To the extent that law firms are to be subject to on-site inspection and audit by the relevant supervisor, files could be inspected on premises but should not be copied or shared with any other competent authorities unless and until very strict criteria are met. Issues relating to the protection of privilege are identified above.

The sharing of AML/CFT related information between government agencies and industry regulators gives rise to concerns about interference with privacy. Appropriate safeguards should be put in place to protect privacy interests. For example, sharing should only occur where it is necessary for the prosecution and punishment of offences; or for the enforcement of a law imposing a pecuniary penalty; or for the protection of the public revenue. There must be good record keeping and audit processes and sound policies around retention of any data that is shared.

Proposal: reliance on third parties

The consultation paper seeks feedback about whether current third party reliance provisions are appropriate or whether they should be enhanced. The consultation question is:

1. Are the existing provisions that allow reporting entities to rely on third parties to meet their AML/CFT obligations sufficient and appropriate? If not, what changes should be made?

The basis upon which these provisions have been set up appears sound. Where a law firm is dealing with another reporting entity in relation to a client's affairs, there should be an ability for AML/CFT information and documentation to be shared between them (subject to the consent of the client) to expedite completion of AML/CFT procedures. This could be done by letters of assurance in relation to individual clients. In some cases, where the dealings are high in frequency it may be appropriate for a reporting entity to issue a blanket letter of assurance in relation to all its clients with whom a law firm may be dealing.

In practice there may be reluctance by reporting entities to put themselves in a position where they may be perceived to be giving an assurance as to the bona fides of a client or otherwise giving assurances in relation to matters of fact which they may not be able to independently verify. Law firms may end up having to carry out due diligence in any event.

Consideration should be given to ensuring the legislation is technology neutral and enables cost-saving solutions – as the cost of due diligence processes is ultimately borne by consumers. (As an example, blockchain is currently being developed and used to securely share information. There is potential for blockchain to provide a secure solution to replicating CDD costs.)

Proposal: trust and company service providers

The consultation paper seeks views about whether it is appropriate to extend the scope of trust and company service providers covered by the Act. The question is whether the scope of the provision requiring persons providing trust and company services to comply with the AML/CFT Act should be extended to activities carried out in the ordinary course of business, rather than just when they're the only or principal part of a business.

The scope of the provision requiring persons providing trust and company services to comply with the Act should be extended to activities carried out in the ordinary course of business, rather than just when they are the "only" or "principal part" of a business. The latter, more limited, option would leave the door open for abuse. In practice it would be difficult to draw a distinction between trust and corporate providers "providing a service in the ordinary course of business" and those for whom it is a "principal part of a business". In any event the mischief which the legislation is intended to detect and prevent could be facilitated by a structure whether set up by a trust and corporate service provider operating in the ordinary course of business or as a principal part of business, and so, in the Law Society's view, any distinction is unhelpful.

Proposal: simplified customer due diligence

The consultation paper seeks views about whether it is appropriate to expand the types of low-risk institutions that reporting entities are allowed to conduct simplified due diligence on. Consultation questions are:

1. Should the simplified customer due diligence provisions be extended to the types of low-risk institutions we've proposed above? If not, why?
2. Should we consider extending the provisions to any other institutions?

From the legal profession's perspective, it would be preferable for there to be no requirement to carry out any due diligence on the persons specified at page 38 of the consultation paper. However, if such an exemption is not possible then the current list of low-risk institutions to which simplified customer due diligence procedures could be applied should be expanded to include State Owned

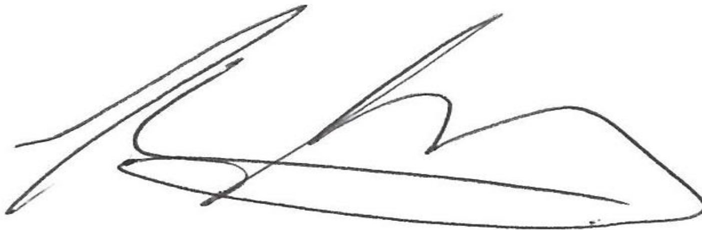
Enterprises and majority owned subsidiaries of publicly traded entities in New Zealand and in low-risk overseas jurisdictions. It should also include businesses licensed and supervised by recognised regulatory authorities (such as other lawyers, financial institutions, chartered accountants etc).

Conclusion

The Law Society will need to discuss these issues further with the Ministry, and will also need to engage more closely with its members to ensure the profession understands the detail of the Phase Two reforms. In particular, it is essential the profession is given the opportunity, and adequate time, to comment on an exposure draft of the Bill and the proposed implementation timeframe. This will be crucial to gaining the profession's support for efficient and effective implementation of the reforms.

We look forward to receiving information from the Ministry on the proposed next steps in the reform process. Please contact the Law Society's General Manager Regulatory, Mary Ollivier (mary.ollivier@lawsociety.org.nz) in the first instance.

Yours faithfully



Kathryn Beck
President

Appendix 1: comparison of obligations [a summary, taken from Appendix 1 to the consultation paper]

The Financial Transactions Reporting Act 1996 (the FTR Act) currently requires lawyers … to comply with obligations such as identity verification, record-keeping and reporting suspicious transactions. … However, these obligations only apply in limited circumstances and are not as robust as those that apply to reporting entities under the AML/CFT Act. This table compares sectors' current obligations and their proposed obligations under Phase Two. …

Phase Two sectors	Current obligations	When the current obligations apply	Additional obligations (Phase Two)	When the additional obligations will apply
Lawyers [and conveyancers, accountants, real estate agents, gambling sector]	Verify the identity of persons paying $10,000 or more in cash or when you suspect the person is trying to launder money through the transaction. Where the person paying $10,000 or more in cash is conducting a transaction on behalf of someone else, you must verify the identity of the underlying client. Retain records of documents associated with transactions (including the nature, amount, currency, date, and parties involved) for not less than 5 years.	For lawyers and conveyancers, the FTR Act applies only when they receive funds in the course of their business for the purposes of deposit, investment or real estate.	Develop and maintain an AML/CFT risk assessment and compliance programme. Conduct customer due diligence (that is, asking for and verifying customers' identification) in a wider range of circumstances. Conduct enhanced customer due diligence (such as verifying source of funds) when conducting high-risk transactions. Proactively monitor accounts to identify and where appropriate, report suspicious activity to the FIU. Retain records of documents associated with transactions (including the nature, amount, currency, date, and parties involved) for not less than 5 years.	Only businesses that conduct specific types of activities will need to comply. Refer to the relevant section in Part 3 of the consultation document for lists of the proposed activities in your sector. For general information about AML/CFT obligations, visit justice.govt.nz/justice-sector-policy/key-initiatives/aml-cft/information-for-businesses/

	Report transactions or proposed transactions to FIU if you reasonably suspect they involve money laundering or proceeds of crime.		Report transactions or proposed transactions to the FIU if you reasonably suspect they involve money laundering or the proceeds of crime. Meet audit and annual reporting requirements. Be supervised by an appropriate authority.	

Appendix 2: **Interaction between Phase Two of the AML/CFT Act, FATCA and AEOI**

New Zealand has already enacted laws to allow New Zealand entities to comply with the information sharing obligations placed upon them under the United States' Foreign Account Tax Compliance Act (FATCA) and has issued draft legislation to give effect to New Zealand's commitment the OECD's Automatic Exchange of Information (AEOI) regime from 1 July 2017 (found in the *Taxation (Business Tax, Exchange of Information, and Remedial Matters) Bill*).

While there are some differences between FATCA, AEOI and the AML/CFT rules, the regimes deal with similar concepts and processes (most notably, all feature complex due diligence processes). There will also be significant overlap in who will have obligations under each regime. The Law Society's view is that (to the greatest extent possible) obligations imposed by Phase Two of the AML/CFT Act should be aligned with the obligations imposed on financial institutions under FATCA and AEOI. This is a pragmatic approach that would help ease the compliance burden and costs for affected persons.

This could include aligning the timeframe for implementation of Phase Two of the AML/CFT regime with the phasing in of AEOI (if possible). At a practical level, this would mean that affected persons would only need a single update to any relevant systems or processes and that any required contact with customers could be streamlined.

Under FATCA, a lawyer's trust account will generally be a "passive NFFE" (assuming that the law firm has adopted the definition of investment entity found in the US Treasury Regulations in lieu of the definition found in the New Zealand/US Intergovernmental Agreement). The trust account is treated as a separate entity from the law firm (which will generally be an "active NFFE"). It is expected that the same classifications will result upon application of the AEOI common reporting standard (CRS) by a law firm.

Under these classifications, a law firm will not have due diligence obligations under FATCA or the CRS in its own right. It will, however, need to determine and verify the identity of clients who deposit funds into the law firm's trust account (referred to as "controlling persons" under FATCA and the CRS). This identification process will enable a law firm to make the required certification to the bank that maintains the trust account as part of the bank's FATCA or CRS compliance.