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AML/CFT Consultation Team
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AML/CFT Phase 2 reforms – Exposure Draft Bill

The New Zealand Law Society appreciates the opportunity to respond to the Information Paper dated December 2016 relating to Phase 2 AML/CFT Reforms and the accompanying exposure draft of the Anti-Money Laundering and Countering Financing of Terrorism Amendment Bill (**Exposure Draft**).

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 that the legal profession has a responsibility to co-operate in the global response to money laundering and terrorist financing.

At the same time, there is a significant tension between the obligations of lawyers to their clients, the traditional lawyer-client relationship and the role of lawyers as trusted advisers and their role as informants under the new regime.

Timing of Phase 2 for the Legal Profession

Clause 6(2)(a) of the Exposure Draft provides that Phase 2 will apply to lawyers from 1 January 2018. Phase 2 will apply to accountants from 1 July 2018, real estate agents and the NZ Racing Board from 1 January 2019 and high-value dealers from 1 July 2019.

The Law Society submits that the introduction date for lawyers of 1 January 2018 is much too early. The list of 'activities' in the definition of 'designated non-financial business or profession' in clause 5 of the Exposure Draft is very wide and is likely to result in a large majority of law firms coming within the definition of non-financial business or profession.

The Law Society view has particular regard to the number of law firms that will need to set up new systems and processes. The Law Society recommends that the Phase 2 lead-in period should be at least two years. During that period, lawyers will continue to be subject to their existing obligations under the Financial Transactions Reporting Act 1996 of identity verification, record keeping and reporting certain suspicious transactions. Further, under the Conduct and Client Care Rules a lawyer must not assist any person in an activity that the lawyer knows is fraudulent or criminal and must not knowingly assist in the concealment of fraud or crime.

Reasons for the Law Society's recommendation include the following:

a Unlike banks, insurers, casinos, and other financial institutions which are well-resourced with compliance teams due to their prudential or other requirements, lawyers (including even the largest commercial law firms) are not currently resourced to prepare for and implement compliance on the scale required by the proposed AML/CFT reforms.

b There is likely to be a shortage of compliance experts with AML/CFT experience available to the New Zealand market. Accordingly, the ability of the legal services sector to hire external compliance expertise will be limited.

c It is understood that even the most sophisticated and well-resourced Phase 1 reporting entities found it challenging to implement their AML/CFT compliance processes within the two-year period they were afforded. For many, compliance is still being developed.

d As lawyers are not currently resourced or experienced in AML/CFT compliance the legal services sector will have to develop capability in existing staff and systems from scratch. This will involve:

   i ensuring the relevant staff have an in-depth understanding of the AML/CFT Act, the regulations and the existing guidance, in addition to the new reforms;

   ii implementing appropriate internal systems and training across the firm or practice;

   iii liaising (where applicable) with the firm's risk committee and board;

   iv factoring the cost of the new systems, and any additional compliance staff hired, into financial planning and budgeting;

   v liaising with insurers as to the impact of civil liability penalties on professional indemnity policies; and

   vi as a profession, developing a dialogue with the sector's AML/CFT supervisor, once the supervisor is appointed.

e Since the AML/CFT regime is principles-based, it will be important that applicable regulations, codes and guidance on Phase 2 are available well in advance of the effective date for compliance.

f It will be important the AML/CFT Phase 2 reporting obligations do not precede the FATCA and CRS requirements, to avoid duplicate or even triplicate information being gathered.

The Law Council of Australia has opposed the introduction of a similar regime to the New Zealand Phase 2 on the grounds that the reporting obligations would impact on professional independence, client confidentiality and client legal privilege. The Law Council's 'Anti-Money Laundering Guide for Legal Practitioners' is available online.[1]

It is submitted that it would be undesirable for Phase 2 to apply to lawyers in New Zealand until a similar regime applies in Australia. If the position were otherwise lawyers and law firms which

[1] http://www.lawcouncil.asn.au/lawcouncil/images/LCA_AML_Guide_for_Legal_Practitioners-_updated.pdf. This sets out the position as at January 2016. The Law Society is advised that an update of this publication is in course of preparation.

practice on either side of the Tasman could find themselves subject to confidentiality requirements in Australia, but at the same time bound to make a suspicious transaction report in New Zealand. This situation would be at odds with the Trans-Tasman mutual recognition principle in relation to occupations, contained in Part 3 of the Trans-Tasman Mutual Recognition Act 1997.

Order of application of Phase 2

The Law Society does not consider there is a case for Phase 2 applying to the legal profession in advance of any of the other occupations. It is submitted that if anything, Phase 2 should apply to other occupations in advance of lawyers.

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. Clients of lawyers (unlike those of any other occupation groups) have the benefit of legal professional privilege. It is generally accepted that legal professional privilege is an important element in a democracy.

Lawyers' ethical duties and legal professional privilege were addressed in the Law Society's submission to the Ministry of Justice of 16 September 2016. An excerpt of the relevant part of the submission is **attached**.

Reconciling lawyers' obligations under Phase 2 with lawyers' ethical duties and legal professional privilege is to say the least challenging. This issue is unique to the legal profession. For this reason, it is submitted that other occupation groups should become subject to Phase 2 in advance of the legal profession.

Other persons and entities

Clause 6 of the Exposure Draft does not specify when the Act would apply to persons or entities other than those referred to, namely lawyers, accountants, real estate agents, NZ Racing Board and high-value dealers.

As the Law Society stated in its submission of 16 September 2016, a growing number of services under the general heading of legal work may be carried out by non-lawyers. The only legal work which is the sole preserve of lawyers is 'reserved areas of work' and 'conveyancing' each as defined in section 6 Lawyers and Conveyancers Act 2006. As the consulting/services sector continues to develop, there will be an acceleration of the current trends under which a growing range of unregulated service providers develop an ever wider range of specialties under labels such as 'compliance' and 'transaction support'.

Accordingly, most of the activities set out in clause 5 of the Exposure Draft may be carried out by non-lawyers.

Persons seeking to avoid the checks and other compliance measures required by Phase 2 could well become aware of this position and instruct non-lawyers in relation to their activities. Accordingly, in the Law Society's submission it is important that the AML/CFT Act applies to persons and entities of this kind at an earlier rather than a later date.

In addition, while the Law Society understands the functional approach taken by the Exposure Draft, which seeks to capture both:

- those operating as a designated non-financial business or profession, and
- persons who operate as a trust and company service provider,

the use of the 'ordinary course of business' qualifier in clause 5(1)(a) is likely to be problematic. While the list of services included in paragraphs (a)(i) to (vii) of the definition of 'designated non-financial business or profession' encompasses many of the services provided by lawyers in the ordinary course of business, it is doubtful there is such an 'ordinary course' gateway for many of the newer service providers.

Regulations

It is noted that regulations are to be developed. The Law Society considers it important that draft regulations be available for comment at an early stage in the process, and certainly whilst the Bill that follows the Exposure Draft is passing through Parliament.

Activities

The scope of services provided by lawyers which will come within the AML/CFT Act is set out in the definition of 'designated non-financial business or profession' in clause 5 of the Exposure Draft. Accordingly, the Exposure Draft extends the scope of the Act to lawyers who engage in any of the specified activities.

The reality is that the list of activities is so wide that it seems likely to apply to almost all law practices in some way and at some time in the ordinary course of practice. The Law Society does not take issue with the significant widening of the scope of the Act, but is concerned that various of the provisions in the listed activities are ambiguous. Some examples of this are set out below:

a An 'activity' includes providing a registered office, a business address, a correspondence address or an administrative address. Would this include a law firm providing an address for service of legal proceedings or a law firm making meeting rooms available in its offices for a corporate client to hold Board meetings?

b Would 'managing or arranging client funds, accounts, securities, or other assets' extend to accepting appointment as an attorney, drafting a trust deed or drafting a will?

   As noted in our September 2016 submission, the concept of 'managing' would usually be interpreted to mean some form of control or discretion is required – but in this context it seems clear that it is also intended to extend to the administrative functions of simply holding or handling client funds.

c It is assumed that in sub-paragraphs (vi) and (vii) the reference to giving instructions is intended to relate to a law firm giving instructions to a third party concerning the specified matters. However, it would be desirable that this be made clear.

In some cases, for the legal profession, questions may arise not only out of relatively commonplace steps required in the ordinary course of business, such as that required in estate administration, but also out of short-term involvement in narrow issues that arise in respect of discrete parts of what are often quite routine transactions or management decision-making processes. Often such involvement is requested at short notice and on the basis of a very limited brief of the issues under consideration.

These issues have the potential to be of considerable significance as, unless a law firm is a reporting entity, it would have no obligation or right to report a suspicious activity under clause 40(3) of the Exposure Draft. Further, it would be doubtful that the law practice would have the benefit of the protection afforded by clause 44 of the Exposure Draft if it was not a reporting entity.

These concerns in relation to the activities referred to in the definition of 'designated non-financial business or profession' will need to be addressed, and any ambiguity clarified, before the legislation is enacted.

Legal professional privilege

Overview

It is difficult to over-emphasise the importance of legal professional privilege. In *B v Auckland District Law Society* [2004] 1NZLR 326, the Privy Council held that:

> Legal professional privilege is more than an ordinary rule of evidence. It [is] a fundamental condition on which the administration of justice as a whole rested. It was upheld not for the sake of the applicant in a particular case but in the wider interests of all who might otherwise be deterred from telling the whole truth to their solicitors … A lawyer had to be able to give a client an absolute and unqualified assurance that whatever the client revealed in confidence would never be disclosed without the client's consent. The privilege could not therefore be balanced against competing public interests as the purpose of the privilege would be undermined.

In the Court of Appeal decision in the same case, the Chief Justice, Elias CJ, stated:

> Even where litigation is not immediately in prospect, the privilege recognises the public benefit in legal professional assistance if members of the community are to avoid disputes and order their affairs lawfully. As such, it supports the principle of legality upon which our society is organised.

The courts have treated legal professional privilege as a fundamental common law right and as a necessary and essential condition of the effective administration of justice[2] as well as aspects of the rule of law.[3]

The Law Society's previous submission identified concerns that the requirement for suspicious transaction reporting (if extended to lawyers) would impact on the lawyer/client 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. 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 presented with difficult situations where they have suspicions that 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. These issues are discussed in more detail in the **attached** excerpt of that submission.

Exposure Draft – privilege

Against this background, the provisions of the Exposure Draft which relate to legal professional privilege need to be carefully considered.

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2 *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.

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

The Law Society is comfortable with the definition of 'privileged communication' in clause 42 of the Exposure Draft as it brings the definition into line with the Evidence Act.

Clause 40(3) requires a lawyer to report a suspicious activity, but subclause (4) states that a lawyer is not required to disclose any privileged communication. Accordingly, a lawyer who reports a suspicious activity will need to determine whether or not communications fall within the AML/CFT Act's definition of privileged communication.

The lawyer will then need to decide whether an otherwise privileged communication should be included in a suspicious activity report because it falls within the exceptions in clause 42(2). Clause 42(2)(a) provides that a communication is not privileged if it is made or brought into existence for a dishonest purpose, or to enable or aid the commission of an offence. Clause 42(2)(b) reflects the existing exception in section 42(2) of the Act relating to trust account records.

The proposed guidelines will need to address factors which a lawyer should take into account in deciding whether an otherwise privileged communication should be included in a suspicious activity report because it falls within one of the clause 42(2) exceptions. It is important that there is absolute clarity in respect of when a lawyer's ethical obligations are to be overridden by the AML/CFT regime.

One of the examples provided in the Information Paper, Scenario 2, highlights some of the potential difficulties in this area. This scenario indicates that a lawyer acting for a client on drugs and AML charges can be compelled to give evidence against the client in relation to information provided to the lawyer. The rationale is that privilege would be displaced because the lawyer knows that the transaction is relevant to the commission of an offence. The concern is that the scenario presented is over-simplified. A lawyer in this situation faces the difficulty of ascertaining whether the privilege exception applies. Documents about the transaction could be compelled because they are technically not privileged. However, any privilege in respect of other communications may not be displaced by the exception because they were not made themselves for a dishonest purpose or commission of an offence. Rather, the client's communications would be made for obtaining advice in respect of defending criminal charges. A lawyer in this situation would need to carefully consider exactly what evidence was compellable and what was not, and would probably need to take legal advice.

The scenario presented in the Information Paper also illustrates how the regime could potentially create access to justice issues. If any lawyer representing a client in respect of charges with an AML aspect may be required to disclose what the client tells them, this could result in defendants effectively being denied the right to legal representation.

Protection of persons reporting suspicious activities

Under clause 44, a lawyer who reports a suspicious activity is protected from civil, criminal or **disciplinary** proceedings in respect of the report unless the information was disclosed in bad faith.

Having regard to the significance of legal professional privilege, the Law Society questions the protection from disciplinary proceedings. Where a lawyer acting other than in bad faith chooses to release privileged information when the lawyer is not obliged to, there would not seem to be any reason why the lawyer should be exempted from the complaints and disciplinary procedures of the Lawyers and Conveyancers Act in cases raising conduct concerns.

Accordingly, the Law Society submits that clause 44(2) should be amended by omitting the reference to disciplinary proceedings when the person concerned is a lawyer.

Suspicious activities

The Information Paper requests feedback on the extent to which the Exposure Draft is clear about when and how lawyers would be required to report 'suspicious activities' and whether there are likely to be any unintended consequences.

Currently, reporting entities are required by section 40 of the AML/CFT Act to report any 'suspicious transactions' to the FIU.

It was noted in the consultation paper which preceded the Exposure Draft that there are some situations when suspicious or unusual activities may not be reported because a transaction does not occur, even though it may provide valuable financial intelligence for detecting crime. Accordingly, the Exposure Draft proposes expanding the current reporting requirement to reporting 'suspicious activities'. However, although clause 39A of the Exposure Draft contains a definition of 'suspicious activity', this does not provide much assistance to a law practice in determining what activities will be considered suspicious for these purposes.

Over the last decade there has been a large influx of foreign capital into New Zealand. This capital inflow has made its presence felt not just in the housing market but also in most spheres of economic activity. Understanding how or what to look for, in conjunction with what are often quite large transactions, in order to form the requisite 'suspicion' will require detailed guidance.

For the obligation to report suspicious activities to be workable in practice, reporting entities will need a high level of certainty around what types of activities would amount to suspicious activities for reporting purposes. This proposed extension of the regime could impose an unreasonable compliance burden and regulatory risk on reporting entities in the absence of an adequate level of certainty and guidance being provided as to what the new rules are intended to capture.

It is suggested that the best way to provide certainty would be to include an amplified or expanded definition of suspicious activity in the Exposure Draft with particular emphasis on what constitutes reasonable grounds for suspicion. It is accepted that the definition would not be able to be exhaustive – given that those included in money laundering and terrorist financing activities are regularly adjusting and developing those activities to avoid detection and exploit new technologies. That said, having a clearly articulated principle and framework for this new aspect of the AML/CFT regime, coupled with a non-exhaustive list of the types of activities which should be considered suspicious for these purposes, would:

a provide greater certainty to reporting entities about what activities they should definitely be reporting;

b give reporting entities a better understanding of both the policy intent behind the change, and of the activities that are intended to be captured, which should in turn allow them to form better views on what types of activities should be considered suspicious; and

c ensure reporting entities have sufficient statutory guidance to enable them to alter their compliance programmes to make sure that appropriate processes are in place to identity and respond to relevant activities.

In the absence of an amplified or expanded definition in the AML/CFT Act, reporting entities will:

a need to form their own views on what constitutes a suspicious activity – which has the potential to result in inconsistent processes being put in place and inconsistent

reporting between entities, resulting in under-reporting or over-reporting (depending on what parameters are adopted);

b need to amend and develop their compliance processes in the absence of clear requirements, which is likely to increase the investment of time and money required, given the broadness of the concept; and

c have greater difficulty in effectively managing the risk of non-compliance.

If an amplified or expanded definition of suspicious activities is not provided, then the next best approach would be for AML/CFT supervisors to provide unambiguous, pragmatic joint guidance on this issue. However, a definition is preferable to guidance because:

a guidance does not have the same status as a legislative provision, and accordingly there is always a risk that complying with guidance may not actually result in compliance with the law;

b reporting entities would need to wait for guidance to be issued, which could result in an unnecessary regulatory burden being imposed upon them in the meantime to consider what would constitute a suspicious activity and how their processes will need to be altered to capture such activities. This situation would obviously be exacerbated where any guidance provided:

i was not issued in a timely manner;

ii was changed after being issued – whether before or after the proposal comes into effect; and

iii was not provided by the AML/CFT supervisors jointly – creating the potential for inconsistencies of approach which could impact on situations where suspicious activities arise and there are several reporting entities involved that are supervised by different AML/CFT supervisors.

Given the increased globalisation of the financial services industry, it would be helpful for the definition (or guidance, in its absence) to draw upon and be aligned with guidance that already exists offshore in respect of the meaning of suspicious activities. In particular, it is noted that both AUSTRAC and HM Revenue & Customs have issued guidance on this question. If an approach were adopted which was inconsistent with such offshore guidance, additional compliance costs for reporting entities (that operate in those jurisdictions) would be incurred without a clear offsetting benefit to New Zealand.

At an early stage in instructions or indeed prior to instructions, a lawyer may have very little information to make the necessary judgement as to whether or not a suspicious activity is involved. The lawyer can of course seek further information, but there will be a temptation to decline a potentially problematic instruction. This of course raises access to justice considerations.

Reporting of suspicious activity

Clause 40(3) of the Exposure Draft would require a reporting entity to report an activity 'as soon as practicable but no later than three working days after forming its suspicions'.

A difficulty with this provision is that the expression 'forming its suspicions' is imprecise. A lawyer may consider that a matter may amount to a suspicious activity, but may wish to take advice and/or

make further enquiries before deciding whether it crosses the threshold and amounts to a suspicious activity.

It is submitted that it would be preferable for the relevant part of the subclause to be reworded along the following lines:

> three working days after concluding that a matter constitutes a suspicious activity

Further, it is submitted that three working days could in many cases be an unduly short period to prepare what may be a time-consuming suspicious activity report. A lawyer may need to give careful consideration to precisely what information should be disclosed in the report, including whether any privileged information should be disclosed. It may be necessary for the lawyer to take independent legal advice. It is submitted that a period of seven working days would be preferable.

Changes aimed at reducing compliance costs

Currently, there are a number of mechanisms under the AML/CFT Act and Anti-Money Laundering and Countering Financing of Terrorism (Class Exemptions) Notice 2014 by which reporting entities may rely on third parties to meet their AML/CFT obligations.

The Exposure Draft proposes further amendments to reduce the compliance burden including:

a permitting reliance on 'designated business groups';

b permitting reliance on another business;

c exempting businesses from identifying and verifying existing customers;

d extending the current 'simplified due diligence' provisions and include these within the AML/CFT Act; and

e streamlining the ministerial exemptions process.

The Information Paper seeks feedback as to whether these measures are likely to be useful, whether the wording of the Exposure Draft is clear and whether there could be unintended consequences.

The Law Society considers that the proposed changes are likely to be useful. For example:

a the exemption provided by clause 13 would allow lawyers to rely on customer due diligence carried out by other reporting entities; and

b the exemption provided by clause 5(3) would avoid the need for lawyers to conduct customer due diligence on existing clients, unless there is a material change in the service or circumstances.

While the mechanisms for relying on a third party to conduct due diligence are undoubtedly welcome it is significant that in each case the relevant reporting entity remains statutorily liable for any failure by the relevant person to conduct the necessary due diligence to the required standard. Commercially, this risk is often addressed by other reporting entities conducting due diligence on the third party's due diligence processes or by procuring an indemnity from the third party to cover civil liability (and sometimes reputational liability) arising from deficient due diligence, or both.

The civil liability risk is particularly pertinent for lawyers who may well be personally liable to an unlimited extent.

In addition, in the context of legal services, there will usually be another reporting entity involved in transactions or dealings that are regulated by the AML/CFT regime – such as a financial institution which has already conducted due diligence on the customer. In these cases, it would be an inefficient duplication for lawyers to undertake due diligence independently to the same standard. Instead lawyers could rely on the other reporting entity's due diligence where it is reasonable to do so – for example, where a registered New Zealand bank confirms it has undertaken due diligence on the customer. However, it is unclear at this stage whether this would be workable in practice. Furthermore, for commercial and confidentiality reasons lawyers are likely to have only limited ability to undertake due diligence on another reporting entity and it is not realistic to expect that law firms will be indemnified by financial institutions or other reporting entities.

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

Additional complexity arises in relation to instructions from foreign law firms to provide advice on behalf of that firm's clients. These instructions may involve no transfer of funds or assets. It would be difficult for New Zealand law firms to undertake due diligence on the foreign firm or the underlying client in most cases. Accordingly, it would be helpful if these dealings could be excluded from the scope of the legal services regulated by the Exposure Draft to the extent the instructions came from a law firm operating in a jurisdiction with a comparable AML/CFT regime.

Barristers

The definition of 'designated non-financial business or profession' in clause 5(1) of the Exposure Draft includes a lawyer. 'Lawyer' has the meaning given to it by section 6 Lawyers and Conveyancers Act 2006.

That Act defines 'lawyer' as a person who holds a current practising certificate as a barrister or as a barrister and solicitor. Accordingly, a barrister can come within the definition of a designated non-financial business or profession. It follows that a barrister will be a reporting entity under the Exposure Draft.

Barristers sole may consider that they should be exempted from the definition of designated non-financial business or profession or excluded by regulations under clause 5(1)(c) of the Exposure Draft. Some arguments in support of this view would be as follows:

- Barristers do not have trust accounts.
- Unlike each of the other listed occupation groups, barristers are unable to receive or hold money or other valuable property on behalf of anyone.
- They may not practise as a solicitor or carry out transactional aspects of conveyancing.
- They must be sole practitioners and may not practise in partnership. Many barristers do not employ anyone. Complying with all the Phase 2 requirements could be very onerous for them.
- Most barristers do not in the ordinary course of business carry out any of the listed activities set out in the definition of 'designated non-financial business or profession'.

- In many, if not most, cases barristers have an instructing solicitor who will be a reporting entity and will have carried out the due diligence requirements of the AML/CFT Act.
- The overriding duty of a barrister is as an officer of the Court.
- Barristers, like other lawyers, must not assist a client in an activity that the barrister knows is fraudulent or criminal, must not knowingly assist in the concealment of fraud or crime, and must disclose confidential information which relates to the anticipated or proposed commission of a crime punishable by imprisonment for three years or more.

Drafting

There are a number of drafting issues that will need addressing in the Exposure Draft. By way of example, the Law Society understands that in the definition of 'designated non-financial business or profession' the activities set out in subparagraphs (i) to (vii) are to qualify all of the occupation groups referred to and not just a trust and company service provider. The provision needs amendment to make this clear.

Supervisor

The Law Society in its submission of 16 September 2016 set out what it considers to be cogent reasons why the Law Society should be appointed supervisor of the legal profession in relation to AML/CFT matters. An excerpt of the relevant part of the submission is **attached**.

The Law Society notes that the Ministry in its Information Paper does not appear to have been persuaded by this reasoning.

Under section 65 Lawyers and Conveyancers Act, one of the functions of the Law Society is to control and regulate the practice in New Zealand by lawyers of the profession of the law. Also, under section 65, the Law Society is required to uphold the fundamental obligations imposed on lawyers which include the obligation to uphold the rule of law and to facilitate the administration of justice in New Zealand.

As required by the Act, the Law Society maintains a complaints and discipline system, manages the Lawyers' Fidelity Fund, and also carries out numerous other regulatory functions.

The Law Society considers it is well placed to develop very quickly the necessary experience in AML/CFT supervision and has the capability to do this very effectively. The Law Society is thoroughly familiar with all aspects of the legal profession and understands the unique features of the legal profession and the practice of law.

The Law Society has a very competent inspectorate which carries out on-site inspections of law firms. Its function could readily be expanded to include AML/CFT supervision matters, in a manner which would be much more cost effective than could be achieved by a separate supervisor.

Neither the Law Society nor the legal profession wish to see dual regulation of the profession. This would increase compliance costs which would ultimately be borne by consumers of legal services.

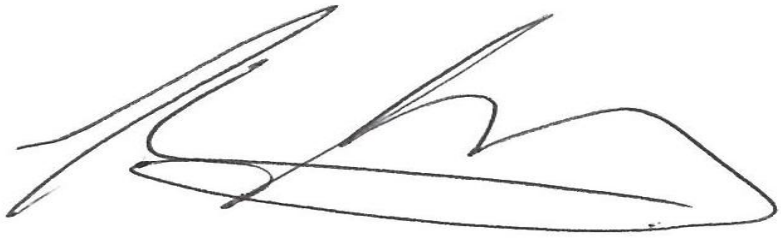
Consultation timeframe

The Law Society appreciates the opportunity to comment on the Information Paper and the Exposure Draft Bill. The very short consultation timeframe has however caused significant

difficulties. The consultation materials were released on 13 December 2016, with responses due by 27 January 2017 – a period of less than five working weeks over the holiday period. This has hindered our ability to fully consider the Exposure Draft and to properly consult the profession, and for lawyers to consider the complex matters involved in the AML/CFT Phase 2 reforms.

The Law Society considers it is important that it be given the opportunity, and adequate time, to consider and comment on the proposed draft Phase 2 Regulations and Guidelines. We look forward to receiving information from the Ministry as the reforms proceed. Contact can be made with the Law Society's General Manager Regulatory, Mary Ollivier (mary.ollivier@lawsociety.org.nz) in the first instance.

Yours faithfully



Kathryn Beck
President

Attached excerpts from New Zealand Law Society submission of 16 September 2016 to the Ministry of Justice on a consultation paper relating to Phase 2 of the AML/CFT Act –

1. Lawyers' ethical duties and legal professional privilege (pp10 – 14)
2. Current regulatory models for AML/CFT supervision – single vs multiple supervisor (pp16 – 18)

Excerpt 1:
Lawyers' ethical duties and legal professional privilege

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.[4] 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.[5]

The lawyer's duty of confidentiality as well as legal professional privilege are necessary and essential conditions of the effective administration of justice[6] as well as aspects of the rule of law.[7]

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.[8] Limited exceptions are provided including if '*disclosure would be in breach of law …*'.[9]

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.[10]

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

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

5 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).

6 *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.

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

8 Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008 r7.

9 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.

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

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.

Legal professional privilege

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 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 *[sic: 42]* 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."[11] This exception has been treated as the codification of long-standing common law authority.[12] 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

11 Evidence Act section 67(1).

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

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.[13]

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.

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.[14] 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).[15] 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

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

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

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

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.

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.

Excerpt 2:

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

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.[16] 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.[17]

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.[18] 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[19] in England and Wales, supervises most law firms and solicitors in relation to AML/CFT. It has found that in general law firms now have the right systems in place to manage money-laundering risks and

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

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

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

19 Solicitors are also regulated by other legal regulators.

report suspicious activities.[20] 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.[21]
- 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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20 SRA Anti-Money Laundering report (May 2016)

21 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.