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Criminal Law Team
Ministry of Justice Tahu o te Ture
WELLINGTON

By email: aml@justice.govt.nz

RE: Expiring AML/CFT Regulations – Targeted Consultation

Introduction

1. The New Zealand Law Society (Law Society) welcomes the opportunity to participate in targeted consultation on the Ministry of Justice paper *Expiring AML/CFT Regulations* dated 3 October 2019 (Paper).

2. The Paper proposes changes to expiring regulations issued under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) as well as setting out proposals for new regulations to address urgent issues.

3. The Paper has been considered by the Law Society's in-house regulatory legal team members and commercial and property lawyers familiar with the AML/CFT regime. The Law Society is also grateful to the New Zealand Bar Association which has considered the Paper and supports the response provided below, and with particular reference to the comments concerning "Exempting low-risk disbursements as 'managing client funds'" (at para 10 below).

General comment

4. The Law Society considers that the purposes of the AML/CFT Act (to detect and deter money laundering and terrorism financing (ML/TF); to maintain and enhance New Zealand's international reputation by adopting, where appropriate in the New Zealand context, recommendations issued by the Financial Action Task Force, and contribute to public confidence in the financial system) are best served by ensuring maximum compliance by reporting entities. Consequently, although the diversity of ML/TF risk to the New Zealand financial system means that some complexity in the AML/CFT compliance regime is unavoidable, that complexity should be minimised so far as possible. This will best facilitate compliance with the regime by New Zealand reporting entities.

5. Accordingly, the Law Society's general views are that:

- As much as possible, AML/CFT compliance matters should be addressed by way of regulatory means, rather than non-regulatory means (e.g. guidance) or semi-regulatory means (e.g. codes of practice). This is because the AML/CFT is already (understandably) complex, and it is important to ensure that it is as simple as possible for reporting entities to navigate. As

discussed further at paragraph [15] below, the Law Society supports the amalgamation of the existing six AML/CFT regulations into one. It is concerned that a surrounding proliferation of non-regulatory or semi-regulatory measures would undermine positive steps in facilitating reporting entities' understanding of, and compliance with, their AML/CFT obligations.

- As much as possible within the scheme of the AML/CFT Act, compliance matters should provide certainty to reporting entities. The Law Society recognises that this is not practicable in relation to some aspects of AML/CFT compliance (for example, only a reporting entity is capable of properly assessing its own ML/TF risk, and therefore creating an appropriate and unique risk assessment and compliance programme suiting its own needs). However, it is important that as much clarity as possible is provided in relation to more mechanical or technical aspects of compliance. For this reason, the Law Society considers that regulations should favour the provision of clear thresholds for the activities, products and instruments that are excluded from the regime rather than, for example, providing broad statements of principle that leave room for time-consuming and potentially risky interpretation (see for example the discussion of the proposed amendments to definitions regulation 15 and exemptions regulation 15 relating to stored value instruments at paragraph [7] below)

Regulations identified in the Paper as requiring substantive changes

1.1. Definitions regulation 24A – Time at which real estate agents must conduct customer due diligence

6. The Paper proposes that regulation 24A be amended in respect of commercial lease transactions so that customer due diligence must be completed before the real estate transaction is conducted in respect of commercial leases (an exception from the current requirement that customer due diligence (CDD) be conducted before the real estate agent enters into an agency agreement (within the meaning of section 4(1) of the Real Estate Agents Act 2008) with a customer. The Law Society agrees with the proposed amendment but is cautious of any measure that may add further unnecessary complexity to compliance with the regime, such as requiring CDD at different times based on the type of transaction at issue, rather than where the risk in the transaction actually arises. Accordingly, the Law Society submits that any amendment to regulation 24A should extend to all real estate transactions. The Law Society considers that this is consistent with a risk-based approach to regulation - as implicitly recognised in the proposed amendment to regulation 24A, in the case of real estate agents, any ML/TF risk arises not from the agency agreement (under which there is no guarantee that any transaction will occur, regardless of whether an agent has exclusive agency), but from the transaction itself. Accordingly, there would be no harm (and may be some benefit, in terms of lessening of the compliance burden) if real estate agents were required to conduct CDD only prior to a transaction occurring in all cases.

1.2. Definitions regulation 15 and Exemptions regulation 15 – Stored value instruments

7. The Paper raises a perceived concern that the rate of technological change makes it impractical to re-examine the points at which the issuing or provision of stored value instruments outside a business relationship are captured as "occasional transactions" or excluded from the AML/CFT regime. The Paper proposes to address this concern by prescribing principles that specify higher and lower risk characteristics of stored value instruments, to allow reporting entities and supervisors to apply a more flexible risk-based approach as new instruments are developed instead of requiring new exemptions or changes to regulations. The Law Society has concerns about this approach. As mentioned previously, it

is important that reporting entities have clarity so far as possible around what instruments are and are not captured, and the value thresholds at which they are captured. While it is difficult to comment substantively in the absence of detail, the Law Society is concerned that the proposed system whereby reporting entities assess any particular stored value instrument to determine how many of a prescribed set of high-risk or low-risk principles the instrument meets will lead to unacceptable levels of uncertainty and inconsistency. This is because of the need to first interpret any given principle and then establish whether or not it applies.

1.3. Exemptions regulation 16 – exclusion: relevant services provided to related entities

8. The Law Society agrees with this proposal.

Potential new regulations

2.1. Allowing for inclusion of limited partnerships in a designated business group

9. The Paper proposes to extend the definition of "designated business group" to allow for the inclusion of limited partnerships in a designated business group in circumstances other than where they are providing a service under a joint venture agreement with the other members of the group. The Paper does not indicate whether and if so, how often this problem may have been encountered in practice, so it is difficult for the Law Society to comment substantively at this stage. However, although not specifically mentioned in the Paper, the Law Society considers that the "designated business group" concept would benefit from some refinement in terms of how it applies to incorporated law firms. In that context, it is unclear what "related" means, given that a law firm cannot be a subsidiary of another firm or hold shares in another firm.[1]

2.2. Exempting low-risk disbursements as 'managing client funds'

10. The Paper states that the Government considers that receiving money in advance from clients is captured as "managing client funds", on the basis that "managing client funds" encompasses any instance where a DNFBP receives or holds client funds and controls the payment of those funds. This is viewed as capturing even situations where there is no or negligible ML/TF risk, including payments made to: Government departments and local authorities (e.g. application and filing fees); expert witnesses, particularly where the expert is a member of a professional organisation; professional mediators and adjudicators; and barristers. The Paper proposes to address this problem by issuing a regulation exempting such payments, ensuring that the scope of the exclusion is in line with the money laundering or terrorism financing risk. Specifically, it is envisaged that it may be appropriate to entirely exclude disbursements "for"[2] Government departments, whereas other disbursements may be excluded if the value is below a specific threshold. The Law Society's views in this regard follow, and relate only to lawyers and law firms as DNFBPs.

As previously set out in a letter to the Ministry of Justice of 28 March 2019, the Law Society's position is that the receipt by a lawyer of disbursements or barrister's fees in advance is not "managing client funds" within the plain meaning of that phrase (given that they are received for a pre-designated purpose, so that the lawyer cannot be said to control the flow of funds). Amounts received by an instructing solicitor in advance of barrister's fees would in any event be within the exception to "managing client funds" in respect of "fees paid for professional

[1] See the definition of "incorporated law firm" contained in section 6 of the Lawyers and Conveyancers Act 2006 and the prohibition on income sharing in s7(3) of the LCA.

[2] Presumably this should read "paid to".

services" because there is no requirement that the professional fees be those of the recipient firm itself[3]. The Law Society respectfully suggests that it is unnecessary to strain the plain meaning of the AML/CFT Act to include situations such as the payment of application and filing fees or the payment of professional fees (which are not included within the scope of captured activities for DNFBPs in the first place) and then introduce a specific regulation to exclude them. However, the Law Society welcomes the recognition that the current situation (with its attendant concerns around access to justice and inconsistency of treatment) is unsustainable and inconsistent with a risk-based approach to regulation. The Law Society agrees that any such regulation should entirely exclude funds received and held for the purpose of payment to Government departments or agencies (such as application and filing fees). The Law Society also considers that such regulation should go further and exclude all amounts received and held in a trust account operated by a lawyer or law firm in advance of professional fees (whether it is anticipated that those professional fees will be incurred by the lawyer/law firm, a barrister instructed by that lawyer or law firm or some other professional, for example an expert witness).

The Law Society is concerned that attempting to set a threshold value is unnecessary in a context where lawyer's trust accounts are already heavily regulated and subject to oversight by the inspectorate. There may also be an element of arbitrariness, and it could lead to confusion and different treatment of situations where there is no actual difference in risk. As also noted in the letter of 28 March 2019, the Law Society considers that any attempt by the client to instruct the lawyer to direct funds received in advance of disbursements or professional fees other than towards the payment of those disbursements or professional fees would (on the ordinary meaning of the AML/CFT Act and should under any regulation) result in a change of status of the funds. The result of this would be that the situation would *become* one of managing client funds. At that point, AML/CFT obligations would then be triggered for the lawyer or law firm operating the trust account.

2.4. Requiring enhanced due diligence when a company has nominee directors

11. The Law Society is unable to comment on this proposal in the absence of detail, but notes the need for workability in any regulation.

2.5. Limited exemption for court-appointed liquidators

12. The Law Society has no substantive comments on this proposal in the absence of detail, but again notes the need for workability in any regulation and appreciates the recognition of the difficulties inherent in the inclusion of court-appointed liquidators in the regime.

2.6. Changing the timeframes for section 59 audits

13. The Law Society agrees that it is not necessary for low risk entities to be audited on a biennial basis and that the suggested three-to-four year alternative timeframe proposed is likely to strike an appropriate balance between the need for oversight and the need to avoid over-enforcement for low-risk entities.

[3] See part (iv) of the definition of "designated non-financial business or profession" set out in section 5(1) of the AML/CFT Act.

Regulations requiring technical changes - 3.1. Definitions regulations		
Regulation	**Proposed change**	**Law Society Comment**
13A – Inclusion: wire transfer of more than $1,000	Clarify that this regulation applies to ordering institutions for wire transfers that occur outside of a business relationship with a customer, as well as applying to beneficiary institutions for wire transfers outside of a business relationship with a customer.	Agree.
15 – Inclusion: transactions involving certain stored value instruments.	Review the definition of 'debit card'; ensure that structuring cannot be used with respect to stored value instruments.	Clarification as to the precise nature of the concern would assist. Note that reg. 15 defines "**debit card**" as "an instrument that can be used to withdraw cash or make payments by *debiting an account held at a financial institution*". In other words, a debit card must be linked to an account held at a financial institution (which in turn, is presumably subject to AML/CFT obligations). It is therefore difficult to see how a debit card, the only function of which is to facilitate a withdrawal or payment from such an account, creates an ML/FT risk.

Reg 16 – Inclusion: certain financial advisors	Update regulation to continue the policy of including financial advisors who are proximate to products and services offered by other reporting entities that carry a higher money laundering or terrorism financing risk, but without relying on the 'category 1' distinction. The regulation currently includes these financial advisors in part by reference to the definition of 'category 1 product' in the Financial Advisors Act 2008, but the Financial Services Legislation Amendment Act 2019 removes this definition from the financial advice regime. As an interim measure., the regulation will continue to rely on the definition of 'category 1 product', but it may be possible to include the types to financial advisers referred to above in another way.	Unable to comment substantively without more detail of proposed alternative approach.
18A – Exclusion: non-finance businesses that transfer money to facilitate purchases of goods and services	Clarify that the regulation does not apply to DNFBPs in respect of managing client funds.	See discussion at paragraph [10], above. In the event of the amalgamation of the 6 existing regulations as proposed in the Paper and supported by the Law Society, thought could be given to amalgamating this regulation with regulation 13 in the exemptions regulations.

20 – Exclusion: lawyers, etc.	Update heading to reflect amended scope of exemption (estate administration and family trusts); tidy up regulation to ensure application is clear by for example removing 'by reason only'; potentially restructure the regulation.	Agree that the proposed changes are necessary. However, the confusion and unclear wording of this regulation demonstrate the need for clear guidance for lawyers on which activities are covered by this exclusion and which are not. Note that for many firms, these issues are critical as they may be determinative of whether or not they are reporting entities, particularly if the proposed changes in approach to funds received in advance of disbursements and professional fees (discussed at paragraph [10], above) proceed
21B – Exclusion: persons carrying out property management activities	Update this regulation to exempt property management services from 'managing client funds' rather than 'real estate agency work'.	Appears to be much more than a minor/technical change. Likely brings many property managers back into the net. "Real estate agency work" is one of two "exclusions from the exclusion" in reg. 21B (so that carrying out property management activities will not make a person a reporting entity, but they will be a reporting entity if, relevantly, they carry out "real estate agency work" as defined in section 4(1) of the Real Estate Agents Act 2008 and referred to in the regulation (broadly covers work done or services, in trade, on behalf of another person for the purposes of bringing about a [real estate] transaction). Changing the reference to real estate agency work to "managing client funds" would be a fundamental change, and does not easily reconcile with reg 21B(2)(a)(ii).

Regulations requiring technical changes - 3.2. Exemptions regulations		
Regulation	**Proposed change**	**Law Society Comment**
8 – Transactions that are not occasional transactions or wire transfers exempt from section 49(2)(d) of Act	Update this regulation to ensure clarity and ensure that transactions below applicable thresholds are exempt from record keeping requirements; repeal reg 8(3) as it appears unnecessary.	Agree.
Reg 11 – Relevant services provided in respect of insurance policies that are closed to new customers and new premiums	Clarify that the regulation only applies to life insurers and not all insurance policies.	Appears to be much more than a clarification/technical change. Nothing in reg 11 seems to confine its application to life insurers. Query what harm is sought to be prevented by this proposal; more information required to enable substantive comment.
Reg 15 – Relevant services provided in respect of certain stored value instruments	Review the definition of 'debit card'; ensure that structuring cannot be used with respect to stored value instruments.	Same comment as in relation to definitions reg 15, above.

Reg 17 – Relevant services provided under premium funding agreement by insurance company **Reg 18 – Relevant services provided under premium funding agreement by non-insurance company**	The definitions for both reg 17 and reg 18 are contained within reg 17, which has the potential for confusion. As the regulations are similar in scope it may be appropriate to amalgamate the regulations.	Agree.
Reg 19 – Relevant services provided in respect of certain low-value life insurance policies	Remove contracts of consumer credit from scope of the regulation as they are pure risk contracts and exempt by virtue of Exemptions reg 12.	Agree.
Reg 20 – Relevant Services provided in respect of certain superannuation schemes **Reg 20A – Relevant services provided in respect of certain employer superannuation schemes**	Update these regulations to also capture retirement schemes excluded by the 'Services provided in relation to certain retirement schemes' exemption. This class exemption was intended to act as a temporary solution as some retirement schemes cannot rely on reg 20A.	Agree.

Regulations requiring technical changes - 3.3. Cross-border transportation of cash		
Regulation	**Proposed change**	**Law Society Comment**
6 – Form of cash report prescribed schedule	Amend these regulations to no longer prescribe the specific form to be used for cross-border cash declarations but instead prescribe the information the form must contain (in line with other AML/CFT forms).	Agree, but suggest that an approved/acceptable form remain easily accessible, to facilitate compliance.

Regulations not requiring changes

14. Page 30 of the Paper sets out the regulations that the Ministry considers do not require changes. The Law Society agrees that the regulations identified do not require any technical changes, although observes that if the proposed amalgamation of the existing 6 regulations into one (supported by the Law Society) proceeds, it would be a useful opportunity to streamline and reorganise the regulations - for example, by removing reference to the now-repealed Financial Transactions Reporting Act 1996 in exemptions regulation 24, and by ensuring that regulations that are likely to apply to similar types of activity or classes of entity are amalgamated or appear in proximity in the legislative instrument (for example definitions regulation 18A and exemptions regulation 13).

Other matters- expiry dates for regulations

15. The Law Society considers that the complete removal of expiry dates for regulations is undesirable. While accepting that the whole regime is to be reviewed in 2021, the Law Society agrees that as mentioned in the Paper at paragraph 1.2 and discussed at paragraph [7], above, in relation to stored value instruments, the pace of change in the ML/TF space makes it desirable to ensure that regular reviews continue to take place beyond that horizon. Again, for the sake of providing certainty and facilitating compliance by reporting entities, the Law Society favours regulatory solutions over semi-regulatory or non-regulatory solutions. Accordingly, it is the view of the Law Society that retaining expiry dates for regulations is desirable as it compels review and updating of regulations which might otherwise (through lack of resource or simple oversight) be left to "stale" over time. Ultimately, this could lead to regulations that fail to assist with achieving the purposes set out in section 3 of the AML/CFT Act.

Other matters – structure of the AML/CFT regulations

16. The Law Society strongly supports the consolidation of the existing AML/CFT regulations into a single AML/CFT regulation. The Law Society considers that there is no good justification for various aspects of the AML/CFT regime to be dealt with in discrete regulations, and the present situation often requires reporting entities and their advisers to refer to multiple different legislative instruments in order to understand the regime. This is unnecessarily time consuming and confusing and increases the risk of inadvertent non-compliance.

17. The Law Society also notes that the rapid evolution of the AML/CFT regulations as Government and regulators adjust to and optimise New Zealand's AML/CFT regime means that the regulations as set out on the New Zealand Government legislation website are frequently out of date. This obliges reporting entities and their advisers to conduct a "treasure hunt" through the various amending instruments in order to ensure a correct understanding of the regime. The Law Society is concerned that the combination of the inherent complexity of the regime, the fact that much of the substance of the regime is, almost uniquely, contained in regulations rather the AML/CFT Act itself and that many persons needing to understand the Act are either not legal professionals or, if they are, are not subject matter experts, creates a unique challenge. Although it is outside the scope of the Paper, it is therefore submitted that resource needs to be dedicated to having a coherent set of regulations to the AML/CFT Act that are available at all times. These should be as complete and correct as reasonably practicable – perhaps aiming to have updated regulations available on supervisors' websites no later than 5 working days after any amendment is made.

Further assistance

18. We trust that the Ministry will find these comments helpful. If you wish to discuss any aspect of this response, please do not hesitate to contact the Law Society through its regulatory department (via Charlotte.Walker@lawsociety.org.nz). Thank you.

Yours faithfully,

Andrew Logan
Vice President