New Zealand Law Society
Te Kāhui Ture o Aotearoa

AML/CFT industry levy – initial levy design consultation

Submission of the New Zealand Law Society Te Kāhui Ture o Aotearoa

30 May 2025

1. Introduction

1.1. The New Zealand Law Society Te Kāhui Ture o Aotearoa (**Law Society**) welcomes the opportunity to respond to the Targeted Industry Consultation document (**the Consultation Document**) regarding the initial design of a proposed industry levy to fund New Zealand's Anti Money Laundering and Countering Financing of Terrorism (**AML/CFT**) regime.

1.2. This submission sets out the feedback of the Law Society, which has also been informed by feedback received from the profession. Where views may differ, or specific feedback received by legal practitioners differs from the general nature of the feedback provided by the Law Society, that is noted. In addition, the **appendix** to this submission sets out the feedback the Law Society received from the profession. Where requested, we have enclosed full copies of the comments we received.[1]

1.3. This submission follows the following structure:

- General comments
- Feedback on the stated justification for the proposed levy
- Feedback on the assumed private benefit of the AML/CFT regime to the legal sector
- Concerns relating to application of the proposed metrics to the legal sector
- Feedback on certain questions posed in the Consultation Document (not all questions are responded to).

1.4. We acknowledge this is the first consultation on design of the proposed levy, and that further consultation and decisions will be required in respect of the amount it is intended to raise, how recovery of that amount will be distributed across the regulated sectors, and the activities the levy is intended to partially cover. We also note that the Consultation Document indicates the metrics used to design the levy, and its structure, will likely be altered in future. Our feedback is, therefore, necessarily subject to change as this work progresses. We have, though, attempted throughout to provide information on signalled future changes to the levy design. For example, the effect of broadening liability in future, whether through the introduction of a broadly applied fixed fee component, or the application of risk-based metrics.

Summary of position

1.5. In summary, the Law Society is of the view that:

- When designing the levy, it is important to have regard to the circumstances of each regulated sector. This should include consideration (and where possible, quantification) of any benefit the sector receives from the AML/CFT regime, and the compliance costs already incurred. In the case of the legal sector, there is

[1] For context, most feedback was provided by email, and most contributors preferred not to have those original emails attached.

limited direct benefit to the profession, and compliance costs met by the profession and consumers already contribute to the effective operation of the AML/CFT regime, lawyers' primary role being the reporting of suspicious activities.

- There are compelling reasons for the legal profession to be excluded from liability for the proposed levy. While the proposed levy design may work for some sectors, the proposed initial levy metrics cannot achieve a proportional and equitable levy for the legal sector.
- At a minimum, implementation of the levy for the legal profession should be paused to enable fuller information gathering and analysis, to determine whether it is possible to design an equitable and appropriately nuanced levy for the legal sector, without increasing administrative and compliance burden.

2. General comments

2.1. The Law Society recognises the importance of an effective regulatory system to support a well-functioning AML/CFT regime. However, in assessing the efficacy of the regime or designing new mechanisms, it is important to have regard to the individual attributes of the different regulated sectors. In relation to the legal sector, the nature of legal practice, the role of lawyers in society, and the extent of the interaction of the legal profession with the AML/CFT regime differs significantly to other sectors that are subject to it. These features of legal practice and the operation of the AML/CFT regime in the legal sector, are relevant to structural issues that arise when considering a levy. This context is set out below and, where relevant, throughout the submission.

2.2. There is a tension between the role and duties of lawyers in society and the inclusion of lawyers in the AML/CFT regime, primarily because the obligations of lawyers as reporting entities under the AML/CFT Act in many ways run counter to the strict duty of confidentiality which lawyers are otherwise bound to uphold, and upon which their ability to properly serve their clients significantly depends.[2]

2.3. Lawyers must comply with the fundamental obligations placed on them by section 4 of the Lawyers and Conveyancers Act 2006. They are obliged to uphold the rule of law and to facilitate the administration of justice in New Zealand. They also have overriding duties as officers of the High Court. Lawyers are members of a highly regulated profession which serves important societal functions and is not an "industry" as such. The AML/CFT regime is primarily designed for banks and other financial institutions, creating a number of difficulties for Phase 2 entities, including lawyers.

2.4. Against this background, there are compelling reasons, consistent with both Cabinet's intention to implement a levy and the design principles articulated in the Consultation Document, for the legal profession to be excluded from liability to pay an AML/CFT levy. At the very least, the legal profession should not be subject to a levy until such time as sufficient work is done to enable a targeted levy, relating only to (and relatively

[2] By way of illustration of the tension, privileged communication (as defined in section 42 of the AML/CFT Act) is between a lawyer and their client and is excluded in some key reporting and disclosing obligations.

proportionate with) the earnings and risks associated with captured activities conducted by law firms that are reporting entities for AML/CFT purposes.

2.5. As the Law Society noted during the Statutory Review of the AML/CFT regime in 2021, there is no current cost-benefit analysis of the AML/CFT regime in New Zealand, particularly as it relates to the Phase 2 entities and to differences across the regulated sectors. The Law Society would have expected that analysis to be undertaken in advance of any proposal for a levy, and certainly in advance of the design of that levy.

2.6. Quite apart from the cost of the levy itself, existing compliance costs are relevant to both proportionality and affordability. There is a substantial cost associated with compliance with the AML/CFT regime for the legal profession and, therefore, consumers of legal services. These costs have been increasing.

2.7. The Law Society's Costs of Practice Survey in 2024 showed that compliance costs associated with AML/CFT had increased by 15.2% between 2021 – 2023 alone.[3] This figure was particularly pronounced for the medium-sized firms surveyed, some of which may be liable to pay the proposed levy, if not initially then in future iterations. These firms had experienced an increase in compliance costs of almost 173%. Many respondents raised AML/CFT compliance as one of their most significant operational challenges. Around 14% of all respondents indicated that a reduced compliance burden would make the greatest difference for their business operations.

2.8. These findings are important, as they indicate that a future move to metrics other than earnings will likely capture reporting entities for which a levy will simply not be affordable. Although reform currently underway (and signalled for the future) may reduce some of that compliance burden, changes such as expanding the definition of 'designated non-financial business or profession' are likely to exacerbate it.[4] The Law Society is already aware, anecdotally, of lawyers and law firms changing the services they provide, so that they are no longer captured by the AML/CFT regime. Those who provided this feedback indicated that senior lawyers have chosen to cease practice and to leave the profession altogether due to the existing compliance burden. This has implications for the ability of individuals to obtain legal advice, as does the fact that as costs increase so, inevitably, must the costs to the public of legal services.

2.9. It is important the levy design does not have the unintended consequence of restricting access to legal services and access to justice in New Zealand, either now or in future. Another potential unintended consequence is that captured activities which are currently carried out by regulated professionals could be "driven underground" and undertaken by clients directly without advice.

---

3 Available via: https://www.lawsociety.org.nz/assets/Cost-of-practice-survey/Law-Society-Costs-of-Practice-Report.pdf

4 See clause 4(2)(b) of the Anti-Money Laundering and Countering Financing of Terrorism Bill, and the Law Society's submission on that Bill: https://www.lawsociety.org.nz/assets/Law-Reform-Submissions/AMLCFT-Amendment-Bill-28-March-25.pdf

3. General justification for the proposed levy

3.1. The Consultation Document appears to start from the premise that the "private sector" should fund part of the AML/CFT system, the implication being that it does not already do so. As set out above, the costs of compliance are significant and have increased for law firms in recent years. They include the preparation and maintenance of risk assessments and compliance programmes, staff training and vetting, the conduct of customer due diligence and fulfilling reporting obligations and arranging for regular independent audits as prescribed. That is to say, the costs of all the main activities which comprise the New Zealand AML/CFT regime are already borne by the private sector: directly by the reporting entities engaged in the activities to which they relate, and indirectly, to an extent, by their clients and customers.

3.2. The Law Society observes that as taxpayers, the private sector (both providers and consumers of legal services) already wholly funds the AML/CFT system. What is in fact proposed is that parts of the private sector that are subject to the AML/CFT regime in respect of part of their ordinary business activities and already incurring substantial compliance costs in relation to it, should contribute above and beyond the contribution they already make to the funding of the AML/CFT. This raises questions about proportionality and fairness.

3.3. The Consultation Document (at page 3) seeks to justify this on the basis that:

- A well-functioning AML/CFT system provides 'club good' benefits for the regulated sectors (while acknowledging that the system provides public good benefits for the economy and society, including risk and cost reduction enhancing consumer confidence, and protecting national and industry reputation and access to capital and international markets).
- Industry levies are appropriate where benefits, costs and risks of regulation are shared more broadly and are not readily attributable to individual entities (contrasted against user charges or fees for service, which are said to be appropriate where entities directly capture the benefits of work or services from a public agency, or costs or risks can be directly attributed to individual parties).

3.4. The Law Society respectfully observes that the Consultation Document does not define, much less quantify, these 'club good benefits.' This is important, because the concept is employed to identify a benefit derived by the regulated sectors that would justify the imposition of an industry levy to fund the AML/CFT regime. The term 'club good' appears only in one other place in the Consultation Document, in part 4 (page 20) which states:

> *It would not reflect the 'club good' nature of the benefits from a well-functioning AML/CFT system. For example, while much intelligence effort is committed to the banking sector, the risks this work addresses can arise in all other subsectors.*

3.5. The issue of 'club good benefits' is discussed further below.

4. The assumed private benefit to the legal sector

4.1. The Consultation Document and associated Cabinet materials indicate the proposed levy is founded partially on the assumption that reporting entities derive private benefit from the AML/CFT regime, in particular benefits to industry reputation and access to capital and international markets. The regime also provides public benefit, and accordingly the levy is only intended to partially recover the costs of the regime (as incurred by regulatory agencies).

4.2. The Law Society agrees that best practice for the setting of charges and levies by public bodies indicates that cost-recovery may be appropriate where a regulated entity receives direct benefit from the regulation.

4.3. The Law Society submits that applying a levy to the legal profession for AML/CFT purposes, particularly on a non-targeted basis, is inconsistent with this best practice standard. In the case of the legal sector, the compliance undertaken is primarily directed to ensuring the public benefits of the AML/CFT regime. The benefits of AML/CFT compliance activities, particularly those undertaken by the law firm reporting entities, accrue largely to the supervisors and law enforcement agencies, who receive (or are able to retrieve) intelligence from reporting entities.

4.4. Unlike other sectors, the legal sector is typically not concerned with seeking offshore capital. Many of the services provided by lawyers which are captured by the AML/CFT Act are jurisdictionally bound to New Zealand – common examples include conveyancing, the incorporation of New Zealand companies, or the establishment of trusts to hold New Zealand situs assets. Any private benefit is minimal and indirect, and reporting entities already absorb the existing (and growing) cost of compliance with a regime that is designed for financial institutions.

5. Initial metrics and fairness and equity for the legal sector

5.1. The two-limb definition of 'proportional' creates difficulties when considering law firms. The AML/CFT regime does not benefit smaller law firms to any great degree (quite the opposite), but smaller firms can create (at least theoretical) risk with conveyancing and trust establishment. Conversely, large law firms could benefit from a perception overseas that New Zealand is a low-risk jurisdiction, but the business of the large firm will often have a lower proportion of high-risk activities (acting for government and listed entities). In addition, smaller firms will not have the same resources as large firms to absorb the costs of any levy.

5.2. There is also the complexity of medium-size law firms who may operate a trust account but be low risk due to their main activities (such as advice and advocacy in relation to employment, environment, family, commercial or construction matters). Such firms would most likely bear a disproportionate levy burden if the levy was based on financial scale alone. There are also medium-size law firms which have a significant conveyancing or trust/entity establishment and maintenance component to their business.

5.3. None of this nuance can be accommodated by the proposed initial levy design. Further consideration is needed to establish what is appropriately proportional given the complex and diverse nature of law firms. Financial scale may be an appropriate starting point, but there must be reasonable metrics for adjustment from there, and far greater nuance is required if a levy is to be applied to the legal sector.

Inclusion of non-AML/CFT related earnings

5.4. The financial scale metric proposed for the initial levy, while simple and verifiable, raises particular issues of horizontal inequity in the case of law firm reporting entities. This is because the Consultation Document makes clear that the metric of financial scale – based on earnings – will not differentiate between earnings that are AML/CFT related, and those that are not.

5.5. It is not clear what the spread of liable law firm reporting entities will look like, but it seems likely the levy could apply (at least initially) to only a small group of large law firms. What "large" means in this context is not entirely clear. Few (if any) of the large law firms likely to be captured by the levy threshold will be undertaking solely captured activities. The Consultation Document identifies this when considering the setting of different earnings thresholds, noting that for entities in sectors like banking, remittance and forex services, most activity is AML/CFT-related.[5] This is not the case for law firms. More so than for other sectors, an earnings-based metric means the levy will be calculated on law firm earnings unrelated to the AML/CFT regime. It will also fail to account for differences across law firm reporting entities who are of similar financial scale but undertake different volumes of AML/CFT related work. This means that not only will there be precision and proportionality issues compared to other sectors, but also *within* the sector.

5.6. Similar concerns have been raised within the jurisdictions considered by the Ministry. In England and Wales, the Solicitors Regulation Authority (one of the AML/CFT supervisors) noted in 2020 that Economic Crime Levy should be applied on a risk-based approach, but accepted in the interim a revenue based calculation applied 'ideally only of activity that is in scope.'[6] Similarly, the Law Council of Australia raised that the AUSTRAC levy methodology creates a 'potential disconnect between the amount of the industry contribution levy payable and the relative significance of the provision of designated services to a reporting entity's business operations.' The Law Council submitted:

> *Under the current arrangements, leviable entities with a large revenue base, of which only a small fraction may in fact derived from designated services, are required to make a financial contribution to the funding of AUSTRAC's operations which is significant, yet may be disproportionate to the designated services they provide (which may be limited in their scope and nature)… the Industry Contribution Act should be amended to narrow the definition of "earnings" in the*

5 Page 28.

6 Solicitors Regulation Authority (10 December 2020), Submission on Economic Crime Levy, at 6. Law Council of Australia (4 July 2024), Submission on *Reforming Australia's anti-money laundering and counter-terrorism financing regime*, at 47.

AUSTRAC annual determination to only cover earnings which are derived from the provision of designated services.

5.7. Although the decision taken in Australia, and England and Wales, was that it was too difficult to target the levy in this way, the Law Society is of the view that efforts should be made to identify what information, and processes would be required to effect this in New Zealand. Those other jurisdictions have significantly larger legal sectors than in New Zealand, and it may be that the reduced scale here would make the additional work of differentiating AML/CFT and non-AML/CFT related earnings more feasible. Equally, it may be determined that it is not feasible to identify and monitor with any certainty what proportion of earnings in a year is attributable to captured activities (at least without imposing significant additional cost on law firms). Either way, such an exercise is appropriate to determine whether the levy can be more fairly and effectively imposed on the legal sector.

5.8. To illustrate the point, during this consultation the Law Society received information from law firms indicating the approximate percentage of their fees which were derived from captured activities. This ranged from:

- 20% of total fee revenue.
- A maximum of 35% of *matters* include activities that are captured, but this figure likely also includes work that is non-captured.
- A maximum of 40% of matters opened for captured activities,

In all cases, captured activities represented less than half of all opened matters or fee revenue.

6. Response to selected questions in Consultation Document

Theme 1: Levy Design Principles

What is your view of the proposed levy design principles?

6.1. The Law Society agrees with the proposed levy design principles, and supports in particular the principles that the levy should be proportional and equitable, as well as cost effective and efficient. Our concerns relate to whether those principles can be achieved, for the legal sector, in the preferred initial approach outlined in the Consultation Document, and to the potential unintended consequences of imposing a levy on the legal sector, particularly having regard to the consequent impact on the accessibility of key legal services and impact on consumers with the associated flow-on effects.

Where trade-offs and tensions arise between the principles, do you have views on how the principles should be prioritised or reconciled?

6.2. The Law Society considers that proportionality and equity should be prioritised where there is conflict between design principles.

6.3. The Law Society considers that a fifth principle, "non-distortion", should form part of the levy design as applied to phase 2 entities, and particularly law firms. It is submitted that although regulatory regimes are by definition intended to influence behaviours, that influence should be direct, deliberate and consistent with the stated purpose of the regulatory regime, not the indirect result of factors that are secondary to a regulatory regime – such as a levy to fund it.

6.4. While it could be argued that this is a subset of current proposed principle (d) (avoid unintended consequences), and potentially covered to a limited extent by the expressed concern that the levy design not incentivise businesses to "game" business structures and practices to minimise their levy liabilities, the Law Society considers this does not fully address the issue. As set out above, the Law Society is already anecdotally aware of lawyers and law firms that have changed the services they provide (put another way, reduced the scope of legal services available to the public) to avoid capture by the AML/CFT Act. This is not done to "game" the system, but is a pragmatic response to an increasingly unsustainable compliance burden with little or no direct benefit to the subject lawyers and firms, as set out above. While this may be partially answered by the proposed exclusion of smaller firms and practices from the levy, the Law Society considers that this issue should be specifically considered in the levy design process, now and in future.

Theme 2: Options for levy metrics

Do you agree that a measure of financial scale should be the primary base for calculating reporting entities' AML/CFT industry levy liabilities?

6.5. As a starting point, yes. The Law Society acknowledges that a measure of financial scale may be more indicative of affordability, which is important given the profile of law practices in New Zealand. However, we reiterate our concern about the propriety of including non-AML/CFT related earnings in that metric, and the need for greater nuance in respect of the legal sector.

6.6. The proposed levy metric of financial scale (at least initially) combined with the threshold for levy liability, does mean that larger law firms will bear the full burden of meeting the costs intended to be recovered from the legal sector. As noted above, this outcome is particularly inappropriate given the majority of their revenue does not relate to captured activities.

6.7. Pending the provision of further detail in future, we signal at this point in the process that we do not agree that Inland Revenue should be used for information collection.

What risks or undesirable behavioural responses may arise if the levy includes a transaction reporting component, and how might these be mitigated?

6.8. We consider it unlikely that metrics based on PTRs would incentivise non-compliance within the legal profession on any significant scale. The legal profession is highly regulated in terms of conduct, and lawyers largely seek to comply with legal obligations. That is, deliberate non-compliance with legal obligations could have wider implications for a lawyer than penalties under the AML/CFT regime.

6.9. We consider that adding a levy component based on PTRs could assist in improving proportionality in some regulated sectors, on the basis that such a component could assist in ensuring that an entity's liability for a levy bears some relationship to the entity's level of activity potentially presenting AML/CFT risk. However, the Law Society again emphasises the need to observe a design principle of "non-distortion" in relation to phase 2 entities, and the lack of direct benefit from the AML/CFT regime to law firms in particular. We reiterate our view that more information about the effects on law firms and other Phase 2 entities, including cost-benefit analysis of the AML/CFT regime on Phase 2 entities, is required before a levy is imposed.

In principle, should levies be based in part on measures of subsectors' AML/CFT risks?

6.10. In principle, yes. However, this must involve more regular, transparent, and consultative processes for analysing sectoral and national risks. Feedback from the profession indicates concern with how robust these assessments currently are, including: the breadth and reliability of information relied upon; the reasoning employed in the assessment; a lack of transparency around how sectoral risk is objectively assessed; and limited opportunity for regulated sectors to openly engage on that assessment before it is finalised.

6.11. In practice, a risk metric would be difficult to achieve (and to achieve fairly) as there are reporting entities within subsectors that have vastly different risk profiles. A law firm without a trust account has a very different risk profile to a law firm which specialises in trust/entity formation.

What is your view of our proposal that the initial AML/CFT industry levy design should not include:

- *Measures of the relative AML/CFT risk of different sectors or types of reporting entity*
- *Measures of agencies' costs in relation to different sectors or types of reporting entity*
- *A base charge to be paid by all but the smallest reporting entities? Are there other options/metrics available to better align individual reporting entities' levy liabilities with the AML/CFT risks and costs associated with their activities?*

6.12. The Law Society agrees the levy should not initially include a base charge, for the reasons identified in the Consultation Document. However, not all members of the profession agree with this, and below (at section 7) we outline one suggestion received regarding imposition of a low flat fee.

6.13. The Law Society observes that (as the Consultation Document indicates) there is currently insufficient information available to properly target a levy to relative sectoral risk, and to relative sectoral cost (the latter in part due to ongoing structural reform of the regulatory system, such that measures of regulatory agencies' current costs are not considered a suitable basis for the apportionment of a levy between either entities or regulated subsectors). This suggests the imposition of a levy at present is to "put the cart before the horse". It is submitted that attempting to design a levy to recover costs associated with regulatory activities intended to mitigate risk before establishing a complete understanding of what those costs or (relative) risks actually are or will be, is arbitrary, and therefore difficult to justify.

6.14. The Law Society further observes that one of the reasons given for why agencies' current costs are not considered a suitable basis for apportionment of a levy between entities or subsectors is that "*[i]t would not reflect the 'club good' nature of the benefits from a well-functioning AML/CFT system. For example, while much intelligence effort is committed to the banking sector, the risk this work addresses can arise in all other subsectors."*[7]

6.15. The Consultation Document neither provides a definition of "club good", nor identifies or quantifies the supposed club good benefits arising from the AML/CFT regime. The Law Society understands the term "club good" to mean a good *"[…] where people can be excluded from its benefits at a low cost but its use by one person does not detract from its use by another, at least until the point where congestion occurs."*[8]

6.16. By that definition, the suggestion that the AML/CFT regime provides club good benefits appears misconceived. As set out above, the AML/CFT regime generally (and lawyers and law firms' compliance with it in particular) provides largely public benefits, from which it is difficult to see how (or why) people could be "excluded". A fundamental feature of the design of the AML/CFT regime is to maximise layers of customer due diligence and reporting points, to allow the creation of a broader intelligence picture. The "use" of (legislatively prescribed participation in) the AML/CFT regulatory system by one reporting entity exclusively enhances, rather than "detracts from", use by other reporting entities. It is a case of "the more users the better" and the issue of problematic "congestion" does not arise.

6.17. The Consultation Document states (at page 3) that "[*a*] *well-functioning AML/CFT system provides 'club good' benefits for the regulated sectors, and public good benefits for New Zealand's economy and society, by reducing risks and costs, enhancing consumer confidence, and protecting national and industry reputation and access to capital and international markets"*. The Law Society considers that this statement asserts some public goods, but does not identify any assumed "club good" benefits that might justify the imposition of a further compliance cost burden on reporting entities. As an aside, given the available information regarding significant and growing AML/CFT compliance costs for the legal sector as identified by the Law Society (discussed above) it is not clear how the AML/CFT regime is providing the asserted public good of "reducing…costs".

Theme 3: Structuring levy rates

Which levy structure best suits our levy principles: especially in balancing proportionality and equity with simplicity and predictability

- *fixed rate charges (entities charged in direct proportion to their scale);*
- *variable rate charges (entities charged at a diminishing marginal rate based on their scale); or*

7 Page 20, Consultation Document.
8 Page 20, Consultation Document.

- *stepped charges (entities grouped in size categories with all entities in each category charged the same dollar amount)?*

6.18. The Law Society considers that, if a levy on law firms is introduced, charging entities in direct proportion to scale is likely (at least initially) the best approach to achieving the balance sought, provided the charges are based on the scale of their regulated activities/activities that carry an AML/CFT risk. For this reason, the Law Society considers that a fixed charge based on pre-tax earnings/profits would be inappropriate, particularly for lawyers and law firms where it is likely that a substantial proportion of their activities are not regulated. The Law Society observes that in any event, pre-tax earnings/profits do not necessarily reflect the capacity of an entity to sustain added regulatory costs, in addition to the substantial costs of compliance with the AML/CFT regime they are already bearing.

6.19. In terms of proportionality, the Law Society notes that according to the National Risk Assessment 2024, on average, law firms handle $684 for every $1,000,000 handled by the banks. Any levy rate should recognise and be set with reference to this disparity.

6.20. While the Law Society agrees that a cap may be undesirable in that it risks transferring costs from entities with the largest profits/reporting activity to smaller entities, it is important that "levy creep" is avoided. The potential advantage of a fixed-sum cap is that it may provide a level of fiscal discipline, by imposing a need for a more formal review process to determine if an increased cap is justified. This may assist in preventing undue increases in compliance costs, and resulting negative impact on productive sectors and increases in costs for consumers.

Theme 4: Should any reporting entities be excluded from paying a levy?

In balancing our levy design principles, do you agree that minimum thresholds should exclude most reporting entities from levy liability?

6.21. In respect of law firm reporting entities, the Law Society agrees that minimum thresholds should exclude most reporting entities from levy liability, particularly in the early iterations of the levy which, based on the preferred approach outlined in the Consultation Document, will not be particularly detailed. The majority of law firm reporting entities are sole practitioners and small to medium firms, for which affordability may be a real issue and which, as set out above, could otherwise be distortionary and have the undesirable consequence of reducing the availability of legal services to the public.

6.22. There are many small law firms in the provinces and rural areas supplying much needed regulated activities and which do not have the profit margins to take on more liabilities. The levy may discourage small firms from undertaking certain captured activities, thus removing essential legal services from the provinces and other remote areas of the country.

6.23. We are concerned that future iterations of the levy may not include a minimum threshold, or that the threshold will be lowered in the future to expand cost recovery. We recommend that levy's empowering legislative provisions safeguard against this in

some way, whether by stipulating the threshold itself or requiring that a threshold is specified (and must be set in accordance with identified principles).

6.24. The Law Society recommends that, as a minimum, law firms which do not operate a trust account should not be subject to a levy. Such lawyers do not handle client funds, and are obliged to make an election under s 317 of the Lawyers and Conveyancers Act 2006 to provide an annual certification under section 112(2) of that Act. The AML/CFT risk associated with such law firms is low, and a levy would be an undue burden for them.

6.25. Feedback from some firms indicates there is some disagreement around excluding most reporting entities from levy liability. The reasons given for this were:

- AML/CFT compliance is complex and expensive. Smaller and medium sized reporting entities may accordingly have weaker AML/CFT compliance, and be more susceptible to non-compliance.
- Acknowledging issues of affordability, in principle all persons contributing to the AML/CFT regime's area of capture should be treated equitably and no person's business model should be subsidised by others.
- Large firms are already able to invest in compliance. They are therefore likely to receive much less benefit from the sector supervisor, than smaller exempt firms.

Would setting different pre-tax earnings thresholds for reporting entities in different sectors improve proportionality and equity of levy charges without adding undue complexity to the levy design?

6.26. Proportionality and equity of levy charges could be improved by setting different thresholds across the sectors, particularly if the levy cannot be targeted only at AML/CFT related earnings. The Law Society suggests this may be appropriate for the legal sector, if our preference for setting a levy only in respect of AML/CFT related earnings (i.e. on a properly targeted and principled basis) is not initially possible.

6.27. However, depending on levy settings, this could exacerbate inequity: it could leave an even smaller number of law firm reporting entities to pay the levy, with the payment obligation based substantially on earnings that are wholly unrelated to AML/CFT activity.

6.28. Much of this will depend on the methodology ultimately used. If the levy is set according to a figure that must be recovered, and not further broken down into figures that must be recovered from each sector, the risk will be less. However, if the figure is then allocated across sectors, an increased threshold in one sector will disproportionately affect remaining liable reporting entities in that sector. Increasing the threshold for some reporting entities in certain sectors will only improve proportionality and equity where the impact of that reduced pool of entities is borne by all sectors.

Are there classes of reporting entity that should be explicitly excluded from any liability to pay a levy? On what grounds?

6.29. For the reasons set out above, the Law Society considers that all law firms should be excluded from liability to pay such a levy. These reasons are particularly compelling for law firms that do not operate trust accounts, and which provide an annual certification under section 112(2) of the Act.

7. Recommendations and alternative options for the legal sector

7.1. The Law Society is of the view that the levy should not apply to the legal sector.

7.2. However, if it does proceed for the legal sector, we urge the Ministry to delay implementation, so that further work can be carried out to address the unique circumstances of the legal sector (as outlined above). This should include:

- A more specific, comprehensive analysis of the legal sector, including the structure and operation of law practices, the nature of its captured activities, and the comparative risk.
- How levy metrics can then take account of the comparatively lower risk of the legal sector as a whole, the likely significant proportion of non-AML/CFT related earnings that will be captured, and the potential impact on the availability of legal services (alongside the unintended consequences of clients completing transactions without legal advice).
- How a more nuanced calculation can ensure affordability, while not disproportionately placing the full burden of the legal sector's cost recovery on a handful of large firms.

7.3. Whether the levy can be fairly achieved in the legal sector, without so much work as to render the effort disproportionate, must also be considered. At present, the proposed design appears to have been developed with the banking and finance sector in mind.

7.4. We reiterate again that these comments are provided based on the limited information to hand. The provision of even indicative information about how much is to be recovered via the levy, the likely amount of the levy, and whether sectors will be expected to recover a specific proportion of that figure (and what that proportion would be), would have assisted and may have altered some of this feedback. Further, the gathering of relevant information about reporting entities will take place *after* this consultation and the Ministry's design work. That seems a questionable approach if the design is truly to comply with the specified design principles.

Alternative options provided by those who gave feedback to the Law Society

7.5. We received suggestions from some members of the profession for alternative approaches to the design of the levy, insofar as it relates to the legal sector. This feedback is set out below.

The threshold for levy liability

7.6. On where the threshold for the levy should be set, the Law Society received suggestions ranging from around $30 million, through to $100 million (in alignment with the Australian regime), so as to exempt all but the very largest of law firms.

Use of Prescribed Transaction Reports (PTRs) as the primary metric

7.7. It was suggested that for law firms, a levy based on PTRs is the most practical, equitable and transparent approach. PTRs are reported to the FIU and are an existing dataset of information relating to law firm activity that is 100% captured by the AML/CFT regime. Focussing on PTRs may also be a good proxy for providing relief to smaller firms that have a largely domestic business. Even though they would still be cross-subsidised by larger firms through this levy mechanism, it would be more palatable because at least the mechanism is based on an area of activity that is 100% captured and is also an area of higher vulnerability to money laundering.

7.8. A levy based on PTR activity should also be able to be crafted in a way that allows firms to treat it as a disbursement that can be passed on to those clients actually engaging in activity leading to the filing of PTRs, rather than having to treat the levy as a general overhead passed on across all clients. This would make the levy more equitable to the client base as a whole.

7.9. Separately, it was noted that, as PTR charges will be passed on to the client, it may make smaller overseas payments uneconomic. Such payments are quite common where there is a bequest in an estate left, for example, to overseas grandchildren. A de minimum threshold for any PTR based levy component would be appropriate, set relatively high and in alignment with the Australian levy.

Use of a flat fee as part of the levy

7.10. For those concerned about the impact on larger firms (set out at paras 5.5 and 6.6 above) and of the view that all reporting entities should contribute if a levy is imposed, it was suggested that low flat fee payable by all reporting entities could be a component of the levy.

7.11. Such a fee could be payable by all reporting entities at the time of filing their annual report with the Supervisor. It would be set at a low rate and affordable, would be simple to administer, consistent with other levy regimes, and also provide a predictable base level of funds recovered via the levy.

Payment of fee by banking sector

7.12. It was suggested that the funding of the regulator should be met by Government, as the AML/CFT regime is set up by them for the benefit of the country as a whole. However, if a levy is to be rendered, it should simply be a levy against the banking and finance sector. This was suggested as there are significant complexities in establishing a fair levy to render against law firms and other Phase 2 entities, and because all payments made by law firms and other Phase 2 entities that relate to captured activities run through the banking system in any event.

8. Next steps

8.1. As noted above, the Law Society is of the view that significantly more work is needed on the design and settings of the levy. The views and the experiences of the legal profession are critical to this, and we urge further engagement.

8.2. In the meantime, we would be happy to meet with you to discuss this further, or to answer additional questions. You can contact us via Aimee Bryant, Manager Law Reform and Advocacy (aimee.bryant@lawsociety.org.nz).

Nāku noa, nā

David Campbell
Vice President

Appendix One: Feedback received from the profession

Levy is not supported by the sector / is not justified	All but a couple of submissions made to the Law Society explicitly stated opposition to the levy.
	The current reform programme proposes to reduce the compliance burden associated with AML/CFT compliance. If the regulatory burden is reduced, then the cost of compliance should be correspondingly reduced. This includes the cost of monitoring compliance by the DIA
	AML/CFT is not a voluntary regime: it is mandatory. It is linked to organised crime, including international organised crime. The cost of investigating and enforcing crime is, and should be, borne by taxpayers as it is a core function of any government. The Cabinet Paper acknowledges that the criminal justice component will remain Crown-funded, but some feedback did not agree there is separation between the industry regulation and the criminal justice component. The industry regulation allows the criminal justice process, and so the funding for both should remain with the Crown.
Existing compliance burden goes against imposition of a levy	AML/CFT compliance is already 'extremely expensive' and is disproportionately so for sole practitioners. Irrespective of the number of transactions conducted in a year that are captured by the AML/CFT regime, a lawyer must have a full compliance system with periodic audits. This would be the case even if the practitioner conducted only 1 or 2 captured matters in a year.
	Regular amendment to the regime necessitates further expenditure on reviewing and implementing changes.
	The costs and complexity of AML/CFT have pushed many small law firms out of transactions they would have previously been involved in.
Unsuitability of proposal for legal sector	Proposals that link a levy to gross income or EBIT or similar will be unfair/difficult if only part of the business carries out AMLCFT.
	The National Risk Assessment (NRA) states that, for the 6 years from the start of Jan 2018 to the end of Dec 2023, only 614 SARs were reported and only 6 formal warnings given - this is from a total of 1292 entities. Lawyers and conveyancers therefore take up very little resource and this should be reflected in any levies to be imposed.
	The NRA is not particularly detailed in respect of the legal sector, noting that the most recent iteration states law firms remain at the same level of risk previously, given they

	'feature' in investigations. It then goes on to report the small numbers noted above. It was noted the NRA is also flawed in its logic as it states, on an apparently positive note, that: "Reporting indicates that the requirement to produce source of wealth documentation appears to be dissuading some criminals from exploiting this sector to launder criminal proceeds". Source of wealth is only typically required to be considered when a trust entity triggers the enhanced due diligence regime by the reporting entity and is therefore the exception. Could not the reason be that the assumed level of offending via lawyers is minimal in the first instance?
	Much of the AML/CFT regime, particularly those parts that relate to discretionary family trusts, clearly misunderstand the nature of trusts and are at odds with trust law obligations. The AML/CFT regime assumes no fiduciary duties and that appointers and beneficiaries have control, which is not the case.
Assumed private benefit for lawyers	It is encouraging to see a sole regulator for the industry. However, it should be funded by the Crown. The Cabinet Paper (para 55) says, "*The AML/CFT regime is predominantly Crown funded, but it not a pure public good*". This is the subject of disagreement. The entire reasoning behind the legislation is for New Zealand to comply with its international FATF obligations – that is entirely a public good.
	If the levy charges banks based on turnover, as well as other regulated sectors such as large law firms, accounting firms, real estate businesses, car dealers etc., customers effectively bear the burden of repeated charges for the same funds. All transactions go through the banking sector. It may be more appropriate to simply levy banks, which can more readily build the costs into their bank fees. Society as a whole then bears the partial cost, reflecting that the AML/CFT regime is intended primarily as a public good.
Likely impact of levy	It is a given that regulation in any sector increases the production cost of that sector because regulatory compliance adds both labour and other external costs to a business. Those costs are then passed on to clients/customers. It is also well-publicised that the costs for running a law firm have increased markedly over recent years, most of which comes from the AML/CFT legislation.

	Lawyers and law firms go to some lengths to avoid triggering AML obligations on the firm. A levy is likely to increase avoidance of captured activities, and reduce the provision of services.
	While the proposed initial design of the levy indicates [firm submitter] would not be captured, if this is to change in future then serious consideration would need to be given as to whether continuing to provide these services.
	Recovery of levy cost from clients will not be sufficient to warrant continued provision of captured activities – the additional time and effort is not worth it.
	If the proposals are introduced, law firm businesses will end up paying twice for the entire regime: Once through tax, and secondly through the levy. That cannot improve access to justice and is contrary to the concerns raised by the Law Society in its Costs of Practice Survey.
Insufficient evidence to indicate efficacy of the regime, such that a levy is justifiable	The AML/CFT regime is a blunt tool, and in the case of the legal sector there are strong doubts about the extent to which it would enable the identification of significant ML or CFT risk.
	The regime itself has been imposed on New Zealand, and rather than investing in detection and investigation of ML and terrorism, it begins from an assumption that everyone is guilty and must prove the origin of their funds. The client then has to pay more for legal services as a result of the regulatory regime.
	It was noted by a practitioner that all funds received in their last 30+ years of practice have originated via the client's holdings in registered banks which already have far more sophisticated systems, infrastructure and resources than a sole practitioner.
Additional comments	The consultation document – and levy design – appears aimed at the banking sector, and not DNFBPs.
	Concern as to what the levy will pay for, and the likelihood it will not correlate to greater assistance for reporting entities.
	Regulatory reform under Workstream 1 of the reform programme is welcomed (though it remains to be seen what a 'low risk trust' is).