

10 May 2024

Hon Nicole McKee
Associate Minister of Justice

By email: N.McKee@ministers.govt.nz

CC: p.goldsmith@ministers.govt.nz

Tēnā koe, Minister

Re: Lawyers' compliance obligations under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (AML/CFT Act) and regulations

I am writing to raise with you the ongoing impact of AML/CFT compliance on the legal profession, and to urge prioritisation of reform in this area.

The Law Society regularly receives feedback from lawyers who are struggling to meet their obligations under the AML/CFT Act and regulations, both from a practical and resource perspective. While we agree that some level of AML/CFT compliance is appropriate for lawyers, we believe this should be achieved through a risk-based regime (as was originally intended), which imposes the minimum necessary compliance burden and cost.

The 2021 Statutory Review

In the 2021 statutory review of the AML/CFT Act, the Law Society outlined the experience of lawyers since implementation of the regime, and recommended the review consider where obligations can be appropriately reduced. Our submission noted:

We recognise the importance of an effective regulatory system to support a well-functioning AML/CFT regime and the role that lawyers have in preventing the harms that result from the targeted conduct. However, lawyers are concerned that, whilst the purposes of the Act are understood, the compliance cost and burden that the Act has introduced is, for many practitioners, disproportionate to the risk posed by their activities. The feedback the Law Society has received from many lawyers is that implementing and complying with this regime is perhaps the most difficult thing they have had to cope with during their careers. For some it is prompting early retirement. These lawyers consider they do not have the time, resource, or necessarily the expertise, to meet this compliance burden. They are concerned that the costs are disproportionate to the risks inherent in their business and their client base. We consider the regime needs to balance these compliance costs with the risks relating to lawyers, especially sole practitioners or small legal practices.

To our knowledge, there is no current detailed cost/benefit analysis of the regime. In 2016, the Ministry of Justice obtained a 'Business Compliance Impacts' report in advance of the Phase 2

reforms. At that time, it was difficult to quantify compliance costs, just as it was difficult to quantify the benefits of implementing Phase 2 of the scheme.

The Law Society recommended that such work be undertaken as a part of the Statutory Review. While that does not appear to have been done, the need remains. We have received feedback from lawyers that while the cost of compliance is significant for both lawyers and clients, the prescriptive 'tick box', form-driven regime seems unlikely to capture any serious fraudulent or money laundering conduct, nor the funding of terrorism.

Recent research on operational challenges facing lawyers

The Law Society recently released a report on the costs of running a legal practice in New Zealand.¹ This report, prepared by KPMG, used the financial data of over 100 practices to identify the operational costs and challenges associated with running a legal practice in New Zealand over the past three years. Lawyers have not been immune to recent financial pressures. In the last three years alone, the cost of running a legal practice has increased by 15.3% *each year*.

The majority of legal practices are small businesses. For sole practitioners, and small – medium law firms, AML/CFT compliance was raised as a significant operational challenge. AML/CFT costs for sole practitioners increased by 35.4% over the last three years. That figure was 22.9% for small firms, and 172.9% for medium firms.

Around 14% of respondents indicated that a reduced compliance burden would make the greatest difference for their business operations. Of these, the majority of comments related to AML/CFT. Comments raised the following themes:

- Compliance is onerous, particularly in completing annual audit reports, external audits, reporting money transfers, and trying to understand the complicated language used by the DIA and external auditors.
- Compliance is costly and time consuming, but not necessarily relevant to the risk profile of the practice and its work.
- Outsourcing of AML/CFT compliance, potentially at a higher cost, has become necessary.
- Some practitioners are changing the type of work they do to reduce AML/CFT compliance obligations.
- Overwhelmingly, respondents sought a reduction or simplification of AML/CFT obligations, and the provision of more guidance and templates. They did not suggest the regime should not capture the legal profession.

An additional concern is that the time spent on AML/CFT compliance, including when this work must be outsourced, typically attracts a cost for clients. While cognisant of the fact that this increases the cost of legal advice and representation, it simply is not a cost that the profession is able to absorb. This has implications for access to justice. Unnecessary duplication also has a flow on effect for commerce, impacting on consumers of legal services.

¹ The full report is available on our website: <https://www.lawsociety.org.nz/assets/Cost-of-practice-survey/Law-Society-Costs-of-Practice-Report.pdf>

Key challenges

The overall concern for the legal profession is the cost and time involved with compliance (both initially and on an on-going basis), and whether this is proportionate to the actual AML/CFT risks inherent in their businesses. A significant issue is that the regime is not 'fit for purpose', and the regime/supervisor approach is not tailored to the realities and requirements of legal practice.

There are some specific areas where reform could offer significant relief, while maintaining the integrity of the regime:

- **Customer Due Diligence (CDD):** The time, cost and resource involved in collecting information from clients, (particularly in circumstances where there may be multiple reporting entities in a single transaction, all of whom may be required to perform CDD on the client), often seems disproportionate to the real risk posed by any client or transaction and difficult to justify. For example, in a real estate transaction, a person selling and buying a home may be subject to three or more CDD reviews:
 - Real estate agent
 - Bank or other lender(s)
 - Lawyer
 - Accountant
- **Sharing of CDD information:** The Law Society considers lawyers should be able to rely on CDD conducted by other New Zealand reporting entities (particularly 'Phase 1' entities, such as banks) without being required to duplicate or to verify the process or information.
- **Access to verified information:** In addition to reliance on CDD completed by other New Zealand reporting entities, reliance on verified information held on Government registries (such as Companies Office records) would help to reduce compliance burden. Beneficial ownership should be recorded.
- **Enhanced CDD on trusts,** particularly source of wealth information on family trusts, can be complex and, at times, virtually impossible. The Law Society encourages consideration of whether there are circumstances in which it is appropriate for there to be an exemption from this requirement, for example where funds are clearly already within the New Zealand financial system, at an entity such as a bank, or where the family trust holds only the family home.
- Overall, the AML/CFT Act and regulations are too prescriptive for a regime that intends to operate in a risk-based manner, and which covers a range of reporting entities with varying levels of risk.

Engagement with the Ministry of Justice

We recently approached the Ministry of Justice to understand whether any policy work or legislative change is anticipated. It is clear we share similar views on changes required, immediately and in the longer-term. We support the view that reform should be prioritised now.

We would be very happy to discuss this with you further, and gather further information from the profession, if that would assist. You can contact me via Bronwyn Jones, General Manager Policy, Courts and Government (bronwyn.jones@lawsociety.org.nz).

Nāku noa, nā

A handwritten signature in black ink that reads "Frazer Barton". The signature is written in a cursive, flowing style.

Frazer Barton
President