

Anti-money laundering liability

Are you protected?



The risk

The introduction of the anti-money laundering and counter financing of terrorism (**AML/CFT**) regime has brought about a seismic change in the way lawyers run their practices.

The AML/CFT Act is complex. NZLS has commented that there is 'much confusion' about the nature and extent of a law firm's obligations. This stems from:

- The legislation was designed for financial institutions and then re-purposed for lawyers and other professionals. Some of the obligations are not easily applicable to law practices.
- The Act takes a risk based, principled approach rather than a prescriptive approach. It is necessary to refer to a host of other regulations, codes of practice, ministerial exemptions and guidance notes to determine how to apply the obligations in practice.
- Even then, businesses are given significant discretion as to how to comply with the Act, which leaves plenty of room for differing interpretations on what is required. There is certainly no one size fits all approach. What works for one legal practice may give rise to non-compliance in another.

The Department of Internal Affairs has indicated a willingness to work with lawyers to assist them in complying with their AML/CFT obligations, and to assist reporting entities who are trying to comply.

But it has also said it will use the full force of the law on reporting entities that refuse to comply.

In the few cases that have come before the courts so far, the judiciary has indicated that it will *'deal sternly with non-compliance'* to safeguard New Zealand's reputation for anti-corruption and financial transparency. This has included, in one case, an award of civil penalties of over \$5 million. In other cases, criminal liability has been established.

Insurance protection

In this environment, insurance cover against AML/CFT liability and defence costs is as essential for lawyers as traditional professional indemnity cover. However, you may need to make changes to your insurance programme to ensure you have this protection. Most insurers do not provide AML/CFT cover under traditional professional indemnity insurance so it is important for lawyers to understand whether they have this cover, and if not, how to obtain it.

Justitia offers AML/CFT insurance protection under its companion statutory liability policy. However, there are many legal practices who have not yet purchased this cover. We recommend you talk to your broker about your AML/CFT risks and whether you need to refresh your insurance programme to ensure you are protected.

Ten things lawyers need to know about the AML/CFT regime

1. **Template forms:** Helpfully, NZLS has put together a suite of resources, including template forms for lawyers to use when establishing their compliance programme. However, these should be used with appropriate caution. Using the NZLS AML/CFT templates does not guarantee compliance. Anecdotally, the DIA have already found non-compliance in cases where the templates have been used. Every law practice has to assess the risks specific to its business and its customers, which are unlikely to fall neatly into template form.

2. **Don't set and forget:** The Act specifically requires ongoing monitoring and assessment of AML/CFT risks. It is not enough to simply 'set and forget' your AML/CFT programme. As well as obligations to conduct ongoing customer due diligence and account monitoring on existing clients, there is a requirement to update risk assessments whenever there is a material change to the business, its service offerings, customer base, or if deficiencies are identified. It is good practice to review your risk assessment at least annually.
3. **Delayed CDD:** In the vast majority of cases, customer due diligence (**CDD**) has to be done before you start legal work. The circumstances where you can delay customer due diligence are extremely limited and should be carefully documented, for example, by using the NZLS delayed CDD form. Even then, you must do your CDD before the legal matter is finalised, for example, before you issue a legal opinion. Some law firms have reprogrammed their systems so it is impossible to open a new client matter until CDD has been completed.
4. **Existing clients:** You may be aware of the exemption for CDD in relation to existing clients that you had a relationship with before July 2018. But did you know that this only applies if there is no material change in the nature of the instructions or the risk? The DIA is likely to consider even relatively minor changes in the nature of the work you are doing for existing clients to be material, which will trigger CDD obligations. For example, this could be if the funds are coming from somewhere different than on previous matters, or if the transaction has a larger dollar value. In practice, CDD should be carried out on all existing clients over time.
5. **Captured activities:** Although a client instruction may not appear to be a 'captured activity' at the outset, often instructions can evolve into something that does come within the ambit of the Act. For example, it can be hard to pinpoint exactly when providing advice to a client on the best way to structure a company crosses over into engaging in creating or operating a company. Many lawyers are taking the approach of carrying out CDD for all new clients to avoid difficult decisions as to whether an activity is captured or not.
6. **Training:** The Act requires each law practice to carry out training for its senior managers and employees so that everyone understands their AML/CFT obligations. Do you have a training programme in place? How often will you update or repeat it? Does it cover new staff?
7. **Trusts:** Enhanced CDD has to be conducted where the client is a trust. There are different requirements for discretionary and non-charitable trusts. Lawyers specialising in trusts work should be across these requirements but there are potential pitfalls for lawyers who only carry out occasional trusts work.
8. **Record keeping is crucial:** NZLS advises lawyers to keep file notes of the reasons for decisions made in relation to AML/CFT matters, such as a decision not to do CDD or not to make a suspicious activity report. It will be much easier to establish compliance if you have a contemporaneous note to demonstrate AML/CFT processes have been followed. Many firms set up a separate folder within each client matter to record CDD status, even if none is required.
9. **External assistance is available:** Many firms are looking at outsourcing the client ID verification process to specialist providers who have access to reliable and verified data sources. There are also a number of AML/CFT consultants operating in the market. However, engaging external support only works if the law firm is sufficiently engaged in the process to ensure the consultant fully understands the nature of the practice, client base and risk so that a fully tailored programme is established. Compliance is never guaranteed.
10. **Technology can help:** Is your software configured to enable easy annual reporting to DIA and for external audits? There are increasing numbers of technology companies offering 'RegTech' solutions to assist in managing compliance obligations, including AML/CFT compliance.