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HUNG OUT TO DRY: REGULATORY CONCERNS ABOUT IMPOSING ANTI-MONEY LAUNDERING OBLIGATIONS ON LEGAL PROFESSIONALS

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Table of Contents

Table of Contents **2**
I Introduction **4**
A Questions Underlying the Discussion 5
B What is Money Laundering? 5
C The Fight Against Money Laundering 7
1 FATF 8
a) Compelling compliance 9
2 Criticisms of FATF 10
a) Hegemonic capture 11
b) Democratic deficit 11
c) Normativity 12
D FATF's Regulatory Regime 12
1 What is 'risk-based' regulation? 12
2 How is FATF's framework risk-based 13
3 Meta-regulation 14
II New Zealand's Anti-money Laundering Regime and Phase 2 ..... **14**
A The Appetite for Risk in New Zealand Regulation 15
B Why Extend the AML Act to Legal Professionals? 17
1 The Recommendations 17
2 Vulnerability risk 18
3 International and FATF pressure 19
4 Recent pressure – Shewan Trusts Inquiry ("The Inquiry") 20
C The AML Act 21
1 Stakeholders 21
a) Reporting Entities 21
b) Supervisors 22
2 Current obligations of the legal profession 23
3 Obligations under the AML Act 24
a) Compliance obligations 24
b) Know your client obligations 25
c) Ongoing and reporting obligations 26
4 Record keeping 27
5 Enforcement and liabilities 27
D Is New Zealand's Regime Risk-Based-Meta-Regulation? 27
III Assessment of New Zealand's Regime and the Appropriateness of Risk-Based-Meta-Regulation **31**

A *Rationales* ... 31
1 Efficiency of self-regulation ... 31
a) Economic efficiency ... 32
b) Logistical efficiency ... 32
c) Expertise ... 33
2 Externalities ... 34
3 Regulation for the public good ... 34
4 Prevention of 'free-riding' ... 36
B *Strengths* ... 37
1 Flexibility ... 37
2 Responsiveness ... 38
3 Public-private sector relationship ... 38
4 Transparency ... 39
C *Weaknesses* ... 40
1 Compliance cost ... 40
a) An absence of cost-benefit ... 41
b) Training ... 43
c) Minimising cost ... 43
2 Supervision ... 44
a) Potential Supervisors ... 45
3 Issues with privatisation ... 47
a) Clash of Objectives ... 47
b) Industrial absolutism ... 47
c) Reliance on the private sector ... 48
4 Particular ethical issues for legal professionals ... 48
a) Canadian Experience ... 50
5 Creative compliance ... 52
6 Tension between potential liabilities ... 52
IV Conclusion – What Regulatory Model Will Be Used? ... 55
V Bibliography ... 59

I Introduction

"Money laundering is a very sophisticated crime and we must be equally sophisticated."[1] – *Janet Reno*

To address the "sophisticated crime" of money laundering there are various regulatory measures a government may enact, all with varying degrees of sophistication. This paper analyses the appropriate sophistication of the Financial Action Taskforce's ("FATF") regulatory model in relation to anti-money laundering obligations in New Zealand and their extension to legal professionals. FATF is an international organisation leading the fight against money laundering and has established the global regulatory standard for anti-money laundering measures. As a core member of "FATF", New Zealand is committed to implementing its regulatory recommendations, including the application of comprehensive anti-money laundering measures to legal professionals.

This paper argues that although legal professionals should not be exempted from comprehensive anti-money laundering obligations, application of FATF's recommended risk-based-meta-regulatory model is not principled regulatory reform. Within the New Zealand context, many of the strengths and rationales behind FATF's regulatory model are inapplicable, the compliance cost on the legal profession does not appear proportionate or supported by cost-benefit analysis and issues arise around appropriate supervision as well as consistency with lawyers' ethical duties. Despite these problems, the government has proposed that legal professionals will have explicit anti-money laundering obligations by 2017.[2]

This paper uses anti-money laundering regulation as a case study to illustrate how New Zealand's international relations can have far reaching consequences for domestic regulation and business. Commitment to international organisations and a willingness to establish oneself as a desirable trading partner may, as it will likely do with the extension of anti-money laundering obligations, cause regulation to be implemented not by need or evidence but rather by reputation. This paper articulates that adopting FATF's regulatory model to extend legal professionals' anti-money laundering obligations is unprincipled and inappropriate.

1 Janet Reno (Attorney-General of the United States) "New offensive against money laundering launched" (Press conference, 23 September 1999, Washington DC).

2 Ministry of Justice "Phase 2 of the AML/CFT Act: What's happening and why" (2016) <www.justice.govt.nz>.

To give context to this argument, this paper first examines money laundering as a general concept and comprehensively describes New Zealand's anti-money laundering regime. Comprehensive understanding of New Zealand's regime is an essential foundation on which the appropriateness of its extension can be scrutinised.

A Questions Underlying the Discussion

Although this paper focusses on the particular issues arising when certain regulatory models are used to impose anti-money laundering obligations on legal professionals, some broader questions around regulatory reform underlay this discussion. Fundamentally, this paper questions the place evidence-based policy actually holds in regulatory reform. Are robust evidence and cost-benefit analysis essential cornerstones of regulatory change or are they merely factors which can be used to justify reforms but may be ignored if they fail to lend the reform support?

In the anti-money laundering context, these questions of evidence and cost-benefit are inherently tied to the influence international relations have on domestic legislation. Can regulatory reform be justified solely on the basis of international commitments, relationships and reputation? How do regulators answer this question when it is complicated by an absence of knowledge about the ramifications of compliance or non-compliance with particular international standards? This paper ultimately calls into question the degree to which it is proper to impose a particular regulatory model in absence of cost-benefit and evidentiary foundations because of international pressure. By engaging in a comprehensive analysis of the appropriateness, in theoretical and practical terms, of applying FATF's anti-money laundering regulatory model to legal professionals in New Zealand, this paper draws some preliminary conclusions to the questions posed above.

B What is Money Laundering?

Money laundering is the process whereby money generated from criminal activity, "dirty money", is transformed into money that appears to come from a legitimate source. Through money laundering, criminals distance themselves from their illegal activities. It makes it more difficult for authorities to trace the origin of criminal proceeds and hinders their ability to successfully prosecute criminals. Ultimately, money laundering enables criminals to enjoy the profits of their offending.[3]

[3] For an outline of what the New Zealand government defines money laundering as see Ministry of Justice "Key Initiatives: Money Laundering" (2016) <www.justice.govt.nz>.

Money laundering is commonly broken into three stages: placement – putting criminal proceeds into the financial system; layering – splitting the funds into various amounts and assets to hide their origin; and integration – withdrawing or realising the funds so the money reappears as legitimate.[4] However, this conceptualisation can be criticised for its rigidity. A more accurate description defines money laundering as the "exchange of one form of value to another."[5] Money laundering is not committed only by those stereotypically associated with it, for example, the cash-rich drug dealer. Money laundering is effected through various methods and can be committed by any criminal.

The harms anti-money laundering regulation seeks to remedy have been heavily discussed in literature. At a surface level these are:

- direct harms to those whose money is illicitly obtained by the launderer (i.e. through fraud, theft or tax evasion);
- legitimisation of crime by giving "economic power to criminals and tak[ing] it from the law abiding tax payer";[6]
- distorting effects on business activities, relative prices,[7] consumption,[8] investment and savings[9] as well as output and growth;[10]

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4 See Ministry of Justice, above n 2.

5 Peter Yeoh "Enhancing effectiveness of anti-money laundering laws through whistleblowing" (2014) 17(3) JMLC 327 at 329.

6 Neil Mackrell "Economic Consequences of Money Laundering" in Adam Graycar and Peter Grabosky (eds.) *Money Laundering in the 21st Century: Risks and Countermeasures* (1996 Australian Institute of Criminology, Research and Public Policy Series, Canberra) at 3.

7 Launderers are willing to pay more for particular assets if it means they can utilise their illicit profits. This may push prices up and be seen as 'unfair' competition. See John Walker "Estimates of the Extent of Money Laundering in and through Australia" (paper prepared for the Australian Transaction Reports and Analysis Centre, Queanbeyan**,** September 1995) at 33. See also Douglas Keh "Economic Reform and Criminal Finance" (1996) 2(1) Trans Org Crim 66 at 71 which illustrates how money laundering via land purchases increased relative prices of land in Colombia from $500 to $2,000 per hectare.

8 See Walker, above n 7, at 30. Here he argues that the spending choices of criminals are different to ordinary citizens. This effect is multiplied as money laundering takes spending power away from non-criminals.

9 See John McDowell "The Consequences of Money Laundering and Financial Crime, Economic Perspectives" (2001) 6(2) Elec J US Department of State; Vito Tanzi "Macroeconomic Implications of Money Laundering" in: Ernesto Ugo Savona *Responding to Money Laundering, International Perspectives* (1997, Harwood Academic Publishers, Amsterdam) 91. These papers argue that money laundering creates a misallocation of resources as capital is not invested on the basis of money returned but the ability to launder money. See further Peter Alldridge "The Moral Limits of the Crime of Money Laundering" (2002) 5 Buff Crim LR 279 at 306.

10 Economic growth can suffer if money is directed away from sound and productive investments to risky or sterile ones. See Brent Bartlett "The negative effects of money laundering on economic development" *Platypus Magazine* (Canberra, December 2002). Industries reliant on laundered money for income streams are vulnerable to the withdrawal or detection of the launders and may collapse once laundered money ceases to be invested economies. See also McDowell, above n 9.

- reduction in public sector revenues through tax evasion;[11]
- reduction of the government's ability to make sound policy decisions through the creation of errors in economic statistics and trends;[12] and
- an undermining of state authority generally by criminals infiltrating industry and institutions.[13]

An essential task of money launderers is to stay ahead of enforcement agencies and thus money laundering practices or typologies are continually changing.[14] Money laundering poses enormous difficultly to those trying to prevent and detect it, and to those trying to capture it within economic and financial statistics. No statistics on the amount of money laundered worldwide have been submitted with assurance. The International Monetary Fund is often quoted for its estimate in 1998 that money laundering accounts for between 2-5% of the world's GDP.[15] This figure received support in 2009 from the United Nations Office on Drugs and Crime who estimated laundered money accounts for 2.7% of the world's GDP, US$1.6 trillion in 2009.[16] Although it remains largely unquantified, money laundering is commonly regarded as "a significant threat to the stability of the global economy, national security and businesses around the world."[17]

C The Fight Against Money Laundering

Many transnational bodies fight money laundering. Within the United Nations various groups coordinate anti-money laundering events and information.[18] Further, its Office on Drugs and Crime carries out the Global Programme against Money-Laundering, Proceeds of Crime and the Financing of Terrorism.[19] Other non-governmental entities such as the Wolfsberg Group (thirteen of the world's largest banks developing frameworks and guidance to manage financial crime) and the Egmont Group (facilitating coordination between national Financial Intelligence

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11 Peter Quirk *Macroeconomic implications of money laundering* International Monetary Fund No 96/66 (Washington DC, 1996) at 19; Alldridge, above n 9 at 315.

12 Tanzi, above n 9 at 101.

13 Brigette Unger *The Amounts and Effects of Money Laundering* (Report for the Minister of Finance, Utrecht School of Economics, Feb 2006) at 99.

14 Yeoh, above n 5, at 329.

15 Michel Camdessus (Managing Director of the International Monetary Fund) "Money Laundering: the Importance of International Countermeasures" (Plenary Meeting of the Financial Action Task Force, 10 February 1998, Paris).

16 United Nations Office on Drugs and Crime *Estimating illicit financial flows resulting from drug trafficking and other transnational organized crimes* (Vienna, October 2011).

17 Nicholas Ryder *Money Laundering – An Endless Cycle?* (Rutledge, New York, 2012) at 2.

18 United Nations Office on Drugs and Crime "International Money-Laundering Information Network (IMoLIN)/Anti-Money-Laundering International Database (AMLID)" (2006) <www.unodc.org>.

19 United Nations Office on Drugs and Crime "Money Laundering" (2006) <www.unodc.org>.

Units) contribute to and facilitate a global response to money laundering.[20] However, the pre-eminent international body leading the fight against money laundering is FATF.

As the driving force behind money laundering regulation both in New Zealand and at a global level, FATF is focussed on in this paper. Advocates for the FATF have held that such is the threat and nature of money laundering, the regulatory response must be uniform across the globe.[21]

1 FATF

FATF was established at the G-7 Summit in 1989.[22] Since then, its mandate has expanded "to set standards and to promote effective implementation of legal, regulatory and operational measures for combating money laundering…".[23] FATF is an independent international organisation but operates out of the Organisation for Economic Cooperation and Development's offices. There are 37 core member states of FATF. However, through its global network of nine FATF-Style Regional Bodies ("FSRBs") over 190 jurisdictions have committed to implementing its standards.[24] New Zealand is a core FATF member and is a member of the Asia/Pacific FSRB.[25]

FATF provides regulatory and operational standards for member countries through its Recommendations ("the Recommendations"). The Recommendations were first published in 1990 and have evolved through reviews in 1996, 2003 and 2012.[26] They are recognised as the global anti-money laundering and counter-terrorist financing standard.[27] The Recommendations set out 40 essential measures to address money laundering including:[28]

- identification of the risks and development of policies coordinating responses against money laundering;
- creation of preventative measures against money laundering;
- establishment of powers for authorities; and

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20 The Wolfsberg Group "Global Banks: Global Standards" (2015) <www.wolfsberg-principles.com>.

21 See for example Jarrod Wiener "Money Laundering: Transnational Criminals, Globalisation and the Forces of 'Redomestication'" (1997) 1(1) JMLC 51 at 52.

22 *Economic Declaration* G-7 Summit of the Arch, Paris (1989) at [53].

23 Financial Action Task Force *International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation (updated October 2015)* (Paris, 2012) at 7.

24 Financial Action Taskforce "FATF Countries" (2016) <www.fatf-gafi.org>.

25 Asia and Pacific Group Money Laundering "Overview of APG Members" (2016) <www.apgml.org>.

26 Financial Action Task Force *Forty Recommendations* (Paris, 1990).

27 Financial Action Task Force, above n 23, at 1.

28 At 7.

- facilitation of international cooperation around anti-money laundering.

FATF differs from other similar international organisations in that it has no constituent charter or internal constitution. Thus, the Recommendations are not binding on member states. This characteristic has led commentators to call the Recommendations “soft regulations” or “soft international law”.[29] However, the FATF complements its lack of binding power by monitoring the implementation of the Recommendations through a Mutual Evaluation process and publishing a list of “noncompliant” jurisdictions. FATF also regularly publishes specific guidelines around anti-money laundering practices and behaviour. Alongside the Recommendations, these guidelines produce uniformity across global anti-money laundering regimes.[30]

Although “soft law” in status, the United Nations Security Council “strongly urges” all member states to implement the Recommendations to support FATF.[31] This works to “harden” FATF’s soft law status.[32] Similarly, the non-binding nature of the Recommendations is “hardened” through FATF’s connection to the International Monetary Fund who have incorporated FATF anti-money laundering measures into its conditionality requirements.[33]

a) Compelling compliance

Mutual Evaluations involve FATF member states assessing each other’s compliance with the Recommendations. The onus is placed on the assessed state to demonstrate that its framework against money laundering is compliant and effective.[34] Since 2013, the methodology of Mutual Evaluations has placed substantial focus on the effectiveness of anti-money laundering measures alongside technical compliance with the Recommendations.[35] Assessors seek to answer whether, in practice, the key objectives of the anti-money laundering system are being

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29 Saby Ghoshray "Compliance Covergence in FATF Rulemaking: The Conflict between Agency Capture and Soft Law" (2014) 59(3) NY LSch L Rev 521 at 528.

30 At 527.

31 *Resolution about threats to international peace and security caused by terrorist acts* SC Res 1617, UN SCOR 5244 mtg (2005) at 3.

32 James Gathii “The Financial Action Task Force and Global Administrative Law” (2010) J Prof Law at 198 at 198.

33 At 198.

34 Financial Action Task Force “Mutual Evaluations” (2016) <www.fatf-gafi.org>.

35 Financial Action Task Force *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems* (Paris, February 2013) at 15.

effectively met.[36] FSRBs assist in Mutual Evaluations and foster the development of national anti-money laundering policies which satisfy the Mutual Evaluation process.[37]

This ongoing process of evaluation and feedback affords FATF greater normative scope by ensuring anti-money laundering measures are regularly aligned with the Recommendations.[38] New Zealand's last evaluation was completed in October 2009.[39] A follow-up report was published in October 2013 after the Anti-Money Laundering and Counter Financing of Terrorism Act 2009 ("the AML Act") came into force.[40]

As well as Mutual Evaluations, the FATF engages in what is colloquially referred to as "name and shame listing" or "blacklisting" to promote compliance with the Recommendations.[41] Although this practice has been criticised as a method of "extraterritorial bullying"[42] the FAFT continues to list "high-risk" and "non-cooperative jurisdictions" to shame states into compliance with the Recommendations.[43] Financial institutions in these states are not necessarily engaging in any more money laundering activity (intentionally or otherwise) than other jurisdictions, but do not engage in anti-money laundering measures as directed by FATF.

2 *Criticisms of FATF*

Although the global standard setter for anti-money laundering policy, FATF has been criticised for developing a compliance agenda too closely aligned with the narrow interests of a minority of states. Within FATF's core 37 member states, there is an "overwhelming presence of Western market oriented economies" and "the exclusion of all but one African country".[44] This can lead to multiple issues:

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[36] At 15.

[37] Financial Action Taskforce "FATF Countries" (2016) <www.fatf-gafi.org>.

[38] Financial Action Task Force, above n 23, at 7-9.

[39] Financial Action Task Force *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – New Zealand* (Asia/Pacific Group, Paris, October 2009).

[40] Financial Action Task Force *2nd Follow-Up Report: Mutual Evaluation of New Zealand* (Asia/Pacific Group, Paris, October 2013).

[41] Michelle Gallant "Lawyers and Money Laundering Regulation: Testing the Limits of the Secrecy in Canada" (2013) available at SSRN at 5.

[42] Guy Stessens "The FAFT 'Black List' of Non-Cooperative Countries or Territories" (2001) 14 LJIL 199; Todd Doyle "Cleaning up Anti-money Laundering Strategies Current FATF Tactics Needlessly Violate International Law" (2002) 24 Hous JIntLaw 279 at 281.

[43] Financial Action Task Force "High-risk and non-cooperative jurisdictions" (2016) <www.fatf-gafi.org>.

[44] See Gathii, above n 32, at 201. All 37 core FATF member states are permanent members of the European Union (or closely affiliated) or the United Nations Security Council with the exception of: Brazil, Hong Kong, Iceland, Japan, Korea, Malaysia, Mexico, New Zealand, Singapore, South Africa, Switzerland and Turkey.

a) Hegemonic capture

Formulated by a concentrated group of predominately European and North American states, the Recommendations can be seen to embody the views of a close-knit minority of influential states.[45] Collusion within FATF means obligations are placed on jurisdictions to implement domestic regulation in line with a minority's image of the developed world.

FATF's structure only affords states within the 37-strong core membership power to participate in the formulation of FATF standards. In contrast to organisations such as the World Trade Organisation or the International Monetary Fund, where less powerful nations are offered significant opportunity to participate in agenda formulation, there is no cooperation and interaction between all FATF states. Over 150 associate member states of FATF have no influence over the rules and standards which they must implement.

The Mutual Evaluation process supports this hegemony. Countries are evaluated by those countries producing the Recommendations. This may pressure states into adopting the Recommendations without adequate domestic ratification processes or without paying suitable attention to domestic values and circumstances.[46] Rather than receive a poor Mutual Evaluation report, some states may opt to implement regulation quickly, without fully developing and considering the regime.

b) Democratic deficit

As FATF's Recommendations and policy initiatives are wholly shaped by a minority group, FATF rule-making suffers from a democratic deficit. Most jurisdictions must implement a "manufactured global standard forced upon them without having participated in its formulation."[47] Furthermore, the Recommendations are not formulated by diplomats representing their respective states, but by international civil servants working with domestic agencies.[48] Thus, the Recommendations are not only lacking democratic contribution from all interested states, but also lacking democratically accountable individuals engaging in the policy development process.

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[45] Ghoshray, above n 29, at 532.

[46] See Ben Hayes "'Policy Laundering' and the FATF: Legalising surveillance, regulating civil society" (2012) Transnational Institute and Statewatch (available online).

[47] Ghoshray, above n 29, at 535.

[48] Gathii, above n 32, at 201.

c) Normativity

Adopting anti-money laundering measures that diverge from the Recommendations is not a viable option for many states. To receive support from strong nations at the core of FATF (the European Union, United States and United Kingdom), states must subscribe to FATF's "non-binding" standards. Signatory states may be reliant on favourable trade agreements with core FATF member states and cannot afford the foreign policy consequences of opposing the conditions of a potential trade partner. Similarly, states may be seeking help from the International Monetary Fund. Any potential benefits to be gained by adopting alternative anti-money laundering measures may be subverted by the ramifications of resisting the "global standard on anti-money laundering."[49]

Through its direct ties to the International Monetary Fund, the United Nations Security Council and other powerful Western governments including the United States, European Union and the United Kingdom, individual states lack the power to challenge the utility of the regulatory regime endorsed by FATF. FATF is a pervasive, normative force despite its apparent soft-law status and the fact its agenda lacks democratic contribution. The Recommendations have transcended "from mere prescriptions on desired conduct to legitimate legal norms."[50]

D FATF's Regulatory Regime

FAFT's regulatory regime purports to be a risk-based system which compels "the state's oversight of self-regulatory arrangements."[51] This section introduces the two characteristics underlying the regulatory model set out in the Recommendations: risk-based and meta-regulation. Public sector supervision of self-regulatory arrangements has been described as meta-regulation in academic literature, appropriately labelling the transfer of regulatory responsibility that this style of regulation embodies.

1 What is 'risk-based' regulation?

Regulators are permanently pushed for time and financial resources to respond to all the issues confronting them. Risk provides a framework allowing regulators to justify their allocation of resources. Resources are prioritised and targeted through assessments of risk to the regulator's objectives. Those individuals or activities that present the highest risk to the objectives usually

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[49] Financial Action Task Force, above n 23, at 1.

[50] Ghoshray, above n 29, at 529.

[51] Bridget Hutter "Risk, Regulation, and Management" in Peter Taylor-Gooby and Jens Zinn (eds.) *Risk in Social Science* (Oxford University Press, New York, 2005) 202 at 215.

receive a greater prioritisation of scarce resources. Risk-based regulation presents a logical structure through which decisions can be understood and explained.

Scarcity of resources means that regulators, often overburdened with rules, must select which rules are to be enforced at any given time: how many resources should be expended on enforcement and monitoring?[52] Focus on risk acknowledges this fact of resource allocation and provides an open, more transparent framework in which analysis and selection can be made. Thus, risk-based frameworks principally look to control risks, rather than secure compliance with rules.[53]

Risk-based regulation can be broken down into constituent elements:[54]

1. identification of the objectives of the regulator. This is what the regulator is concerned with controlling;
2. identification of the risks to achieving those objectives that exist and which risks (and at what level) the regulator can tolerate;
3. development of a system or formula for assessing or evaluating these risks; and
4. linking the risk assessment or evaluation with the allocation of resources.

2 *How is FATF's framework risk-based*

Many commentators believe that an effective anti-money laundering regime must be risk-based.[55] FATF has openly adopted this belief. The first of the Recommendations explicitly requires risk-based concepts to be incorporated into a state's anti-money laundering measures: an authority must coordinate risk assessments and apply resources to ensure money laundering risks are mitigated effectively.[56] The Recommendations also stress that anti-money laundering measures must operate in ways which are proportionate to the risks involved.[57]

Affording risk greatest priority within the Recommendations illustrates FATF's awareness that regulation must be efficient and justify the allocation of resources. Although the Recommendations were first formulated in 1990, it took until 2003 for risk to be explicitly

52 Julia Black and Robert Baldwin "Really responsive risk-based regulation" (2010) 32(2) Law & Pol 181 at 184.
53 Robert Baldwin, Martin Cave and Martin Lodge *Understanding regulation: theory, strategy, and practice* (Oxford University Press, New York, 2012) at 281.
54 At 282.
55 Stuart Ross and Michelle Hannan "Money laundering regulation and risk-based decision-making" (2007) 10(1) JMLC 106.
56 Financial Action Task Force, above n 23, at rec 1.
57 At 31.

included. The 2003 Recommendations held that anti-money laundering measures were to be performed on "a risk sensitive basis."[58] The inclusion of risk was supported by FATF guidance attempting to establish a common understanding of what was meant by "risk" and how risk-based regulation can be operationalised.[59] The prioritisation of risk into its own Recommendation, first of the 40 in 2012 illustrates the ever-increasing significance attached to "risk" and the imperative of efficient regulation.

3 Meta-regulation

FATF's risk-based approach is unusual as risk assessments are not carried out by the regulator itself. Instead, a reporting entity's compliance (i.e. an entity to whom the anti-money laundering regime applies) depends on carrying out their own risk assessments and reporting activities which, in their judgement, are suspicious and worthy of further investigation. The "locus" of regulation is shifted to non-state actors.[60] FATF's model is meta as the regulatory authority "steers rather than rows", overseeing the risk management system rather than directly carrying out the regulation itself.[61]

With meta-regulation private companies become quasi-regulators with discretion as to how to control the mischief or harms of money laundering. A necessary consequence, explicit in the Recommendations, is that the resources allocated to anti-money laundering measures are those of private business.[62] Thus, anti-money laundering regulation "seeks to make [private companies] an essential and self-financing component of the law enforcement and regulatory processes."[63]

Publically funded resources available to the actual regulators (in the public sector) are spent on ensuring reporting entities' risk assessment frameworks and processes are adequate. Tax-payer resources are not spent directly on criminal activity but on monitoring private business.

II New Zealand's Anti-money Laundering Regime and Phase 2

New Zealand adopts FATF's risk-based-meta-regulation framework predominately through the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 ("the AML

[58] Financial Action Task Force, above n 23, at Recs 5 and 24.
[59] Financial Action Task Force *Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures* (Paris, June 2007).
[60] Christine Parker *The Open Corporation* (Cambridge University Press, Cambridge, 2002).
[61] See David Osborne and Ted Gaebler *Reinventing Government* (Addison Wesley, Boston, 1992).
[62] Financial Action Task Force, above n 8, at 31.
[63] Yeoh, above n 5, at 329.

Act"). Obligations under the AML Act became effective on 30 June 2013,[64] giving stakeholders four years "lead-in time" to develop compliance arrangements and guidance.[65] Shortly after obligations under the AML Act came into effect, the Ministry of Justice began policy development on a second phase of reform which would extend the application of the AML Act to specified non-financial businesses and professions ("Phase 2"). In August 2016 the Ministry of Justice began consulting on Phase 2 and announced that it aims to have the reforms passed by July 2017.[66] Phase 2 extends the anti-money laundering obligations in the AML Act to legal professionals.[67]

This section examines the relevant parties to and the obligations arising under the AML Act. During this examination, detail on legal professionals' additional obligations under Phase 2 will be provided. The section concludes by considering the extent to which New Zealand's anti-money laundering scheme conforms to FATF's risk-based-meta-regulation model. To give this section context, the reasons behind extending anti-money laundering obligations to legal professionals are highlighted alongside a discussion of the appetite in New Zealand for risk-based regulation generally. It is to this context this section first turns.

A The Appetite for Risk in New Zealand Regulation

Similar regulation to FATF's explicitly risk-based regime can be found in New Zealand. The Commerce Commission prioritises resources "on matters where the greatest harm exists or may occur"[68] and the Financial Markets Authority allocates monitoring and enforcement resources "to those participants and practices that present the greatest risk to fair, efficient and transparent markets".[69] Risk-based regulation advocated for by FATF corresponds with a growing trend in New Zealand for regulatory resources to be allocated in a justified manner.

This trend began during the 1980s with a global push for government administration that provided "more for less".[70] In many countries, regulation was deemed to be over-burdening business with ineffective and inefficient constraints.[71] Matching the "considerable deregulatory

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64 Anti-Money Laundering and Countering Financing of Terrorism Act 2009, s 2.
65 (13 October 2009) 658 NZPD 6956.
66 Ministry of Justice, above n 2.
67 Gareth Vaughan "Govt mulling extension of anti-money laundering laws to lawyers, accountants, real estate agents and others" *Interest.co.nz* (New Zealand, online ed, 12 August 2013).
68 Commerce Commission *Enforcement Response Guidelines* (October 2013) at 5.
69 Financial Markets Authority "Compliance" (2016) <www.fma.govt.nz>.
70 Bridget Hutter *The attractions of risk-based regulation: accounting for the emergence of risk ideas in regulation* (ESRC Centre for Analysis of Risk and Regulation, London, 20005) at 1.
71 See Daniel Yergin and Joseph Stanislaw *The Commanding Heights: The Battle for the World Economy* (Free Press, New York, 1998).

rhetoric" in the United Kingdom and United States, New Zealand undertook extensive economic deregulation measures in the 1980s.[72] Deregulation engaged in by the Fourth Labour and Fourth National Governments included floating the exchange rate and lifting of all other interest rate controls.[73]

Alongside economic liberalisation, deregulatory measures extended to government itself.[74] The Government's administration systems underwent comprehensive restructuring, emphasising personal accountability, transparency and performance management.[75] Ultimately this restructuring ushered in "new public management", a governance system which comprises:[76]

- explicit standards and measures of performance;
- emphasis on private sector styles of management;
- hands-on professional management in the public sector; and
- stress on greater discipline and frugality in resource use.

New public management has fostered a regulatory climate where public services and policy initiatives must justify their resource allocation as effective and efficient. These changes work to "modernise" government, altering its administration to be run like a business and have increased accountability.[77]

The effects of this "modernisation process" have been heightened by New Zealand's emphasis on evidence-based policy.[78] Policy initiatives must be centralised around notions of accountability and efficiency. The centrality of this to law reform has been made explicit by Treasury: "we have to make sure what looks like a good policy idea is backed up by solid evidence and quality analysis".[79] Emphasis on evidence-based policy materialises a "cost-benefit culture" where the benefits of regulation must exceed the cost of implementation.[80]

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72 Peter Grabosky "Beyond *Responsive Regulation*: The expanding role of non-state actors in the regulatory process" (2013) 7 Regulation & Governance 114 at 116.

73 For an examination of the reforms see Lewis Evans, Arthur Grimes and Bryce Wilkinson "Economic Reform in New Zealand 1984-95: The Pursuit of Efficiency" (1996) 34(4) J Ec Lit 34.

74 Graham Scott, Ian Ball and Tony Dale "New Zealand's Public Sector Management Reform: Implications for the United States" (1997) 16(3) Journal of Policy Analysis and Management 357.

75 At 377-379.

76 Christopher Hood "A public management for all seasons" (1991) 69 Pub Admin 3 at 4-5.

77 Christopher Hood and David Jones *Accident and Design: Contemporary Debates in Risk Management* (University College of London Press, London, 1996).

78 See Hutter, above n 70, at 3.

79 Gabriel Makhlouf, Secretary to the Treasury "Stewardship of the Public Service: Serving New Zealand's Needs and Changing the Way We Do Business" (speech at Chapman Trip, Wellington, 15 April 2013).

80 Term borrowed from Christopher Hood *The Government of Risk: Understanding Risk Regulation Regimes* (Oxford University Press, Oxford, 2001).

Risk-based regulation is a favourable strategy to transparently justify resource allocation with its implicit incorporation of cost-benefit analysis.[81]

B Why Extend the AML Act to Legal Professionals?

The Financial Intelligence Unit's National Risk Assessment 2010, designed to generate knowledge and support decisions regarding anti-money laundering identified the industries vulnerable to money laundering as those now targeted by Phase 2.[82] This includes the legal profession. Extension of the legal profession's obligations is consistent with this strategic document.

New Zealand's proposed extension in Phase 2 also mirrors planned extensions (first proposed in 2007) of the Australian anti-money laundering regime ("Tranche 2"). Phase 2 and Tranche 2 would bring New Zealand and Australia in line with jurisdictions in the European Union (including the United Kingdom) who have been imposing anti-money laundering obligations on legal professionals since 2003. However, these reforms have proven slow and difficult to implement in New Zealand and Australia.[83] Evidence illustrating the benefits of such an extension have failed to be produced. Outlined below are the key motivating factors of imposing anti-money laundering obligations on New Zealand legal professionals. Ultimately, it is clear that legal professionals should be obliged to carry out some more robust anti-money laundering activity than they currently do.

1 The Recommendations

Since 2003, FATF's Recommendations have required non-financial businesses and professions ("DNFBPs") including legal professionals, who provide access to and act as "gatekeepers" for the financial system to engage in anti-money laundering measures. The Recommendations specifically apply FATF's risk-based-meta-regulation to legal professionals in two instances.

Recommendation 22(d) holds the customer due diligence and record-keeping requirements set out in Recommendations 10, 11, 12, 15, and 17 must apply to legal professionals when they prepare for or carry out transactions for their client concerning:

- buying and selling of real estate;
- managing of client money, securities or other assets;

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81 Hutter, above n 70, at 1.

82 Financial Intelligence Unit *National Risk Assessment 2010* (New Zealand Police, 2010) at 21.

83 Directive 2001/97/EC on prevention of the use of the financial system for the purpose of money laundering [2001] OJ L344.

- management of bank, savings or securities accounts;
- organisation of contributions for the creation, operation or management of companies; or
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.

Recommendation 23(a) holds legal professionals should have to report suspicious transactions when they engage in a financial transaction relating to the activities listed above in Recommendation 22(d). The Recommendations also hold that the legal profession should engage in a risk-based assessment to identify and mitigate money laundering risks as well as be subject to effective monitoring and compliance supervision.[84]

In effect, nine of the 40 Recommendations directly apply to the legal profession. Application is limited to legal professionals acting in the specific capacities mentioned above meaning some legal services such as acting in litigation are not within the scope of the Recommendations. However, the obligations under the Recommendations are engaged by many common legal services.

2 Vulnerability risk

As more anti-money laundering measures are implemented within the financial sector, research has noted that money launderers have sought the services of specialised professionals, including legal professionals, to help them launder criminal funds.[85] The legal profession, particularly in New Zealand where it is not subject to comprehensive anti-money laundering obligations, is perceived vulnerable and may inadvertently facilitate money laundering.[86] AUSTRAC, Australia's anti-money laundering Supervisor, noted that 13 per cent of 174 recorded case studies of money laundering activity between 2007 and 2010 involved professional services such as lawyers, accountants or real estate agents.[87]

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84 Financial Action Task Force, above n 23, at Recs1 and 28(b).

85 Financial Action Task Force *Misuse of Corporate Vehicles Including Trust and Company Service Providers* (Paris, 2006); Financial Action Task Force *Money Laundering and Terrorist Financing through the Real Estate Sector* (Paris, 2007).

86 Financial Action Task Force *Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals* (Paris, June 2013).

87 Australian Transaction Reports and Analysis Centre *Typologies and case studies report 2010* (Canberra, 2010) at 15.

Other literature indicates that elements of the services provided by the legal profession make them particularly susceptible to being complicit in money laundering activity.[88] Legal professionals may be targeted for the following reasons:

- engaging a lawyer adds respectability and legitimacy to transactions;[89]
- some services provided by lawyers such as the use of companies or trusts and conveyancing can directly be used to carry out money laundering; and
- the use of the lawyer's trust account can "cleanse" laundered funds, enabling access into the financial system and hiding the ownership of illicit funds or assets.[90]

Vulnerability is further heightened as many legal services used by criminals to launder money are everyday services used by clients with legitimate means and purposes. It is more difficult to determine which transactions are laundering funds when there are high volumes of legitimate transactions occurring. Allowing legal professionals to offer their services largely unregulated by money laundering measures does not proactively limit the occurrence of money laundering.

3 International and FATF pressure

As a core member of FATF, New Zealand is committed to implementing the Recommendations and meeting FATF's standards on anti-money laundering.[91] Addressing money laundering risks identified by FATF has also been noted as an important way New Zealand can improve its international reputation as a stable trading partner with a robust economy.[92] As New Zealand's top eight trading partners are all core members of FATF there is trade incentive to strengthen these existing relationships through greater commitment to the Recommendations via Phase 2.[93]

A direct source of pressure to comply with the Recommendations comes from New Zealand's impending Mutual Evaluation. Although the next Mutual Evaluation is not likely to occur until 2019, New Zealand will take example from the recently completed Mutual Evaluation of

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88 See for example International Bar Association, American Bar Association and the Council of Bars and Law Societies of Europe *A Lawyer's Guide to Detecting and Preventing Money Laundering* (Singapore Management University, October 2014) at 24.
89 Financial Intelligence Unit *Q2 Quarterly Report 2014-2015* (New Zealand Police, January 2015) at 7.
90 Financial Intelligence Unit *Q3 Quarterly Report 2013-2014* (New Zealand Police, May 2014) at 6.
91 (30 June 2009) 655 NZPD 4769-4770.
92 (30 June 2009) 655 NZPD 4770; (4 November 2014) 701 NZPD 503.
93 New Zealand Immigration "Economic Overview" (New Zealand Now, August 2016) <www.newzealandnow.govt.nz>.

Australia in 2015.[94] While the report commended Australia for having a largely robust anti-money laundering scheme, it was critical of some key deficiencies in their system.[95] Importantly, the report rated Australia non-compliant with Recommendations 22 and 23,[96] and outlined that a priority task of the Australian government was to ensure DNFBPs, including legal professionals, "are required to effectively implement [anti-money laundering] obligations and risk mitigating measures in line with FATF Standards."[97]

Criticism about regulation of DNFBPs can similarly be made of New Zealand. The sooner New Zealand creates anti-money laundering obligations for the legal profession, the more time these professionals have to understand their obligations, effectively reduce the risks of money laundering and not merely technically implement an anti-money laundering system. The Ministry of Justice has stressed the importance of this upcoming Mutual Evaluation, holding "the results could affect New Zealand's international trade reputation."[98] Extension of anti-money laundering obligations to legal professionals is an essential step in a Mutual Evaluation report favourable for New Zealand's international reputation.

4 Recent pressure – Shewan Trusts Inquiry ("The Inquiry")

Following the revelation of documents purporting to show that New Zealand foreign trusts are used to hide assets and evade taxation, an independent inquiry evaluated the adequacy of New Zealand's disclosure rules around foreign trusts. The Inquiry was established to maintain New Zealand's reputation as a country that deters abusive tax practices.[99] This intention to preserve and enhance the reputation of New Zealand mirrors intentions present in the anti-money laundering context.

The Inquiry noted that lawyers are exempt from the AML Act's obligations. The Inquiry recommended this exemption be removed when legal professionals provide services related to foreign trusts.[100] However, this recommendation is unrealistic and impractical as it would

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94 Fiducia "FATF and the Upcoming New Zealand Mutual Evaluation" (25 October 2015) <www.fiducia.co.nz>; Financial Action Task Force "Calendar: New Zealand" (2016) <www.fatf-gafi.org>.

95 Financial Action Task Force *Mutual Evaluation Report: Anti-Money Laundering and Combating the Financing of Terrorism – Australia* (Asia/Pacific Group, Paris, April 2015) at 8.

96 At 168.

97 At 11.

98 Ministry of Justice *Improving New Zealand's ability to tackle money laundering and terrorist financing* (August 2016) at 9.

99 John Shewan *Government Inquiry into Foreign Trust Disclosure Rules* (New Zealand Government, Wellington, 2016) at 6.

100 At 4.

impose anti-money laundering obligations in an ad hoc manner to a small section of the legal profession without comprehensive administrative frameworks. Nonetheless, the Inquiry noted that the extension of the AML Act in Phase 2 would also address this recommendation. Accordingly, it supports the reform, implying that it will be beneficial for New Zealand's international reputation.[101] The Inquiry failed to acknowledge that even if Phase 2 is implemented, it would not ameliorate the Inquiry's criticism in respect of beneficial ownership.[102] Even if greater due diligence is required of lawyers, beneficial owners can conceal their identity unless a register of beneficial ownership is created.[103]

The Inquiry further supported Phase 2, noting it would also remedy concerns made in the 2013 Mutual Evaluation follow up report about information gathering standards in New Zealand.[104] The Inquiry articulated the importance of commitment to international financial and monetary arrangements, including those of FATF. The Inquiry stressed that New Zealand has "a reputation for being actively involved, speaking up and working to ensure that, wherever possible, the country leads by example" in these international financial forums.[105] The Inquiry highlighted that intentionally subverting the Recommendations by not adopting FATF's risk-based-meta-regulation is not becoming of a country that "leads by example."

C The AML Act

1 Stakeholders

The AML Act creates various obligations and responsibilities for two parties.

a) Reporting Entities

"Reporting entities" have anti-money laundering obligations if they carryout activities "that may give rise to a risk of money laundering".[106] A reporting entity currently means:[107]

- a financial institution carrying on one or more of a range of financial activities defined in the Act;
- a casino; or
- a trust and company service provider.

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[101] At 53.
[102] At 30.
[103] At 11.
[104] At 39.
[105] At 41.
[106] Anti-Money Laundering and Countering Financing of Terrorism Act 2009, s 6.
[107] Section 5.

Consistent with the Recommendations, the AML Act imposes obligations on institutions based on the activities which are "within the ordinary course of business", independent of their status.[108] For example, a bank has obligations whether or not it is registered.

Under Phase 2, the definition of reporting entity will be extended to legal professionals and some other DNFBPs including accountants, conveyancing practitioners, real estate agents and high-value goods dealers such as auctioneers and bullion dealers.[109]

b) Supervisors

Although the Ministry of Justice is responsible for the AML Act, three government agencies are appointed anti-money laundering Supervisors. Supervisors must monitor, provide guidance and enforce compliance of reporting entities. They also coordinate anti-money laundering measures across different businesses and monitor the level of money laundering generally.[110]

The New Zealand Supervisors, and their current responsibilities are set out below:[111]

- The Reserve Bank of New Zealand: registered banks, life insurers and non-bank deposit takers;
- The Financial Markets Authority: financial institutions defined under the Financial Service Providers (Registration and Dispute Resolution) Act 2008 not supervised by the Reserve Bank; and
- The Department of Internal Affairs: casinos, non-deposit-taking lenders, money changers, and other reporting entities not supervised by the above.

During the passage of the AML Bill, the Foreign Affairs and Trade Select Committee urged the government to consider establishing a single regulatory agency.[112] Government rejected the single regulator model such as that utilised in Australia in favour of a multi-agency supervisor model.[113]

Although the legal profession is currently required to engage in some forms of anti-money laundering activity, application of the AML Act under Phase 2 will impose more robust and

[108] Financial Action Task Force, above n 23, at 112.
[109] Vaughan, above n 67.
[110] Section 131.
[111] Section 130.
[112] Anti-Money Laundering and Countering Financing of Terrorism Bill (46-2) (select committee report) at 2.
[113] Australia's Supervisor is the Australian Transaction Reports and Analysis Centre ["AUSTRAC"].

comprehensive obligations.[114] The legal profession's current obligations are set out before an examination of the obligations under the AML Act.

Phase 2 will affect many New Zealand business, including those within the legal industry. There are 12,816 practicing lawyers in New Zealand.[115] Of those, 2,795 or around 22 per cent are practicing as in-house lawyers and will likely be exempt from the AML Act.[116] However, in 2015, the New Zealand Law Society noted there are 1,877 law firms in New Zealand, most of whom would have to comply with an extension of the AML Act.[117]

2 Current obligations of the legal profession

Under the Financial Transactions Reporting Act 1996 ("FTR Act") legal professionals are required to engage in some anti-money laundering practices. Legal professionals must:

- verify the identity of their client(s) when a person is made an account holder of a new or existing account, when a cash transaction of $10,000 or more occurs or if they have reasonable grounds to suspect the transaction may relate to the investigation or prosecution of a money laundering offence or the enforcement of the Criminal Proceeds (Recovery) Act 2009;[118]
- make a Suspicious Transaction Report ("STR") to the Commissioner of Police if they have reasonable grounds to suspect that the transaction or proposed transaction may relate to the investigation or prosecution of a money laundering offence or the enforcement of the Criminal Proceeds (Recovery) Act 2009 or the Terrorism Suppression Act 2002;[119] and
- keep records of every transaction which they are involved in for five years, to the extent that the transaction can be "readily reconstructed at any time."[120]

Failure to comply with these provisions can incur civil liability of up to $20,000 for an individual or $100,000 for a body corporate.[121] Liability can also extend to legal professionals

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114 Ministry of Justice, above n 98, at 9.

115 Geoff Adlam "Snapshot of the Legal Profession 2016" *LawTalk 883* (online ed, 11 March 2016) at 18.

116 Ministry of Justice, above n 98, at 13.

117 Geoff Adlam "Snapshot of the Legal Profession 2015" *LawTalk 859* (online ed, 27 February 2015) at 14.

118 This is the prescribed amount included in Financial Transactions Reporting (Prescribed Amount) Regulations 2010, s 3.

119 Financial Transaction Reporting Act, s 15.

120 Section 29.

121 Sections 13 and 22.

who help structure transactions to avoid anti-money laundering regulation as they can be found to aid or abet criminal offending.[122]

The FTR Act does not require legal professionals to reveal any privileged information when filing a STR. The FTR Act holds communication is privileged if:[123]

a) confidential communication, whether oral or written, passes between lawyers or a lawyer and client in a profession capacity; and
b) it is made for the purpose of obtaining or giving legal advice or assistance; and
c) it is not made for the purpose of committing or furthering a wrongful act.

As well as explicit obligations under the FTR Act, the legal profession also has an ethical duty to uphold the rule of law and to facilitate the administration of justice.[124] To this extent, the legal profession is obliged not to facilitate or support criminal activity, including money laundering efforts. Although this does not compel legal professionals to actively engage in anti-money laundering measures, they are ethically obliged not to be involved in any activity which they reasonably believe to be criminal or fraudulent.

3 Obligations under the AML Act

A reporting entity, which will include legal professionals if Phase 2 is implemented, has various obligations it must fulfil under the Act.

a) Compliance obligations

A reporting entity's first compliance task is to perform a risk assessment of their business.[125] Considering the factors in s 58(2), a risk assessment must:[126]

a) identify the risks of money laundering faced in the course of business; and
b) describe how the entity's risk assessment will remain up-to-date; and
c) enable determination of the level of risk involved in activity relevant to obligations under the AML Act.

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122 New Zealand Law Society "Money laundering: beyond cash-stuffed briefcases" *LawTalk 842* (online ed, 23 May 2014).

123 Section 19.

124 See generally Lawyers and Conveyancers Act 2010 and Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules 2008.

125 Anti-Money Laundering and Countering Financing of Terrorism Act, s 58.

126 Section 58(3).

Businesses must develop an anti-money laundering compliance programme based on their risk assessment, including internal procedures to detect, manage and mitigate the risk of money laundering.[127] A person must also be appointed to act as the business's anti-money laundering compliance officer.[128]

None of these obligations currently exist for legal professionals under the FTR Act. To aid development of a legal firms' risk assessment they could look to the *Risk Assessment Guideline* jointly published by the Supervisors.[129] Further guidance can be drawn from the New Zealand Police Financial Intelligence Unit's *National Risk Assessment*[130] and each Supervisor's own risk assessment in their respective sectors.[131]

b) Know your client obligations

Reporting entities must carry out "customer due diligence" ("CDD") on a customer, the beneficial owner of a customer and any person acting on behalf of a customer.[132] The level of CDD required can be "simplified", "standard" or "enhanced" depending on the risk profile of the customer in question. The standard of information required varies at each level.[133] Simplified CDD is only available for customers Parliament has deemed "low risk", for example, a listed issuer, a New Zealand government department or the New Zealand Police.[134] Enhanced CDD is required for high-risk customers designated in the legislation or when:[135]

a) a customer seeks to conduct and unusually large transaction or unusual pattern of transactions that have no apparent or visible economic or lawful purpose; or
b) a reporting entity considers that the level of risk involved is such that enhanced due diligence should apply to a particular situation.

Engagement of CDD processes on a risk-determinant basis marks a large change for the legal industry. Similarly, enhanced CDD requires the reporting entity to obtain information relating

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127 Section 56.
128 Section 56(3).
129 Financial Markets Authority, Reserve Bank of New Zealand, Department of Internal Affairs *Interpreting "ordinary course of business" Guideline* (September 2012).
130 Financial Intelligence Unit, above n 82.
131 Financial Markets Authority, Reserve Bank of New Zealand, Department of Internal Affairs *Risk Assessment Guideline* (June 2011).
132 Anti-Money Laundering and Countering Financing of Terrorism Act, s 11.
133 Sections 14, 18 and 22.
134 Section 18(2).
135 Section 22.

to the source of the funds or the wealth of the customer which is not required of legal professionals under the FTR Act.[136]

c) Ongoing and reporting obligations

Reporting entities have ongoing CDD and transaction monitoring obligations.[137] These obligations ensure the business relationship between the customer and the reporting entity are consistent with the reporting entity's knowledge of the customer. A reporting entity is obliged to make a STR when a person conducts a transaction through the reporting entity and the reporting entity has reasonable grounds to suspect that the transaction or proposed transaction is or may relate to the investigation or prosecution of any person for money laundering or an offence under a range of Acts including the Terrorism Suppression Act 2002 and the Proceeds of Crime Act 1991.[138]

A STR must be sent to the Commissioner of Police within three working days of the suspicion arising and stipulate details required by the AML Act.[139] Other ongoing requirements imposed upon a reporting entity include submitting an annual report to the relevant supervisor,[140] periodically reviewing the reporting entity's risk assessment and anti-money laundering programmes, and having these programmes audited.[141]

Although legal professionals are required to file STRs under the FTR Act, the government has noted that there is a low number of STRs filed currently under the FTR Act. However, this number is set to increase under Phase 2.[142] The other ongoing obligations are not currently imposed on legal professionals. Other New Zealand regulatory regimes, such as the Financial Markets Conduct Act 2013, require disclosure of information from the private sector to the government. However, the reporting obligations under the AML Act are unusual as disclosure is not always required. A risk-based-meta-regulatory scheme affords the private sector discretion when to disclose information.

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136 Section 23(a).
137 Section 31.
138 Section 40.
139 Section 40(2).
140 Section 60.
141 Section 59.
142 Ministry of Justice, above n 98, at 14.

4 Record keeping

Reporting entities must keep records of every transaction which occurs through the entity to the extent that transactions can be "readily reconstructed at any time."[143] Customer identity and verification records must be kept as well as records relevant to the establishment of a business relationship, the anti-money laundering programme and any risk assessments.[144] Most records must be kept for five years after the business relationship ended or the transaction was completed. This is similar to what is required under the FTR Act.

5 Enforcement and liabilities

Both criminal and civil proceedings can be launched against individuals or companies who breach their obligations under the AML Act. However, there can be no concurrent civil and criminal liability in relation to the same unlawful conduct.[145] Parties are largely exposed to civil liability for failing to take the required steps to detect and report money laundering.[146] Criminal liability arises for those who engage in conduct constituting civil liability knowingly or recklessly.[147]

The AML Act also creates a range of offences relating to STRs such as failing to report a suspicious transaction, or unlawfully disclosing information relating to a STR, including to the customer.[148] Civil liability extends up to $200,000 against an individual and $2 milllion for a body corporate.[149] Criminal liability can extend to a maximum term of two years imprisonment and/or a fine up to $300,000 for an individual and a fine up to $5 million for a body corporate.[150]

D Is New Zealand's Regime Risk-Based-Meta-Regulation?

The AML Act largely complies with FATF's desired risk-based-meta-regulatory regime. Reporting entities are delegated regulatory responsibility for the monitoring and prevention of money laundering activity and Supervisors retain only an administrative function. This compliance was recognised by New Zealand's 2013 Mutual Evaluation which held that the

143 Section 49.
144 Sections 50 and 51.
145 Section 73.
146 Section 78.
147 Section 91.
148 Sections 92-97.
149 Section 90.
150 Section 100.

regime is "largely compliant" with 31 of the 40 FATF Recommendations and "partially complaint" with the remaining nine.[151]

Risk is a central component of New Zealand's anti-money laundering framework. A reporting entity must detail how it will "manage and mitigate risks of money laundering" in its anti-money laundering programme and carry out an individual risk assessment.[152] As such, both the civil and criminal liability offences for non-compliance arise out of the procedural aspects of conduct, rather than outcome. Failure to make an STR for a transaction which laundered money does not create liability *per se*; liability arises only when the reporting entity's processes insufficiently identify or appreciate risks.

Although the know-your-customer requirements may deter potential money launderers and aid in the investigation and prosecution of money laundering, the primary responsibility of reporting entities is to decide what activity to report as suspicious. As this task is delegated to reporting entities, they are a fundamental, self-regulating component of New Zealand's anti-money laundering scheme.

However, many of the AML Act's obligations are actually rule-based despite their appearance as risk-based obligations. For example, the legislation heavily prescribes the instances when a particular level of CDD must be performed. Discretion to perform risk-based CDD is only afforded if the reporting entity "consider[s] the level of risk involved is such that enhanced due diligence should apply …".[153]

The arbitrariness of the prescriptive criteria governing CDD further undermines the risk-based premise of the AML Act. Enhanced CDD must be performed if a transaction involves a "politically exposed person", a person who holds or has held a prominent public role within government, the armed forces, the judiciary or politics or is a member of such a person's family.[154] The risk that such a politically exposed New Zealander will carry out money laundering activity is no higher than any other New Zealand person. Similarly, if a transaction involves "a non-resident customer from a country that has insufficient anti-money laundering systems" enhanced CDD must be completed.[155] Although this criterion may appear reasonable

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151 Financial Action Task Force *2nd Follow-Up Report: Mutual Evaluation of New Zealand* (Asia/Pacific Group, Paris, October 2013) at 4.
152 Anti-Money Laundering and Countering Financing of Terrorism Act, ss 57(f) and 58.
153 Sections 22(1)(d) and 31(1)(b).
154 Section 26
155 Section 22(1).

and risk sensitive, it too is arbitrary. The United States has been identified as having the highest amount of money laundering in the world, yet, as a foundational member of FATF and formulator of the Recommendations, it is not a "high-risk" jurisdiction.[156] Other jurisdictions, with fewer money laundering activities (in frequency and value) remain high-risk due to a political unwillingness to implement FATF standards.[157] This prescription highlights FATF's normative influence compelling strict adherence with the Recommendations. The strict compliance fails to realise a tailored perception of risk, specific to a local context.

Further divergence away from a risk-based system is soon to occur. Recent amendments to the AML Act (not yet in force) will require reporting entities to file a "prescribed transaction report" ("PTR") to the FIU for international wire transfers of $1,000 or more and domestic physical cash transactions of more than $10,000.[158] PTRs impose rule-based obligations on reporting entities removing their discretion to report based on their own consideration of risk.

These kinds of prescriptive obligations undermine the risk-based foundation of the risk-based-meta-regulatory framework. Although elements of a transaction such as the jurisdictions, amount of money or individuals involved may validly be considered risk factors, they "should remain just that" and not compel a pre-determined response.[159] Forcing responses on the basis of a single, often arbitrary factor establishes New Zealand's anti-money laundering is only partially committed to being risk-based. Effective risk assessment requires consideration of multiple risk factors and is not contingent upon one specific, predetermined factor in isolation.[160] Making certain factors determinative of risk and therefore mandating a particular response resembles the inflexibility of rule-based regulation.[161] If the government decides that "the distinction between suspicious and non-suspicious will become a bureaucratic decision...the anti-money laundering system is reduced to ticking boxes."[162]

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[156] See Burak Dolar and Wiliam Shughart "Enforcement of the USA Patriot Act's anti-money laundering provisions: Have regulators followed a risk-based approach?" (2011) 22(1) Global Finance Journal 19 at 57; Ghoshray, above n 29, at 533.

[157] Abdullahi Usamn Bello and Jackie Harvey "From a risk-based to an uncertainty-based approach to anti-money laundering compliance" (2016) Security Journal 1 at 7.

[158] Anti-Money Laundering and Countering Financing of Terrorism Amendment Act 2015, s 9.

[159] Letter from David Bagley and Philipp von Turk (The Wolfsberg Group) to Luis Corral (Financial Action Task Force ATF) regarding the Financial Action Taskforce Consultation paper (6 January 2011) at 3. See also Letter from Director of Anti-money Laundering Compliance (Western Union Holdings) to Luis Corral (Financial Action Task Force ATF) regarding the Financial Action Taskforce Consultation paper (January 2011).

[160] Anna Simonova "The risk-based approach to anti-money laundering: problems and solutions" (2011) 14(4) JMLC 346 at 353.

[161] Letter from Director of Anti-money Laundering Compliance, above n 159, at 4.

[162] Dionysios Demetis and Ian Angell "The risk-based approach to anti-money laundering: Representation, paradox, and the 3rd directive" (2007) 10(4) JMLC 412 at 423.

Although New Zealand's system is largely in line with FATF's risk-based-meta-regulatory model, it is incorrect to describe the regime as totally risk-based. The risk-based-meta-regulation label which New Zealand's anti-money laundering regime derives from FATF suggests a veneer of effective and tailored allocation of resources. In reality, private businesses must apply their own resources to anti-money laundering activity whilst still complying with some rule-based, prescribed obligations.

III Assessment of New Zealand's Regime and the Appropriateness of Risk-Based-Meta-Regulation

Bearing in mind the structure of New Zealand's anti-money laundering regime, this section addresses the respective justifications, strengths and weaknesses of that regime. It analyses the regime with specific reference to Phase 2's proposed extension to legal professionals. This discussion informs whether risk-based-meta-regulation is a suitable model to regulate and impose anti-money laundering obligations on the legal profession.

It is established that although risk-based-meta-regulation has strengths and can be rationalised, it is not a regulatory model that can impose anti-money laundering obligations on legal professionals in New Zealand justifiably. Outlined below are some of the most confronting issues with a risk-based-meta-regulation extension, notably inapplicability of the risk-based-meta-regulation's strengths and rationales, practical issues with cost and structure as well as conflict with ethical duties of a lawyer.

A Rationales

Shifting regulatory responsibility to private business can be rationalised in various ways. Although none of these rationales alone justify risk-based-meta-regulation, a combination may rationalise a risk-based-meta-regulatory anti-money laundering regime.

1 Efficiency of self-regulation

Delegating regulatory responsibility onto private businesses answers industry and political demand for self-regulatory mechanisms popular within new public management.[163] The AML Act establishes a self-regulatory framework as private actors create then execute their own anti-money laundering measures on a risk-based discretionary basis.[164] This transfer of regulatory responsibility away from the public sector plainly adopts management techniques of the private sector and seeks to generate private-sector-like efficiency. Efficiency is realised in numerous ways:

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163 Hood, above n 76.

164 Darren Sinclair "Self-Regulation versus Command and Control? Beyond False Dichotomies" (1997) 19 Law & Pol 529 at 534.

a) Economic efficiency

Where public resources are scarce, it is unlikely the public sector will be sufficiently resourced to tackle an issue as widespread and diverse as money laundering alone.[165] All the government funds currently allocated to anti-money laundering are exhausted on Supervision. Enlarging the government's responsibility to monitor and detect money laundering activities would greatly increase the tax-payer resources required. The most economically viable way to implement anti-money laundering measures is through self-regulation.[166]

Risk-based-meta-regulation ensures regulatory efforts are proportionate to the risks involved and enables regulators to justify the allocation of limited resources.[167] By focussing resources on those activities which, in the reporting entity's view, pose the greatest risk, the Police are provided with more meaningful intelligence. The number of STRs are reduced as they are provided upon close scrutiny of high-risk transactions.

b) Logistical efficiency

Questions of resources aside, requiring the government to carry out an anti-money laundering regime independently would require government officials to access private financial records. Requiring more information to be shared across multiple organisations (both public and private) gives rise to issues of privacy and the protection of personal information and data. Self-regulation ensures that information of those engaging in the regulated activity remains only with private business until information must be passed onto investigation authorities. A meta-regulatory structure enables the government to administer effective regulation without practical hurdles arising out of its third party status.[168]

Requiring government actors to monitor and assess private financial activity is inefficient. Reporting entities have more readily available and less expensive ways to access or acquire information necessary to carry out anti-money laundering regulation and therefore experience lower costs.[169] Furthermore, requiring the government to carry out anti-money laundering measures means a customer's details would be considered twice: once by the reporting entity

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165 Ian Ayres and John Braithwaite *Responsive Regulation: transcending the deregulation debate* (Oxford University Press, New York 1992) at 121.

166 Baldwin, Cave and Lodge, above n 53, at 140.

167 Ross and Hannan, above n 55, at 107.

168 See for example Lori Snyder Bennear "Evaluating Management-Based Regulation: A Valuable Tool in the Regulatory Toolbox?" in Cary Coglianese and Jennifer Nash (eds.) *Leveraging the Private Sector: Management-Based Strategies for Improving Environmental Performance* (RFF Press, Washington DC, 2006).

169 Baldwin, Cave and Lodge, above n 53, at 140.

as the transaction occurs and then again by the responsible government anti-money laundering authority. As self-regulating entities are wholly involved in the transactions of the regulated party, as well as acting as quasi-regulator, they enjoy the trust of the regulated group more so than an external third party.[170]

However, the New Zealand legal profession is already heavily regulated[171] with the New Zealand Law Society appointed the self-regulating body of all legal professionals.[172] Adoption of FATF's risk-based-meta-regulatory model in Phase 2 will impose additional obligations on a profession continually undertaking self-regulatory functions.

c) Expertise

The transfer of regulatory responsibility to private business best utilises corporate expertise and experience not present in the public sector.[173] Particularly for financial institutions, concepts of risk and risk assessment processes are familiar.[174] Thus, risk-based-meta-regulation leverages off "professional know-how and experience" of the private sector.[175] Better knowledge of the differentiated approaches of institutions, products and services ensures risk assessment frameworks are adequate and fit for purpose.[176] Self-regulating entities may also perceive their own regulatory measures more reasonable than those imposed by the government and therefore be more likely to comply with them.[177]

However, unlike financial institutions such as banks who continually assess the risk of fraudulent activity, lawyers do not engage in explicitly risk-orientated practices. Requiring the legal profession to perform risk assessment and analysis is not utilising pre-existing experience and expertise but compelling a profession to learn and then apply, effectively, unfamiliar and complex tasks. Although the New Zealand Law Society has indicated that lawyers have

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170 At 140.

171 International Bar Association, American Bar Association and the Council of Bars and Law Societies of Europe, above n 88, at 6.

172 Lawyers and Conveyancers Act, s 65.

173 Ross and Hannan, above n 55.

174 Baldwin, Cave and Lodge, above n 53, at 139.

175 Mark Pieth and Gemma Aifoli *Anti-money laundering: levelling the playing field* (Basel Institute on Governance, 2003) at 16.

176 Pieth and Aifoli, above n 175, at 16; Cary Coglianese Cary and Evan Mendelson "Meta-Regulation and Self-Regulation" in Robert Baldwin, Martin Cave and Martin Lodge (eds.) *The Oxford Handbook on Regulation* (Oxford University Press, New York, 2010) 146 at 157.

177 Coglianese and Mendelson, above n 176 at 9.

recently become more familiar with risk-based concepts,[178] commentators have noted that money laundering risk assessment is particular and different to other risk assessments.[179]

2 Externalities

For some activities or services, an unregulated price does not reflect the true cost to society those services create; there are 'externalities' or 'spillover' costs borne by society rather than the provider.[180] Risk-based-meta-regulation acknowledges the existence of externalities when financial services are utilised for money laundering and therefore the true cost of offering those services includes the cost of prevention and detection measures. Risk-based-meta-regulation compels those private businesses who offer services amenable to money laundering to internalise externalities and finance their own anti-money laundering measures.[181]

However, this rationale is not perfectly applicable to anti-money laundering risk-based-meta-regulation. Many of the posited harms of money laundering such as the distortion of the market, demand, prices and investment or the loss of government revue are all theoretical. Thus, the externalities of money laundering are indeterminable.[182] Secondly, the proportion of regulated services actually used to launder money is small and externalities are materialised infrequently. An externalities rationale is better utilised to regulate industries that produce harmful waste products on a "polluter pays" basis.[183] Businesses in such industries always produce the harmful by-products (externalities) which are then internalised via regulation. In contrast, financial service providers create an opportunity for money laundering but do not generate externalities with every transaction as polluters do. In such circumstances it is impossible to determine whether burdensome obligations imposed on private business are proportional to the externalities which they create. With this uncertainty, it seems unprincipled to force the legal profession to internalise unknown externalities through risk-based-meta-regulation.

3 Regulation for the public good

The prevention and detection of money laundering delivers a public good to society that is realised in numerous ways. Anti-money laundering measures:

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178 New Zealand Law Society *Re: Consultation on Phase Two of the AML/CFT Act* (16 September 2016) at 18.

179 Ross and Hannan, above n 55, at 111.

180 Stephen Breyer *Regulation and its Reform* (Harvard University Press, Cambridge, 1982 at 23.

181 At 23.

182 United Nations Office on Drugs and Crime, above n 16.

183 Baldwin, Cave and Lodge, above n 53, at 18.

- stop further crime being facilitated through illicit self-finance;[184]
- make it more difficult to enjoy the profits of crime, consequently acting as a disincentive to offending;
- enable the return of illicit gains to their rightful owners; and
- aid the successful prosecution of other criminal offending.[185]

Despite this public good, the incentive for private business to implement anti-money laundering systems to deliver this good is low as:

a) implementing a system to monitor, prevent and detect money laundering is expensive; and
b) a capitalist drive to maximise profit is undermined by anti-money laundering measures. The "good" created by anti-money laundering measures is enjoyed largely by society itself rather than by individual businesses. Recent experience indicates businesses perceive any money brought into the economy is positive for business, regardless of its source or legitimacy, as long as the business is not actively or knowingly facilitating crime.[186] Anti-money laundering runs counter to business models which seek to maximise profit at all costs. The suggestion that money laundering is a victimless crime may further legitimise this business approach, where failure to effect a public good is not morally questionable as there are no "true" victims of the crime.[187]

Placing a statutory requirement on private businesses to become quasi-regulators through risk-based-meta-regulation negates the market's failure to provide an incentive to carry out public good.[188] Moving regulatory responsibility from the public sector compels greater corporate social responsibility whereby, instead of focussing on profit maximisation for shareholders, a business is responsible to a range of stakeholders with ethical and legal obligations.[189] Risk-based-meta-regulation ultimately requires the private sector to deliver a public good and compete for capital in transparent ways not using criminal funds to support business.

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184 Michael Levi "Money laundering and its regulation" (2002) 582(1) Annals Am Acad Pol & Soc Sci 181 at 183.
185 Ministry of Justice, above n 3.
186 Brigette Unger and Gregory Rawlings "Competing for criminal money" (2008) 10(3) Global Bus Econ Rev 331.
187 Brigette Unger "Money Laundering" Encyclopaedia of Criminology and Criminal Justice 3137 at 3139.
188 Baldwin, Cave and Lodge, above n 53, at 41.
189 Simonova, above n 160, at 352.

Other authors have argued that some core financial institutions such as banks involved in business and retail lending are, effectively, quasi-public institutions due to their ability to access a "government safety net".[190] As quasi-public institutions they should be expected to deliver the public good through anti-money laundering measures and engage in greater corporate social responsibility.

However legal professionals already have a role in delivering a public good by facilitating access to justice and robust business transactions. They are ethically bound to fulfil this role.[191] It is unlikely that a risk-based-meta-regulatory structure will compel them to delivery on these duties more effectively than they currently do.

4 Prevention of 'free-riding'

Private business may indirectly derive benefits from anti-money laundering initiatives. The prevention of money laundering plays an important role in preserving New Zealand's international reputation as a trustworthy and respectable financial system, and maintains confidence more generally in the financial trading system.[192] Discovery of money laundering activity erodes the reputation of New Zealand's financial system and consequently tarnishes reputation of all businesses within it, not just those who may have been implicated in the laundering activity.[193] Preserving the integrity of the financial system, customer trust and financial institutions' collective reputation through anti-money laundering measures fosters growth of a sound financial sector and the general sustenance of the economy:[194] "integrity is a pathway to economic prosperity."[195]

If performance of anti-money laundering measures is a duty of the public sector, private businesses effectively "free-ride" and receive the benefits flowing from a reputable and robust financial system. Evidence has established that financial systems perceived to be associated with money laundering suffer a reduction in legitimate transactions with foreign clients.[196] Inversely, if those clients perceive that financial system to be free from money laundering, businesses would profit from greater investment. Placing regulatory responsibility in private

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190 Peter Reuter and Edwin Truman Chasing Dirty Money: The Fight against Money Laundering (Peterson Institute for International Economics, Washington DC, 2004) at 130.
191 See Lawyers and Conveyancers Act (Lawyers: Conduct and Client Care) Rules.
192 (15 October 2009) 658 NZPD 7098.
193 Unger, above n 13 at 91.
194 Bartlett, above n 10.
195 Simonova, above n 160, at 349.
196 Peter Quirk "Money Laundering: Muddying the Macroeconomy" (1997) 34(1) Finance & Development 7 at 11.

business prevents them free-riding and enjoying the benefits of anti-money laundering measures which would otherwise be extremely costly for the public service to implement.[197] Those enjoying the benefits flowing from the prevention and detection of money laundering pay for those benefits as quasi-regulators. However, this rationale has only been proven in respect of financial institutions, it is unclear whether more robust anti-money laundering measures will positively benefit legal professionals.

B Strengths

Risk-based-meta-regulation has many strengths. However, these are not realised by an implementation of a risk-based-meta-regulatory anti-money laundering regime for legal professionals.

1 Flexibility

Risk-based-meta-regulation allows reporting entities more scope than rule-based regulation to adopt individualised measures appropriate to their own perception of their business.[198] This flexibility better appreciates the nuances of unique business structures and clientele.[199] Risk-based-meta-regulation recognises that money laundering is not static activity comprising only generic or archetypal cases affording discretion to develop tailored responses addressing the dynamic nature of money laundering.[200]

However, although it affords scope to tailor anti-money laundering measures, a flexible risk-based-meta-regulatory system places a substantial burden on businesses to design bespoke, appropriate and proportionate measures.[201] Unlike financial institutions who each offer a range of different financial products to a variety of customers, many law firms offer similar legal services. Thus, even if there is a distinct risk that money launders may abuse legal professionals, the risks will be similar across the industry. In such situations, demand for individualised anti-money laundering programmes and risk-based-meta-regulation appears low.

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197 Baldwin, Cave and Lodge, above n 53, at 20.
198 Financial Action Task Force, above n 23, at 8.
199 Lishan Ai "Rule-based but risk-oriented approach for combating money laundering in Chinese financial sectors" (2012) 15(2) JMLC 198 at 199.
200 Yeoh, above n 5, at 332.
201 Marcus Killick and David Parody "Implementing AML/CFT measures that address the risks and not tick boxes" (2007) 15(2) Journal of Financial Regulation and Compliance 210 at 215.

This issue may be quelled by each law firm regulating "in blocks", basing much of their risk assessment and compliance programmes on industry-wide guidance.[202] However, this solution undermines the flexibility of a risk-based framework. If regulation will largely be implemented on a prescriptive and uniform basis, risk-based-meta-regulation is not a cost effective regulatory strategy.

2 Responsiveness

Risk-based-meta-regulation is more responsive than rule-based regulation to the dynamic nature of money laundering. Reporting entities at the coal-face of money laundering activity can apply their initiative and respond to developments in money laundering practices as they emerge.[203] Risk-based-meta-regulation allows measures to keep pace with developing trends without obtaining government or industry-wide agreement.[204] Thus, innovative responses are encouraged and not stifled by bureaucracy. This responsiveness is consequent of a reporting entity's proximity and resulting sensitivity as quasi-regulator to changes in "the market" of money laundering practices.[205]

However, even if risk-based-meta-regulation allows for anti-money laundering measures to respond quickly to changing money laundering typologies, an expectation that law firms will proactively adapt risk management without some industry lead is wholly optimistic. Due to the legal profession's lack of expertise in anti-money laundering and risk assessment, they are unlikely to act independently of macro-guidance. Accordingly, there is a strong argument that effective and responsive anti-money laundering measures will be best realised if resources were concentrated in a centralised body who establishes prescriptive rules rather than being dispersed throughout businesses under risk-based-meta-regulation.[206] Even if a Supervisor can establish effective guidance, risk-based-meta-regulation reduces the concentration of anti-money laundering expertise available to formulate guidance.

3 Public-private sector relationship

Entrusting private businesses with discretion to act as quasi-regulator fosters a closer relationship between the public and private sectors.[207] Under risk-based-meta-regulation, public regulators are not perceived as over bearing regulators but as guiding bodies. Private

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202 Ayres and Braithwaite, above n 165, at 121.
203 Bello and Harvey, above n 157, at 3.
204 Baldwin, Cave and Lodge, above n 53, at 148.
205 Neil Gunningham and Joseph Rees "Industry Self-Regulation: An Institutional Perspective" (1997) 19 Law & Policy 363 at 366.
206 Baldwin, Cave and Lodge, above n 53, at 151.
207 Ryder, above n 17, at 23.

institutions are afforded responsibility rather than being shut out from the regulatory process. This inclusion promotes greater buy-in from all stakeholders.

Whilst risk-based-meta-regulation avoids inherent barriers between regulators and business, it also works to reduce any barriers to legitimate business activity otherwise affected by regulatory rules. Mandatory incorporation of risk theoretically ensures that standard or ongoing business transactions are not hampered by disruptive regulatory measures.[208] However, this strength is undermined in New Zealand where the anti-money laundering regime includes many rule-based requirements. The legitimate services performed by legal professionals will be hindered if Phase 2 is implemented with wide ranging application.

The closer relationship between the public and private sector also enables the regulatory scheme to utilise corporate knowledge and expertise.[209] Through risk-based-meta-regulation, public and private sector institutions can share information and knowledge, collaborating resources to best identify "where the bodies are buried" and tackle money laundering.[210]

However, although it can be said that risk-based-meta-regulation fosters closer relations between the public and private sectors, it also isolates the stakeholders within the regime. When a reporting entity files a STR, the outcome is not relayed back to the entity. The only feedback is contained in a non-specific report of the Financial Intelligence Unit issued every quarter.[211] Without a feedback-loop, the anti-money laundering system is susceptible to false-positive and ineffective STRs. This lack of feedback within New Zealand's regime is particularly problematic for the legal profession. If legal professionals are required to engage in more frequent reporting yet operate in isolation, the effectiveness of risk-based-meta-regulation is inhibited.[212] Problems regarding the absence of feedback loops are exaggerated by entry of new stakeholders into the regime; legal professionals will require continued support to ensure their expensive anti-money laundering measures are useful.

4 Transparency

Under risk-based-meta-regulation, firms that develop rigorous anti-money laundering systems highlight themselves as responsible and actively pursuing best practice. As such, risk-based-

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208 Yeoh, above n 5, at 331.
209 Ross and Hannan, above n 55, at 111.
210 Baldwin, Cave and Lodge, above n 53, at 148.
211 See Financial Intelligence Unit "Financial Intelligence Unit (FIU) assessments and reports" (New Zealand Police, September 2016) <www.police.govt.nz>.
212 Yeoh, above n 5, at 330.

meta-regulation encourages reporting entities to demonstrate the robustness of their risk management systems, training and disciplining of staff. This is opposed to governmental regulation where there may be an incentive to conceal infringements.[213]

However, this transparency is dependent on the level of supervision on a reporting entity. If the Supervisor of legal professionals is relaxed on the standard of anti-money laundering compliance due to risk-based-meta-regulation's high cost and complexity, risk-based-meta-regulation may alternatively foster a system with greater opaqueness and inconsistency.

C Weaknesses

If Phase 2 were to impose risk-based-meta-regulation on the legal profession, the weaknesses of this regulatory style will be pronounced.

1 Compliance cost

Although risk-based-meta-regulation may take pressure of the public purse by making the private sector "an essential and self-financing component" of the anti-money laundering regime, the cost of compliance can damage private business.[214] Effective risk-based-meta-regulation requires up-to-date knowledge of the money laundering risks faced by that business and therefore requires risks to be continually reassessed and each transaction scrutinised.[215] The compliance cost of anti-money laundering measures is therefore not limited to capital outlay, but involves the ongoing costs of reassessment, monitoring and reporting. As each business must implement its anti-own money laundering scheme, the costs of compliance are multiplied across all reporting entities.[216] This multiplication effect is marked for the legal profession: compliance costs must be met by most of New Zealand's 1,877 law firms if they offer a regulated service. This includes 944 sole practitioner firms.[217]

Compounding the compliance cost problem is the expensiveness of individualised risk-based money-laundering programmes. As each business must effect similar measures under risk-based-meta-regulation irrespective of its size, costs are disproportionately burdensome on smaller organisations.[218] Over 99 per cent of New Zealand's legal firms are small to medium

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[213] At 348.
[214] At 329.
[215] Ai, above n 199, at 199; Ross and Hannan, above n 55, at 111.
[216] Ayres and Braithwaite, above n 165, at 120.
[217] Note these are 2015 statistics.
[218] Law Council of Australia "Statutory Review of the Anti-money Laundering and Counter-Terrorism Financing Regime in Australia" (Canberra, 30 April 2014) at 19.

sized businesses who will be most affected by burdensome compliance costs of risk-based-meta-regulation.[219] Accordingly, there is a real risk that anti-money laundering compliance costs under risk-based-meta-regulation may cause some legal firms to leave the regulated market. Risk-based-meta-regulation under Phase 2 could narrow the market for legal services to large firms able to meet compliance costs.[220] There have been instances of market narrowing in the United Kingdom where anti-money laundering compliance costs have been so onerous businesses no longer offer particular services or offer them only to certain clients.[221]

It is likely that an increase in overheads caused by anti-money laundering compliance will be reflected by an increase in fees charged by the legal profession. It is of strong concern that legal fees may become even less affordable when "the civil justice system is unaffordable for most people."[222] From a legal professional's point of view these cost increases are similarly unsatisfactory. In the United Kingdom, the legal profession have criticised that unwarranted money laundering compliance costs have rendered legal services uncompetitive in an international market. [223]

a) An absence of cost-benefit

With an emphasis on evidence-based policy under new public management, an assumption exists that a new regulatory framework is the most cost-effective means of achieving policy objectives. Data most closely resembling cost-benefit analysis for anti-money laundering risk-based-meta-regulation can be seen in the assets seized through investigations stemming from STRs. Between 2013 and May 2015, STRs have resulted in $220 million worth of assets being seized by the police.[224] However over this same period around 18,000 STR's were filed with a combined value of around $7.7 billion.[225] For every $1 reported suspicious, only 2.85 cents have been recovered in criminal assets.

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219 These are firms with less than 20 partners and or directors. See Geoff Adlam "Snapshot of the Legal Profession 2016" *LawTalk 883* (online ed, 11 March 2016) at 14.

220 Baldwin, Cave and Lodge, above n 53, at 153.

221 Tim Wallace "Banks dump small businesses, charities and fintech firms to save on red tape costs" *The Telegraph* (London, online ed, 24 May 2016).

222 Newstalk ZB "Problems growing from unaffordable legal costs" (New Zealand, online ed, 15 January 2016).

223 Law Society of England and Wales *Response of the Law Society to Select Committee on the European Union – Sub Committee F (Home Affairs) Inquiry into Money Laundering and the Financing of Terrorism* (February 2009) at [1.4].

224 Amy Adams, Minter of Justice "Keynote address to Opening Ceremony of the Asia/Pacific Group on Money Laundering Annual Meeting 2015" (speech at the Asia/Pacific Group on Money Laundering Annual Meeting, Auckland, 13 July 2015).

225 Financial Intelligence Unit *Q3 Quarterly Report 2015-2016* (New Zealand Police, June 2016).

No further evidence has been submitted to suggest that the substantial costs of implementing risk-based-meta-regulation will result in tangible benefits to New Zealand.[226] A report commissioned by the Ministry of Justice in 2008 indicated that compliance costs for legal professionals under Phase 2 at that time would be $24 million initially and then $35 million annually.[227] The Law Society has noted that although lawyers now undertake more client due diligence procedures than 2008, the compliance costs of Phase 2 to the legal profession will still be substantial.[228] Basing their estimates on data obtained by the Law Society of England and Wales in 2009, the Law Council of Australia estimated that the annual compliance cost for the Australian legal profession to implement anti-money laundering measures would be $51,861.40 AUD per law firm.[229] Adjusted for inflation this is $56,306.38 NZD in 2016.[230]

Compliance costs in New Zealand can be expected to be greater than in the United Kingdom and Australia due to New Zealand's smaller purchasing market for anti-money laundering services. Furthermore, estimates of anti-money laundering compliance costs have traditionally been erroneous. Reporting entities in the United Kingdom noted that their compliance costs rose by over 60 per cent between 2001 and 2004, and again by 58 per cent between 2004 and 2007, far in excess of forecasts.[231] Estimating potential compliance cost is particularly complicated for law firms who cannot accurately predict the time staff will take:

- assessing the risks posed by clients;
- chasing up due diligence material;
- monitoring clients and transactions for warning signs; and
- discussing suspicions and internal reports.

The inadequacies of Phase 2's cost-benefit are illustrated by the experience of legal professionals in the United Kingdom who are subject to equivalent anti-money laundering obligations.[232] In the United Kingdom, only 1 per cent of STRs (totally 3,827 in 2015) are filed by legal professionals, despite the profession having to implement the same anti-money laundering measures and pay similar amounts for compliance as other reporting entities.[233]

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226 Law Society of England and Wales, above n 223, at 23.
227 New Zealand Law Society "AML cost of compliance" *LawTalk 892* (online ed, 14 July 2016).
228 New Zealand Law Society, above n 227.
229 Law Council of Australia, at 218, at 21.
230 Using the Reserve Bank of Australia's Inflation Calculator available at: http://www.rba.gov.au/calculator/
231 British Broadcasting Corporation "AML Costs Soar" *BBC News* (online ed, 9 July 2007).
232 Yeoh, above n 5, at 331. The reports are termed "suspicious activity reports" in the United Kingdom.
233 National Crime Agency *Suspicious Activity Reports (SARs) Annual Report 2015* (London, 2015) at 10.

Adopting risk-based-meta-regulation to extend anti-money laundering to legal professionals lacks the cost-benefit justifications of evidence-based policy and would exemplify regulatory blindness.

b) Training

Part of the compliance costs faced by the legal profession if Phase 2 is implemented will include training on anti-money laundering and risk assessment. A shortage of expertise in these essential areas will hinder the adoption of best practice and *effective* implementation of the AML Act, required for a positive Mutual Evaluation report.[234] Although external consultants may initially be brought in to address inevitable issues of inexperience within the legal profession, the successful extension of anti-money laundering regime ultimately requires industry to control and manage risks independently.[235] In an industry such as New Zealand's legal profession, where business is spread across numerous small firms, it is difficult to mobilise independent expertise internally. In such situations it may prove more cost efficient for the government to act as the regulator rather than delegating regulatory responsibility through risk-based-meta-regulation.[236]

c) Minimising cost

Some argue that discretion is given to reporting entities to individualise their anti-money laundering programmes under risk-based-meta-regulation. Otherwise risk-based-meta-regulation could be implemented uniformly in "blocks" consistent across industry by adopting the suggestions of a guidance agency or having a template programme.[237] In these circumstances, compliance cost is reduced and the administrative work of the supervisors would merely be "routine", creating subsequent savings in resources expended on supervision.[238] However, the savings made from uniform practices and routine inspection must be weighed against the intention of risk-based-meta-regulation. As mentioned above, uniform anti-money laundering programmes undermines proportional and flexible risk-based regulation.[239] Regulating in blocks reduces the system to 'tick-boxing' rather subverting the expenditure required under risk-based-meta-regulation with prescription.

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234 International Monetary Fund "Accountability arrangements for financial sector regulators" (2006) 39 Ec Issues 22 at 22.

235 Ai, above n 199, at 201.

236 Ayres and Braithwaite, above n 165, at 121.

237 At 121.

238 At 121.

239 Julia Black "Talking about Regulation" (1998) PL 77 at 98.

2 *Supervision*

In order to effectively implement risk-based-meta-regulation a Supervisor must be appointed to monitor and guide reporting entities. This Supervisor will ensure businesses remain on "a level playing field " and are not disadvantaged by competitors who fail to comply with their obligations.[240] The legal profession is no exception and will require an effective supervisor. As noted in the recent Mutual Evaluation of Australia, small to medium sized entities find it difficult to effectively carry out anti-money laundering measures.[241] Work done by KPMG suggests the same is true of smaller reporting entities in New Zealand who find the discretionary options within risk-based-meta-regulation complex.[242]

It is crucial the Supervisor of legal professionals facilitates effective implementation of the AML Act by promoting a clear understanding of the money laundering risks and obligations.[243] Although obviously central to risk-based-meta-regulation, a definition of "risk" remains elusive. Risk is not defined in guidance of the New Zealand Supervisors nor in FATF's own guidance on the risk-based approach.[244] Is "anti-money laundering risk" the risk that large sums of money may be laundered, or is it risk that any sum of money is laundered?

Compounding this problem is the fact that there is an excess of varied terminology surrounding "risk". Risk can be defined in respect of its different elements. In a money laundering context these include:[245]

- probabilistic risk – the likelihood of specific consequences;
- consequence risk – the seriousness and extent of consequences (including therefore reputation risk); and
- vulnerability risk – how vulnerable the actor is to the consequences.

Money laundering risk may also be divided into sub-groups or categories, including: [246]

- integrity risk – risk that money laundering activity generates a negative perception of the financial system;

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240 Ministry of Justice, above n 98, at 28.
241 Financial Action Task Force, above n 95, at 88.
242 KPMG *The FATF Mutual Evaluation of Australia: Are there lessons for New Zealand's reporting entities?* (Auckland, May 2015) at 9.
243 Financial Action Task Force, above n 59 at 30.
244 See Louis de Koker "Identifying and managing low money laundering risk" (2009) 16(4) Journal of Financial Crime 334.
245 Ross and Hannan, above n 55, at 110.
246 Simonova, above n 160, at 352.

- legal risk – exposure to legal consequences for non-compliance;
- reputational risk – tarnishing of a specific business or industry reputation;
- operational risk – deploying human resources in a particular area;
- IT risk – implementing IT resources; and
- systems and outsourcing risk – hiring third parties to fulfil anti-money laundering obligations.

Although these categories may be useful to describe risk, these groups do not elevate the uncertainty surrounding risk, merely transfer uncertainty into adjectives.

The difficulty of defining risk arises as money laundering activity is detected and ultimate outcomes achieved with such infrequency that reliable probabilistic calculations cannot be drawn, despite activity apparently being abundant.[247] In this context, traditional risk management tools and conceptualisations are inadequate.[248] Anti-money laundering measures can be more accurately described therefore as targeting "uncertainty" – events that are unknown and the consequences unknowable, rather than "risk" – events are known and determinable with measurable consequences.[249] Uncertainty within money laundering has generated "an overflow of useless anti-money laundering information."[250] An effective Supervisor is integral to ensuring that legal professionals know what "risk" is and what is "suspicious", and can accordingly file effective STRs. This is particularly problematic as the existing Supervisors under New Zealand's multi-supervisor model have limited experience with the legal profession.[251]

a) Potential Supervisors

Extension of anti-money laundering obligations to the legal profession will require the creation of a new Supervisor. There is no apparent government agency suitably placed to supervise the legal profession. Accordingly, the government has two main options: a) to create a single regulator, or b) extend the self-regulatory powers of the New Zealand Law Society. Both

[247] Ross and Hannan, above n 55, at 112.
[248] Bello and Harvey, above n 157, at 6.
[249] At 4; Demetis and Angell, above n 162, at 413.
[250] Dalla Pellegrina and Donato Masciandaro "The risk-based approach in the New European anti-money laundering legislation: A law and economics view" (2009) 5(2) International Review of Law & Economics 931 at 934.
[251] Ministry of Justice, above n 98, at 29.

options will involve substantial cost to the taxpayer and will have to be met regardless of whether or not a risk-based-meta-regulatory framework is implemented.

a) Wholesale change may be made to the supervision of reporting entities by establishing a single Supervisor. Utilising the model of AUSTRAC in Australia, a single supervisor ensures a consistent and holistic approach to supervision. It also avoids the issues of coordination and fragmentation of practice existent in a supervisory system lacking of a central locus of authority.[252] However, this option is extremely resource intensive and will involve a long implementation period. It will also disrupt the existing relationships between the current Supervisors and reporting entities.[253]
b) Alternatively, the New Zealand Law Society could act as supervisor with assistance from a government agency. This model is applied in the United Kingdom where the Treasury appoints 27 bodies as Supervisors to act under Crown agencies.[254] This model leverages off the self-regulating bodies' close relationship with their own sectors. However, the British Government is considering submissions regarding a potential reform of their supervisory structure. It is acknowledged that the system inadequately allocates specific monitoring to bodies without overlap and operates inconsistently as the standard of compliance varies greatly between the different Supervisors.[255] Although less expensive than establishing a new agency, this dual-supervisor model will impose significant change and additional cost on the Law Society who has no previous experience in anti-money laundering supervision.[256] However, if the Law Society was not chosen as Supervisor, its self-regulating certainty would be critically challenged. The Law Society "considers it has the necessary experience and capabilities to be the Supervisor" however, concerns exist about how they would be funded in this role.[257] The Law Society is currently funded by levies of legal professionals.[258] This funding issue should be borne in mind when determining what regulatory model to

[252] Julia Black "Constructing and contesting legitimacy and accountability in polycentric regulatory regimes" (2008) 2(2) Regulation and Governance 137 at 140
[253] Ministry of Justice, above n 98, at 30.
[254] HM Treasury "Anti-money laundering and counter terrorist finance supervision report 2013-14" Gov.UK (26 May 2016) <www.gov.uk/government>.
[255] HM Treasury "Call for Information: Anti-Money Laundering Supervisory Regime" Gov.UK (21 April 2016) <www.gov.uk/government>.
[256] Ministry of Justice, above n 98, at 30.
[257] New Zealand Law Society, above n 178, at 14.
[258] Lawyers and Conveyancers Act, ss 73-75.

implement in Phase 2 as risk-based-meta-regulation is considerably more expensive for legal practitioners.

3 Issues with privatisation

Placing regulatory responsibility in the private sector means those acting as quasi-regulators are not democratically accountable like public servants.[259] This creates various issues, all of which are relevant to the legal profession:

a) Clash of Objectives

The AML Act stipulates its purposes are to detect and deter money laundering, protect the integrity of the financial system and the public confidence in that system.[260] However, these purposes do not align: there is a conflict between commercial (preserving the reputation and integrity of the financial sector) and general regulatory goals (ensuring the financial system is not used for money laundering).[261] The former provides clear benefits to the private sector, where the latter benefits the wider public. This conflict may explain the initial reluctance of reporting entities overseas to commit to fully implementing robust anti-money laundering measures.[262] Commentators have suggested that to get greater 'buy-in' from private businesses, the goals must be weighed in favour of private businesses to avoid "the tension inherent in the anti-money laundering fight between the commercial ethos and regulatory injunctions."[263]

b) Industrial absolutism

Although regulatory responsibility is shifted onto the private sector by risk-based-meta-regulation, it nonetheless creates discretionary powers for the supervisors. Where a Supervisor must monitor varying systems

.(as should be the case under risk-based-meta-regulation) they may make concessions for, on one hand, less resourced firms or, on the other, firms who are economically powerful and have political influence. This could foster "industrial absolutism" where business is shown leniency

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259 Baldwin, Cave and Lodge, above n 53, at 151
260 The Anti-Money Laundering and Countering Financing of Terrorism Act, s 4.
261 See for example: Gilles Favarel-Garrigues, Thierry Godefroy and Pierre Lascoumes "Sentinels in the banking industry: Private actors and the fight against money laundering in France" (2009) 48(1) BritJCriminol 1; and Ricardo Araujo "Assessing the efficiency of the anti-money laundering regulation: An incentive-based approach" (2008) 11(1) JMLC 67.
262 Gilles Favarel-Garrigues, Thierry Godefroy and Pierre Lascoumes "Reluctant partners? Banks in fight against money laundering and terrorism financing in France" (2011) 42(2) Security Dialogue 179.
263 Favarel-Garrigues, Godefroy, and Lascoumes, above n 261, at 9.

in respect of the law.[264] Where industrial absolutism reigns, absolute standards are replaced by moral relativism at the expense of the rule of law.[265]

c) Reliance on the private sector

Transaction monitoring and risk assessments are highly qualitative tasks that critically rely on the skill and experience of private sector officials making subjective judgments.[266] This reliance on the skill of regulatory officials expounds the danger there will be a miscalculation of risk.[267] Although this is a problem when the regulation is carried out by the public sector, the efficacy of a system is reliant on the training of staff. With risk-based-meta-regulation, training is carried out by private entities.

This is problematic as the corporate culture of many reporting entities focuses on profits. In these entities, risk-based anti-money laundering measures are usually performed by interface staff who are driven by targets and performance measures (for example time spent with customers and rate of turnover). Performance measures of how well staff execute anti-money laundering measures are at odds with this corporate culture, and may rarely be considered.[268] Thus, reliance on the private sector in risk-based-meta-regulation is not buttressed by a focus on adequate anti-money laundering procedures and a specific emphasis on anti-money laundering training.

4 Particular ethical issues for legal professionals

Extension of anti-money laundering obligations to legal professionals is seen by many to be in direct conflict with a lawyer's ethical duties. These duties, broadly speaking, require lawyers to uphold the administration of justice and the interests of their clients.[269] An obligation to act as quasi-regulator, pass judgement over a client and then report suspicions of money laundering to authorities may breach the confidentiality, privilege and fiduciary relationship between lawyer and client. [270]

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264 Louis Brandeis "The Opportunity in the Law" (1905) 3(1) CL Rev 22 at 29.
265 Ayres and Braithwaite, above n 165, at 123.
266 Black and Baldwin, above n 52, at 185.
267 HM Treasury *A new approach to financial regulation: building a stronger system* (London, 2011) at 117.
268 Killick and Parody, above n 201, at 211.
269 See Lawyers: Conduct and Client Care Rules, preface.
270 Anti-Money Laundering and Countering Financing of Terrorism Act, s 40.

Underlying the provision of legal services is an understanding that "the client must be sure that what he tells his lawyer in confidence will never be revealed without his consent."[271] This confidentiality exists to encourage full and frank communication between the lawyer and client, ensuring clients have effective representation and justice is properly administered.[272]

Legal privilege, distinct from confidentiality is "a fundamental condition on which the administration of justice as a whole rests."[273] The Ministry of Justice has indicated that the obligations under the AML Act will not apply to privileged information as is currently done under the FTR.[274] However, reporting obligations under the AML Act arise before a fiduciary relationship of trust and confidence would be established. STRs must be made regarding the potential provision of services from which suspicion of money laundering arises. What may become privileged information is compromised as legal professionals will be obliged under Phase 2 to disclose these details in a STR.

Confidential information shared between the client and lawyer will not be subject of an exemption from anti-money laundering obligations. Phase 2 obligations may require a lawyer to disclose information they are otherwise obliged to protect, without demonstrating that in the particular circumstances disclosure was justified. The lawyer must simply hold that the transaction "raised suspicion". Breaches of confidentiality like this may be justified retrospectively where disclosure leads to money laundering detection and prosecution. Here the lawyer is validly upholding their primary duty to the court by stopping wrongful conduct.[275] However, a lawyer's duty to uphold the rule of law over their client's interests arises only when they know of wrongful activity. Phase 2 requires a lawyer to breach confidentiality upon suspicion instead of knowledge, and become an agent in their client's downfall. If a STR is unsubstantiated, it cannot be justified retrospectively as upholding the rule of law. This is in breach of a lawyer's ethical duties and could result in disciplinary action from the New Zealand Law Society.

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271 *R v Derby Magistrates' Court, ex p B* [1996] AC 487 at 507. Confirmed in New Zealand by *B v Auckland District Law Society* [2004] 1 NZLR 326 [2003] UKPC 38.

272 Geoffrey Hazard Jr, Susan Koniak and Roger Cramton *The Law and Ethics of Lawyering* (New York, Foundation Press, 1999) at 204.

273 *R v Derby Magistrates' Court*, above n 271, at 508.

274 Ministry of Justice, above n 98, at 14.

275 See Lawyers: Conduct and Client Care Rules, preface.

Similarly, legal professionals are obliged to disclose all information known about a client that is related to their affairs.[276] However, Phase 2 makes it an offence for legal professionals to tell their clients that they have made or know of a STR involving any client's business. This is in direct conflict with a lawyer's duty.[277] Even if privileged information is protected under Phase 2, confidentiality and a duty to ensure the client's interests are looked after are compromised.

Furthermore, obligation to act as a quasi-police force reduces the independence of the legal profession. Having to report suspicious transactions compromises the lawyer's undivided loyalty to the court and their client.[278] Legal professionals must rely on private statements of individuals to verify identity information required under the AML Act as there is no interests register to determine beneficial interests. An obligation to question these statements undermines the lawyer's fundamental duty to support their client and independence in exercising their duties.[279]

a) Canadian Experience

In some jurisdictions legislators have been met with considered resistance by the legal profession when imposing anti-money laundering obligations. In Canada, legal professionals' statutory anti-money laundering obligations have been struck down by constitutional courts. After facing enormous pressure from law societies across Canada, the Attorney-General agreed to conduct "a binding test case" on the validity of anti-money laundering regulations in 2002. In three judgements delivered in the British Colombia Supreme Court in 2011,[280] the British Columbia Court of Appeal in 2013[281] and the Supreme Court of Canada in 2015[282] have held various anti-money laundering obligations are constitutionally inconsistent with the ethical duties of a Canadian lawyer.

The British Columbia Supreme Court held that solicitor-client privilege is a principle of fundamental justice and that obligations to make and retain detailed copies of clients' transactions were contrary to the privilege because they "result in having lawyers' offices

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[276] Chapter 7.
[277] Anti-Money Laundering and Countering Financing of Terrorism Act, s 94.
[278] Lawyers: Conduct and Client Care Rules, ch 5.
[279] Simonova, above n 160, at 353.
[280] *Federation of Law Societies of Canada v Canada (Attorney General)* [2011] BCSC 1270, 25 BCLR (5th) 265.
[281] *Federation of Law Societies of Canada v Canada (Attorney General)* [2013] BCCA 147, 41 BCLR (5th) 238.
[282] *Canada (Attorney General) v Federation of Law Societies of Canada* [2015] 1 SCR 401.

turned into archives for the use of the prosecution".[283] On appeal, the British Columbia Court of Appeal overturned the Supreme Court by holding the Canadian equivalent of the AML Act sufficiently protects solicitor-client privilege.[284] However, the Court held that the anti-money laundering obligations were not consistent with the Canadian constitution as they infringed the independence of the legal profession by turning "at least some lawyers into agents of the state" for the purpose of collecting information about their client.[285] The Supreme Court of Canada held on a separate challenge that search provisions to enter legal premises and search for transaction records without a warrant did not sufficiently protect solicitor-client privilege.[286] This search power is not available to New Zealand investigative bodies under the AML Act.

In all three courts, the fact that the Federation of Canadian Law Societies had adopted a system to prevent lawyer's facilitating money laundering in substitution of the government's risk-based-meta-regulatory regime was crucial to their success. Under the Canadian Law Societies' alternate system, domestic law societies ensure compliance with know-your-client and prescribed rule-based suspicious transaction reporting obligations through annual reports and audits of law firms.[287]

Canadian experience illustrates that anti-money laundering obligations may conflict with the ethical duties of legal professionals. A Mutual Evaluation of Canada's anti-money laundering regime has recently been completed and is being finalised.[288] This report may be a useful gauge on a potential fall out of not applying FATF's risk-based-meta-regulatory model to legal professionals. If criticism of the Canadian regime in this respect appears minimal, perhaps the Canadian self-regulatory model poses a viable option New Zealand could utilise to impose some anti-money laundering obligations on legal professionals without incurring the burdensome costs of risk-based-meta-regulation.

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283 *Federation of Law Societies of Canada*, above n 280, at [144].

284 Proceeds of Crime (Money Laundering) and Terrorist Financing Act RSC 2000 c 17, ss 5(i), 5(j).

285 *Federation of Law Societies of Canada*, above n 281, at [124].

286 *Canada (Attorney General)*, above n 282, at [105].

287 *Federation of Law Societies of Canada*, above n 281, at [23]; *Canada (Attorney General)*, above n 282, at [107].

288 Financial Action Task Force "Outcomes of the Plenary meeting of the FATF, Busan Korea, 22–24 June 2016" (24 June 2016) <www.fatf-gafi.org>.

5 Creative compliance

Creative compliance is using the letter of the law to defeat the spirit of the law;[289] subverting the goal to be achieved and the harm to be prevented from the regulation.[290] Affording private entities discretion to develop their own anti-money laundering systems under risk-based-meta-regulation provides them with an opportunity to use their "ingenuity" to circumvent the intended spirit of the AML Act.[291] Wealthy companies have more resources available to spend analysing their compliance obligations, looking for loopholes, than the Supervisors tasked with enforcing and checking compliance.[292]

The legal profession's familiarity with legal structures and obligations may position it better than other professions to engage in creative compliance. To be discouraged from engaging in creative compliance, legal professionals must not perceive compliance from a positivist viewpoint as a technical task, but see compliance as realising the spirit of the law.[293] This requires the spirit of the AML Act to capture the conscience of the legal profession. However, as risk-based-meta-regulation poses substantial financial burdens on legal professionals without apparent cost-benefit justification, it is dubious whether the "spirit" of the Act will receive effective buy-in from private businesses. This theory mirrors experience in the United Kingdom where qualitative data holds around two-thirds of reporting entities comply with anti-money laundering obligations simply to avoid penalties, as opposed to the obligations representing good business practice.[294]

6 Tension between potential liabilities

New Zealand's anti-money laundering scheme exposes reporting entities (and staff) to civil and criminal liability. Cases in the UK have illustrated that the onerous obligations and a threat of liability for non-compliance encourage defensive reporting.[295] Defensive or umbrella

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289 Doreen McBarnet *Enforcing Ethics: New Strategies for Tackling Creative Compliance* (Australian National University, Canberra, 2007) at 1.

290 Bronwen Morgan and Karen Yeung *An Introduction to Law and Regulation: Text and Materials* (Cambridge University Press, Cambridge, 2007) at 154.

291 Baldwin, Cave and Lodge, above n 53, at 151.

292 Ayres and Braithwaite, above n 165, at 124.

293 Bronwen Morgan and Karen Yeung *An Introduction to Law and Regulation: Text and Materials* (Cambridge University Press, Cambridge, 2007) at 2.

294 Z/Yen Ltd *Anti-money Laundering Requirements: Costs, Benefits and Perceptions* (City of London, London, June 2005) at 32; and Law Society of England and Wales *Financial Action Taskforce Consultation Response: Reviewing the standards preparing for the 4th round of mutual evaluations* (January 2011) at 5.

295 Yeoh, above n 5, at 330; Ross and Hannan, above n 55, at 107. See *R v Swan* [2011] EWCA Crim 2275; *Ahmad* [2011] HJCJAC 21: [2009] SCL 1093 HM Advocate; and *R v Griffiths and Pattison* [2006] EWCA Crim 2155: [2007].

reporting involves the reporting entity filing excessive STRs to avoid the consequences of non-reporting.[296] Although disciplinary action under the AML Act in New Zealand has been limited to "warnings" issued to reporting entities, reporting entities may still file STRs out of fear of supervisory action, rather than genuine suspicion of money laundering.[297] This issue of defensive reporting is compounded by uncertainty in the conceptualisation of risk in anti-money laundering guidance. Without clear and effective guidance, it is likely that legal professionals will engage in defensive reporting to avoid supervisory sanctions or penalties for non-compliance.[298]

Whilst potential liabilities from the public sector may incentivise reporting entities to engage in defensive reporting, risk-based-meta-regulation also exposes reporting entities to liability from the public. This liability is best exemplified by a recent case in the United Kingdom. In *Shah v HSBC,*[299] Shah sought £300 million in damages arising from delays by HSBC in executing transfers from his account without due explanation. HSBC's delays were consequent of filing a STR regarding the transfers.[300] Informing Shah that the delays were due to anti-money laundering measures would have breached HSBC's obligations under the United Kingdom's equivalent AML Act.[301] Shah's damages claim was unsuccessful as the HSBC staff had acted in good faith and genuinely formed suspicion requiring them to submit a STR (even though this suspicion was erroneous).[302] The court also found the damages claimed were too remote and Shah did not adequately mitigate his losses.[303] However, *Shah* illustrates how risk-based-meta-regulation may create practical issues and impose liability on private companies as quasi-regulators. HSBC, the United Kingdom's largest bank,[304] successfully defended the private damages claim due to their sound anti-money laundering systems.[305] Whether or not a small law firm's anti-money laundering scheme would prove so robust under extended cross-examination is questionable. This concern is particularly salient for the New Zealand legal profession which is dominated by small businesses. Risk-based-meta-regulation would not

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[296] Favarel-Garrigues, Godefroy, and Lascoumes, above n 262, at 185.
[297] See for example: Reserve Bank of New Zealand "Enforcement action under the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 - Kiwibank Limited" (press release, 28 October 2015).
[298] Favarel-Garrigues, Godefroy, and Lascoumes, above n 262, at 185.
[299] *Shah v HSBC Private Bank (UK) Ltd* [2012] EWHC 1283 (QB).
[300] At [4].
[301] At [201].
[302] At [112].
[303] At [232-233].
[304] Advisory HQ "Top UK Banks 2016 Ranking" (2016) <www.advisoryhq.com>.
[305] *Shah v HSBC Private Bank*, above n 299, at [70-122].

only expose legal professionals to large compliance costs, but it would extend their potential liability to both the public and private sectors.

IV Conclusion – What Regulatory Model Will Be Used?

The previous sections illustrate that application of risk-based-meta-regulation in order to impose anti-money laundering obligations on the legal profession under Phase 2 is unprincipled. Although risk-based-meta-regulation is a sound regulatory strategy in some circumstances and has obvious strengths, its application to legal professionals in New Zealand lacks a sound evidentiary foundation.

The manner in which FATF stresses risk and the self-regulatory nature of its risk-based-meta-regulatory model highlights the global demand for regulation which can readily justify its existence. FATF's risk-based-meta-regulation initially appears to justify its implementation: transferring regulatory responsibility to private business creates regulation which is flexible, efficient, responsive, transparent and conducive of working relationships between the public and private sectors. Explicitly incorporating risk generates a framework which justifies the allocation of scarce resources. Positing the model anti-money laundering framework in this manner FATF packages its regulatory model as an easily adoptable and digestible product. This product caters to a "cost-benefit culture" that expressly exists in New Zealand – "we *have to* make sure what looks like a good policy idea is backed up by solid evidence and quality analysis" (emphasis added).[306]

However, the cost-benefit promised by FATF's risk-based-meta-regulation product is not realised when it is applied to legal professionals; there is a distinct absence of evidentiary or cost-benefit drivers. Furthermore, many aspects of New Zealand's anti-money laundering regime resemble rule-based rather than risk-based regulation. The regime is an unsatisfactory hybrid between the two styles: undermining notions of risk with prescriptive criteria yet imposing the same burdensome costs as a truly individualised risk-based-meta-regulatory regime. Accordingly, "risk-based-meta-regulation" is political rhetoric which exudes a sense of proportionality but fails to deliver truly to its namesake. This model should not be applied to legal professionals under Phase 2.

Despite the inappropriateness of risk-based-meta-regulation as a regulatory strategy to impose anti-money laundering obligations on legal professionals as illustrated in this paper, it is likely to be chosen to implement Phase 2. As such, Phase 2 illustrates the substantial influence New Zealand's international relations may have over domestic regulation. If risk-based-meta-regulation is implemented, New Zealand will have foregone its sovereign power of legislative

306 Makhlouf, above n 79.

freedom in favour of conformity to an international financial organisation in FATF. Although FATF have no basis on which they can make "hard law", the imposition of risk-based-meta-regulation on legal professions would illustrate how soft-law may be hardened by external pressures present in international politics. Adherence to FATF's risk-based-meta-regulatory regime will not arise out of need or appropriateness but rather willingness to please existing and potential international trade partners. Accordingly, it is ironic that the Recommendations purport not to "compromise the freedom to engage in legitimate transactions or threaten economic development" as in New Zealand's case they are perceived fundamental to international relations and the nation's reputation more generally.

The imposition of risk-based-meta-regulation in absence of cost-benefit or a compelling evidentiary foundation highlights the extent New Zealand's international relations may be damaging to domestic business. Risk-based-meta-regulation will impose far greater costs on business than a more prescriptive rules-based regime. What is interesting about Phase 2 as a process of law reform is that the repercussions are unknown if the government decided to implement rule-based regulation at lower cost to domestic legal firms as Canada does in preference to FATF's risk-based-meta-regulatory model. Although it is unlikely New Zealand would be placed on FATF's blacklist for not applying a risk-based-meta-regulatory approach in respect of legal professionals, there could be negative ramifications arising from an unfavourable Mutual Evaluation. Perhaps the implementation of risk-based-meta-regulation can be rationalised as the adoption of a known evil (high costs in absence of cost-benefit or theoretical justification) in favour of an unknown one.

In theory New Zealand has full sovereign powers over its laws. Under the Charter of the United Nations each member state is deemed to have equal sovereignty and is free from the influence of other states in the ordering of its regulatory affairs.[307] Phase 2 illustrates how these notions are theoretical. In practice the consequences of non-compliance may be so great they limit New Zealand's sovereign freedom and justify the imposition of burdensome obligations. Phase 2 underscores the question whether New Zealand's relationship with FATF and its other core members places New Zealand in a corner, compelled into conformity with rules for which the country has "no meaningful participatory linkage."[308]

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[307] Charter of the United Nations, art 2.

[308] Ghoshray, above n 29, at 536.

Other issues also arise when regulation is born solely out of international pressure or relations rather than genuine need or evidence. Such regulation, as appears to be the likely case for legal professionals under Phase 2, is a bureaucratic product and may suffer from a lack of buy-in. Risk-based-meta-regulation which places large costs on private businesses to become quasi-regulators is contrived when it is born not from need but political pressure and will struggle to be implemented effectively. Thus, in regard to legal professionals under Phase 2, the New Zealand government appears to be stuck in a quandary. They may either alienate businesses by imposing substantial compliance costs under risk-based-meta-regulation but remain on side with FATF, or alternatively, regulate in a manner less intrusive to businesses but face international backlash from FATF. Phase 2 neatly highlights these subtle complexities acting upon domestic law reform.

This manner in which subscription to international organisations and international relations more generally may influence domestic legislation should be understood when assessing law reform. A willingness to please international bodies and establish an international reputation may render New Zealand's legislative frameworks vulnerable to reforms that:

- favour concerns not applicable in a local context;
- impose large financial burdens on business; and
- when analysed more closely, are absent of any cost-benefit analysis "that underpins quality regulation."[309]

The likely implementation of a risk-based-meta-regulatory anti-money laundering regime for legal professionals highlights the inconsistency in New Zealand's perceived image of its financial regulation. The Shewan Trusts Inquiry stressed that New Zealand does and seeks to continue to "lead by example" in financial market initiatives and regulation.[310] It is therefore ironic that the regulatory regime most likely to be implemented, in absence of a principled or evidentiary foundation, is a result of New Zealand following the lead of an international body. In respect of anti-money laundering, New Zealand cannot profess to be a world leader but is rather a zealous devotee of international organisations and relationships.

The current government has "committed to sending a clear message that crime is not profitable in New Zealand" through its anti-money laundering regime.[311] However, this is not a message

309 (24 September 2009) 657 NZPD 6882.
310 Shewan, above n 99, at 2 and 41.
311 Adams, above n 224.

to criminals, but rather to other nations and international organisations. With eager and conceited desire to support this commitment, New Zealand's regulatory frameworks face hypocrisy. If risk-based-meta-regulation is implemented for legal professionals, private business will incur large costs with no evident benefit. This is an unnerving and unsatisfactory prospect. This paper does not suggest that legal professionals should be exempt from anti-money laundering obligations. However, it does call for New Zealand's commitment to FATF and anti-money laundering to be tempered by respect for the financial interests of private businesses who are faced with compliance costs. Albeit under the duress of international pressure, Phase 2 should be sophisticated, imposing anti-money laundering obligations and subsequent costs on legal professionals consistently with the demands of evidence-based policy.

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