

VOLUNTARY GOOD PRACTICES GUIDANCE FOR LAWYERS TO DETECT AND COMBAT MONEY LAUNDERING AND TERRORIST FINANCING

A collaborative effort of representatives of the American Bar Association (“ABA”) Task Force on Gatekeeper Regulation and the Profession, the ABA Section of Real Property, Trust and Estate Law, the ABA Section of International Law, the ABA Section of Business Law, the ABA Section of Taxation, the ABA Criminal Justice Section, the American College of Trust and Estate Counsel, the American College of Real Estate Lawyers, the American College of Mortgage Attorneys, and the American College of Commercial Finance Lawyers.

These organizations have not necessarily formally endorsed or approved this paper, and this Guidance should not be viewed as representing the policy of any of these organizations.

[Insert date]

VOLUNTARY GOOD PRACTICES GUIDANCE FOR LAWYERS TO DETECT AND COMBAT MONEY LAUNDERING AND TERRORIST FINANCING

In 1989, the major industrialized nations formed an intergovernmental body known as the Financial Action Task Force on Money Laundering (“FATF”) to coordinate efforts to prevent money laundering in both the international financial system and the domestic financial systems of the member entities. FATF first issued a comprehensive action plan, known as the Forty Recommendations, for combating money laundering that was intended to present the basic framework for anti-money laundering (“AML”) efforts and be of universal application.¹ The Forty Recommendations are not a binding international convention, but many countries (including the United States) have committed to implementing them.

A decade after the creation of FATF, FATF sought to enlist the support of so-called “gatekeepers” to combat money laundering and terrorist financing. “Gatekeepers” include lawyers, notaries, trust and company service providers (“TCSPs”), real estate agents, accountants, auditors and other designated non-financial businesses and professions (“DNFBPs”) who assist with transactions involving the movement of money in the domestic and international financial systems. This effort is known as the “Gatekeeper Initiative.”

A month after the September 11, 2001 terrorist attacks in the United States, FATF expanded its mandate to address terrorist financing and issued the Special Recommendations on Terrorist Financing. The Special Recommendations, originally comprised of eight recommendations, are intended to supplement the Forty Recommendations and are designed to combat the funding of terrorist acts and terrorist organizations. A ninth special recommendation was added in October 2004 to address concerns with cash couriers, thereby transforming the Special Recommendations into what have become known as the Nine Special Recommendations. The Forty Recommendations and the Nine Special Recommendations are sometimes referred to as the “40+9 Recommendations.” In sum, the 40+9 Recommendations, together with their interpretative notes, constitute the international standards for combating money laundering and terrorist financing.

The 40+9 Recommendations encourage countries to develop a risk-based approach to prevent money laundering and to combat the financing of terrorism (“CFT”). The theoretical and practical underpinning of the risk-based approach is to ensure that the limited resources (both governmental and private sector) available to fight money

¹ The acronyms used in this paper are based on linguistic naming conventions used by FATF. Annex 2 (Glossary of Terminology) attached to the Lawyer Guidance (as defined below) contains a glossary of many of the terms used in the Lawyer Guidance. Appendix B attached to this Guidance contains a glossary of many of the acronyms used in this Guidance.

laundering and terrorist financing are employed and allocated in the most efficient manner possible so that the activities posing the greatest risks receive the most attention and are targeted with the greatest funding. In this manner, the risk-based approach differs fundamentally from a rules-based approach. Under a rules-based approach, a person would be required to comply with particular laws, rules, or regulations irrespective of the underlying quantum or degree of risk.

In June 2007, FATF collaborated with representatives of the international banking and securities industries to formulate risk-based guidance for financial institutions. Known as the “Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing—High Level Principles and Procedures” (“Financial Institution Guidance”), this document was the first risk-based guidance paper issued by FATF for a specific industry sector.

Shortly after the issuance of the Financial Institution Guidance, FATF met with representatives of the DNFBP sectors, including lawyers, to determine if they would be willing to engage in a similar collaborative effort to develop risk-based guidance for their businesses and professions. The DNFBPs agreed to do so, and following such efforts FATF ultimately issued separate risk-based guidance papers in 2008 for every DNFBP sector, including lawyers.

During the negotiations with FATF over the guidance for lawyers, representatives of the legal profession emphasized to FATF the importance of ensuring that any risk-based approach developed did not undermine the attorney-client privilege or the duty of client confidentiality or otherwise impede the delivery of legal services generally. After over a year of intense debate and discussion, in October 2008 FATF issued risk-based guidance for the legal profession entitled “RBA Guidance for Legal Professionals” (“Lawyer Guidance”).²

The Lawyer Guidance contains 126 separately numbered paragraphs and organizationally tracks the Financial Institutions Guidance that served as a template for the DNFBP guidance papers. The Lawyer Guidance is a complex document that addresses different audiences (e.g., private sector and public authorities), undertakes to identify the AML and CFT issues specific to the legal profession, and outlines the risk factors that lawyers need to consider in developing a risk-based system.

The Lawyer Guidance is “high level” guidance intended to provide a broad framework for implementing a risk-based approach for the legal profession. It does not offer detailed direction on the application of this approach to specific factual situations, nor does it take into account the practical realities of the practice of law in an increasingly complex environment or attempt to address jurisdictional variations among the FATF member countries. For those reasons, the Lawyer Guidance urges the legal profession

² RBA GUIDANCE FOR LEGAL PROFESSIONALS (“LAWYER GUIDANCE”), adopted October 23, 2008, available at <http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf>.

generally, or in different countries, to develop “good practice in the design and implementation of an effective risk-based approach.”³

Accordingly, the purpose of this paper is to assist members of the legal profession in the United States in designing and implementing effective risk-based approaches consistent with the broad contours of the Lawyer Guidance. It is not intended to be, nor should it be construed as, a statement of the standard of care governing the activities of lawyers in implementing a risk-based approach to combat money laundering and terrorist financing. Rather, given the vast differences in practices, firms, and lawyers throughout the United States, this paper seeks only to serve as a resource that lawyers can use in developing their own voluntary risk-based approaches. At the same time, this paper is not intended to be an academic exercise. The federal government is under pressure from FATF and others (including development agencies, the Organisation for Economic Co-Operation and Development, the International Monetary Fund, The World Bank, and the United Nations) to adopt legislation implementing some or all of the provisions of the Lawyer Guidance. An overarching purpose of this paper is to encourage lawyers to develop and implement voluntary, but effective, risk-based approaches consistent with the Lawyer Guidance, thereby negating the need for federal regulation of the legal profession.

To assist practitioners in understanding the practical implications of a particular provision in the Lawyer Guidance, this paper provides various “Practice Pointers.” These Practice Pointers are intended to offer insight into the Lawyer Guidance provision in question, especially from the perspective of a practitioner.

This paper represents a collaborative effort by representatives of the following organizations acting in their individual capacities:

- American Bar Association (“ABA”) Task Force on Gatekeeper Regulation and the Profession;
- ABA Section of Real Property, Trust and Estate Law;
- ABA Section of International Law;
- ABA Section of Business Law;
- ABA Section of Taxation;
- ABA Criminal Justice Section;
- American College of Trust and Estate Counsel;
- American College of Real Estate Lawyers;
- American College of Mortgage Attorneys; and
- American College of Commercial Finance Lawyers.

These organizations have not necessarily formally endorsed or approved this paper, and this paper should not be viewed as representing the policy of any of these organizations.

³ LAWYER GUIDANCE ¶ 6.

This paper will be revised and updated on an as-needed basis in response to evolving developments.

OVERVIEW

The first section of this paper will provide an overview of the mechanics of money laundering and terrorist financing so that practitioners can better understand and achieve the goals of the United States' and FATF's AML/CFT efforts. The sections that follow will then describe the risk-based approach and recommended client due diligence, identify those lawyers who are subject to the Lawyer Guidance, specify the activities that are addressed by the Lawyer Guidance, list and analyze the risk categories and risk variables, and conclude with a suggested protocol for client intake and assessment and a discussion of the importance of on-going education and continuing legal education efforts in this area.

The “practice pointers” appearing throughout the text, which take the form of hypothetical fact patterns to highlight specific issues or points, are designed to provide practical guidance and insights to practitioners. They may also elaborate on a statement or concept contained in the Lawyer Guidance.

What is Money Laundering?

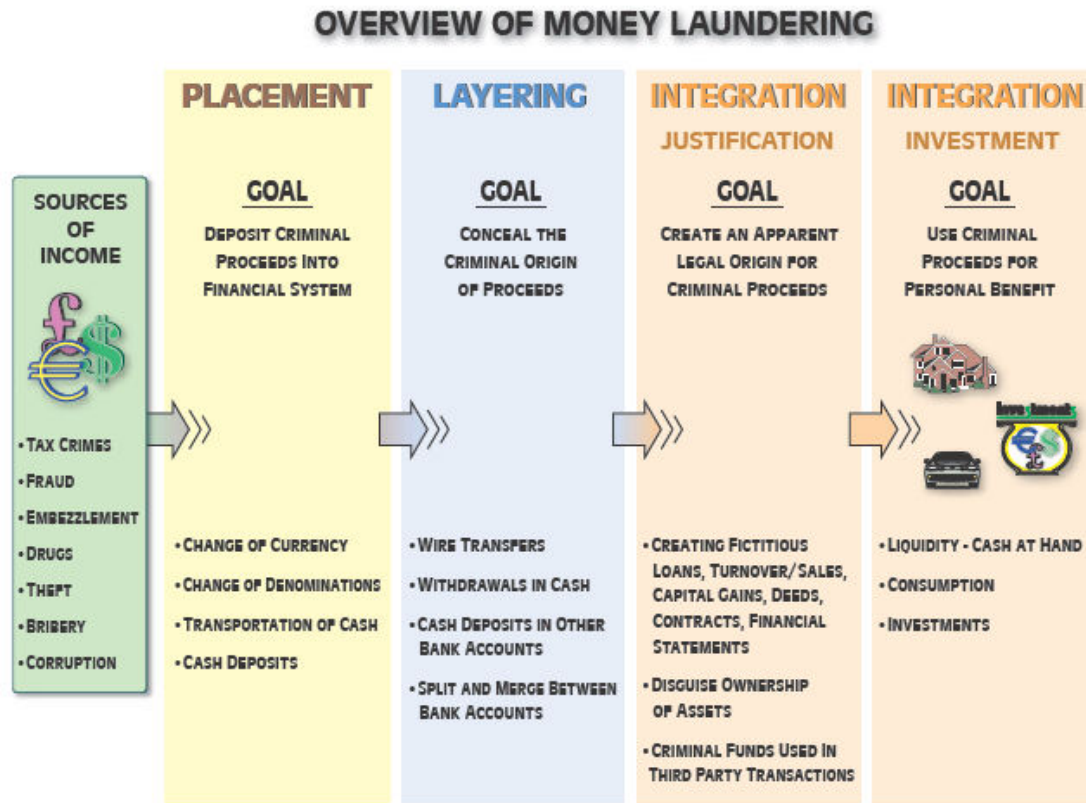
Money laundering “is the criminal practice of filtering ill-gotten gains, or ‘dirty’ money, through a series of transactions; in this way the funds are ‘cleaned’ so that they appear to be proceeds from legal activities.”⁴ Money laundering was made a federal crime in the U.S. under the Money Laundering Control Act of 1986 and is addressed under 18 U.S.C. § 1956 (laundering of monetary instruments) and § 1957 (engaging in monetary transactions in property derived from specified unlawful activity). Money laundering involves three distinct stages: the placement stage, the layering stage, and the integration stage.⁵ The placement stage is the stage at which funds from illegal activity, or funds intended to support illegal activity, are first introduced into the financial system. The layering stage involves further disguising and distancing the illicit funds from their illegal source through the use of a series of frequently complex financial transactions. This stage may include the creation of tiered entities and complicated entity structures designed to conceal the source of the illicit funds. The integration phase of money laundering results in the illicit funds, now laundered, returning to “a status of expendability in the hands of the organized crime group that generated them.”⁶

⁴ BANK SECRECY ACT ANTI-MONEY LAUNDERING EXAMINATION MANUAL, Federal Financial Institutions Examination Council at 14 (June 25), available at www.occ.treas.gov/handbook/BSA-AMLexamprocedures.pdf.

⁵ See http://www.fatf-gafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.-html# (explaining three stages of money laundering).

⁶ See http://www.fincen.gov/news_room/aml_history.html. (explaining three stages of money laundering).

Practice pointer: The following diagram provides an overview of the three phases of money laundering. See MONEY LAUNDERING AWARENESS HANDBOOK FOR TAX EXAMINERS AND TAX AUDITORS, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, available at www.oecd.org/dataoecd/61/17/43841099.pdf:



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A 2008 federal district court case also illustrates a money laundering scheme whereby the defendant was convicted of, among other things, conspiring to commit money laundering. Factually, the defendant led a scheme that involved manipulating documents associated with real estate sales and closings to obtain excess mortgage loan proceeds generated from the property sales. The defendant recruited unsuspecting investors to purchase low income, dilapidated, and depressed properties at prices artificially inflated above legitimate fair-market values (placement phase). The mortgages were financed with fraudulent loans facilitated, brokered, and closed by the defendant and his conspirators (layering phase). The conspirators provided the down payments on the properties, paid kick backs to the loan applicants, and opened bank accounts to disguise the true nature, location, source, ownership, and control of the proceeds and profits from the transactions (integration phase).⁷

⁷ For a more complete description of this case, see the press release issued by the U.S. Department of Justice at www.usdoj.gov/usao/ohs/Press/03-26-08-Day.pdf.

What is Terrorist Financing?

Terrorist financing includes the financing of terrorists, terrorist acts, and terrorist organizations. FATF defines a “terrorist” basically as anyone who commits, participates in, organizes, or contributes to the commission of terrorist acts. FATF defines “terrorist acts” as including any act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organization to do or to abstain from doing any act. Finally, a “terrorist organization” refers to any group of terrorists that: (a) commits, or attempts to commit, a terrorist act by any means, directly or indirectly, unlawfully and willfully, (b) participates as an accomplice in terrorist acts, (c) organizes or directs others to commit terrorist acts, or (d) contributes to the commission of terrorist acts by a group of persons acting with a common purpose when the contribution is made intentionally and with the aim of furthering the terrorist act or with the knowledge of the intention of the group to commit a terrorist act.⁸

The Lawyer Guidance acknowledges that it is significantly more challenging to detect and identify terrorist financing than potential money laundering and other suspicious activity. Transactions facilitating terrorist financing often do not exhibit the same characteristics as conventional money laundering. For example, terrorist financing may involve low dollar value transactions and the appearance of innocence (such as purportedly charitable activities), and can involve a variety of sources (such as business, criminal activity, self-funded, and state sponsors of terrorism). The Lawyer Guidance thus does not comprehensively address the application of the risk-based approach to terrorist financing.⁹

⁸ See <http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf> (contains definitions used in this paragraph). Prohibitions on terrorism and terrorist financing also are mandated by the United Nations and federal law. United Nations Security Council Resolution (“UNSCR”) 1267 (and its progeny) calls on Member States to ban travel for, freeze the funds and financial resources of, and impose an arms embargo on members of the Taliban and Al Qaeda. See <http://www.un.org/sc/committees/1267/>. The United States implements UNSCR 1267 pursuant to the United Nations Participation Act (“UNPA”), 22 U.S.C. § 287c, and the International Emergency Economic Powers Act (“IEEPA”), 50 U.S.C. § 1701 *et seq.* The U.S. Department of the Treasury’s Office of Foreign Assets Control (“OFAC”) administers the regulations promulgated pursuant to IEEPA and the UNPA. In particular, pursuant to OFAC’s regulations, U.S. persons (including lawyers) are prohibited from engaging in transactions (including the exchange of services) with certain terrorists, those they own or control and those who are acting on their behalf. These persons (individuals and entities) are identified on the SDN List (as defined in text accompanying footnote 9 below). OFAC’s terrorism regulations are implemented pursuant to the IEEPA, the UNPA, and the Anti-terrorism and Effective Death Penalty Act of 1996, 18 U.S.C. § 2332d, among others. OFAC administers the following sanctions programs specifically targeting terrorists, those they own or control, and those who provide material support to terrorists: The Global Terrorism Sanctions Regulations, 31 C.F.R. 594; Terrorism Sanctions Regulations, 31 C.F.R. 595; the Terrorism List Government Sanctions Regulations, 31 C.F.R. 596; and the Foreign Terrorist Organizations Sanctions Regulations, 31 C.F.R. 597.

⁹ LAWYER GUIDANCE ¶¶ 40-44. For a detailed discussion of terrorist financing, see MONEY LAUNDERING & TERRORIST FINANCING RISK ASSESSMENT STRATEGIES, Financial Action Task Force (issued June 18, 2008), <http://www.fatf-gafi.org/dataoecd/46/24/40978997.pdf>.

Practice pointer: A common method of terrorist financing identified to date has been the movement of funds donated to cross-border (i.e., between the United States and another jurisdiction, not between two states) non-profit organizations. For example, a not for profit organization (“NPO”) in the United States may appear, from all outwardly signs, to be operating legitimately, but through multiple transfers and manipulations of funds, may in fact be funneling funds offshore to an organization with hidden terrorist ties. Alternatively, the terrorist group may actually run the NPO. An examination of available public source information, including the charity’s tax return, Form 990 PF, the charity’s website, corporate formation documents, and other due diligence methods may disclose how funds are ultimately used. However, the terrorist link may not be evident from a review of the charity’s tax return. The practitioner should thus inquire of the charity what due diligence procedures it has in place and to identify the recipient of the funds. If funds are paid to foreign charities or to private charities, then the charity is supposed to monitor and keep records of how the funds are used. As part of the client due diligence (as defined below), the practitioner should ask for these records and in appropriate circumstances check the list of Specially Designated Nationals and Blocked Persons (“SDN List”) maintained by OFAC.¹⁰

What is the Risk-Based Approach?

The risk-based approach is grounded in the premise that the limited resources (both governmental and private sector) available to combat money laundering and terrorist financing should be employed and allocated in the most efficient manner possible so that the sources of the greatest risks receive the most attention. A risk-based approach is intended to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified, thereby facilitating an efficient allocation of this limited pool of resources.

The proportionate nature of the risk-based approach means that higher risk areas should be subject to enhanced procedures, such as enhanced client due diligence (“CDD”) and enhanced transaction monitoring. By contrast, simplified, modified, or reduced controls may apply in lower risk areas (for purposes of this Guidance, “reduced” shall hereafter include “simplified” and “modified”). In no case does FATF suggest that the risk may ever be so low as to eliminate any form or level of CDD.

An effective risk-based approach involves identifying and categorizing money laundering and terrorist financing risks and establishing reasonable controls based on the risks identified. This paper will identify the risk categories and offer voluntary good

¹⁰ See Section 2.6 and accompanying footnote for further discussion of charities and NPOs.

practices designed to assist lawyers in detecting money laundering while satisfying their professional obligations.

Practice pointer: For example, a general practitioner in rural Montana would have no reason to engage in extensive due diligence or know your client measures (as discussed below) if a long term client called the lawyer and asked her to form a limited liability company for the purpose of buying a ranch. However, if that same lawyer received a call from a new and unknown client saying that the client had just won several million dollars at poker in Nevada and needed the lawyer to form a limited liability company to buy a ranch, then a risk based approach would suggest that in this latter case, more extensive due diligence and know your client measures would be appropriate.

What is Client Due Diligence?

The 40+9 Recommendations require that lawyers perform CDD when they perform or carry out specified activities. CDD is intended to assist lawyers in forming a reasonable belief that they have appropriate awareness of the true identity of each client¹¹ and the true nature of the matter they have been engaged to undertake. CDD is not intended to place the lawyer in an adversarial relationship with the client; rather, the purpose is to make sure the lawyer knows the true identity and business goals of the client.

CDD should be performed at client intake, but it also should be periodically performed during the course of the engagement. The level of required CDD varies depending on the risk profile of the client. For some clients, “basic” CDD may be appropriate. For clients posing a higher risk, “enhanced” CDD may be necessary. At the other end of the spectrum, reduced CDD may be sufficient. The relative levels of CDD are described in greater detail below.

The three (3) steps required to be taken in “basic” CDD are as follows:

- Identify and appropriately verify the identity of each client on a timely basis.¹²
- Identify the beneficial owner,¹³ and take reasonable measures to verify the identity of the beneficial owner of the client such that the lawyer is

¹¹ LAWYER GUIDANCE ¶ 114.

¹² See Section 6 for a more detailed discussion of this step.

¹³ The Lawyer Guidance defines “beneficial owner” as follows: “*Beneficial owner* refers to the natural person(s) who ultimately owns or controls a client and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.” See LAWYER GUIDANCE Annex 2.

reasonably satisfied that the lawyer knows who the beneficial owner is. Clients generally should be subject to the full range of CDD measures, including the requirement to identify the beneficial owner in accordance with Lawyer Guidance ¶ 114. The purpose of identifying beneficial ownership is to ascertain those natural persons who exercise effective control over a client, whether by means of ownership, voting shares, contract rights, or otherwise. Lawyers may use a risk-based approach when determining the extent to which they are required to identify the beneficial owner, depending on the type of client, suspicious behavior that might suggest someone is seeking to conceal the true party in interest, the difficulty of ascertaining the identity, the business relationship and transaction, and other appropriate factors, including the geographic location of the client.

The issue of whether a lawyer must, in all cases, identify the beneficial owners of a client was a highly controversial issue in the drafting of the Lawyer Guidance. Although FATF initially sought to adopt a rules-based approach that would require lawyers to always identify the beneficial owners of a client, after strong opposition from representatives of the legal profession, FATF ultimately agreed that this analysis would be subject to a risk-based approach. Consequently, depending on the risks presented by the client, it may be appropriate to identify the beneficial owners of a client. Lawyers should do so only when, from a risk-based standpoint, such an analysis is warranted. It is impractical in some instances for a lawyer to identify the beneficial owners of a client. The cost, time, and effort to undertake such an analysis is typically disproportionate to advancing the goals of detecting and preventing money laundering and terrorist financing unless other factors are present.

Practice pointer: For example, if a lawyer is dealing with a syndication of investors or financiers or an entity that has a large number of owners but is not publicly traded, ascertaining the client's beneficial owners would be extremely time consuming. Unless other facts put the lawyer on notice that something unusual or suspicious were transpiring, the process of determining all the beneficial owners of the client would be disproportionate to the level of risk.

- Obtain information to understand the client's circumstances and business depending on the nature, scope, and timing of the services to be provided. This information may be obtained from clients in the normal course of the lawyers' acceptance of the retention and receipt of instructions from the client.

Who is covered by the Lawyer Guidance?

The Lawyer Guidance covers “legal professionals,” which includes lawyers and notaries.¹⁴ The Lawyer Guidance is principally focused on transactional lawyers, especially those creating entities and those handling funds, but not all lawyers are subject to the Lawyer Guidance. For instance, in-house lawyers are not covered by the Lawyer Guidance.¹⁵ Several other exclusions are described below.

Importantly, the Lawyer Guidance is limited to those lawyers who “prepare for and carry out specified activities.” The Lawyer Guidance does not define “prepare for and carry out,” but it does define “specified activities” as described below. Thus, even if the lawyer is subject to the Lawyer Guidance, CDD may not be required because of the particular nature of the proposed engagement.

Local and special counsel engagements present unique and challenging issues. Local counsel may be engaged by the primary transaction counsel to assist on a discrete local law issue peripheral to an overall transaction and may have little or no direct involvement with the client. At the other extreme, local counsel may be intimately involved with the transaction, including drafting and negotiating the applicable transactional documents. The Lawyer Guidance recognizes that lawyers providing advice or services (such as a local law enforceability opinion) peripheral to the overall transaction who are not preparing for or carrying out the transaction may not be required to observe the applicable CDD and record-keeping obligations.¹⁶ In short, those lawyers would not be covered by the Lawyer Guidance. Section 4.7 below explores the issue of local and special counsel in greater detail.

A special situation arises for a lawyer who is serving as a trustee. FATF has issued not only Lawyer Guidance, but also risk-based guidance for trust and company service providers, another category of DNFBPs (“TCSP Guidance”).¹⁷ This would appear to create uncertainty as to which guidance a lawyer acting as a trustee is to follow. Generally speaking, a lawyer acting as a trustee need only follow the Lawyer Guidance; the primary exception is if the lawyer is offering the trustee services through a separate entity, such as a trust company. In this latter case, the lawyer should refer to the TCSP Guidance rather than the Lawyer Guidance. The TCSP Guidance imposes obligations on

¹⁴ Legal professionals include notaries, but the Lawyer Guidance does not cover those common law notaries who perform merely administrative acts such as witnessing or authenticating documents (such as deeds and mortgages).

¹⁵ LAWYER GUIDANCE ¶ 8 fn. 2.

¹⁶ LAWYER GUIDANCE ¶ 13. The record-keeping obligations are designed to ensure that documents, data, or information collected under the CDD process is kept up-to-date and relevant by undertaking reviews of existing records, particularly for higher risk categories of clients.

¹⁷ RBA GUIDANCE FOR TRUST AND COMPANY SERVICE PROVIDERS (TCSPs), Financial Action Task Force (issued June 17, 2008). http://www.fatf-gafi.org/newsEvents/0,3382,en_32250379_32235720_1_1_1_3_1,00.html

TCSPs that differ from those imposed on lawyers, thereby underscoring the importance of knowing which guidance applies.

What specified activities are covered by the Lawyer Guidance?

The “specified activities” (collectively, “Specified Activities” or, individually, “Specified Activity”) consist of the following five (5) categories: (a) buying and selling of real estate, (b) managing of client money, securities or other assets, (c) management of bank, savings or securities accounts, (d) organization of contributions for the creation, operation, or management of companies, and (e) creation, operation, or management of legal persons or arrangements, and buying and selling of business entities.¹⁸

1. Buying and Selling of Real Estate. The Lawyer Guidance does not define “buying and selling of real estate.” The Specified Activity of buying and selling of real estate appears to apply to both residential and commercial purchase and sale transactions. No dollar limits or thresholds apply to this Specified Activity. However, this Specified Activity does not appear to encompass a number of real estate-related transactions, such as leasing transactions, the preparation of condominium documentation, or the negotiation of easement agreements that do not involve the immediate exchange of funds. Less clear is whether the financing of a purchase or sale of real estate constitutes a Specified Activity, which is discussed in more detail below. However, since financing and re-financing involve the movement of funds, practitioners should assume that these activities would constitute Specified Activities.

Practice pointer: A lawyer who prepares for and carries out the sale of real estate would need to perform the basic CDD and record-keeping requirements envisioned by the 40 +9 Recommendations. But that same lawyer who is engaged by a client to draft and negotiate leases for a shopping center or office complex is not preparing for or carrying out a transaction involving the buying and selling of real estate and need not perform CDD.

2. Managing of client money, securities or other assets. The Lawyer Guidance does not define “managing of client money, securities or other assets.” Here, as well as under items 3 and 4 below, the lawyer would in all cases be handling the client’s funds and, as emphasized above, FATF is particularly focused on the potential risk in situations where the lawyer is actually handling funds. In any situation where the lawyer controls the use, application, or disposition of funds or has signatory authority over the client’s financial account, the risk must be addressed at some level. Recognize,

¹⁸ LAWYER GUIDANCE ¶ 12. The wording used in this paragraph, although syntactically challenging, tracks the precise language of the Lawyer Guidance. Earlier drafts of the Lawyer Guidance used the phrase “regulated activities” when referring to the Specified Activities. FATF replaced the “regulated activities” formulation with the “Specified Activities” formulation to avoid conveying the impression that the Lawyer Guidance “regulated” the legal profession.

however, that in almost all cases the funds in the lawyer’s control will have been transferred to the lawyer through a financial institution that has performed its own required due diligence and, in some cases, the lawyer should be able to rely on that in lieu of conducting the lawyer’s own due diligence. In other cases, however, the financial institution may have simply satisfied itself that the money is flowing into the trust account of a reputable lawyer or law firm. Nonetheless, any time lawyers “touch the money” they should satisfy themselves as to the bona fides of the sources and ownership of the funds in some manner and should inquire of any involved financial institution as to any CDD performed by such institution.

Practice pointer: Lawyers should consider using third party escrow agents to avoid responsibility generally.

3. Management of bank, savings or securities accounts. The Lawyer Guidance does not define “management of bank, savings or securities accounts.” In addition to the risks identified in item 2 above, a lawyer or a law firm must be particularly cognizant of the funds that move through the firm’s trust account or client account. In this particular situation, the Lawyer Guidance would extend to trial lawyers who frequently hold funds in the firm’s trust account.

Practice pointer: Lawyers should exercise caution to avoid situations where they are essentially providing banking services for their clients as opposed to merely holding client money for a legitimate transaction. For example, in a real estate sale, if the lawyer is being asked to make payments not just to mainstream lending institutions, but to more obscure recipients including private individuals whose identities are difficult to verify, the lawyer should exercise caution or treat this as a higher risk situation.¹⁹

4. Organization of contributions for the creation, operation, or management of companies. The Lawyer Guidance does not define “organization of contributions for the creation, operation, or management of companies.”

Practice pointers:

- An example of this Specified Activity is when a lawyer prepares for or carries out a transaction where investors contribute capital to a legal entity. This category does not appear to cover financing or refinancing transactions because the funds are not being contributed to the company.

¹⁹ This discussion is derived from Section 11.2.3 of the Anti-Money Laundering Practice Note prepared by the Law Society of England and Wales (issued February 22, 2008). See <http://www.lawsociety.org.uk/productsandservices/practicenotes/aml/463.article>.

- In addition to the risks identified in item 2 above relating to handling a client's funds, note that an expansive interpretation of this "specified activity" would conceivably cover financing and refinancing transactions.

5. Creation, operation, or management of legal persons or arrangements, and buying and selling of business entities. The Lawyer Guidance does not define "creation, operation, or management of legal persons or arrangements, and buying and selling of business entities."²⁰ It is under item 5 that the widest range of transactional lawyers fall within the "specified activities." This category of Specified Activities appears to include most of the routine work that is done by real estate lawyers, corporate and business lawyers, and trust and estates lawyers. As in all cases, lawyers must evaluate the risks to determine the extent of CDD required. Even lawyers who do nothing more than prepare for or carry out the task of forming legal entities are likely to be subject to the Lawyer Guidance under this criterion.

Practice pointer: The following is an example of the creation of business entities used for money laundering. Mr. S headed an organization importing narcotics into country A from country B. Mr. S employed a lawyer to establish a web of off-shore corporate entities through which Mr. S could launder proceeds of a narcotics importing operation. These entities were incorporated in Country C where there was lax scrutiny of ownership, records, and finances. A local management company in Country D administered these companies. These entities were used to camouflage movement of illicit funds, acquisition of assets, and financing criminal activities. Mr. S was the holder of 100% of the bearer share capital (i.e., bearer shares are negotiable instruments that accord ownership in a corporation to the person who possess the bearer share certificate) of these off-shore entities. In Country A, a distinct group of entities without any apparent association to Mr. S transferred large amounts of money to Country D where it was deposited in, or transited through, Mr. S's offshore companies. This same web network was found to have been used to transfer large amounts of money to a person in Country E who was later found to be responsible for drug shipments destined for Country A.²¹

²⁰ See THE MISUSE OF CORPORATE VEHICLES, INCLUDING TRUST AND COMPANY SERVICE PROVIDERS, Financial Action Task Force (issued October 13, 2006), <http://www.fatf-gafi.org/dataoecd/30/46/37627377.pdf>.

²¹ See Case 20, REPORT ON MONEY LAUNDERING TYPOLOGIES 2003-2004, Financial Action Task Force, <http://www.fatf-gafi.org/dataoecd/19/11/33624379.PDF>.

Upon the request of the U.S. Department of Treasury, the Uniform Law Commissioners adopted in July 2009 a uniform act known as the Uniform Law Enforcement Access to Entity Information Act that would in certain circumstances ensure transparency and disclosures to law enforcement authorities of the ownership of various legal entities. Legislation is also currently pending in Congress dealing with this issue.

Practice pointer: Lawyers engaged in the performance of these legal tasks should satisfy themselves that, at a minimum, they have performed the basic CDD measures described previously (unless the client is otherwise exempt as described in this paper).

What are the risk categories?

The Lawyer Guidance identifies three major risk categories with regard to legal engagements: (a) country/geographic risk, (b) service risk, and (c) client risk. Lawyers need to determine their exposure to each of these risk categories. The relative weight to be given to each risk category in assessing the overall risk of money laundering and terrorist financing will vary from one lawyer or firm to another because of the size, sophistication, location, and nature and scope of services offered by the lawyer or the firm. Based on their individual practices and judgments, lawyers will need to assess independently the weight to be given to each risk factor. These risk factors are subject to variables that may increase or decrease the perceived risk posed by a particular client or type of work. This section will discuss the risk factors and Section 4 will highlight in detail the risk variables that affect each of the risk factors.

Practice pointer: The risk profile of a lawyer or firm whose practice is limited to domestic clients and transactions differs from the risk profile of a lawyer or firm that engages in international and cross-border transactions. The risk factors are intended to attune the lawyer to these differences so as to enable the lawyer to design and implement a risk-based approach that is tailored to that specific, and unique, practice profile.

1. Country/Geographic Risk

The Lawyer Guidance notes the absence of a universally adopted listing of countries or geographic areas that are deemed to present a lower or higher risk. The client's domicile, the location of the transaction, and the source of the funding are but a few sources from which a money laundering risk can arise.

The Lawyer Guidance does, however, identify the profile of those countries that in FATF's view pose a higher risk of money laundering. These higher risk countries include those that are subject to sanctions, embargoes, or similar measures issued by certain bodies, such as the United Nations and those identified by credible sources as

having significant levels of corruption or other criminal activity or a location from which funds or support are provided to terrorist organizations. Countries are also considered to pose a higher risk of money laundering when credible sources identify those countries as generally lacking appropriate AML/CFT laws, regulations, and other measures. The Lawyer Guidance defines “credible sources” as information that is produced by well-known bodies that generally are regarded as reputable and that make such information publicly and widely available. Examples of credible sources include FATF, the International Monetary Fund, The World Bank, FinCEN, OFAC, and the U.S. Department of State.²²

Practice pointers:

- Most U.S. lawyers deal only with clients and parties located exclusively within the United States. The country/geographic risk should thus not present a meaningful risk in most transactions.
- In assessing the country risk, a lawyer needs to take into account the client’s domicile, the location of the transaction, and the source of the funding.
- A lawyer representing a client who is involved in acquiring a non-U.S. business that has operations in, or has business with, a country subject to a United Nations embargo or a U.S. government sanctions program (e.g., Zimbabwe, Sudan, and Iran) should understand that the transaction represents a higher risk based on the geographic location and activities of the business being acquired. The lawyer also should determine during the initial client intake efforts whether the lawyer, as a U.S. person, is authorized to participate in the representation because U.S. sanctions programs generally prohibit U.S. persons from engaging in most transactions with persons in Iran, Sudan, and Cuba.
- Transparency International, a global civil society organization formed to fight corruption, has developed a jurisdiction-specific corruption perceptions index that ranks countries based on the degree to which corruption is perceived to exist among public officials and politicians. *See* http://www.transparency.org/policy_research/surveys_indices/cpi/2007/faq#general1. This website may be a useful resource in assessing the level of corruption in a specific country. Another useful resource is the individual Country Reports prepared annually by The World Bank. These reports are available at

²² The U.S. Department of State’s International Narcotics Strategy Control Report, Volume II Money Laundering and Financial Crimes, provides an annual report on money laundering risks posed on a country-by-country basis. *See* <http://www.state.gov/p/inl/rls/nrcrpt/2009/vol2/index.htm>.

<http://web.worldbank.org/WBSITE/EXTERNAL/PROJECTS/0,,menuPK:115635~pagePK:64020917~piPK:64021009~theSitePK:40941,00.html#CountryReports>.

2. Client Risk

A critical component to the development and implementation of an overall risk-based framework is determining the potential money laundering or terrorist financing risk posed by a client. Clients range from individuals, partnerships and limited liability companies with dozens of partners or members to multi-national corporations. Given this spectrum of clients, a lawyer will be challenged to determine whether a particular client poses a higher risk and, if so, the level of that risk and whether the application of any mitigating factors influences that assessment. The Lawyer Guidance identifies various categories of higher risk clients. If a client falls into one of these categories, the lawyer is then required to apply a set of risk variables that may mitigate or exacerbate the risk assessment the lawyer is required to make to determine the necessary level of CDD.

The Lawyer Guidance identifies nearly a dozen categories of potentially higher risk clients.²³ Lawyers need to determine whether any of their clients fall into one or more of these categories and therefore warrant an evaluation of any mitigating circumstances and increased risk assessment. These categories are as follows:

- 2.1 Politically Exposed Persons. Politically exposed persons (“PEPs”) are individuals who are or have been entrusted with prominent functions in a foreign country. Examples include heads of state or of government, senior politicians, senior government, judicial, or military officials, senior executives of state owned corporations, or important political party officials. PEPs do not include middle ranking or more junior individuals in the foregoing categories. If a lawyer is advising a client that is a PEP or is beneficially owned by the PEP, the lawyer would have to perform a higher and more exacting form of CDD known as “enhanced CDD.” The extent and nature of the enhanced CDD will depend on the relevant factors, such as the PEP’s home country, the type of work the PEP is instructing the lawyer to perform or carry out, and the scrutiny to which the PEP is subjected in the PEP’s home country.

Practice pointers:

- It is important to note that PEPs are high level political officials in *foreign* countries. For example, a senior U.S. government official would not be a PEP vis-à-vis a U.S. lawyer. By contrast, a U.S. lawyer representing a high level government official of a foreign country would be

²³ LAWYER GUIDANCE ¶ 109.

representing a PEP for purposes of the Lawyer Guidance.

- FATF identified a typology where a senior politician and a senior official were involved in high level corruption. An intermediary received a payment of USD 50 million from Company A. The intermediary then transferred the money into two accounts held off-shore; the funds were then moved to company accounts that were also held offshore. The beneficial owners of these company accounts were discovered to be a former head of the secret service in Country B and a state secretary for the Ministry of Defence in Country C.²⁴

2.2 Unusual Activity. Clients conducting their relationship or requesting services in unusual or unconventional circumstances (as evaluated in light of all the circumstances of the representation).²⁵

Practice pointer: This broad category, which is viewed through the prism of the overall representation, includes a client's inexplicable demand to close a purchase or sale in an extremely short period of time or the client's refusal to provide the lawyer with any details about the client. Similarly, a client who insists that a lawyer who does not usually handle cross-border transactions assume responsibility in an international business transaction should raise suspicions.

2.3 Masking of Beneficial Ownership. Where the structure or nature of the client entity or relationship makes it difficult to identify in a timely manner the true beneficial owner or controlling interests, such as the unexplained or seemingly unnecessary use of legal persons or legal arrangements, nominee shares or bearer shares.²⁶

Practice pointer: This might be typified by a client, particularly a new client, who insists on the formation of a complex, multi-tiered entity (such as a limited liability partnership, corporation, or limited liability company) involving other entities and a notable absence of any individuals and offers only the briefest of explanations or no

²⁴ See Case 15, REPORT ON MONEY LAUNDERING TYPOLOGIES 2003-2004, Financial Action Task Force, <http://www.fatf-gafi.org/dataoecd/19/11/33624379.PDF>.

²⁵ *Id.* (third bullet).

²⁶ *Id.* (fourth bullet).

justification for or explanation as to the purpose or the ownership structure of the new entity.

- 2.4 Cash Intensive Businesses. Clients that are cash (and cash equivalent) intensive businesses, such as: (a) money services businesses (e.g., remittance houses, currency exchange houses, or other businesses offering money transfer facilities), (b) casinos, betting and other gambling related activities, and (c) businesses that while not normally cash intensive, generate substantial amounts of cash.²⁷

Practice pointer: Lawyers need to be especially sensitive to cash intensive businesses, such as residential rental operations. Money launderers have been known to use bars, restaurants, car washes, and parking lots – all legitimate enterprises, but cash intensive. Indeed, money launderers have sought to launder funds through collection plates at churches.

- 2.5 Cash Intensive Businesses—Mitigation of Risk. Where clients are cash intensive businesses that are already themselves subject to and regulated for a full range of AML/CFT requirements consistent with the 40+9 Recommendations, this may mitigate the client risks to the lawyer.²⁸

- 2.6 Charities and NPOs. Charities and other NPOs that are not subject to monitoring or supervision (especially those operating on a “cross-border” basis) by designated competent authorities or self-regulating organizations (“SROs”) are potentially higher risk clients.²⁹

Practice pointer: A lawyer should carefully scrutinize a charity that has raised funds domestically and then disbursed them abroad, no matter what may appear on the surface to be its charitable cause or mission. When dealing with a charity/NPO, a lawyer may consider it appropriate to assess whether the policies and procedures of the charity/NPO comply with the guidelines set forth in U.S. DEPARTMENT OF THE TREASURY ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S. BASED CHARITIES, <http://www.ustreas.gov-press-releases-reports-0929%20finalrevised.pdf>.

²⁷ *Id.* (fifth bullet).

²⁸ *Id.* (sixth bullet).

²⁹ *Id.* (seventh bullet). For a discussion of voluntary best practices for U.S. based charities, *see* U.S. DEPARTMENT OF THE TREASURY ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S. BASED CHARITIES, <http://www.ustreas.gov-press-releases-reports-0929%20finalrevised.pdf>.



2.7 Financial Intermediaries Not Subject to Adequate AML/CFT Laws. Clients using financial intermediaries, financial institutions or legal professionals that are not subject to adequate AML/CFT laws and measures and that are not adequately supervised by competent authorities or SROs are potentially higher risk clients.³⁰

Practice pointer: Almost all domestic U.S. financial institutions are covered by AML/CFT rules that apply to them. Perhaps the greatest risks here are (i) a transaction with an unregulated financial institution or (ii) a transaction involving a foreign financial institution not subject to AML/CFT rules.

2.8 Clients with Certain Criminal Convictions. Clients having convictions for proceeds generating crimes who instruct the lawyer (who has actual knowledge of such convictions) to undertake specified activities on their behalf are potentially higher risk clients.³¹

Practice pointer: Lawyers who deal with clients knowing that they have been convicted of financial crimes (such as embezzlement) present a potentially higher client risk to the lawyer.

2.9 Clients with No Address/Multiple Addresses. Clients who have no address, or multiple addresses without legitimate reasons.³²

Practice pointer: This risk factor informs the issue of the client's true identity. A client with no address or multiple addresses without a legitimate explanation is a higher risk to the lawyer. A higher risk situation may also arise where a client operates seemingly unrelated and different businesses at the same address.

2.10 Unexplained Change in Instructions. Clients who change their settlement or execution instructions without appropriate explanation are potentially higher risk clients.³³

³⁰ *Id.* (eighth bullet).

³¹ *Id.* (ninth bullet).

³² *Id.* (tenth bullet).

³³ *Id.* (eleventh bullet).

Practice pointer: The most likely instructions to raise concerns are those given in connection with the receipt of funds (source of funds) or the delivery of funds (the recipient of funds), including those involving last minute and unexplained changes in the flow of funds or instructions directing that the funds be sent to a person or entity unrelated to the transaction.

- 2.11 Structures With No Legal Purpose. The use of legal persons and arrangements without any apparent legal or legitimate tax, business, economic or other reason are potentially higher risk situations.³⁴

Practice pointer: This high risk factor requires the lawyer to determine whether there is any apparent legal or legitimate tax, business, economic or other reason for the use of a particular legal entity or transaction structure. Obviously, a lawyer cannot knowingly facilitate criminal activity by creating deal structures whose only purpose is to mask money laundering or terrorist financing. The lawyer needs to evaluate whether the use of particular entities or deal structures advances a legal or legitimate tax, business, economic or other reason. A client who is unwilling to explain the rationale for the use of particular entities or deal structures would require the lawyer to intensify his or her CDD.

3. Service Risk

FATF has determined that some services are at higher risk for money laundering and terrorist financing. Typically those services involve the movement of funds and/or the concealment of beneficial ownership.

- 3.1 “Touching the Money” Test. Services where lawyers, acting as financial intermediaries, actually handle the receipt and transmission of funds through accounts the lawyers actually control in the act of closing or facilitating a transaction.³⁵ Without knowing the sources and destination of the funds, a lawyer may unwittingly aid money laundering or terrorist financing activities.

Practice pointers:

- This service risk factor is the classic “touch the money” factor. If a lawyer handles (or “touches”) money in

³⁴ *Id.* (twelfth bullet).

³⁵ LAWYER GUIDANCE ¶ 110 (first bullet).

performing or carrying out a Specified Activity or if cash moves through the lawyer's client account, that lawyer is exposed to a higher risk of being unknowingly involved in money laundering or terrorist financing activity. For example, a real estate lawyer who represents a seller of commercial real estate may also function as an escrow agent who holds the earnest money deposit in an escrow account and conducts closing by receiving and transmitting the closing funds through the lawyer's escrow account.

- Trust and estate lawyers frequently “touch the money,” for example, in the process of funding a trust or in administering an estate. Risk thus exists at the point of funding the trust and thereafter in the administration of the trust.
- The lawyer should be aware of not only the source of funds transferred to a trust but the use of the funds by the trustee. The lawyer should be alert to the purpose of the trust, the reasons behind any unusual structures, and the use of jurisdictions that have minimal compliance with AML/CFT regulation.

3.2 Concealment of Beneficial Ownership. Services to conceal improperly beneficial ownership from competent authorities.³⁶

Practice pointer: Anonymity, or the lack of transparency, is disfavored by criminal enforcement authorities. However, there may be legitimate reasons to keep confidential the beneficial ownership of an entity from the public because of business competitive reasons. For example, a developer may desire to acquire multiple tracts of land. If the developer discloses the identity of its beneficial owners, landowners may force the developer (with perceived “deep pockets”) to pay a higher price for the tracts being sold. By keeping the identity of its beneficial owners out of the public record, the developer may be able to acquire the tracts at fair market value without paying a premium. Non-business reasons for confidentiality may apply as well. For instance, a wealthy investor may desire anonymity to enhance personal safety (e.g., avoid kidnappings). Lawyers should be mindful, though, that law enforcement authorities may have a legitimate need to know the identity of the true beneficial owner in appropriate circumstances, such as bona fide criminal

³⁶ *Id.* (second bullet).

investigations.

- 3.3 Performing Services Outside Area of Expertise. Services requested by the client for which the client knows the lawyer does not have expertise excepting where the lawyer is referring the request to an appropriately trained professional for advice.³⁷

Practice pointer: A lawyer regularly represents a client in commercial real estate transactions. The client asks the lawyer to handle the creation of various off-shore trusts. The client is aware that the lawyer has no training in creating these types of trusts. The lawyer should inquire why the client would like the lawyer, and not that lawyer's colleagues who are experienced in trusts, to handle this work.

- 3.4 Accelerated Real Estate Transfers. Transfer of real estate between parties in a time period that is unusually short for similar transactions with no apparent legal, tax, business, economic or other legitimate reason.³⁸

Practice pointers:

- Accelerated, or frequent, transfers or “flips” of real property may be accomplished for specific tax or other business reasons. But real property transfers made in an unusually short time frame in comparison to similar deals and with no apparent legal, tax, business, economic or other legitimate reason represent a higher risk to the lawyer. For example, a client asks the lawyer to handle the transfer of a residence from the client to a new entity controlled by the client. The client then directs the lawyer to convey the property immediately from the new entity to yet another new entity controlled by the client. The lawyer needs to understand the legal, tax, business, economic, or other legitimate reason for the serial transactions within a compressed time period.
- In a 2008 report, FinCEN noted that a bank reported a series of transactions occurring within a one-month period in which the same property was bought and sold among related individuals. As a result of this flipping of the property, the

³⁷ *Id.* (third bullet).

³⁸ *Id.* (fourth bullet).

bank granted a loan re-finance of over \$600,000 to an individual who did not hold title to the property at the time the loan closed. The bank indicated in the suspicious activity report narrative that it was not able to definitively determine the motive for these transactions, but surmised that they may have been conducted to promote money laundering or tax evasion.³⁹

- 3.5 Cash Payments; Payments From Other Sources. Payments received from unassociated or unknown third parties and payments for fees in cash where this would not be a typical method of payment.⁴⁰

Practice pointer: If a client offers to pay in cash, the lawyer is dealing with a higher risk situation. For payments from third parties, the lawyer should always understand the reason for that arrangement. The lawyer should be aware of the requirement that each person engaged in a trade or business who, in the course of that trade or business, receives more than \$10,000 in cash in one transaction or in two or more related transactions, must file Form 8300 with the Internal Revenue Service.

- 3.6 Inadequate Consideration. Transactions where it is readily apparent to the lawyer that there is inadequate consideration, such as when the client does not identify legitimate reasons for the amount of the consideration.⁴¹

Practice pointer: In assessing the adequacy of consideration, a lawyer is not required to undertake a rigorous analysis of the economics of the transaction. Rather, the lawyer simply needs to understand whether the stated consideration is reasonably related to the value of the transaction after factoring in the known relevant criteria. For instance, a client proposes to sell a parcel of land valued at \$1 million to a third party for \$20,000. On its face, the disparity between the value of the land and the stated consideration should prompt the lawyer to inquire into the justification for the disparity in consideration. Inadequate consideration is typically not a risk factor in the practice of estate planning where clients are

³⁹ SUSPECTED MONEY LAUNDERING IN THE RESIDENTIAL REAL ESTATE INDUSTRY: AN ASSESSMENT BASED UPON SUSPICIOUS ACTIVITY REPORT FILING ANALYSIS, APRIL 2008, http://www.fincen.gov/news_room/rp/files/MLR_Real_Estate_Industry_SAR_web.pdf.

⁴⁰ *Id.* (fifth bullet).

⁴¹ *Id.* (sixth bullet).

routinely making gifts to spouses, children, other family members and charities.

- 3.7 Estate Administration—Convictions for Proceeds Generating Crimes. Administrative arrangements concerning estates where the decedent was known to the lawyer to be a person who had been convicted of proceeds generating crimes.⁴²

Practice pointer: If the decedent was involved or even reputed to have been involved in criminal activity, then the lawyer is dealing with a higher risk situation. A lawyer should assume a higher level of risk if the decedent was involved in any of the following businesses: casinos, bars, strip clubs, or dealers in pornography. Although these businesses are not necessarily illegal, they involve sufficient indicia of criminal elements being associated with such businesses that the assumption of higher risk is warranted.

- 3.8 Extraordinary Legal Fees. Clients who offer to pay extraordinary fees for services which would not ordinarily warrant such a premium. Bona fide and appropriate contingency fee arrangements, where a lawyer may receive a significant premium for a successful representation, should not be considered a risk factor.⁴³

Practice pointer: If the client offers to pay the lawyer a percent of the proceeds for a sale where the client wants the closing to be quick and anonymous, a lawyer should view this as a higher risk situation.

- 3.9 Source of Funds/Wealth. The source of funds and the source of wealth. The source of funds is the activity that generates the funds for a client, while the source of wealth describes the activities that have generated the total net worth of a client.⁴⁴

Practice pointer: Most clients can quickly inform a lawyer of how they made or acquired their wealth. A lawyer can usually verify easily such representations by references, a review of the clients' income tax returns (but only to the extent the client has provided

⁴² *Id.* (seventh bullet).

⁴³ *Id.* (eighth bullet).

⁴⁴ *Id.* (ninth bullet).

the lawyer with this information), or Internet research. A higher risk situation may arise if the client is unable or unwilling to identify the source of wealth.

- 3.10 Out of Character Transactions. Unusually high levels of assets or unusually large transactions compared to what might reasonably be expected of clients with a similar profile may indicate that a client not otherwise seen as higher risk should be treated as such. Conversely, low levels of assets or low value transactions involving a client that would otherwise appear to be higher risk might allow the lawyer to treat the client as lower risk.⁴⁵

Practice pointer: This risk factor focuses on transactions that appear out of character for a particular client because of the size of the transactions or assets. For example, a lawyer represents a client who typically buys tracts of land for development, and the average size of these transactions is approximately \$500,000. The client/developer asks the lawyer to handle the acquisition of an operating business unrelated to the client's real estate development business for a purchase price of \$6 million. In this case, the lawyer should inquire into the client's historical acquisition practices and why this client now appears to be engaged in transactions that are out of character.

- 3.11 Shell Companies. Shell companies, companies with ownership through nominee shareholding and control through nominee and corporate directors.⁴⁶

Practice pointer: These are the kinds of structures typically used to conceal beneficial ownership. The risk is higher when such entities are being utilized.

- 3.12 Hard to Identify Trust Beneficiaries. Situations where it is difficult to identify the beneficiaries of trusts; this might include a discretionary trust that gives the trustee discretionary power to name the beneficiary within a class of beneficiaries and distribute accordingly the assets held in trust, and when a trust is set up for the purpose of managing shares in

⁴⁵ *Id.* (tenth bullet).

⁴⁶ *Id.* (eleventh bullet).

a company that can make it more difficult to determine the ownership of the company managed by the trust.⁴⁷

Practice pointer: Typically trust beneficiaries are obvious. In any situation where they are not, the risk is higher. Sometimes trusts are used to conceal beneficial ownership, but there is no reason that the beneficial owners should not be disclosed to the lawyer so the lawyer can make an assessment of the risk based on that knowledge.

- 3.13 Anonymity. Services that deliberately have provided or purposely depend upon more anonymity in the client identity or participants than is normal under the circumstances and in the experience of the lawyer.⁴⁸

Practice pointer: As described in a previous Practice Pointer, a developer assembling multiple parcels may have a legitimate need to anonymity and, in that case, anonymity is not by itself a higher risk factor.

- 3.14 Trust Services. Firms that, as a separate business, offer TCSP services should look to the TCSP Guidance, even if those firms are owned or operated by lawyers. Lawyers, however, who offer TCSP services should look to the Lawyer Guidance, but those lawyers should also consider the customer or service risks related to TCSPs, such as the following: (a) unexplained use of express trusts, (b) unexplained delegation of authority by the client through the use of powers of attorney, mixed boards and representative offices, (c) in the case of express trusts, an unexplained relationship between a settlor and beneficiaries with a vested right, other beneficiaries and persons who are the object of a power, (d) in the case of an express trust, an unexplained (where explanation is warranted) nature of classes of beneficiaries and classes within an expression of wishes.⁴⁹

Practice pointers:

- In the usual case a trust lawyer will know immediately if the trust arrangement has odd or unusual characteristics. Even then, some of these features may be easily explained by the

⁴⁷ *Id.* (twelfth bullet).

⁴⁸ *Id.* (thirteenth bullet).

⁴⁹ *Id.* (fourteenth bullet).

client, but such factors may be a sign of a higher risk situation.

- In performing trustee services the lawyer will almost certainly be “touching the money” and so that service risk is higher.

4. Risk Variables that May Affect Risk

The Lawyer Guidance recognizes that vast and profound differences exist within lawyers and the nature of their practices, types of clients, size of firms, scale, and expertise. All lawyers and law firms are not the same. For that reason, when creating a reasonable risk-based approach and evaluating the resources that can be reasonably allocated to implement and manage it, due consideration must be given to these factors. The Lawyer Guidance notes that a sole practitioner would not be expected to devote an equivalent level of resources as a large law firm. Instead, the sole practitioner would need to develop appropriate systems and controls and a risk-based approach proportionate to the scope and nature of the practitioner’s practice.

A lawyer needs to consider whether the client and the proposed work would be unusual, risky, or suspicious. This significant factor must always be considered in the context of the lawyer’s practice. The risk-based approach and its concept of proportionality dictates that the presence or absence of one or more of these variables may require a lawyer to perform enhanced due diligence or lead the lawyer to conclude that standard CDD can be reduced. As noted earlier, in no case does FATF suggest that the risk may ever be so low as to eliminate any form or level of CDD. This approach is best viewed as a sliding scale where one or more of the following variable factors may increase or decrease the perceived risk posed by a particular client or type of work.

- 4.1 Nature of Client Relationship. The nature of the client relationship and the client’s need for the lawyer to provide specified activities.⁵⁰

Practice pointers:

- If the lawyer has been regularly representing the client for several years in performing and carrying out one or more Specified Activities, the client’s request that the lawyer perform the same or similar work for another similar transaction suggests that the risk of money laundering or terrorist financing is low. In this situation, it would be disproportionate to perform standard CDD; rather, reduced CDD would be warranted and the focus should be on the transaction involved.

⁵⁰ LAWYER GUIDANCE ¶ 112 (first bullet).

- Reduced CDD may simply entail confirming the on-going accuracy of the client information.
- The type of client influences the scope, level, and intensity of the CDD. Lawyers should thus determine the type of entity involved, such as whether the client is a natural person or a legal entity. If the client is a legal entity, is the client privately held or publicly traded? Is the client subject to AML/CFT regulations or other form of governmental oversight and regulation? If the client is a legal entity, who is acting on behalf of the client in directing the performance of the Specified Activities?

4.2 Existing Regulation. The level of regulation or other oversight or governance regime to which a client is subject.⁵¹

Practice pointer: A client that is a financial institution or legal professional regulated in a country with a satisfactory AML/CFT regime poses less risk of money laundering than a client in an industry that has money laundering risks and yet is unregulated for money laundering purposes.

4.3 Reputation and Publicly Available Information. The reputation and publicly available information about a client. Clients that are transparent and well known in the public domain and have operated for a number of years without being convicted of proceeds generating crimes may have low susceptibility to money laundering.⁵²

Practice pointer: A client has been operating a family owned business in the same location for several generations. The client has an excellent reputation in the community and is active in various community organizations. In this example, the client can be viewed as having a low susceptibility to money laundering. By contrast, a client has just relocated to a distant geographic location and has not had an opportunity to establish the client's reputation. The client is publicity shy and there appears to be no publicly available information about the client. The lawyer does not know the criminal background of the client. In that situation, the lawyer should perform standard CDD unless other risk factors suggest that

⁵¹ *Id.* (second bullet).

⁵² *Id.* (third bullet).

enhanced CDD should be performed.

- 4.4 Regularity/Duration of Relationship. The regularity or duration of the relationship.⁵³

Practice pointer: The regularity and duration of the attorney-client relationship influences the level of CDD. A lawyer who has been regularly representing a client for several decades would have no need to perform standard or enhanced CDD. Reduced CDD would be warranted in that situation. By contrast, a lawyer who has represented a client for several decades but only deals with the client once or twice every five years should perform standard CDD given the lack of regular, on-going interaction with the client.

- 4.5 Familiarity with Country/Laws. The familiarity of the lawyer with a country, including knowledge of local laws, regulations and rules, as well as the structure and extent of regulatory oversight, as the result of a legal professional's own activities within the country.⁵⁴

Practice pointer: This likely is only going to be an issue for lawyers who practice cross-border work. Even then this requested service may not be a higher risk situation. For example, in dealing with a country that has stringent AML/CFT laws (such as the United Kingdom), the risk might be lower than when dealing with Liechtenstein. In dealing with Liechtenstein or another small financial center jurisdiction, the frequency of the transactions and the knowledge about the reputation of one's professional counterpart can affect the risk assessment.

- 4.6 Duration/Magnitude of Lawyer-Client Relationship. The proportionality between the magnitude or volume and longevity of the client's business and its use of the lawyer for its legal requirements, including the nature of professional services sought.⁵⁵ This factor focuses on the duration and magnitude of the lawyer-client relationship.

- 4.7 Local Counsel. Subject to other factors (including the nature of the services and the source and nature of the client relationship), providing limited legal services in the capacity of a local or special counsel may be

⁵³ *Id.* (fourth bullet).

⁵⁴ *Id.* (fifth bullet).

⁵⁵ *Id.* (sixth bullet).

considered a low risk factor. This may also, in any event, mean that the lawyer is not “preparing for” or “carrying out” a transaction for a regulated activity specified in Recommendation 12.⁵⁶

Practice pointer: The local or special counsel’s experience and relationship with referring counsel can have a significant impact on risk. If the referring counsel is well known and has a good reputation for ethics and professionalism, the risk is lower than if the referring counsel is not known or does not enjoy a good reputation.

- 4.8 Geographic Disparity. Significant and unexplained geographic distance between the lawyer and the location of the client where there is no nexus to the type of work being undertaken.⁵⁷

Practice pointer: If a California client asks a Florida lawyer to form a Nevada limited liability company or corporation, the client’s request may call for a higher risk assessment.

- 4.9 “One Shot” Transaction. Where a prospective client has instructed the lawyer to undertake a single transaction-based service (as opposed to an ongoing advisory relationship) and one or more other risk factors are present.⁵⁸

Practice pointer: If the entire scope of representation of a new client is to form a limited liability company for the client to receive the proceeds of a sale, the narrowness of the representation may pose a higher risk factor.

- 4.10 Technological Developments Favoring Anonymity. Risks that may arise from the use of new or developing technologies that permit non-face to face relationships and could favour or promote anonymity. However, due to the prevalence of electronic communication between lawyers and clients in the delivery of legal services, non-face to face interaction between lawyers and clients should not, standing alone, be considered a high risk factor. For example, non-face to face, cross-border work for an existing client is not necessarily high risk work for certain organisations

⁵⁶ *Id.* (seventh bullet).

⁵⁷ *Id.* (eighth bullet).

⁵⁸ *Id.* (ninth bullet).

(such as regional, national or international law firms or other firms, regardless of size, that specialize in that type of work).⁵⁹

Practice pointer: It is not unusual for lawyers and clients, who have never met in person, to deal and interact with each other via e-mail and voicemail messages. This should not, standing alone, constitute a high risk factor.

4.11 Client Origination/Referral Source. The nature of the referral or origination of the client relationship.⁶⁰

Practice pointer: A prospective client may contact a legal professional in an unsolicited manner or without common or customary methods of introduction or referrals, which may increase risk. By contrast, where a prospective client has been referred from another trusted source subject to an AML/CFT regime that is in line with the FATF standards, the referral may be considered a mitigating risk factor.

4.12 Structure of Client/Transaction. The structure of a client or transaction.⁶¹

Practice pointer: Structures with no apparent legal, tax, business, economic or other legitimate reason may increase risk. Legal professionals often design structures (even if complex) for legitimate legal, tax, business, economic or other legitimate reasons. In those cases, the structure used is not a high risk factor.

4.13 Pension Funds. Trusts that are pensions may be considered lower risk.⁶²

5. Controls for Higher Risk Clients

An assessment of the applicable risk factors may lead to the conclusion that the client may be higher risk. The Lawyer Guidance does not prohibit a lawyer from representing a higher risk client; instead, the Lawyer Guidance directs the lawyer to implement appropriate measures and controls to mitigate the potential money laundering

⁵⁹ *Id.* (tenth bullet).

⁶⁰ *Id.* (eleventh bullet).

⁶¹ *Id.* (twelfth bullet).

⁶² *Id.* (thirteenth bullet).

and terrorist financing risks of that client. Lawyers and appropriate staff need to be trained to identify and detect changes in client activity by reference to risk-based criteria. The measures and controls for higher risk clients may include the following:

- 5.1 General Training. It is paramount that general training be made available to lawyers and appropriate staff on money laundering methods and risks relevant to lawyers.⁶³
- 5.2 Specific Training. Targeted training for increased awareness by the lawyers providing Specified Activities to higher risk clients or to lawyers undertaking higher risk work. The key is to ensure that those lawyers who will be exposed to the higher risk work be specifically trained so that they are attuned to the applicable risks.⁶⁴
- 5.3 Enhanced Due Diligence. Enhanced levels of CDD for higher risk situations (see section 6.3 below for a more detailed discussion).⁶⁵
- 5.4 Peer/Managerial Oversight. Enhanced or additional review and/or consultation by the lawyer or within a firm at the establishment of a relationship. Peer or managerial review and oversight are important measures to take when dealing with higher risk clients. Additional review may detect other risk factors or may reveal factors that mitigate the risk. In larger firms, various management levels or committees may review these types of engagements with close scrutiny. At smaller firms, these types of formal controls may not be feasible or practical, but the lawyer should nonetheless seek additional review when exploring an engagement with a higher risk client.⁶⁶
- 5.5 Evolving Evaluation of Services. Periodic review of the services offered by the lawyer and/or firm to determine whether the risk of money laundering and terrorist financing occurring has increased. Services offered by a lawyer may, over time, become more susceptible to money laundering and terrorist financing. Lawyers should periodically review their services to see if the risks of money laundering and terrorist financing occurring have increased.⁶⁷

Practice pointer: If a lawyer's practice evolves from domestic

⁶³ LAWYER GUIDANCE ¶ 113 (first bullet).

⁶⁴ *Id.* (second bullet).

⁶⁵ *Id.* (third bullet).

⁶⁶ *Id.* (fourth bullet).

⁶⁷ *Id.* (fifth bullet).

work to international work, the service risk may possibly increase. Similarly, if a lawyer's practice results in an increased use of the firm's trust account (client account), service risk may increase. Another example of increased risk is when a lawyer's client base involves over time the increasing use of more entities or more tiered entity structures.

- 5.6 On-Going/Evolving Evaluation of Clients. Reviewing client relationships from time to time to determine whether the risk of money laundering and terrorist financing occurring has increased. Clients may enter into new businesses or affiliate with other investors, all of which may increase the risk of money laundering and terrorist financing. Lawyers should be attuned to their client relationships to detect whether the risk of money laundering and terrorist financing occurring has increased.⁶⁸
- 5.7 Overlap. The same measures and controls may often address more than one of the risk criteria identified, and it is not necessarily expected that a legal professional establish specific controls targeting each risk criterion. Lawyers may adopt measures and controls that address multiple risk factors. For that reason, lawyers are not required to mechanically apply a specific measure or control to each risk criterion.⁶⁹

6. Basic Protocol for Client Intake and Assessment

The fundamental starting point for implementing a risk-based approach is for the lawyer to make an overall risk assessment of the client. Most lawyers perform elements of that assessment as part of their established client intake and conflicts review system. The protocols outlined in this Section 6 and in Appendix A attached hereto are designed to supplement, not supplant, that system. The complexity of that system will vary depending on the practice profile of the lawyer and the firm.

In making an overall risk assessment of the client, the lawyer needs to take into account any appropriate risk variables (and any mitigating factors) before making a final determination to accept the engagement. The lawyer's risk assessment, which is made on an individualized basis for each client, will then dictate the overall approach to CDD requirements and appropriate verification. The lawyer determines which CDD requirements are appropriate for each client based on the overall risk assessment and the lawyer's familiarity with the client. These CDD requirements may include the following:

⁶⁸ *Id.* (sixth bullet).

⁶⁹ *Id.* (seventh bullet).

6.1 Standard Level of CDD. A standard level of CDD is generally applied to all clients. Standard level CDD includes the following elements:

6.1.1 Identifying the client and verifying that client’s identity using reliable, independent source documents, data, or information. The lawyer needs to document its findings.

- Basic Identification. Client identification may entail a review of the client’s driver’s license or other governmentally-issued photographic identification, the verification of the client’s address, and a check of the client’s financial and business references.
- OFAC Scan. A basic part of the verification process includes performing an “OFAC scan” to determine whether the client’s name appears on the SDN List. The SDN List identifies a list of persons (individuals and entities) with whom U.S. persons may not engage in the exchange of goods, services, or technology. U.S. persons are prohibited from engaging in the exchange of goods, services, or technology with (a) persons owned or controlled by, or acting for or on behalf of, persons on the SDN list; and (b) persons in or the governments of Cuba,⁷⁰ Sudan, and Iran. Helpful information on performing OFAC scans and dealing with the results of that effort are set forth in OFAC’s website: <http://www.treas.gov/offices/enforcement/ofac/>.

6.1.2 Identifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner of the client such that the lawyer is reasonably satisfied that the lawyer knows who the beneficial owner is.

Practice pointer: The verification of the identity of beneficial ownership is risk-based. Lawyers should evaluate the risks of not verifying the identity of the beneficial owners of a client. Law firms should consider developing or revising their intake forms to capture this information.

6.1.3 Obtaining information on the purpose and intended nature of the business relationship.

6.1.4 Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken periodically throughout the course of

⁷⁰ For purposes of the Cuban Assets Control Regulations, Cuban nationals located outside of the United States are also prohibited parties.

that relationship to ensure that the transactions being conducted are consistent with the lawyer's knowledge of the client, its business and risk profile, including, where necessary, the source of funds.

Practice pointer: Client due diligence is not a static analysis. The attorney-client relationship often evolves over time, and the lawyer needs to be sensitive to changes that may occur during the course of the relationship.

- 6.2 Reduced CDD. A lawyer can apply a reduced level of CDD in recognized lower risk scenarios, such as: (a) publicly listed companies (and their majority owned subsidiaries), (b) financial institutions subject to an AML/CFT regime consistent with the FATF Recommendations (all U.S. banks are subject to an AML/CFT regime), and (c) government authorities and state run enterprises (other than those from sanctioned countries). Reduced CDD may simply include obtaining information on the purpose and intended nature of the new matter or business relationship, which information is necessary to perform the engagement.

Practice pointer: Lawyers do not need to perform standard CDD for clients that are publicly listed companies. These companies present a recognized lower risk profile than other clients. The lawyers will need to know the purpose and nature of the new matter or business relationship.

- 6.3 Enhanced CDD. An enhanced level of CDD is required for those clients that are reasonably determined by the lawyer to be of higher risk. An assessment of higher risk may be based on a number of factors, such as the client's business activity, ownership structure, particular service offered including work involving higher risk countries or defined by applicable law or regulation as posing higher risk, such as the risks outlined in paragraphs 108-109 of the Lawyer Guidance (geographic risk and customer risk). Enhanced CDD means a more in depth, systematic inquiry into the client and its ownership and business activities.

Practice pointer: Higher risk clients require enhanced CDD. The lawyer needs to ensure that the client and its ownership and business activities comply with applicable law and that no criminal activity is involved.

- 6.4 Timing. The overall risk assessment should be performed as part of the client intake and conflict review process, meaning that the lawyer should refrain from performing the work until the completion of the risk

assessment process. In those situations where the verification process may be time consuming, the lawyer may determine to cease work on a matter if the overall risk assessment is not completed within a defined time period after the work begins.

What if Client Presents an Unacceptable Risk?

Not every risk-based approach analysis of a potential client will inexorably lead to the conclusion that, with appropriate controls, the lawyer can accept and proceed with the proposed engagement. It may be possible that the lawyer's analysis will lead the lawyer to reject the engagement or to withdraw from the representation. Rule 1.16 of the ABA Model Rules of Professional Conduct governs declining or terminating the lawyer-client relationship. When faced with a situation where the lawyer is compelled to decline or terminate the relationship, the lawyer should comply with the requirements of the applicable rules of professional conduct, including Model Rule 1.16 or its equivalent. For example, a lawyer may withdraw from representing a client if, among other things, the client persists in a course of action involving the lawyer's services that the lawyer reasonably believes is criminal or fraudulent or the client has used the lawyer's services to perpetrate a crime or fraud.

Education and Continuing Legal Education Efforts

The Lawyer Guidance places a premium on on-going educational efforts to enhance awareness of money laundering and terrorist financing risks.⁷¹ Once the lawyer or law firm has assimilated the basics of the risk-based approach, a decision needs to be made about how to implement policies and procedures firm wide. At a minimum the lawyer or law firm needs to implement an AML/CFT policy and procedures for client intake and the periodic review of clients' activities. The lawyer or law firm should designate a compliance officer. All lawyers in the firm will need a certain level of training and education as will paralegals and key administrative staff. The policies, procedures, and education should be set, endorsed, and reviewed by the firm's senior management.

The firm should designate one or more lawyers whose task will be to remain current on developments in this area. These lawyers will need to make determinations about ongoing education in the firm as well as periodic revisions to policies and procedures.

⁷¹ LAWYER GUIDANCE ¶¶ 33, 97, 102, and 121.

Appendix A **Basic Client Intake**

Upon the intake of a new client, a lawyer may wish to take some or all of the measures discussed below to help the lawyer assess the risk of money laundering and terrorist financing the potential representation of the client may entail. The degree and scope of this assessment will vary based upon, among other factors, the particulars of the proposed representation and the nature and identity of the client. This Appendix A is intended only to highlight some of the key elements of the assessment lawyers should consider and is not intended to be, nor should it be construed as, a mandatory checklist for client intake that is to be used or applied in all circumstances or a rote or mechanical fashion.

1. **Client Identity.** Once the lawyer has gained an understanding of the representation being sought and the client's objective, the lawyer will need to verify the identity of the client by obtaining some basic information that will enable the lawyer to "know the client" and, if applicable, its beneficial ownership.

1.1 **Natural Person as Client.** In the case of an individual client, depending upon the nature of the representation and level of initial concern the lawyer may have regarding the intentions or background of the client, the lawyer may need to obtain some or all of the following information: the client's name, employment background, place of birth, prior residential addresses, current residential address, business address, phone numbers, date of birth, marital status, names of prior or current spouses and/or names of children, dates of birth and social security numbers of any such spouses and/or children, the name and contact information of any other lawyers with whom the client regularly deals, the name and contact information of the client's certified public accountant, prior criminal convictions, pending lawsuits, and status of tax filings with governmental authorities. The lawyer may also wish to retain a copy of the client's driver's license or another federally issued form of photo identification and/or request that the client submit a summary of his or her personal and business history. This could help the lawyer to determine and/or verify the source of the funds to be involved in the transaction(s) in question.

1.2 **Entity as Client.** If the client is an entity rather than an individual (and dependent on other risk factors, such as whether the client is publicly traded), depending upon the nature of the representation and level of initial concern the lawyer may have regarding the intentions or background of the client, the lawyer should seek to obtain the names of any subsidiary/parent/nominee entities, and should obtain information on one or more of the following: the primary directors, officers, trustees, partners, managers, and/or people serving in another fiduciary capacity in connection with this entity and the entity's federal employment identification number. The lawyer should also consider whether it is necessary to obtain some of the basic information on the fiduciaries of the entity as described above. Depending on other risk factors, if not disclosed by partners, members, or shareholders of the entity when the above information

is provided, the lawyer may also need to determine beneficial ownership, as discussed in more detail in the main body of this guidance.

2. **Client Due Diligence.** In addition to the basic information discussed above, depending on risk factors and the level of disclosures made by the client, the lawyer may find it advisable to request letters of introduction or letters of reference from other professionals that have past experience with the client, such as other transactional lawyers, bankers, and certified public accountants

2.1 **OFAC List.** It would also be prudent for the lawyer to check the Office of Foreign Assets Control's Specially Designated Nationals and Blocked Persons list at <http://www.treas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf> for the name of the client, the client's spouse, the client's beneficial owners, and/or other related persons, and any relevant business entities.⁷²

2.2 **Other Searches.** Another suggested due diligence measure is the conducting of an Internet search (for example, a Google search (www.google.com)) of the client's name, the client's spouse and/or other related persons, and any relevant business entities. Although the accuracy of the Internet should not be relied upon, search results may provide the lawyer with valuable information that is not readily available elsewhere. For example, an Internet search might yield a link to an article that indicates a potential client's connections to a business entity involved in a pending or previous criminal proceeding. If so, the lawyer can then determine whether and to what extent to check available court records to verify this information.

2.3 **Background Checks.** Depending on the risk profile of the client, background checks can also prove to be useful in evaluating the potential risk involved in accepting the representation of a new client. For instance, Accurint (www accurint.com) is a service that provides information on a client's past and current addresses, any bankruptcies, liens, judgments and UCC filings against it, and any business entities and job titles associated with the client's name. It also provides information on the client's business associates as well as driver's licenses issued to the client, and possibly information regarding any criminal record, sexual offenses, concealed weapons permits, associates, relatives, and properties of the client.

3. **Periodic Update.** Depending on a current evaluation of risk factors, the lawyer may wish to repeat some or all of these steps on an annual or other appropriate periodic basis to ensure that the status of the client has not changed.

⁷² In circumstances where the client's business or the proposed engagement warrants (such as where the client is engaged in the export business), it may also be prudent for the lawyer to check the Denied Persons List at <http://www.bis.doc.gov/dpl/Default.shtm>.

Appendix B
Glossary of Terms

Set forth below is a list of certain acronyms used in this Guidance.

ABA	American Bar Association
AML	Anti-money laundering
CDD	Client Due Diligence
CFT	Combating the financing of terrorism
DNFBPs	Designated Non-Financial Businesses and Professions
FATF	Financial Action Task Force
NPO	Not for profit organization
OFAC	Office of Foreign Assets Control
PEP	Politically Exposed Person
RBA	Risk Based Approach
SDN List	List of Specially Designated Nationals and Blocked Persons
SRO	Self-regulating organization
TCSPs	Trust and company service providers

Risky Business: Transactional Lawyers and the Gatekeeper Initiative

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May 7, 2010

VENABLE LLP

Gatekeeper Initiative: What is it?



- Financial Action Task Force on Money Laundering ("FATF"). FATF is an inter-governmental body established by the G-7 Summit in 1989.
- FATF formed to develop and promote anti-money laundering ("AML") policies, both at national and international levels.
- Professionals (e.g., lawyers, accountants, auditors, trust and company service providers, dealers in precious metals and stones, and other "DNFBPs") are viewed as the "gatekeepers" to the international and domestic monetary system.

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What is Money Laundering?



- Three distinct stages: "PLI"
- **Placement:** funds from illegal activity introduced into the financial system
- **Layering:** Illicit funds distanced from source
- **Integration:** illegal funds appear to have been derived from a legitimate source

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Forty Recommendations + 9

- 1990—FATF issues Forty Recommendations.
- October 2001—FATF issues 8 Special Recommendations (later 9) in response to 9.11 attacks and terrorist financing concerns.
- June 2003—FATF amends Forty Recommendations. Extends application of various AML measures described in the Forty Recommendations to *designated non-financial businesses and professions* (“DNFBP”), including lawyers.
- Now 34 FATF member countries.

FATF’s “Authority”

- International peer pressure system.
- FATF delegates are not elected.
- FATF has no legislative authority.
- FATF member countries voluntarily support and are committed to its principles.
- FATF makes policy recommendations and then monitors the implementation of those recommendations through periodic evaluations of its member countries to measure compliance.

Where does US Stand?



- US most recently underwent the mutual evaluation process in 2005-06. FATF issued an opus-length 300 page evaluation report.
- Four FATF “grades” of compliance: (a) compliant, (b) largely compliant, (c) partially compliant, and (d) non-compliant.
- US lawyers *non-compliant* in the areas of customer due diligence, monitoring of customers and filing of suspicious activity reports (“SARs”).
- Recommends that US Government issue a final rule to expedite the introduction of AML obligations to “persons involved in real estate closings and settlements.”

Where does Europe stand?

- Third Money Laundering Directive—issued by European Commission
- UK: Third Money Laundering Directive incorporated into UK law by the Money Laundering Regulations 2007 and the Terrorism Act of 2000 and Proceeds of Crime Act.
- STR and tipping off obligation—defensive filings

What is the ABA's Position?

- ABA Task Force of Gatekeeper Regulation and the Profession created in 2002; still active.
- Adverse effect on attorney-client privilege and duty of client confidentiality.
- ABA **adamantly** opposed to suspicious transaction reporting and "no tipping off" rules pursuant to House of Delegates Resolutions (104 and 300).
- To the extent that the FATF Recommendations are applied to lawyers, they should be carefully tailored and focused primarily on attorneys who, when acting as *financial intermediaries*, receive and transfer funds on behalf of clients.

Development of Risk Based Approach ("RBA")

- FATF met with DNFBBs in London, Bern, Paris, and Ottawa in 2007-08 to develop risk based guidance. FATF and legal profession representatives gave a joint presentation in Madrid on Monday.
- DNFBBs included lawyers, casinos, accountants, precious metal dealers, trust and company service providers, real estate agents, and others.

What is the Risk Based Approach?

- RBA based on premise that AML obligations should be proportionate to AML risks—employ reason and judgment. Devote limited resources to areas of greatest risk.
- Risk based approach differs from "RULES BASED APPROACH."

RBA for Legal Profession

- In October 2008, FATF adopted RBA for Legal Professionals.
- No suspicious transactions reporting ("STR") and no tipping off ("NTO") rule—differs from RBA guidance for other DNFBPs (e.g., accountants). Critical decision point at April 2008 Paris meeting.
- Lawyer Guidance is a complex document—126 separately number-paragraphs.

Who are covered by the Lawyer Guidance?

- Lawyers/legal professionals are included.
- Notaries are included, but not the "American" type notaries.
- In-house counsel excluded!

What is covered by the Lawyer Guidance?

- Lawyers who "prepare for or carry out specified activities."
- Phrase "prepare for or carry out" not defined.
- 5 categories of "specified activities," such as "buying and selling of real estate."
- Lawyer Guidance does not define "buying and selling of real estate": does it include financing or leasing transactions?

What is covered by the Lawyer Guidance?

- Another specified activity is the "creation of companies"—company formation agents.
- Another specified activity: buying and selling of business entities.
- What about local counsel? May not be covered because they may not be preparing for or carrying out a specified activity—role is peripheral to overall specified activity. Current changes to R.9—third party reliance—June 2009 meeting in Paris and March 29, 2010 meeting in Strasbourg, France.

What are the risk categories?

- Lawyer Guidance requires lawyers to assess risk as part of client due diligence.
- Three major risk categories:
 - Country/geographic risk
 - Service risk
 - Client risk

Country/Geographic Risk (Para. 108)

- No universally agreed definition of whether a particular country or geographic area represents a higher risk.
- Higher risk countries: countries subject to sanctions or embargoes and countries identified by credible sources as generally lacking appropriate AML/CFT laws, regulations, and other measures.

Client risk (Para. 109)

- Lawyer Guidance identifies about a dozen categories of potentially higher risk clients.
- PEPs—politically exposed persons. PEPs are high level officials in *foreign* countries. Report issued in February 2010 by Senate Permanent Subcommittee on Investigations focuses on PEPs.
- Structures with no apparent legal or legitimate tax, business, economic, or other reason.

Service risk (Para. 110)

- "Touching the money"—lawyers acting as financial intermediaries—handling receipt and transmission of funds.
- Concealment of beneficial ownership—lack of transparency concerns FATF.
- Accelerated real estate transfers.
- Inadequate consideration.

Variables that affect risk (Para. 111-112)

- Concept of proportionality—"variables" tell the lawyer whether to increase/decrease level of client due diligence. No situation where risk is zero!!
- Nature and regularity or duration of client relationship.
- Local counsel—providing limited legal services may be considered a low risk factor.
- "One shot" transaction.

Development of "Good Practices" Guidance

- FATF Lawyer Guidance urges development of "good practices" guidance by the legal profession
- Voluntary approach—not rules based
- Effort to fend off legislation in this area (e.g., S.569)—no need to regulate legal profession at the federal government level.

Stakeholders in Good Practices Guidance

- American Bar Association has led the development of the voluntary good practices guidance.
- Endorsed by the following specialty bar associations: American College of Real Estate Lawyers, American College of Trust and Estate Counsel, American College of Mortgage Attorneys, American College of Commercial Finance Lawyers.
- Endorsed by the following ABA Sections: Real Property, Estate and Trust Law and Taxation (endorsement pending from Business Law, International Law, and Criminal Justice).

Development of Good Practices Guidance

- Good practices guidance—about 40+ pages in length.
- US Treasury has reviewed draft (informally) and has provided valuable comments.

Development of Good Practices Guidance

- Format generally tracks FATF Lawyer Guidance.
- Emphasis on usability and practicality.
- Audience represents a vast cross section of US practitioners, most of whom are unfamiliar with FATF Lawyer Guidance.

Development of Good Practices Guidance

- Guidance contains "practice pointers" designed to highlight or illustrate practical impact of particular point.
- Practice pointers reflect insights into the intent of particular provisions.
- Guidance is not static—will be continually revised to reflect new or better insights.

Development of Good Practices Guidance

- Particular focus on various risk factors and their identification and evaluation.
- Sensitivity to widely varying practice settings of US lawyers.
- Practical explanation of risk based approach, "specified activities," and client due diligence.

Protocol for Client Intake and Assessment

- Good practices guidance contains detailed discussion of sound client intake processes as critical part of implementing a risk based approach.
- Identifies standard level CDD, reduced CDD, and increased/enhanced CDD.
- Appendix contains basic client intake protocol.

Role of Education

- Success of good practices guidance, and the risk based approach, will depend on scope and reach of educational efforts.
- ABA and other specialty bar groups are committed to on-going and widespread educational efforts.

Voluntary compliance is the key

- Profession needs to embrace voluntary good practices model.
- Alternative is potential federal legislation of the legal profession.



External pressures

- S. 569 threatens to regulate lawyers when acting as company formation agents.
- Senate Permanent Subcommittee on Investigations issued report in February 2010 urging ABA to adopt good practices guidance when dealing with PEPs. Report also recommended that Treasury issue regulations for "persons involved in real estate closings and settlements." Issue has been dormant since 2003.



Upcoming action

- ABA House of Delegates will act on voluntary good practices guidance at 2010 annual meeting in San Francisco in August 2010.
- Resolution will seek formal ABA policy endorsement.
- Sends additional signal to FATF, Treasury, and Congress that ABA is serious about Gatekeeper Initiative.