Defending Liberty
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AMERICAN BAR ASSOCIATION

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Via e-mail to: fatf.consultation@fatf-gafi.org

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Re: Comments to Consultation Paper—The Review of the Standards—Preparation for the 4th Round of Mutual Evaluations

Dear John:

Thank you again for hosting the November 22, 2010 meeting in Paris to discuss the above-referenced Consultation Paper. The American Bar Association ("ABA"), which has almost 400,000 members, greatly appreciates the willingness of the Financial Action Task Force ("FATF") to engage the ABA and other private sector representatives to discuss matters of mutual concern. As Chair of the ABA Task Force on Gatekeeper Regulation and the Profession, I am pleased to offer the ABA's comments below on the Consultation Paper and have been authorized to express the association's views on this important topic. These comments are arranged in the order in which they appear in the Consultation Paper. We would like to preface these comments, however, with a number of general observations.

GENERAL REMARKS

1. The consultation process should be made more productive and enriching, thereby resulting in a final product that is truly reflective of the interests, goals, and concerns of the private and public sectors. The format of the Paris meeting left a number of private sector representatives with the distinct impression that FATF had already determined a particular course of action or resolution of a matter and was simply reporting on it at the Paris meeting. It would have been more helpful, at least from the perspective of the private sector representatives, for FATF to engage in a meaningful dialogue with these representatives on these issues before deciding on a course of action or resolution of a matter. As you know, there was little or no debate on any substantive issues, thereby underscoring the point that FATF may have already decided how to address an issue.

2. As we discovered during the consultative process leading to the adoption of the Risk Based Approach for Legal Professionals in October 2008, it was helpful to propose draft language so that the interested stakeholders could weigh in with their views prior to the adoption of the guidance paper. Circulating draft language allows the stakeholders, both private and public sector, to identify issues that may not have been apparent during the initial discussions, to detect language nuances or ambiguities that may lead to unintended results, and to tease out concepts that need further elaboration and clarification. A process that presents language as "final" short circuits the consultative process and precludes the adoption of language that truly reflects a balance of private and public sector interests and goals.

3. The overall timing for the second phase of the consultation seems too compressed. As we understand it, the second phase of the consultation will occur after the completion of the initial consideration in July 2011. It would appear that the public consultation would occur, at the earliest, in September 2011, with FATF's goal to issue the revision in October 2011. If the public consultation is to occur a mere month before the scheduled adoption of the revision, it is unclear to the private sector how meaningful the public consultation will be. The ABA therefore respectfully requests that FATF reconsider the timetable so as to afford sufficient time for meaningful dialogue between the private and public sectors.

4. At the Paris meeting, FATF reported that the member states continue to debate what changes, if any, should be made to Recommendations 33 and 34. As part of the revision process, we think it is important that FATF engage with the private sector on developments with these Recommendations so that the private sector can better understand what impact these proposed changes will have on beneficial ownership issues and the actions member states might be encouraged to take under these Recommendations. Absent this engagement, the ABA is concerned that the private sector will not have an adequate opportunity to discuss these matters with FATF in a meaningful and constructive fashion. Our concerns about the timing of the completion of the consultation expressed above are particularly acute with respect to Recommendations 33 and 34 since work on those Recommendations is already delayed. We respectfully request FATF to take adequate time to consider Recommendations 33 and 34, even if that means revisions of those Recommendations must be separated from the rest of the consultation process.

5. The Hiring Incentives to Restore Employment ("HIRE") Act of 2010 was enacted by the United States government on March 18, 2010. The Foreign Account Tax Compliance Act ("FATCA") constitutes Title V of HIRE (Sections 501 and following), and it imposes significant increased reporting responsibilities on Foreign Financial Institutions and Non-Financial Foreign Entities. We understand that the U.S. Treasury Department ("Treasury") is drafting regulations under FATCA, which we understand will be responsive to a number of the concerns expressed by FATF during the most recent mutual evaluation process of the United States.

SPECIFIC REMARKS

1. THE RISK-BASED APPROACH

1.1 The Risk-Based Approach.

If and to the extent FATF revises the 40+9 Recommendations to set forth a comprehensive statement of the Risk Based Approach ("RBA"), it is critical that this statement not override or render meaningless the RBA for Legal Professionals. The legal profession spent a considerable amount of time and effort in working with the FATF to develop a carefully balanced RBA for the legal profession. Any changes to the 40+9 Recommendations must respect the work that was done on the RBA for Legal Professionals.

1.2.1 Recommendation 5 and its Interpretative Note.

The Consultation Paper notes that FATF plans to give "a more detailed and balanced list of examples of lower/higher ML/TF [money laundering/terrorism financing] risk factors, as well as examples of simplified/enhanced CDD [client due diligence] measures." It is important that FATF demonstrate appropriate sectoral sensitivity to the risk based approach applicable to designated non-financial businesses and professions ("DNFBPs") in the application of simplified CDD measures. For instance, examples of simplified CDD measures must be reflective of the unique client and practice setting characteristics of legal professionals.

1.2.2 Recommendation 8. New Technologies and non-face-to-face business.

We understand that FATF plans to incorporate the issue of non-face-to-face business into the Interpretative Note on the RBA ("INRBA"). As the legal profession noted during the development of the RBA for Legal Professionals, non-face-to-face interaction is neither unusual nor suspicious in delivering legal services to clients. By virtue of electronic communications (such as telephone and e-mail communication), lawyers may deliver legal services to clients without ever meeting them face-to-face. Non-face-to-face communication is not inherently higher risk for the delivery of legal services by legal professionals, and the INRBA should not suggest otherwise.

2. RECOMMENDATION 5 AND ITS INTERPRETIVE NOTE

2.1 The impact of the Risk-Based Approach on Recommendation 5 and its Interpretive Note.

We were pleased to see that the Consultation Paper says that the revised INR.5 will provide a flexible approach to the implementation of the RBA. Endorsement of the RBA by FATF is an important indication that FATF recognizes that placing unnecessary requirements on the private sector is inappropriate. We look forward to reviewing and commenting on the examples that FATF has prepared, as well as the additional guidance on "Risk Variables." To repeat a

comment we have already made, we urge FATF to make available the new text as soon as possible to allow adequate time for review and comment.

2.2 Legal persons and arrangements – customers and beneficial owners.

The Consultation Paper suggests that the revised INR.5 will make clear that the RBA applies to the identification of beneficial owners by financial institutions. We support the application of the RBA to the identification of beneficial owners, and look forward to reviewing and commenting on the new guidance.

We are concerned, however, that FATF has not extended its endorsement of the RBA for determining beneficial owners to Recommendations 33 and 34. Those recommendations have the broadest scope of any of the 40+9 Recommendations and impose compliance costs on the entire private sector without any recognition that the vast majority of private businesses covered by Recommendation 33 and trusts covered by Recommendation 34 pose no ML/TF threat.

Following the consultation meeting in Vienna in May 2010, Messrs. Henry Christensen and William H. Clark, Jr. submitted comments to FATF on Recommendations 33 and 34. The ABA encourages FATF to engage in further substantive dialogue with the private sector, including our Task Force on Gatekeeper Regulation and the Profession, on the May 2010 comments and possible revisions to Recommendations 33 and 34.

2.3 Life insurance policies.

Paragraph 23 of the Consultation Paper states that FATF has concluded that the beneficiaries of life insurance policies cannot be satisfactorily considered as either a customer or a beneficial owner, because their rights are not fixed or determinable until the death of the insured, and that a new rule needs to be developed treating the beneficiary of a life insurance policy as a stand alone concept in the FATF Glossary to the 40+9 Recommendations, with a different level of disclosure required for the potential beneficiaries of life insurance policies.

We suggest that the study of appropriate treatment and disclosure of information concerning the beneficiaries of life insurance policies should be extended to the treatment and disclosure of information concerning the beneficiaries of discretionary trusts, because the same principles apply. A named beneficiary of a life insurance policy has a potential interest, but not a vested interest, because his or her interest can always be changed, diminished, or eliminated by the owner of the policy until the insured dies. Similarly, a named beneficiary of a discretionary trust—either identified by name or "named" as being a member of a named class—has no enforceable interest in receiving income or principal of a trust until the trustee elects to make a distribution to the beneficiary. Thus, the potential beneficiaries of discretionary trusts should be given the same treatment as FATF determines for the beneficiaries of life insurance policies.

3. RECOMMENDATION 6: POLITICALLY EXPOSED PERSONS

We generally believe it is appropriate to reference the United Nations Convention Against Corruption 2003 in the guidance with regard to the 40+9 Recommendations, subject to having a clearer understanding of the language that would be used to do so. We agree that the proceeds of corrupt activity, as well as corrupt payments themselves, can and do raise ML risks. Recent enforcement actions in the United States, for example, have frequently seen ML and corruption charges being brought with regard to the same defendants or illicit scheme. Like any other illicit or criminal act involving financial inducements or payoffs, the perpetrators often take steps to disguise the funding for and ill-gotten gains from such conduct. Therefore, anti-money laundering ("AML") recommendations and guidance can be more complete by reference to other legal or policy frameworks intended to combat the underlying criminal conduct.

We suggest, however, that referencing the UN Convention Against Corruption should not be to the exclusion of referencing other international anti-corruption conventions, such as those developed by the Organization for Economic Cooperation and Development, the Organization of American States, and others. In referencing the UN Convention, the explicit or implicit message should not be to endorse the legal principles and approach set forth therein, as compared to any other national or multi-national anti-bribery framework. This is because the principles and approach of the UN Convention do not reflect the only common standard, and other well-conceived and effective multi-lateral conventions embrace different legal norms and methods for combating corruption.

The issue of how to address Politically Exposed Persons ("PEPs") within the framework of the guidance to the 40+9 Recommendations requires further attention. We observe that domestic and foreign PEPs may be indistinguishable from a corruption risk perspective, since the risk presented by PEPs is based on their governmental position or influence. However, there are practical and still-unresolved legal difficulties in conducting due diligence for ML risks presented by PEPs. Some of these challenges are evident in current practice with regard to "list-based" regulatory regimes, such as the United Nations Consolidated Sanctions List and the Specially Designated Nationals list of prohibited parties administered by Treasury's Office of Foreign Assets Control under U.S. law.

Although both lists contain individuals, entities, and organizations with whom persons cannot engage in transactions and each entry includes some identifying information, any compliance program designed to screen against the lists will still have to address false positives. Problems generated by list-based programs include defining who is the target of the enhanced due diligence, application of due diligence to those related to the target, false positives and how they are resolved, and addressing risks arising from historical circumstances that may no longer be current. Therefore, we suggest that any reference to due diligence for PEPs adopt a risk-based approach for due diligence, consistent with the notion that different circumstances present different risks, and different types of financial and non-financial actors have different risk profiles and resources available.

Furthermore, there is still lack of agreement on the definition, scope, duration, and vulnerabilities of PEPs. RBA due diligence must be informed by the continuing lack of a uniform approach to "who is a PEP"; whether the PEP status ends a year or longer after government service end; and how to treat relatives and close business associates of PEPs (and who is a covered "relative" or "business associate"). Although we can appreciate the enhanced risk that a PEP presents from an AML perspective, we also believe that more work is needed before elaborating on an appropriately adequate guidance document for compliance purposes. Regulatory officials and bodies need to recognize that while regulating private sector engagement with PEPs is wholly consistent with the regulatory agenda, there are practical and operational challenges for those subject to regulation. We thus urge more study on this issue, including the domestic vs. foreign divide, whether a more precise and informative definition of PEP can be achieved, and how long a PEP should be so considered once he/she leaves a position of public trust. More outreach to the private sector, including the ABA and other bar association groups, would assist in this regard.

4. RECOMMENDATION 9: THIRD PARTY RELIANCE

With respect to the issue of who can be relied upon in the context of Recommendation 9, we understand FATF is considering amending Recommendation 9 to make clear that countries have the discretion to determine the types of third parties that can relied upon, and to go beyond the banking, securities, and insurance sectors to include other types of institutions, businesses, or professions as long as they are subject to AML and CFT [combating the financing of terrorism] requirements and to effective supervision or monitoring. We believe it is appropriate to extend the countries' discretion in this fashion.

The proposed changes to Recommendation 9 appear to create an explicit two-part test for third party reliance, i.e., third parties that may be relied upon must be subject to AML/CFT requirements and to effective supervision and monitoring. In the U.S., the state courts and their state bar association agencies license and then closely supervise, regulate and discipline all lawyers. The second prong of this test, supervision and monitoring, is thus satisfied for the legal profession. The first prong of the text, dealing with AML/CFT regulations, would not be able to be satisfied because neither federal nor state law specifically regulates the legal profession in the area of AML/CFT, apart from certain general prohibitions against lawyer misconduct contained in various state bar ethical rules[1]. Pursuant to United Nations Security Council Resolution 1260

[1] *See, e.g.*, ABA Model Rule of Professional Conduct 1.2: Scope of Representation and Allocation of Authority Between Client and Lawyer (stating in part that "(d) a lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent..."); Model Rule 4.1: Truthfulness in Statements to Others (stating that "in the course of representing a client a lawyer shall not knowingly: (a) make a false statement of material fact or law to a third person; or (2) fail to disclose a material fact when disclosure is necessary to avoid assisting a criminal or fraudulent act by a client, unless disclosure is prohibited by Rule 1.6); and Model Rule 8.4: Misconduct (stating in part that "it is professional misconduct for a lawyer to...(b) commit a criminal act that

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and its progeny, however, most governments have implemented sanctions regimes prohibiting their nationals (including members of the bar) from engaging in transactions with designated terrorists and their supporters.

It seems incongruous, and indeed inefficient, for a lawyer who has an effective AML/CFT voluntary good practices regime in place not to be able to serve as a third party another lawyer may rely upon. For example, assume Lawyer A has an effective AML/CFT voluntary good practices regime that hews to the ABA's voluntary good practices guidance protocols. Assume further that Lawyer A refers a matter to Lawyer B. In that situation, Lawyer B, knowing that Lawyer A has an effective AML/CFT regime in place, should be allowed to rely on the CDD performed by Lawyer A. Otherwise, Lawyer B would have to perform duplicative CDD on the same client, waste valuable resources in doing so, and from a risk based approach, devote limited resources where the risk does not demand it. FATF should engage with the legal profession in a principled discussion on this precise issue and not reject out of hand such an approach.

5. Tax Crimes as a Predicate Offence for Money Laundering

We understand that FATF is considering including tax crimes as a predicate offense for money laundering in the context of Recommendation 1. The premise behind Recommendation 1 is to recommend that countries apply the crime of money laundering to all serious offenses, with a view to including the widest range of predicate offenses. We are concerned that including tax crimes as a predicate for money laundering would have a number of adverse implications, including the following: (a) discouraging persons from voluntarily repatriating funds from secrecy jurisdictions to their home jurisdictions where there is a tax amnesty provision in play; (b) undermining due process protections in tax prosecutions by providing prosecutors with the alternative of prosecuting under a money laundering statute; and (c) subjecting even minor tax fraud cases to potentially higher fines under applicable money laundering statutes.

If Recommendation 1 were revised to include tax crimes as a predicate offense, it could discourage taxpayers from repatriating and disclosing funds held in previously unreported accounts out of concern that they would be prosecuted for money laundering offenses. Although many nations have entered into tax treaties with each other, there remain a significant number of nations sheltering off-shore funds. We are concerned that Recommendation 1 could undercut these tax treaties and encourage taxpayers to continue to maintain their funds in off-shore secrecy jurisdictions.

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reflects adversely on the lawyer's honesty, trustworthiness or fitness as a lawyer ...(or) (c) engage in conduct involving dishonesty, fraud, deceit or misrepresentation...")

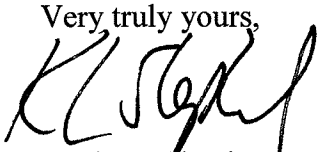
If tax crimes are made a predicate for money laundering, we are also concerned that many of the due process protections inherent in the tax code could be eroded. For example, prosecutors in the U.S. must follow detailed procedures when exercising IRS Code seizures and forfeitures. Where a prosecutor instead pursues a money laundering charge, the prosecutor could circumvent these protections. Similarly, prosecutors may be encouraged to use a money laundering statute rather than a specific tax statute. Where the legal requirements for a tax fraud case are more stringent than for a money laundering case and the latter contains higher penalties, there are serious questions as to whether certain international business transactions linked to tax fraud should be subject to the harsh money laundering penalties.

8. USEFULNESS OF MUTUAL EVALUATION REPORTS

Apart from the mutual evaluations, it would be helpful for FATF to provide typologies where lawyers are being used unwittingly to facilitate ML/TF. The legal profession has repeatedly requested these typologies so as to assist the profession in understanding the vulnerabilities of the legal profession to ML/TF.

The ABA appreciates the opportunity to provide its comments to FATF on the Consultation Paper. If we can address any of these comments in more detail or if we can be of further assistance, please feel free to contact me at (410) 244-7772 or klshepherd@venable.com.

Very truly yours,



Kevin L. Shepherd

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