April 10, 2003

Supplemental Report of the American College of Trust and Estate Counsel ("ACTEC")[1] in response to the Revised FATF Recommendations (Draft) dated 14 March 2003 (the "14 March Draft")

I. INTRODUCTION

At the outset, it should be noted that the original report of ACTEC (the "ACTEC Report"), dated August, 2000, in response to the Consultation Paper issued by the Financial Action Task Force on 30 May, 2002, setting forth the "Gatekeepers' Initiative," continues to be the current position of ACTEC. This Supplemental Report is not intended to change any of the points made in the ACTEC Report and addresses only the revised FATF Recommendations set forth in the 14 March Draft. In this regard, however, we appreciate FATF's consideration of the ACTEC Report (and other comments from the private sector), which consideration is clearly reflected in the revised FATF Recommendations, and FATF's solicitation of comments from selected business and professional groups on the 14 March Draft.

As with the ACTEC Report, ACTEC is commenting upon the provisions of the 14 March Draft which particularly apply to lawyers, trusts, and trust service providers. As an initial observation, we commend the effort of the FATF working group responsible for the 14 March Draft to reflect the comments made by various interested and expert business and professional groups to the Consultation Paper, and the integration of the Gatekeepers'

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[1] The authors of this Supplemental Report are Henry Christensen III and Robert C. Lawrence III, with assistance from Dina Kapur Sanna and Kirstin Sutcliffe and helpful comments from Robert D. Chapin, Michael I. Frankel, Christopher H. Gadsen, Ellen K. Harrison, Carlyn S. McCaffrey and Gideon Rothschild. Because of the short period of time available, this Supplemental Report has not been approved by the Executive Committee of ACTEC and represents only the views of an acting subcommittee of members from the International Estate Planning and Professional Responsibility Committees of ACTEC.

Initiative with the Recommendations. Because of the special considerations pertaining to the application of the Recommendations to lawyers, we have joined many international professional organizations in filing a joint statement that reaffirms ACTEC's commitment to preserve the attorney-client privilege and ability for private citizens to seek legal advice from lawyers in an environment of confidentiality.[2] Subject to that overriding statement, respectfully, the particular concerns that we have with some of the Recommendations and our suggestions for dealing with these concerns are set forth below.

II. THE REVISED FATF RECOMMENDATIONS (Draft) DATED 14 MARCH 2003 AND THE ATTENDANT GLOSSARY AND INTERPRETATIVE NOTES

This Supplemental Report primarily addresses Recommendations 13 and 14. However, because Recommendation 13 may incorporate by reference all or part of Recommendations 6 to 12, and Recommendation 14 may incorporate by reference all or part of Recommendations 15 to 20, our analysis of Recommendations 13 and 14 will include the other relevant Recommendations as well.[3]

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[2] See joint statement by the international legal profession in the fight against money laundering attached as Exhibit A.

[3] The possible incorporation by reference of all or part of Recommendations 6 to 12 into Recommendation 13 and all or part of Recommendations 15 to 20 into Recommendation 14, are bracketed which, presumably, means that such incorporation is only being considered and is not part of the Recommendations at the current time. In both cases, we recommend only partial incorporation. Therefore, we shall comment with regard to Recommendations 6 to 12 after our discussion of Recommendation 13 and Recommendations 15 to 20 after our discussion of Recommendation 14.

A. Recommendation 13 and Recommendations 6 to 12 (Incorporation therein by Reference)

1. Recommendation 13

a. Subparagraph (e)

Recommendation 13 addresses due diligence and record-keeping requirements. Subparagraph (e) applies such requirements to "lawyers, notaries and independent legal professionals..." (hereafter "lawyers"). Thereafter, it sets forth two Alternatives, referred to as Alternative 1 and Alternative 2. We recommend the adoption of Alternative 2, which would require lawyers to comply with the requisite due diligence and record-keeping requirements "when they carry out financial transactions for a client."

We recommend the rejection of Alternative 1 because it has specific references to various functions, some of which are vague and subjective and others of which are an integral part of a lawyer's practice. For example, the "creation, operation or management of trusts, companies or similar structures" constitutes a significant portion of many lawyers' practices. These structures and arrangements are frequently utilized. The adoption of Alternative 1 would eliminate the attorney-client privilege in the vast majority of matters for which many lawyers are retained. This privilege is well established in the United States and is an important part of the relationship our system of jurisprudence seeks to establish between an attorney and his or her clients. It would also mean that lawyers would be subject to these Recommendations if, for example, the lawyer assisted

in the creation of a trust or an entity, even if the lawyer had no role in, or knowledge of, the financing of the trust or entity. Therefore, we believe that Recommendation 13 should apply only when lawyers "... carry out financial transactions for a client."

In order to implement this Recommendation effectively, the term "financial transactions" should have clear meaning. It is not defined in the Recommendations or discussed in the Interpretative Note. The Annex to Recommendation 9 of The Forty Recommendations does list financial activities undertaken by businesses or professions which are not financial institutions, but these financial activities may not be the same as the financial transactions contemplated in Recommendation 13.[4] We would have no objection if the list of financial activities in the Annex to Recommendation 9 were adopted as the list of financial transactions

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[4] The Annex to Recommendation 9 lists the following as financial activities:

1. Acceptance of deposits and other repayable funds from the public.
2. Lending (including inter alia: consumer credit, mortgage credit, factoring, with or without recourse, and finance of commercial transactions (including forfeiting).
3. Financial leasing.
4. Money transmission services.
5. Issuing and managing means of payment (e.g. credit and debit cards, cheques, traveller's cheques and bankers' drafts...).
6. Financial guarantees and commitments.
7. Trading for account of customers (spot, forward, swaps, futures, options...) in: (a) money market instruments (cheques, bills, CDs, etc.); (b) foreign exchange; (c) exchange, interest rate and index instruments; (d) transferable securities; and (e) commodity futures trading.
8. Participation in securities issues and the provision of financial services related to such issues.
9. Individual and collective portfolio management.
10. Safekeeping and administration of cash or liquid securities on behalf of clients.
11. Life insurance and other investment related insurance.
12. Money changing.

referred to in Recommendation 13.[5] In all events, we recommend that the term "financial transactions" be defined.

In addition, the term "to carry out a financial transaction" should be clarified to prevent Recommendation 13 from applying to routine financial transactions that are normally carried out by a lawyer for the convenience of his or her client in the context of a transaction. For example, we do not believe that a lawyer should become subject to this Recommendation if his or her lawyer's escrow account is used to hold the down payment in a real estate transaction until the closing. The lawyer in such case is normally the lawyer for the seller and will have no knowledge of the source of the purchaser's funds.

b. Subparagraph (f)

Subparagraph (f) of Recommendation 13 applies to "trust and company service providers..." Again, there are two Alternatives set forth. We recommend the adoption of Alternative 2. Alternative 1, which requires trust and company service providers (hereafter "providers") to comply with the requisite due diligence and record-keeping requirements "...in all circumstances...," imposes an undue burden on individual trustees. As noted in the ACTEC Report, many individual lawyers in the United States

[5] We note that in the Glossary there is a definition for "financial institutions" which sets forth activities or operations for or on behalf of a customer which are closely similar to the list of financial activities in the Annex to Recommendation 9.

serve as trustees. If this Alternative were adopted for providers, it would be impractical, if not impossible, for them to comply with it.

Alternative 2 requires that such providers be subject to Recommendation 13 only "when they carry out financial transactions for a client." We think Alternative 2 is preferable for the reasons stated previously with regard to lawyers. We do not think that the same definition of "when they carry out financial transactions for a client" should necessarily apply to lawyers and providers.

2. Recommendations 6 to 12 – Possible Incorporation by Reference

We question the advisability of incorporating blocks of certain Recommendations in their entirety into another Recommendation. In the case of the proposed incorporation of Recommendations 6 to 12 into Recommendation 13, the provisions for financial institutions should not always apply to lawyers in the manner set forth because the structure of lawyers' practices is different than the business of financial institutions, and lawyers, generally, do not have the same resources, information and abilities to comply with such Recommendations. Much of the substantive content contained in Recommendations 6 to 12 was discussed in the ACTEC Report, and it would be repetitive to reiterate here the points made therein. However, there are some new points worthy of comment.

Recommendation 6(d) provides for ongoing due diligence and scrutiny of transactions throughout the course of the relationship with the client. The

application of this requirement to lawyers may be unfair. A lawyer often will perform specific services for the client, and even though he or she may have an ongoing relationship with the client, he or she will have no way of knowing or means to check the conduct of the client or the client's use of the planning undertaken. For example, a lawyer may draft a trust for a client. The trustee then administers the trust in accordance with its terms with no involvement of the lawyer. Five years later the client seeks tax advice with regard to contributing additional property to the trust. In such circumstances, the lawyer would not be able to fulfill this requirement even though he or she continued the relationship with the client. We recommend this ongoing responsibility either not apply to lawyers or apply only when there is an ongoing, continuous activity in which the lawyer is engaged and that activity allows the lawyer to exercise ongoing due diligence and scrutiny of the transaction.

Recommendation 7 in the 14 March Draft, which, in its entirety, is in brackets and which refers to Recommendation 6, indicates that it is to apply to "...legal persons or legal arrangements such as trusts." Consequently, in the case of such entities or arrangements, the lawyer would be required to (a) understand the ownership and control structure of the client and (b) verify that each and every person purporting to act on behalf of the client is so authorized, and identify that person. This may not always be possible. For example, with regard to requirement (a), lawyers would be required to identify the natural persons who are the

beneficial owners, including those who comprise the mind and management of any entity, as well as to obtain other extensive information. It may be that lawyers will not have ready access to such information, and it would be an undue burden to require them to obtain the same. For example, lawyers might provide advice with regard to only one aspect of a particular matter and such an extensive requirement would be inappropriate and burdensome. In this regard we distinguish between lawyers, who are acting as lawyers, from lawyers who are acting as providers.

Recommendation 8, which is new, and also in brackets, in effect would permit a lawyer to rely on third parties to perform elements of the due diligence process, but the lawyer would be held responsible for the ultimate truth of the results of the process. For example, under the proposed Recommendation, if the lawyer were relying on a third party financial institution that had not properly undertaken the due diligence process, the lawyer would be held responsible. This result is not fair and will only lead lawyers or financial institutions to conduct their own due diligence. We think that in such case the third party financial institution providing the information should have the sole accountability, and the lawyer should be able to rely on the financial institution's due diligence, if he or she acted reasonably in relying upon the information supplied by the third party financial institution.

Recommendation 10, which is new, provides for enhanced due diligence with regard to certain high risk categories. Such risk categories include politically exposed persons and correspondent banking relationships. The Glossary contains a very broad definition of politically exposed persons and the reference to correspondent banking relationships does not apply to lawyers. In the case of a politically exposed person, as defined, it is unclear how a lawyer would develop "risk management systems" or "conduct enhanced ongoing monitoring". Although we appreciate the issue, we think there needs to be a practical, workable solution. Perhaps, it would be enough to indicate that in the case of politically exposed persons a heightened level of due diligence is required and the source of wealth needs to be verified.

B. Recommendation 14 and Recommendations 15 to 20 (Incorporation therein by Reference)

1. Recommendation 14

Recommendation 14 covers the reporting of suspicious activities and compliance. As noted in the Report, ACTEC is opposed to this Recommendation when a lawyer is solely providing services as a lawyer. However, if the lawyer is providing services to the client other than as a lawyer, such as agreeing to serve as a director or officer of a corporation or as a trustee of a trust, Recommendation 14 should apply to the lawyer. There are three separate Alternatives set forth with regard to this Recommendation, and we recommend that Alternative 2 be adopted. If Alternative 2 were adopted as presented in brackets, it would require

Recommendations 15 to 20 to apply to designated non-financial businesses and professions when they "carry out financial transactions for a client." For the reasons noted above, we request that if Alternative 2 is adopted, the term "financial transactions" be defined.

Also, for the reasons set forth above with regard to Recommendation 13, we do not believe that Alternative 1, which is essentially the same as Alternative 1 for Recommendation 13, is appropriate. Whereas Alternative 3 might be acceptable, we would not wish to consider Alternative 3 unless it is certain Alternative 2 of Recommendation 13 were to be adopted.

The last paragraph of Recommendation 14 provides that lawyers are not required to report suspicious activities if the relevant information is obtained in circumstances where "... they are subject to professional secrecy or legal professional privilege." We believe this is intended to apply to any of Alternatives 1, 2 or 3 for Recommendation 14. Nevertheless, for the reasons set forth in the ACTEC Report, we do not believe that under current law a requirement for the filing of a suspicious activity report can (or should) be applied to a lawyer acting as such. Furthermore, we believe that such a "saving" exclusion is not broad enough. Lastly, we believe that the Recommendations, as a whole, are so broad that it would be unfair to, and unwise for, lawyers to rely on such an exclusion, especially when there are often disputes as to what information might be privileged. We also share the concern of many lawyers that it

will cause clients to doubt whether they can impart confidential information to their lawyers.

In Recommendations 14 and 15, there is a proposal that each jurisdiction should determine what matters fall under legal professional privilege or secrecy.[6] It is stated in such Interpretative Notes that this would generally include information that lawyers "...obtain (a) in the course of ascertaining the legal position of their client and (b) performing their task of defending or representing that client in, or concerning, judicial proceedings." It should be noted that requirements (a) and (b) are in the conjunctive so that the attorney-client privilege would apply only in the cases of judicial proceedings. We believe the privilege is much broader than such a narrow interpretation and should apply to all legal advice. For example, there are many different types of administrative proceedings, arbitrations, mediations and hearings that would not be included in the terminology "judicial proceedings". Lawyers may also render legal advice which is not directed toward a judicial proceeding, but simply involves rendering advice to a client in connection with the client's completion of a transaction or the client's compliance with the law. Therefore, we recommend that a much broader mandate be given to each jurisdiction, which mandate would recognize the application of the privilege with regard to any legal advice and any information obtained in order to render such advice.

[6] This is discussed in the Interpretive Notes to the 14 March Draft for Recommendations 14 and 15.

2. Recommendations 15 to 20 - Possible Incorporation by Reference

Recommendation 15 has a number of bracketed variables. As a result, it is difficult to comment on it and its application without knowing what will be adopted. However, the essence of this Recommendation is that if a lawyer has reasonable grounds to suspect or, in fact, suspects that a financial transaction or an attempted financial transaction is (or possibly may be) related to (a) money laundering or (b) stems from a criminal activity, he or she would be required to report promptly his or her suspicions. This requirement would be impossible for a U.S. lawyer to meet, given the application of the attorney-client privilege in the United States.

In addition, there is bracketed language that suggests terrorist financing might also be covered by Recommendation 15. Although we are opposed to terrorist financing, we believe the extension of Recommendation 15 to terrorist financing would be a mistake and a substantial expansion of FATF's mandate under the Palermo and Vienna Conventions.

Recommendation 16 provides safe harbor protection for the reporting lawyer. Although this safe harbor may be a helpful protection from criminal and civil liability, it has no relevance to a violation of the rules governing U.S. lawyers.

Recommendation 17 indicates that lawyers would not be able to "tip off" their clients. If this means lawyers would be required to continue their

representation of such clients because the fact of withdrawing from representation might constitute a constructive "tip off", this requirement would violate the rules governing U.S. lawyers.

It may be helpful to underscore three relevant points made in the ACTEC Report.[7] First, lawyers in the United States are officers of the Court and, as such, not only have ethical obligations to their clients but also to the Court. Second, a lawyer may not counsel a client to engage, or assist a client who is engaging, in criminal or fraudulent conduct. Third, if a lawyer learns that a client intends to engage in an unlawful activity the lawyer has a duty to advise the client not to engage in such activity, and, if the client refuses, the lawyer should withdraw from representation.

Recommendation 18, regarding the development of internal policies, employee training programs and an audit function, as a minimum, does not generally lend itself to a lawyer's practice. It would be helpful if the Interpretative Note were to address this point in the context of the operation of a lawyer's office, especially one that has only a few employees.

Recommendation 19 should not be applicable to lawyers because it involves branches and majority-owned subsidiaries located abroad. Such a structure generally would not fit the profile of a lawyer's practice.

[7] See subparagraph 1 of paragraph C. of Part II of the ACTEC Report.

Finally, Recommendation 20 imposes a burden upon lawyers to know which jurisdictions either do not, or insufficiently, comply with the FATF Recommendations. This information is not generally available to a U.S. lawyer unless it is the intention of FATF to publish such a list. Even if such a list were published, it is likely that the vast majority of U.S. lawyers would not be aware of it. Therefore, innocent practitioners might unknowingly violate it.

As noted earlier with regard to Recommendation 13, the incorporation of Recommendations 15 to 20 by reference into Recommendation 14 is like fitting a square peg into a round hole. It does not work. Therefore, we recommend that this whole concept of incorporation by reference be more thoroughly analyzed.

C. Miscellaneous Applicable Recommendations

1. Recommendation 22

New Recommendation 22 urges jurisdictions not to permit the establishment or continued operation of "shell banks". We have no objection to the Recommendation, but want to be sure that any proscription of the use of shell banks does not extend to a proscription of the use of private trust companies. While we recognize private trust companies generally are not always banks, often they are and we are not sufficiently familiar with the licensing procedures in different jurisdictions to be sure this Recommendation would never apply to them. Therefore, we would like to point out that private trust companies have been

permitted for some time in offshore jurisdictions such as Bermuda and the Cayman Islands, as well as in some states of the United States, e.g. Delaware. Wealthy families often create and use private trust companies to serve as the trustee of the family's property. Such entities have proven very useful for the continuity of management of a family's own funds. Generally, the private trust company enters into a service agreement with an independent financial institution to provide the necessary administration for such family's trust(s) and may not have a physical presence in the jurisdiction where it is established. Such trust companies do not serve as trustee for third parties. We wish to be sure that the proscription of "shell bank", which is defined in the Glossary as "... a bank incorporated in a jurisdiction in which it has no physical presence and which is unaffiliated with a regulated financial group", not be interpreted to include private trust companies.

2. Recommendation 27

New Recommendation 27 contemplates the subjection of lawyers to regulatory and supervisory measures. These measures are set out in subparagraph (b) and require lawyers to be subject to a regulatory and supervisory regime that insures they have effectively implemented the necessary anti-money laundering measures. The suggestion is that such supervision could be performed by a competent governmental authority or by an appropriate self-regulatory organization. Although there are professional self-regulatory organizations in the various states of the

United States, known as state bar associations, they generally would not have the responsibility or ability to sanction a lawyer with regard to such measures. Furthermore, it would be unprecedented in the United States to subject the conduct of a lawyer to a governmental authority, except in the case of some criminal activity.

3. Recommendations 37 and 38

Recommendations 37 and 38 provide for transparency of legal persons and trusts. These are new recommendations. As indicated above and stated previously in the ACTEC Report, a lawyer may well establish an entity or create a trust for a client but thereafter may not have any ability to know how that particular entity or arrangement is utilized. We suggest, therefore, that Recommendations 37 and 38 apply to financial institutions and to providers (including lawyers acting as trustees) but not to lawyers acting as lawyers. As to the substance of Recommendations 37 and 38, we have these comments:

- We approve of the limitation of Recommendation 38's application to express trusts.
- For the reasons set out in the ACTEC Report, we are opposed to any registration of trusts, or prescribed form for trusts.
- As stated in the ACTEC Report, we approve of the requirement that a lawyer acting as a provider maintain for 5 years records showing the settlor, trustee and beneficiaries of a trust. We would not, however, prescribe a format for the information, or even that it

be in writing, as long as the lawyer can provide the information to competent authorities as requested.

- We oppose giving this information to financial institutions (a bracketed alternative) for the reasons set out in the ACTEC Report, because financial institutions might not have the same standards of confidentiality.
- We believe that the competent authorities should be required to demonstrate a need to have such information.

4. Glossary

a. Tax Offences

In the Glossary, there is a definition for "Designated categories of offences" that includes fraud. It is not clear whether fraud, as so listed, is intended to include offences related to taxation. For reasons set forth in the ACTEC Report, we urge that the Recommendations not apply to matters involving taxation. We are concerned that the Recommendations as set forth in the 14 March Draft might be applied to tax offences and would suggest consideration of the following points.

- Although the Recommendations are intended to combat the laundering of the proceeds of organized crime (the Palermo Convention) and illicit traffic in narcotic drugs and psychotropic substances (the Vienna Convention), Recommendation 1 would apply these Recommendations in their entirety to any "predicate offence". The Glossary includes fraud, without further definition or limitation, as a "designated category of offence."

- As set forth more fully in the ACTEC Report, we are concerned that if a lawyer or provider (or, for that matter, a financial institution) must include in "the proceeds of money laundering" funds on deposit which have not been reported, or have been incorrectly reported, to tax authorities, the application of these Recommendations is expanded to a whole class of transactions and clients or customers never intended to be covered by the Palermo or Vienna Conventions. Lawyers, providers, and financial institutions do not have the knowledge or means to acquire the knowledge of whether their client or customer is in full compliance with all worldwide tax or fiscal laws and regulations applicable to him or her.
- We do not suggest that lawyers, providers or financial institutions should be permitted to assist actively clients or customers in avoiding their fiscal responsibilities (as noted above, in the United States a lawyer has an obligation not to do so), but they should not have an obligation to assure themselves that the client or customer has met those responsibilities.
- The Interpretive Notes to Recommendations 14 and 15 with many bracketed alternatives is at least subject to the interpretation that fiscal offences are included in its scope.
- Recommendation 40 would not permit a compliant jurisdiction to refuse to execute a request for mutual legal assistance on the sole ground that the offence is also considered to involve fiscal matters.

Given the above considerations (and ambiguities) we strongly recommend the addition of an Interpretive Note that the Recommendations are not intended to apply to tax or fiscal offences which do not also involve organized crime or narcotic drugs or psychotropic substances as covered by the Palermo and Vienna Conventions.

b. Definition of Trust and Company Service Providers

The definition of "trust and company service providers" includes lawyers "that as a [business][commercial undertaking],

[provide services to third parties relating to the creation, management, administration or operation of...trusts...]"

or, as an alternative,

"[provide the following services:...acting as (or arranging for another person to act as) a trustee of an express trust...]"[8]

We have serious difficulty with both alternative definitions. First, for the reasons discussed above, a lawyer in the practice of trust law routinely provides services relating to the creation, management, administration or operation of trusts, by providing legal advice to settlors, beneficiaries and trustees. That does not make the lawyer a trust service provider, because he or she is not acting as a trustee. We therefore reject the first definition. Although the second definition is more

[8] We are only commenting with regard to the application of this definition to trust service providers and not as to service providers for companies, foundations, anstalts or other types of legal persons, which categories are also included in such definition.

acceptable than the first, we also are troubled by the suggestion that if a lawyer arranges for another person to act as a "trustee", such as by negotiating a fee agreement with a corporate trustee on behalf of his or her client, the lawyer would be a trust service provider. A lawyer should be treated as a trust service provider only in a case when the lawyer is acting as a trustee for a fee in that relationship. We suggest use of the term "trustee service provider" rather than "trust service provider."

We hope these comments will be helpful in your deliberations and appreciate the opportunity to be able to submit them for consideration.