Approximate Pages: 10
Code Section: Miscellaneous
Author: Zagaris, Bruce
Citations: (24 Apr 2001)
Tax Analysts Reference: 2001 WTD 82-2 (22 TAX NOTES INT'L 2293-98, May 7, 2001)

The Gatekeepers Initiative: An Emerging Challenge for International Financial Advisers

An international initiative to combat money laundering aims to make private-sector attorneys, accountants, and other financial advisers responsible for monitoring and reporting suspicious financial activities.

=============== SUMMARY ===============

An international initiative is under way to increase cooperation between countries to counter money-laundering activities. Private- sector professionals, such as lawyers and accountants, who deal with transactions involving the movement of money, are deemed to have a special role in identifying, preventing, and reporting money laundering.

As a result, the confidentiality that international clients have come to expect from private-sector financial institutions and financial advisers has been eroded by due diligence requirements, particularly in EU member states, and by far-reaching enforcement cooperation agreements elsewhere in the world.

=============== FULL TEXT ===============

An international initiative is under way to increase cooperation between countries to counter money-laundering activities. Professionals, such as lawyers and accountants, who deal with transactions involving the movement of money, are deemed to have a special role in identifying, preventing, and reporting money laundering. In some places, such as the United Kingdom and the Cayman Islands, so-called gatekeepers operate under due diligence requirements like those imposed upon financial institutions (for example, "know your client," identify and report suspicious transactions, and do not tip off persons engaging in suspicious transactions that their actions have been reported).

A related trend has been for law enforcement and regulatory authorities to combine international tax and counter-money-laundering enforcement by: (1) ensuring that obligations to report transactions related to suspected criminal offenses apply, even when such transactions are believed to involve tax offenses; and (2) permitting money-laundering authorities to forward information to their tax authorities to support the investigation of tax-related crimes, and to communicate such information to other jurisdictions so it can be used by their tax authorities. (superscript: 1)

Money-laundering legislation was first introduced in 1986 as a result of efforts in the United States to combat international narcotics trafficking and to deprive criminals of the proceeds of their crimes and the means by which they commit crime. In the normal course of creating anti-money-laundering norms, the tendency has been to agree initially on narrow sets of legal principles and policies and then to broaden them. For instance, one of the initial intergovernmental agreements on anti-money-laundering, the 1988 Vienna Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, was limited in many ways because it was an initial effort and because the participating governments were so diverse. Nevertheless, subsequent efforts have drawn from that convention and use, wherever possible, the same terminology and systematic approach, unless changes are believed necessary for improvements.

Much of the emphasis of the international anti-money-laundering initiative is to deprive criminals -- especially transnational criminals and organized crime -- of the fruits of the crimes and the means of committing more crimes. Another goal is to allocate the seized proceeds to governments and law enforcement. To help with the fight, governments and international organizations have solicited the collaboration of the private sector.

The implications for international business planning are that financial institutions and their employees -- and increasingly, professionals -- are on the front line and responsible for increased due diligence. Some of the confidentiality that clients have come to expect has been eroded by the due diligence requirements and far- reaching enforcement cooperation agreements (for example, Mutual Assistance in Criminal Matters treaties and tax information exchange provisions).

This article will examine the emergence of the Gatekeepers Initiative and its potential for affecting the ways in which attorneys, accountants, and other professionals advise clients about international transactions. In addition, the article also discusses the increasing interaction between international anti-money- laundering and tax enforcement officials.

I. Origin of Gatekeepers Initiative

The origin of the Gatekeepers Initiative was the Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime on 19-20 October 1999 in Moscow. A final communique issued at the end of the conference stated:

> We have agreed to bring our anti-money-laundering regimes into closer alignment and to consider putting certain responsibilities, as appropriate, on those professionals, such as lawyers, accountants, company formation agents, auditors and other financial intermediaries who can either block or facilitate the entry of organized crime money into the financial system.

II. European Union

The principal impetus for the Gatekeepers Initiative comes from the European Union. For the past two years or so, the EU has been trying to revise its 1991 Anti-Money-Laundering Directive. An important aspect of the EU Directive is that it was intended to have some extraterritorial effect. For instance, article 1 of the directive defines "financial institution" and "credit institution" to include EU branches of financial and credit institutions whose head offices are outside the EU. The directive also explains the need to focus on the interaction of national prevention and enforcement with international cooperation. In addition to requiring EU member states to criminalize money laundering, it requires them to undertake broad preventive steps, such as internal control procedures, "know your customer" procedures, employee training, identification and reporting of suspicious activities, and auditing of due diligence programs. (superscript: 2)

A. Action by EU Institutions

On 5 April, the European Parliament voted to impose anti-money- laundering due diligence obligations on lawyers, accountants, and other professional investment advisers. (superscript: 3) Previously, the EU Anti- Money-Laundering Directive had applied only to credit and financial institutions.

As a result of the proposed directive, when lawyers, auditors, tax advisers, and external accountants advise clients on managing financial accounts, creating companies or trusts, or executing financial transactions, the investment "gatekeepers" will be subject to the same requirements as banks and other credit institutions. In particular, attorneys, accountants, auditors, real estate agents, and other independent legal professionals are covered when, on a client's behalf, they participate in -- whether in planning or undertaking -- real estate transactions; the management of investment activities; opening and operating accounts; handling contributions for organizations; managing and operating the same; and creating and operating trusts, companies, or similar structures.

EU member states will be able to decide whether to permit EU- authorized exemptions in national law. They will be able to nominate a bar association, accounting association, "or other self-regulatory bodies for independent professionals," but must determine how those bodies will cooperate with regulatory authorities.

The European Commission's draft anti-money-laundering bill seeks to update the 1991 Directive 91/308/EEC on the Prevention of the Use of the Financial System for the Purpose of Money Laundering. (superscript: 4)

Contrary to the expectations of some observers, many of the amendments recommended unanimously by the EP's Committee on Justice Affairs failed in the plenary vote. Parliamentary amendments must receive the support of at least half the 626 serving members. Most of the proposed amendments to reduce the due diligence requirements and preserve professional confidentiality obtained a wide majority, but because only about two-thirds of the serving membership actually participated in the votes, the amendments narrowly fell short of the required margin of approval. Unless European Council ministers agree on the remaining amendments, the final text of the bill must be negotiated in conciliation talks, which can last up to six months. (superscript: 5)

The vote nearly guarantees that the due diligence rules will apply to professional advisers, but will be increasingly controversial. A conciliation panel consisting of 15 members of the EP and 15 from the European Council will mediate differences between the Council ministers' version (superscript: 6) and the one passed by the EP. Although it is possible that the Council and the EP will not reconcile, in which case the directive will not be revised, the two groups are expected to reach an agreement on the two versions.

The inclusion of professional advisers in EU member states means that their counterparts in non-EU countries that are not otherwise covered by the directive's extraterritorial application provisions will have an advantage because they will not be bound by the due diligence rules. That means investors and clients who do not want their advisers bound by such rules, either for legitimate or illegitimate reasons, are likely to use professionals in non-EU countries. Thus, non-EU countries will come under pressure to enact similar legislation.

The success of the proposed new directive will depend partly on the implementation of due diligence by professional bodies, cooperation between professional bodies and regulatory authorities, the education of professionals, and self-compliance efforts by professional bodies. (superscript: 7)

B. Action by Nongovernmental Organizations

The action to revise the 1991 Anti-Money-Laundering Directive has sparked debate among professional organizations representing attorneys, accountants, auditors, and other affected professionals.

On 27 July 1999, in Brussels, Belgium, the Council of the Bars and Law Societies of the European Community, the Conference of Notaries of the European Union, the European Federation of Accountants and Auditors for Small and Medium-Sized Enterprise (EFAA) and the Federation of European Accountants signed a charter on combating organized crime. (superscript: 8)

The charter contains the ethical principles to which the professions must adhere. Those include checking the identities of their clients and refusing to accept bribes or otherwise contribute to illegal activities. The charter instructs each of the participants to prepare or improve mechanisms to assist their members and to enact supervisory mechanisms and disciplinary sanctions. In addition, the professional organizations will take steps to raise awareness, an effort the EC is considering supporting.

According to a representative of the Council of the Bars and Law Societies, "the charter does not mark the beginning of our commitment to the fight against money laundering, but makes it more visible." While the charter sets forth the major principles, the various signatory professionals must take steps within their own codes of conduct to implement those principles.

The EC initially articulated the basic idea of the charter, and the United Nations Office for Drug Control and Crime Prevention has endorsed those efforts. (superscript: 9)

In addition to the charter, the Federation of European Accountants is working on revising its rules as a result of anti- money-laundering initiatives. (superscript: 10)

Other groups, such as national law societies and the Conseil Consultative Europeen de Barreau, became involved in the legislation quite late in the process. Many of them did not believe they had ample time to present their views and that the deliberative bodies did not even start to grasp, let alone resolve, the manifold implications of the initiative. Because of the different structures of the bar in common and civil law countries, the bar associations did not work well together. Just as importantly, they did not coordinate effectively with the nonlegal groups.

Increasingly, international organizations are developing a partnership between governments and the private sector to combat transnational crime.

III. U.S. Implementation of the Initiative

As a result of the G-8 summit in Moscow and other initiatives to prevent and combat transnational crime, the U.S. Treasury and Justice departments, in their National Money Laundering Strategy for 2000, outlined an initiative to develop a partnership with associations of legal and financial professionals to ensure that money launderers are denied access to the financial system. In particular, lawyers, accountants, and auditors serve as the "gatekeepers" to the domestic and international financial systems. The initiative is designed to ensure that such gatekeepers are not unwitting facilitators of money- laundering schemes. Two actions are in play under the U.S. strategy. First, a study group has been established consisting of the Treasury and Justice departments, the Financial Crimes Enforcement Network, the Securities and Exchange Commission, and federal bank regulators to examine how best to use accountants and auditors to detect and deter money laundering. Second, the chief of the asset forfeiture and money-laundering section of the Department of Justice is reviewing the professional responsibilities of lawyers and accountants with regard to money laundering and will make recommendations as needed. (superscript: 11)

Regarding the review of professional responsibilities of gatekeepers, the U.S. strategy requires an interagency working group to propose preliminary recommendations to a Money Laundering Steering Committee by the end of June. There seem to be three options: increased education; the application of new rules with respect to professional responsibility; and the application of suspicious activity reports (SARs) on the federal and/or state levels for gatekeepers. (superscript: 12)

To explore those options, an interagency task force has held initial meetings with members of the American Bar Association. Officials in the task force have reported that their efforts are somewhat in arrears because of work on the Financial Action Task Force on Anti-Money-Laundering's report on noncooperative countries. In other words, the task force has prioritized compliance by other countries over that of the United States.

IV. Business and Practice Implications of the Initiative

Once the EU enacts legislation, it will increasingly insist that the United States and other G-7 countries act to ensure a level playing field. Other jurisdictions that are the targets of economic sanctions or threatened sanctions already subject professionals to due diligence rules (for example, the United Kingdom, the Cayman Islands, Bermuda, and Switzerland). They believe, not surprisingly, that the country most active in the anti-money-laundering rhetoric -- the United States -- should match its words with actions.

If the United States does not enact similar legislation, investment clients and professionals will take advantage of globalization to meet in a jurisdiction where advice can be given with the least risk of liability or restriction. The ability of a client or adviser to change the place of consultation on international business, estate, tax, and investment depends in part on the applicable legal and ethical considerations and their extraterritorial reach. In some cases, a professional who provides advice on a problem involving multiple entities and jurisdictions faces a series of legal and ethical considerations that are beyond the scope of this discussion.

V. Due Diligence Implications for U.S. Professionals

Many implications may flow from subjecting attorneys, accountants, auditors, and other independent professionals to due diligence rules.

In other lines of business to which due diligence applies (for example, banks, money-service businesses, savings and loans, credit institutions, and broker-dealers), the business must hire a compliance officer and develop mechanisms to prepare a due diligence plan and help implement it, including developing training and internal and external audit procedures. The size of the business is not a factor for that requirement.

Clearly, the implications raised in this section do not apply yet to lawyers because no state has proactively applied the Gatekeepers Initiative. For instance, although the United Kingdom has a law requiring professionals to report suspicious transactions and occasionally warns of enforcement actions against lawyers who do not obey the law, such actions have been rare. (superscript: 13) This section assumes that the United States, if it extends its anti-money-laundering rules to professionals, will continue to proactively implement and enforce them. (superscript: 14)

Some issues that are likely to arise include the proper steps a lawyer/law firm should take when it must report a suspicious transaction. Currently, anti-money-laundering law would preclude them from disclosing the report to their client, because that would be "tipping off" a criminal offense. The more difficult issues include what a law firm does in regard to an existing client after it files an SAR. Banks and financial institutions also must grapple with that problem. Sometimes they obtain guidance from regulatory or law enforcement authorities. However, in most cases, they are not able to obtain any reliable information initially. Continuing to do business with a client against whom a law firm has filed an SAR is precarious. But terminating a relationship is sensitive, especially if the report does not result in prosecution or even a criminal investigation. Terminating a relationship in the middle of an assignment also may lead to liability due to breach of contract, malpractice, breach of ethical obligations (such as the obligation of confidentiality or the obligation to zealously represent the client), or commercial losses to the law firm due to loss of work and overall loss of clients.

Another issue is whether filing an SAR would lead to criminal liability on the part of the law firm. For instance, an SAR may trigger an investigation into prior conduct between the law firm and the client, leading the regulatory and/or law enforcement authority to believe that the law firm should have known and acted earlier, or that it was a co-conspirator. In addition to the SAR violating the right to client confidentiality, it may violate the client's right to attorney-client privilege and the right against self-incrimination. In addition, in the event that law enforcement authorities prosecute the law firm, the lawyer would have waived his or her own right against self-incrimination.

In an international context, SAR information has gained increased significance because it is being shared by some countries. The EU has a policy on exchanging SAR. (superscript: 15) The United States is trying, as a matter of policy, to exchange SAR information. One fundamental obstacle is that the United States treats SAR as intelligence information that can be kept indefinitely, while the EU policy is that unless used for prosecution purposes, such information must be destroyed after a certain number of years. Just as importantly, the United States and many other countries like informal cooperation with no formal rules. The problem with informal cooperation is that the rights of private individuals and entities, whether they are the targets or just third-party stakeholders, are not protected. Recent mutual assistance treaties in criminal matters (MLATs) that grant the U.S. government compulsory process rights expressly state that they do not create a right for a "private person" to obtain evidence. In such MLATs, the United States has insisted on a provision that states:

> This Treaty is intended solely for mutual legal assistance between the Parties. The provisions of this Treaty shall not create any right on the part of any private person to obtain, suppress, or exclude any evidence, or to impede the execution of a request. (superscript: 16)

The purpose is to prevent MLATs from being used to suppress or exclude evidence or to impede criminal investigations. Hence, if adversely affected persons want to prevent the execution of requests that they believe were made in violation of the treaty, their only recourse under the treaty is to the executive authority of the requested country, not its courts. Similarly, if they want to complain that the requested country violated the terms of the treaty in executing a request, they can complain only to the executive authorities of the respective countries. (superscript: 17)

Another major area that will be affected by due diligence rules and the Gatekeepers Initiative is attorney-client privilege. One of the problems is that the privilege varies considerably among countries and among professionals (attorney-client vs. accountant- client). In a global context, a client, whether intending to conduct legitimate or illegitimate activities, will be able to spot and take advantage of the gaps in the law.

To reduce risks and potential liabilities from any actions by potentially disgruntled clients, law firms are likely to follow the lead of banks and financial institutions, inserting into professional service agreements broad clauses warning potential clients of their obligations under the due diligence rules and seeking waivers of their ethical obligations to ensure privacy, zealously represent the client, and so forth.

The ability to send SARs to bar associations rather than the regulatory agency does not appear to be a satisfactory answer if you are an attorney or client. Ultimately, the bar association is faced with the same requirements as the regulatory agency. Decisions must be made about whether to quickly undertake further investigations of a criminal nature or whether to defer action. The decision may result not from the quality of the SAR, but from the prioritization of resources in the context of the number of ongoing leads from other sources. Nevertheless, the aforementioned concerns about privacy, liability, and so forth are not eliminated by investing the bar as a middleman. Further, reliance on the bar raises many sensitive issues about the capabilities of bar associations to act as financial intelligence units, and the nature of the relationship between the bar association, attorneys, and clients once the bar association assumes the role of intermediary for the regulatory agencies.

VI. Final Thoughts

Many European attorneys have lamented their inability to follow and participate in the EU's effort to enact the Gatekeepers Initiative. They believe that policymakers, in some cases, have failed even to identify many of the issues, let alone resolve them. The moral of the story is for professionals who might be affected to become involved at the start, not before it is too late. In that context, common reactions to the Gatekeepers Initiative are horror and shock on the one hand, and utter disbelief on the other. Professionals do not believe it will ever happen in the United States, even though the U.S. Treasury has mentioned the Gatekeepers Initiative in both of its Money Laundering Strategy Control Reports; the G-8 provided a release about the initiative; and news of the EU revised directive has continued to instruct observers of money-laundering and compliance policy. (superscript: 18)

For professionals who want to defer the enactment of anti-money- laundering legislation, the best answer is better self-regulation. Education is a start. In addition to educating their own members, professionals should start educating their clients and constituents about the Gatekeepers Initiative and involve them in the policymaking. Professionals will also want to consider and discuss their own rules of ethics with other affected professionals, even though they compete in the context of a multidisciplinary practice environment.

Clearly, the Gatekeepers Initiative presents some fundamental transformations of law and culture for professionals and their clients. Indeed, international anti-money-laundering law has already transformed some aspects of law and culture in other industries. Hence, lawyers, accountants, auditors, real estate brokers, and other independent professionals may be hard-pressed to completely exempt themselves from the new frontier of anti-money-laundering enforcement.

The Gatekeepers Initiative presents another wrinkle for tax planning purposes. Increasingly, international organizations are calling for broadening of the anti-money-laundering regime to include fiscal offenses, including foreign fiscal offenses. England has already enacted such laws, much to the dismay of English tax practitioners. (superscript: 19) And, while the U.S. anti-money-laundering law does not specifically criminalize foreign fiscal crimes, it does criminalize them in effect. For instance, the conviction of the Bank of New York's Lucy Edwards and Peter Berlin was for wire fraud, namely for helping Russian nationals evade Russian income tax. The U.S. courts also have enforced money-laundering laws to prosecute persons trying to evade Canadian excise tax on alcohol and cigarettes. (superscript: 20) Once anti-money-laundering authorities add tax crimes, the ability to swap intelligence by way of SARs will enable law enforcement to jump the tax secrecy hurdles that have restricted tax police.

Indeed, the new millennium brings tax and investment advisers into a new frontier of international financial enforcement, of which the subregimes of tax and anti-money-laundering loom large.

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FOOTNOTES

(superscript: 1) See, for example, the FATF 1998-99 Survey of Trends and Techniques.

(superscript: 2) For background, see William Gilmore, "Dirty Money: The Evolution of Money Laundering Counter-Measures" 160-88 (1995).

(superscript: 3) For background, see Arthur Rogers, "Lawyers, Other Professionals Not Exempted from EU Money Laundering Reporting Rules," Daily Rep. For Exec., Apr. 9, 2001, at G-5, col. 1.

(superscript: 4) Commission document COM [199] 352, Off. J. C 177, 27 June 2000, at 14.

(superscript: 5) Rogers, id.

(superscript: 6) Common Position (EC) No. 5/2001 adopted by the Council on 30 Nov. 2000 with a view to adopting Directive 2000/. . ./EC of the European Parliament and of the Council of . . . amending Council Directive 91/308/EEC on Prevention of the Use of the Financial System for the Purpose of Money Laundering, OJ C 36/24, 2 Feb. 2001.

(superscript: 7) For background on the bill passed by the European Parliament, see "European Parliament Imposes Money Laundering Due Diligence on Professionals," 17 Int'l Enforcement L. Rep. 191 (May 2001).

(superscript: 8) "European Lawyers Sign a Charter to Combat Organized Crime," 3 United Nations Office for Drug Control and Crime Prevention (UN ODCCP) 4 (Sept. 1999).

(superscript: 9) Id.

(superscript: 10) For additional background on the role of the Conference of Notaries of the European Union, the European Federation of Accountants and Auditors for Small and Medium-Sized Enterprise and the Federation of European Accountants, see "European Professional Associations Agree on Due Diligence Against Organized Crime and U.S. Starts Gatekeepers Initiatives," 16 Int'l Enforcement L. Rep. 719 (May 2000).

(superscript: 11) U.S. Department of the Treasury and Department of Justice, The National Money Laundering Strategy for 2000 44-46 (Mar. 2000).

(superscript: 12) For background, see "European Professional Associations Agree on Due Diligence Against Organized Crime and U.S. Starts Gatekeepers Initiatives," 16 Int'l Enforcement L. Rep. 719, 720.

(superscript: 13) However, the British Fraud Office recently charged two senior solicitors and are investigating four others with respect to alleged major money laundering activities. See Robert Verkaik, "City Lawyers Face Charges Over Money Laundering Charges," The Independent (London), 12 Mar. 2001, Web site.

(superscript: 14) For a discussion about defending money laundering charges against attorneys, among others, see Bruce Zagaris and Ben Hinceman, "Defending Money Laundering Charges," 1 International Wealth Transfer Practice 23-26 (International Bar Assoc., 12-14 Mar. 2001).

(superscript: 15) Bruce Zagaris, "EU Council Initiates Arrangements for Exchange of Information Between FIUs," 17 Int'l Enforcement L. Rep. 3 (Jan. 2001), discussing "Council Decision of Oct. 17, 2000 Concerning Arrangements for Cooperation Between Financial Intelligence Units of the Member States in Respect of Exchanging Information" (2000.642.JHA), Off. J. Eur. Comm., 24 Oct. 2000 (L 2714).

(superscript: 16) See Art. 1(3) of the treaty between the United States and the United Kingdom Concerning the Cayman Islands Relating to Mutual Legal Assistance in Criminal Matters, signed 3 July 1986, entered into force 19 Mar. 1990.

(superscript: 17) For additional discussion of the preclusion of private persons from using MLATs, see Bruce Zagaris, "U.S. Extends Its Reach for Evidence," 15 Crim. Just. 8, 56 (Winter 2001).

(superscript: 18) See, for example, "EU Council and Parliament Agree on Revised Anti-Money Laundering Directive," 17 Int'l Enforcement L. Rep. 135 (April 2001).

(superscript: 19) See, for example, John Rhodes, "The Impact of UK Money-Laundering Legislation on Fiscal Crime," 2000 World Tax Conference Report 33:1 (Canadian Tax Foundation).

(superscript: 20) See Bruce Zagaris, "Coordinated Information-Sharing and Money-Laundering Initiatives," 2000 World Tax Conference Report 32:1, 13 (Canadian Tax Foundation), citing U.S. v Trapilo (5 Dec. 1997), docket no. 97-1011 (2d Cir. 1997) [unreported]; "U.S. Appellate Court Upholds Application of Wire Fraud Laws to Foreign Tax Fraud," 13 Int'l Enforcement L Rep. 47-48 (Feb. 1998); and U.S. v. Boots, 80 F.3d 580 (1st Cir. 1996), cert. denied, 117 S. Ct. 263 (1996).

END OF FOOTNOTES

Geographic Identifier: United States; European Union; Multinational
Language: English
Document Number: Doc 2001-11960 (12 original pages)
Index Terms: accounting profession, accountant-client privilege
accounting profession, ethics
attorneys, ethics
disclosure
European Union
financial institutions
money laundering
practitioner-client privilege
practitioners, ethics
preparers, ethics
Subject Area: Compliance
Criminal violations
Financial institution tax issues
Information reporting
Multijurisdictional taxation
Politics of taxation
Professional responsibility
Tax policy issues