The Financial Action Task Force – Lawyers as “Gatekeepers”: Risk-Based Approach Guidance for Legal Professionals

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Introduction to the Financial Action Task Force

“Since its creation the FATF has spearheaded the effort to adopt and implement measures designed to counter the use of the financial system by criminals”
The Financial Action Task Force (FATF)

- An independent international policy-making body
- Established during the 1989 G-7 World Economic Summit
- Thirty-four members including the United States, the United Kingdom, France, Italy, Germany, Russia, Brazil and China
- Funded by the Organisation for Economic Co-operation and Development (OECD)
- Based in Paris at the OECD headquarters
What does FATF do?

- Develops and promotes national and international policies to combat money laundering and terrorist financing by:
  - setting standards
  - monitoring effective compliance with those standards
  - identifying money laundering and terrorist financing threats
- The FATF has no independent legislative powers and relies on political pressure to achieve reform
- FATF members must endorse the FATF’s recommendations and policies at a political level and agree to attain acceptable ratings
- The Mutual Evaluation Process rates countries’ anti money laundering systems as ‘compliant’, ‘largely compliant’, ‘partially compliant’ or ‘noncompliant’ with FATF standards
The principal FATF policies – “40 + 9”

The 40+9 Recommendations, “together with their interpretative notes, constitute the international standards for combating money laundering and terrorist financing”
“The Forty Recommendations”

- Sets out the basic framework for anti-money laundering (AML) efforts
- Designed to be universally applicable
- Issued in 1990 and revised most recently in 2004
- The latest version represents the international AML standard
- Four sections, addressing:
  1. the role of national legal systems in combating money laundering
  2. the role of financial systems in combating money laundering
  3. the measures necessary to combat money laundering and terrorist financing
  4. international cooperation
“The Nine Special Recommendations”

- The FATF expanded its mandate to address terrorist financing after the terrorist attacks in the United States on 11 September 2001.
- The *Nine Special Recommendations* are intended to combat the funding of terrorist acts and terrorist organisations (CFT).
Two key “rules” that the “regulated” (e.g. lawyers) need to comply with:

1. Carry out customer due diligence (CDD)

2. Report suspicious transactions (STR)
In 1990 FATF introduced:

The Risk-Based Approach

- Under a rules-based approach, one has to comply with particular rules irrespective of the underlying degree of risk
- This can encourage a ‘box-ticking’ approach to AML and CFT procedures
- The FATF encourages countries to develop a risk-based approach to AML and CFT efforts
- This is to ensure that resources are allocated in the most efficient manner so the greatest risks receive the highest attention - the administrative burden of AML/CFT is not necessarily reduced
- Countries may impose a rules-based system if it is more appropriate
- FATF accepted that it needed to issue “guidance” to help develop a risk-based approach and to issue proper and appropriate interpretation of the underlying rules
Evolution of Guidance for Legal Professionals
The Gatekeeper Initiative

- Moscow Communiqué in October 1999 and Consultation Paper in May 2002
- The FATF claims money laundering schemes increasingly involve the use of professionals to launder their funds

‘Gatekeepers’ include:
- lawyers
- notaries
- trust and company service providers
- real estate agents
- accountants
- auditors
- other designated nonfinancial businesses and professions (DNFBPs) e.g. casinos and dealers in precious metals
Evolution of guidance for legal professionals

- **June 2007** - the FATF issued *Financial Institution Guidance* in collaboration with banking and securities industries

- **September 2007 (London)** – it was established it was not appropriate to apply the *Financial Institution Guidance* to legal professionals
  - For example, guidance for the legal profession needed to be subject to the principles of lawyer-client privilege and client confidentiality

- **December 2007 (Bern)** – IBA team with ABA and CCBE to take responsibility for separate guidance for legal professionals (*the Lawyer Guidance*) based on the *Financial Institution Guidance*
Evolution of guidance for legal professionals continued

- **April 2008 (Paris)** – it was agreed that the Lawyer Guidance would not even mention the issue of ‘suspicious transaction reports’ (*STRs*)
  - *STRs* are not part of CDD – they represent a response mechanism once a suspicion is identified
  - The language of the Lawyer Guidance does not impose a mandatory STR obligation on legal professionals
  - Individual jurisdictions need to decide as to whether the filing of an STR is obligatory (Lawyer Guidance, paragraph 120) – although FATF rules require this

It was also agreed that trust and company service providers (*TCSPs*) would be subject to separate guidance
Evolution of guidance for legal professionals continued

- **June 2008 (London)** – issues raised but left unresolved:
  - the difficulties with identifying the beneficial ownership of potential clients as part of client due diligence
  - concerns about imposing client due diligence requirements on local or special counsel

- **September 2008 (Ottawa) and after**
  - a risk-based approach to identification of beneficial ownership would be taken

- **October 2008 (Rio de Janeiro)** – FATF approved the final version of the Lawyer Guidance
The Guidance for Legal Professionals
The purpose of the Lawyer Guidance (Paragraph 6)

- The Lawyer Guidance is designed to supplement the *Forty Recommendations*

- The Lawyer Guidance is intended to outline the high-level principles involved in applying the risk-based approach to CDD and is not intended to act as a template for national legislation or SROs

- The Lawyer Guidance is aimed at legal professionals, but its wider audience include countries, regulators and SROs

- The Lawyer Guidance does not supplant specific professional guidance issued by competent authorities or SROs, and does not constitute a legal interpretation of AML/CFT obligations of legal professionals (Paragraph 15)
Overview of the Lawyer Guidance

- 125 separately numbered paragraphs
- Section One: *Background, context and explanation of the risk-based approach*
- Section Two: *Guidance for Public Authorities*
  - Five high level principles
  - Implementation of the risk-based approach
- Section Three: *Guidance for legal professionals on implementing a risk-based approach*
  - Risk categories, risk factors and variables affecting risk
  - Application of a risk-based approach
  - Internal controls
The Lawyer Guidance applies to **legal professionals** when they
prepare for or **carry out** specified activities (Paragraphs 8-16)

- ‘**Legal professionals**’ include solicitors and barristers
- ‘**Prepare for**’ and ‘**carry out**’ are not defined in the Lawyer Guidance or the
  Forty Recommendations
- ‘**Specified activities**’ include:
  - buying and selling of real estate
  - managing of client money, securities or other assets
  - management of bank, savings or securities accounts
  - organisation of contributions for the creation, operation or management of
    companies
  - creation, operation or management of legal persons or arrangements, and
    buying and selling of business entities
The Risk-Based Approach for Legal Professionals (Paragraphs 17-34)

ADVANTAGES

- more efficient and effective use of resources thus minimising burdens on clients
- provides flexibility to approach AML/CFT obligations using specialist skills
- provides flexibility to adapt systems as AML/CFT risks evolve
- allows entities of differing sizes, structures and practices to develop their own appropriate systems

CHALLENGES

- requires resources to gather and interpret information on risk
- risk-based procedures and systems must be developed
- the risk-based approach requires well-trained personnel with a sound understanding of the risk and who are able to exercise sound judgement
How to implement a risk-based approach

- Risk categories
  - Identify detailed but non-exhaustive risk categories
- ‘Customer Due Diligence/Know Your Customer’
  - Subject the client to a reasonable and proportionate risk assessment (taking into account the risk categories)
- Monitoring
  - Clients and activities must be monitored after the initial assessment
- Implement controls for higher risk situations
- Educate and train personnel
Legal professionals should identify criteria to help them assess the overall potential money laundering and/or terrorist financing threat. The categories suggested by FATF are not exhaustive nor prescriptive. Risk criteria (and the weight allocated to each) will differ.
Country or Geographic Risk (Paragraph 108)

- Risk can arise from the domicile of client, location of transaction or source of funding.
- Countries that pose a higher risk are those which are:
  - subject to sanctions, embargoes or similar measures issued by bodies such as the United Nations
  - identified by credible sources (e.g. the IMF, the World Bank) as generally lacking appropriate AML/CFT laws or regulations
  - identified by credible sources as being a location from which funds or support are provided to terrorist organisations
  - identified by credible sources as having significant levels of corruption or other criminal activity
Client Risk (Paragraph 109)

- 12 categories which may indicate a high risk, including:
  - Politically exposed persons (PEPs) (individuals who carry out prominent public functions in a foreign country)
  - Clients requesting services in unusual or unconventional circumstances
  - Clients whose structure or nature makes it difficult to identify the true beneficial ownership of the client entity
  - Cash intensive businesses e.g. money service businesses, casinos etc.
  - Unmonitored charities or not-for-profit organisations
  - Clients who change their settlement/execution instructions without appropriate explanation
  - The use of legal arrangements without any apparent reason
Service Risk (Paragraph 110)

- The potential risks presented by the services offered by a legal professional
- Factors should be considered cumulatively – any one factor alone may not itself constitute a high risk circumstance
- 18 suggested factors affecting risk, including:
  - services where legal professionals, acting as financial intermediaries, handle the receipt and transmission of funds through accounts they control in the act of closing a business transaction
  - unusually high levels of assets or unusually large transactions compared to what might reasonably be expected of clients with a similar profile
  - transfer of real estate between parties in a time period that is unusually short with no apparent legitimate reason
  - clients who offer to pay extraordinary fees for services which would not ordinarily warrant such a premium
Variables affecting risk (Paragraphs 111-112)

- When developing appropriate systems and controls, consideration must be given to the differences in practices, size, scale and expertise among legal professionals.

- Consistent with the need for proportionality, certain variables may increase or decrease the perceived risk - including:
  - the level of regulation to which a client is subject
  - the reputation and publicly available information about the client
  - the regularity or duration of a relationship
  - the familiarity of the legal professional with the laws of a country
  - significant and unexplained geographic distance
  - pension trusts are lower risk
Controls for higher-risk situations (Paragraph 113)

- There should be appropriate controls for those clients that the legal professional’s systems determine to be higher risk.
- Such controls could include:
  - increased levels of CDD for higher risk situations
  - escalation/consultation procedures at the establishment of a relationship
  - periodic review of services offered and client relationships to determine if risks have increased

‘Paramount among these measures is the requirement to train legal professionals and appropriate staff’

- General training on relevant money laundering methods and risks
- Targeted training for those legal professionals providing higher risk services or working with higher risk clients
Application of a risk-based approach (Paragraphs 114-122)

1. Apply Customer Due Diligence / Know Your Customer procedures

2. Keep monitoring clients and specified activities

3. Education, training and awareness
The Lawyer Guidance and the role of self-regulatory organisations
Five high-level principles for public authorities (Paragraphs 53-73)

The Lawyer Guidance sets out five high-level principles:

**Principle 1** Understanding and responding to the threats and vulnerabilities via a national risk assessment

**Principle 2** A legal/regulatory framework that supports the application of a risk-based approach

**Principle 3** A monitoring framework to support the application of a risk-based approach

**Principle 4** Identifying the main actors and ensuring consistency

**Principle 5** Information exchange between the public and private sector
Key Elements For Success (Page 14)

- Legal professionals and self-regulatory organisations must have access to reliable and actionable information about the threats.
- An emphasis on cooperative arrangements among policy makers, law enforcement, regulators and the private sector.
- Authorities should publicly recognise that the risk-based approach will not eradicate all elements of risk.
- Authorities have a responsibility to establish an atmosphere in which legal professionals need not be afraid of regulatory sanctions where they have acted responsibly and implemented adequate internal systems and controls.
- The staff of self-regulatory organisations must be well-trained in the risk-based approach.
Summary of the role of SROs

- Information sharing between the public and private sector
- Monitoring that takes into account the risk-based approach
- Development of minimum AML/CFT obligations
- Development/provision of training on the risk-based approach
  - SROs’ supervisory staff must be well-trained in the risk-based approach, both as applied by designated competent authorities/SROs and by legal professionals
  - SROs should make greater effort to identify and disseminate guidelines on sound practice
Education, training and awareness

- The role of the Bar Associations in training existing lawyers and providing support
- The role of Bar Associations and universities in training law students
- The importance of typologies
The IBA Anti-Money Laundering Forum website
www.anti-moneylaundering.org

- Created by the IBA Anti-Money Laundering Legislation Implementation Working Group (AMLLIWG) in 2003
- A comprehensive and up-to-date AML/CFT resource for legal professionals
- The site has been developed further and now contains more extensive coverage and new features
- The site received more than 600,000 in the last 90 days (200,000 hits in April 2009)
Country templates

- The website contains country-specific AML research conducted by IBA staff in conjunction with AMLLIWG, with contributions from IBA members from each jurisdiction.
- Each template contains the most current and accurate information possible, and includes hyperlinks to the laws, regulations and institutions mentioned.
- The website contains templates for over 160 countries.
- You are strongly encouraged to contribute material if your jurisdiction is not represented, or the information is inaccurate or incomplete - please contact Gonzalo Guzman (gonzalo.guzman@int-bar.org) or through the “Contact Us” page on the website if you wish to participate.
New features

New features of the website include:

- an educational introduction to AML and how it affects and applies to legal professionals
- a ‘reading room’ containing AML resources such as articles, books, websites and an archive of previous news stories
- an updated homepage focussing on AML news and recent developments
- a syndicated RSS feed to allow users to subscribe to the website and receive alerts regarding AML updates, news and resources
- “Global Chart” feature to allow users to see at a glance the main anti-money laundering information characteristics for any country before opening the whole template (available from the end of June 2009)