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**Hammell, Elizabeth**

**From:** Zarella, Peter  
**Sent:** Tuesday, March 30, 2010 12:30 PM  
**To:** Hammell, Elizabeth  
**Subject:** FW: [CCJBOARD] Anti Money Laundering Practices  
**Attachments:** ACTEC FATF PAPER - APPENDIX C.DOC; ACTEC FATF PAPER - APPENDIX B.DOC;  
ACTEC FATF PAPER - APPENDIX A.DOC; ACTEC PAPER FATF AND THE GOOD  
PRACTICE GUIDANCE.DOC

Could you please?

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**From:** Rogers, Chase  
**Sent:** Tuesday, March 30, 2010 10:48 AM  
**To:** Zarella, Peter  
**Subject:** FW: [CCJBOARD] Anti Money Laundering Practices

give me your thoughts on this when you get a minute.

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**From:** ccjboard List [mailto:CCJBOARD@LISTSERV.NCSCONLINE.ORG] **On Behalf Of** Williams, Brenda  
**Sent:** Tuesday, March 30, 2010 9:58 AM  
**To:** CCJBOARD@LISTSERV.NCSCONLINE.ORG  
**Subject:** [CCJBOARD] Anti Money Laundering Practices

The below message is sent at the request of Chief Justice Jefferson.

Duncan Osborne is an Austin lawyer who is working with the Financial Action Task Force of the American Bar Association. He has sent the attached electronic versions of documents that explain how lawyers can (or must?) comply with national and international efforts to curtail money laundering and terrorist financing. The United States Treasury Department, in particular, wants to see stern consequences for lawyers who do not adopt anti money-laundering practices. The good news, I think, is that both the ABA and the US Treasury Department thought it essential to confer with the Conference of Chief Justices. They would like to come to our summer meeting and, at the very least, meet with the board of directors. I think we should accommodate them.

I propose that we schedule some time at the board meeting to hear from the ABA task force and US Treasury representatives.

<<ACTEC FATF PAPER - APPENDIX C.DOC>> <<ACTEC FATF PAPER - APPENDIX B.DOC>> <<ACTEC  
FATF PAPER - APPENDIX A.DOC>> <<ACTEC PAPER FATF AND THE GOOD PRACTICE  
GUIDANCE.DOC>>

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3/30/2010

**THE AMERICAN COLLEGE OF TRUST  
AND ESTATE COUNSEL**

**2010 ANNUAL MEETING  
BONITA SPRINGS, FLORIDA  
MARCH 9-14, 2010**

**FATF AND THE GOOD PRACTICES GUIDANCE**

**MARCH 11, 2010**

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## FATF AND THE GOOD PRACTICES GUIDANCE

### I. Overview of Money Laundering

#### A. The Problem

Money laundering occurs when profits from criminal activity need to be "cleaned" so that they cannot be traced back to their illegal source. Thus, any illegal activity that brings in money creates a need for money laundering. Money laundering goes back at least to Al Capone and probably to ancient Babylon, and it is a clear and present threat in Europe and the United States ("U.S."). Much of this threat can be traced back to the trafficking of illegal drugs. Because proceeds from the sale of illegal drugs are so large, the criminals need a variety of ways in which to re-introduce the drug dollars to the world financial system, in order that they may invest the criminal proceed or part of them in legitimate business.

According to Narconon, one of the world's leading drug rehabilitation programs, 39.8% of people in the U.S. over the age of 12 years have used marijuana, and of those people, 62% have used cocaine at some point after turning 25. It appears that a large amount of the illegal drugs coming into the hands of these U.S. people comes through Mexico. In fact, Mexico receives approximately \$30 billion annually in proceeds from the sale of illegal drugs in the U.S.<sup>1</sup> Astonishingly, the money received from the Mexican drug business exceeds the amount of money received from Mexico's three leading official sources of foreign exchange (oil, tourism, and money sent home by Mexicans in the U.S.) combined.<sup>2</sup>

The \$30 billion Mexico receives annually from the sale of illegal drugs to U.S. people pales in comparison to the \$122 billion that Americans and Europeans spend annually on heroin, cocaine, and marijuana.<sup>3</sup> Of the \$122 billion spent on these drugs every year, about \$85 billion is laundered and ultimately invested in businesses.<sup>4</sup> U.S. congressional investigators have concluded that the U.S. and European banks are used to launder between \$500 billion and \$1 trillion of dirty money per year.<sup>5</sup>

The sale of illegal drugs and money laundering do not just affect the U.S., Mexico, and Europe. The effects of illegal drug trafficking and money laundering are felt globally. In the spring of 2002, the United Nations pegged the global narcotics trade at \$400 billion per year.<sup>6</sup>

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<sup>1</sup> CHARLES BOWDEN, *DOWN BY THE RIVER: DRUGS, MONEY, MURDER, AND FAMILY* 2-3 (Simon & Schuster Paperbacks, 2004) (2002).

<sup>2</sup> *Id.* at 2.

<sup>3</sup> *Id.* at 214.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.* at 378.

<sup>6</sup> *Id.* at 410.



## B. How Money Laundering Works<sup>7</sup>

The purpose of money laundering is to disguise the source of profits from criminal activity so that the money may be used without alerting authorities to the illegal source of the money. There are three stages of money laundering: placement, layering, and integration. The initial stage is the placement stage, when illegal profits are introduced into the financial system. At this point the money is usually geographically close to the criminal activity, often in the same country. Next, in the layering stage, the money is moved through various transactions to distance it from the illegal source. During this stage, the money will usually be moved to a location that has good financial or business infrastructure but that will leave little trace of the money's movement. In the final stage, integration, the money is moved back into the legitimate economy and may be spent or invested. Often the money will end up in a location with a stable economy and good investment opportunities. There are significant costs at each level, and the amounts reinvested after the several stages of laundering are significantly less than the amounts originally collected from the criminal activity.

## C. The Risk to Financial Institutions<sup>8</sup>

Financial institutions that do not take adequate precautions may be facilitating money laundering transactions. By allowing illegal profits to be laundered and used, these institutions are indirectly supporting the underlying activities that generate the profits, such as robbery, drug trafficking, prostitution rings, embezzlement, bribery, and many other criminal acts. If the profits from these activities could not be laundered, the money could not be used, and there would be little incentive for the criminal activity to continue.

## D. Different Characteristics of Terrorist Financing

While money laundering transactions generally involve high dollar amounts and proceeds from criminal activity, terrorist financing transactions do not necessarily exhibit these characteristics. Money used to fund terrorism may or may not come from an unlawful activity, and many terrorist acts do not require large amounts of money. For example, the attacks on the London subway system that killed 52 people, and injured hundreds more, cost only a few hundred pounds. The Madrid bombings are estimated to have cost about \$10,000.<sup>9</sup>

## II. History of the FATF<sup>10</sup>

### A. Establishment and Purpose of the FATF

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<sup>7</sup> Money Laundering FAQ, [http://www.fatfgafi.org/document/29/0,3343,en\\_32250379\\_32235720\\_33659613\\_1\\_1\\_1\\_1,00.html](http://www.fatfgafi.org/document/29/0,3343,en_32250379_32235720_33659613_1_1_1_1,00.html) (last visited Nov. 12, 2009).

<sup>8</sup> *Id.*

<sup>9</sup> Michael Buchanan, *London Bombs Cost Just Hundreds*, BBC NEWS, Jan. 3, 2006, [http://news.bbc.co.uk/2/hi/uk\\_news/4576346.stm](http://news.bbc.co.uk/2/hi/uk_news/4576346.stm).

<sup>10</sup> For an exceptional treatment of the history of the Financial Action Task Force from a United States perspective see Kevin L. Shepherd, *Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers*, 43 REAL PROP. TR. & EST. L. J. 607 (2009).



The Financial Action Task Force ("FATF") was established in 1989 by the then G-7 nations (U.S., United Kingdom ("U.K."), Germany, France, Italy, Japan, and Canada), the European Commission, and eight other countries. The FATF was created to combat the money laundering "threat posed to the banking system and to financial institutions."<sup>11</sup> In 1990, within a year of its inception, the FATF issued the original version of its now well-known Forty Recommendations, which, as amended in subsequent years, are essentially a comprehensive plan to fight money laundering.

In 2001, the FATF's mission was expanded to include the fight against terrorist financing (Combat the Financing of Terrorism, or "CFT"). In October 2001, following the September 11 terrorist attacks, the FATF added eight new Special Recommendations to the original forty, and in 2004 added a ninth Special Recommendation. These Recommendations are sometimes collectively referred to as the 40+9 Recommendations. By 2009, there were a total of thirty-four (34) FATF member countries dedicated to following and taking steps to implement the FATF 40+9 Recommendations.

As a practical matter, the FATF enforcement process works through international peer pressure. Delegates to the FATF are not elected, and the FATF has no legislative authority. The FATF member countries voluntarily support and are committed to its principles. The work of the FATF is to make policy recommendations and then monitor the implementation of those recommendations through periodic evaluations of its member countries to measure compliance. As was formerly noted on the FATF website:

In the self-assessment exercise, every member country provides information on the status of its implementation of the Forty Recommendations and Nine Special Recommendations by responding each year to a standard questionnaire. This information is then compiled and analyzed, and provides the basis for assessing the extent to which the Recommendations have been implemented by both individual countries and the group as a whole.

The second element for monitoring the implementation of the Forty Recommendations is the mutual evaluation process. Each member country is examined in turn by the FATF on the basis of an on-site visit conducted by a team of three or four selected experts in the legal, financial and law enforcement fields from other member governments. The purpose of the visit is to draw up a report assessing the extent to which the evaluated country has moved forward in implementing an effective system to counter money laundering and to highlight areas in which further progress may still be required.

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<sup>11</sup> About the FATF, [http://www.fatf-gafi.org/pages/0,3417,en\\_32250379\\_32236836\\_1\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/pages/0,3417,en_32250379_32236836_1_1_1_1_1,00.html) (last visited Nov. 12, 2009).



The mutual evaluation process is enhanced by the FATF's policy for dealing with members not in compliance with the Forty Recommendations. The measures contained in this policy represent a graduated approach aimed at reinforcing peer pressure on member governments to take action to tighten their anti-money laundering systems.<sup>12</sup>

It is important to remember that the delegates sent by each country to the FATF are typically bureaucrats from their nation's tax policy and tax collection agencies (similar to the U.S. Department of the Treasury ("Treasury")) and financial crimes enforcement groups (similar to the Financial Crimes Enforcement Network of Treasury ("FinCEN")).<sup>13</sup> Like all bureaucrats, they come to the FATF with certain perspectives, agendas, objectives, and prejudices.

When it comes to trusts, those perspectives and prejudices can be especially pronounced among delegates from those FATF member states that are not common law states, as their understanding of and experience with trusts are very limited. Trusts are not part of their jurisprudence; they do not readily understand the fundamental trust concept of separation of legal and equitable title; and they typically encounter trusts only in the context of tax evasion. Therefore, the FATF delegates from these non-common law states generally associate trusts with tax evasion. Indeed, at the 2004 meeting which FATF held with the private sector, representatives from some civil law countries, perhaps defensively, compared trusts to numbered accounts as a device to achieve anonymity.

Indeed, the FATF Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing describes the following services as high risk for money laundering abuses<sup>14</sup>:

"Services that inherently have provided more anonymity or can readily cross international borders, such as online banking, stored value cards, international wire transfers, private investment companies and trusts" (emphasis added).

The FATF at one time proposed an international registry of all trusts, which would include the names of the settlor, trustee, and beneficiaries. While this concept was soon

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<sup>12</sup> According to the article "Monitoring the Implementation of the Forty Recommendations", which was formerly available on the FATF website, the FATF's policy for handling non-compliant countries includes steps such as the following: requiring the non-compliant country to submit a progress report; a letter or a high-level mission from the President of the FATF to the country not in compliance; a statement to financial institutions requesting that special attention be given to any transactions involving the non-compliant country; finally, the FATF may suspend the non-compliant country's membership in the FATF. Financial Action Task Force, <http://www.fatf-gafi.org>.

<sup>13</sup> According to the "FinCEN" website, the FinCEN consists of analysts, administrative and managerial professionals, regulatory specialists, technology experts, federal agents, and other law enforcement agencies that work together to combat domestic and international money laundering through information sharing. FinCEN Organization, [http://www.fincen.gov/about\\_fincen/wwd/organization.html](http://www.fincen.gov/about_fincen/wwd/organization.html) (last visited Nov. 13, 2009).

<sup>14</sup> FINANCIAL ACTION TASK FORCE, GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING: HIGH LEVEL PRINCIPLES AND PROCEDURES 24 (2007), <http://www.fatf-gafi.org/dataoecd/43/46/38960576.pdf>.



discarded as impractical, and was opposed by the U.S. Treasury, it nevertheless demonstrates the suspicion with which the FATF regards trusts.

While the FATF has no power to enact law, the political pressure it generates and the publication of mutual evaluations will likely produce further compliance with the 40+9 Recommendations by FATF member nations (and those who wish to trade with member nations). For example, the fact that the U.S. supports the FATF's anti-money laundering ("AML") and CFT goals as part of the War on Terror, and has enacted many (but not all) of the elements of the 40+9 Recommendations into Federal law as part of the USA Patriot Act,<sup>15</sup> and has itself pressured other countries to enact legislation implementing the 40+9 Recommendations, makes it awkward for the U.S. to lag in its own compliance. The FATF has powerful institutional allies in the World Bank and the International Monetary Fund, and the FATF has suggested that the influence of these organizations will be brought to bear against recalcitrant nations worldwide.

In the U.K., part of the response to the FATF 40+9 Recommendations was the Proceeds of Crime Act 2002, which among other things, requires solicitors to file Suspicious Activity Reports ("SARs") on their clients, with the additional requirement that solicitors may not tip off clients that a SAR had been filed (the so-called "No Tipping Off" rule, or "NTO"). In the first nine months of 2007, solicitors in the U.K. filed 11,300 SARs on their clients.<sup>16</sup> Thus, in a very real way, solicitors in the U.K. have become part of the law enforcement system in that country, which would seem to create an uncomfortable duality with their traditional role in the judicial process.

In the U.S., some legislation has been enacted in (at least partial) response to the 40 + 9 Recommendations. The Bank Secrecy Act ("BSA") as amended by the USA PATRIOT Act takes some measures toward implementation of the 40 + 9 Recommendations. For other examples, see the June 2006 U.S. Mutual Evaluation Report.<sup>17</sup> (With regard to possible future Federal legislation, see Section VII below.)

Consistent with the 40 + 9 Recommendations, FATF priorities include: (i) increasing transparency with respect to legal persons and arrangements, by reporting and making available to law enforcement authorities the actual or beneficial ownership of LLCs, corporations, partnerships, trusts, etc.; and (ii) increasing communication and sharing information among those involved in the AML and CFT struggles.

## B. FATF Meetings with the Private Sector

The FATF has sponsored a series of meetings, beginning in 2004, to engage certain Designated Non-Financial Businesses and Professions ("DNFBPs"), including lawyers, in

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<sup>15</sup> See *Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism (USA PATRIOT ACT) Act of 2001*, Pub. L. No. 107-56, 115 Stat. 272 (2001).

<sup>16</sup> Anita Rice, *Solicitors Lead Way on Fraud Reporting*, L. GAZETTE, Nov. 29, 2007, <http://www.lawgazette.co.uk/news/solicitors-lead-way-fraud-reporting>.

<sup>17</sup> FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM: UNITED STATES OF AMERICA (2006), <http://www.fatf-gafi.org/dataoecd/44/12/37101706.pdf>.



the AML/terrorist financing dialogue. In general, the main objective of these discussions is to have these specifically identified businesses and professions adopt and implement the core AML rules that financial institutions have adopted:

- Customer Due Diligence ("CDD") procedures
- Know Your Customer ("KYC") procedures<sup>18</sup>
- Maintaining CDD records
- Monitoring customers and transactions on an ongoing basis
- SARs and Suspicious Transaction Reports ("STRs")
- NTO

The DNFBPs attending the FATF meetings usually included lawyers, accountants, notaries, trust and company service providers, casino owners, dealers in precious metals and stones, and real estate agents. The FATF apparently views all DNFBPs as monolithic, as the FATF deemed them all to be at risk of abuse by money launderers and terrorist financiers. Consequently, the FATF wants all DNFBPs to enact and support the same core AML rules and regulations required of banks and other financial institutions. Various groups took positions on the FATF's proposals, and the American Bar Association ("ABA") expressed its policy of strong opposition to requirements for SARs, NTO, and "STRs".<sup>19</sup>

Attorneys generally consider their profession to be uniquely situated among the various categories of professionals lumped together by the FATF as DNFBPs, and there was considerable resistance from attorneys, who articulated the special position and protective role that attorneys play in society and within legal systems. Due to the wide range of countries represented at the meetings, there were variations on the theme, but there was also an extraordinary degree of harmony and unanimity from this group in resisting the FATF's attempts to treat attorneys like every other DNFBP.

Fellows from the American College of Trust and Estate Counsel ("ACTEC") have attended and participated in almost all of the meetings. Because of the very high level of suspicion with which trusts are regarded by the FATF and the resulting high level of scrutiny of trust structures, ACTEC has been proactively involved in an effort to impact the FATF process, and to impart an understanding of trusts and their proper use to FATF staff. As part of that effort, in October 2005, ACTEC issued its Recommendations of Good Practices for ACTEC Fellows Seeking to Detect and Combat Money Laundering (the "ACTEC Recommendations").<sup>20</sup> Because the ACTEC Recommendations preceded the guidance eventually issued by the FATF in

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<sup>18</sup> Suggested CDD/KYC procedures for clients include: (i) Perform Accurint background check on client at <http://www.accurint.com>; (ii) Perform Google search for client; (iii) Check client against the SDN list, DPL list and Entity list at <http://www.ustreas.gov/offices/eotffc/ofac/sdn/t11sdn.pdf> & <http://www.bis.doc.gov/dpl/Default.shtm>; (iv) Obtain copy of client's passport and certification of the passport; (v) Obtain affidavit of client's financial condition; (vi) Obtain written personal and business history of client.

<sup>19</sup> See AM. BAR ASS'N, RES. 104, at 1 (2003); AM. BAR ASS'N, TASK FORCE ON GATEKEEPER REGULATIONS AND THE PROFESSION, RES. 300, at 3 (2008), available at <http://www.abanet.org/leadership/2008/annual/recommendations/ThreeHundred.doc>.

<sup>20</sup> See AMERICAN COLL. OF TRUST AND ESTATE COUNSEL, RECOMMENDATIONS OF GOOD PRACTICES FOR ACTEC FELLOWS SEEKING TO DETECT AND COMBAT MONEY LAUNDERING, available at [http://www.actec.org/public/Governmental\\_Relations/FATFBestPractices.asp](http://www.actec.org/public/Governmental_Relations/FATFBestPractices.asp).



2008 (discussed below), its presentation and format varies somewhat from the FATF document, but it remains a particularly useful tool for trusts and estates practitioners.

### III. Risk-Based Approach Guidance for Lawyers

#### A. Overview

A working group of U.S. lawyers engaged with lawyers from other countries and with the FATF to prepare the Risk Based Approach ("RBA") guidance documents for attorneys, notaries, and other designated legal professionals. In October 2008, at its plenary meeting, the FATF adopted the RBA Guidance for Legal Professionals (the "FATF RBA Guidance").<sup>21</sup> This document is a high level, bureaucratic, jargon-laden instrument designed to provide overarching guidance to a wide variety of jurisdictions and legal systems. Because the FATF RBA Guidance is so broad and generic, in practice, it functions as a template from which member countries can generate their own guidances that are appropriate for their respective circumstances.

#### B. Concepts of the RBA Guidance for Legal Professionals

The FATF RBA Guidance is intended to closely parallel the substance and format of the guidance adopted by the FATF for the financial services sector. For the sake of uniformity among stakeholders, the FATF wanted as much consistency as possible for all the different sectors subject to guidance, with variations being made only to accommodate the realities of different businesses and professions.

#### C. Implementation in the United States

The FATF policies and recommendations have played out in the U.S. in a variety of ways. There are laws on the books, there is additional proposed legislation, and there are proposed non-legally binding responses. All of these are discussed below, with focus on the consequences to lawyers.

### IV. Introduction to United States AML Rules

There are two sets of rules in the U.S. that apply to money laundering. The first is found in the Money Laundering Control Act of 1986 ("MLCA"),<sup>22</sup> which defines money laundering as a federal crime. Second, the statutory sections of the "BSA", as modified by the USA PATRIOT Act,<sup>23</sup> impose reporting and record-keeping requirements and prohibitions upon certain classes of individuals and entities for certain transactions and relations in an effort to prevent money laundering and penalize those involved in money laundering and other illegal activities. The provisions of the BSA also give substantial power to the Secretary of the Treasury (the "Treasury Secretary") to formulate regulations that require even greater reporting requirements and prohibitions, which power the Treasury Secretary has freely exercised. Collectively, the

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<sup>21</sup> See generally FINANCIAL ACTION TASK FORCE, RBA GUIDANCE FOR LEGAL PROFESSIONALS (2008), <http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf>.

<sup>22</sup> See 18 U.S.C.A. § 1956 (West 2009).

<sup>23</sup> See 31 U.S.C.A. §§ 5311-5332 (West 2001).



statutory provisions of the BSA and the corresponding regulations are the AML rules (the "Rules"). As the Rules are comprised of numerous regulations, in addition to the many statutory sections of the BSA, only the statutory sections are covered in this paper.

A. Money Laundering is a Federal Crime

The MLCA defines money laundering to include three actions.

1. The first provision of the MLCA prohibits (i) conducting or attempting to conduct a financial transaction that involves the proceeds of an unlawful activity, (ii) tax evasion, and (iii) filing a fraudulent tax return. The intent requisite for these crimes is to aid in an unlawful activity. If such an intent is present, a crime has been committed. In the absence of such intent, an individual may violate the MLCA by knowingly engaging in a transaction that is designed to (i) conceal information regarding the proceeds of the above-mentioned activities or (ii) avoid a state or federal transaction reporting requirement.

2. The second crime that constitutes money laundering is transporting or attempting to transport a monetary instrument or funds from inside the U.S. to anywhere outside the U.S., or vice versa, with the intent to promote an unlawful activity or with knowledge that the monetary instrument or funds are proceeds of unlawful activity and that the transport of the instrument or funds is designed to conceal some aspect of the proceeds or to avoid a state or federal transaction reporting requirement.

3. Finally, the third crime that constitutes money laundering is conducting or attempting to conduct a financial transaction that involves property "represented to be" the proceeds of an unlawful activity or used to facilitate such activity with the intent of aiding in the activity, hiding some aspect of the property involved in the transaction, or evading a state or federal transaction reporting requirement.

B. Penalties for Violating the Money Laundering Control Act of 1986

An individual who violates the MLCA may be subject to civil penalties, criminal penalties, or both. The penalties applicable to any such violation are set out below.

1. Civil penalties: An individual who conducts or attempts to conduct a transaction that constitutes a violation of the MLCA is liable to the federal government for the greater of (i) the value of the property, funds, or monetary instruments involved in the transaction or (ii) \$10,000.

2. Criminal penalties: Individuals who intentionally or knowingly violate the provisions of the MLCA generally shall be required to pay the federal government the greater of (i) \$500,000 or (ii) twice the value of the property involved in the transaction or transfer. In addition, violators may be imprisoned for up to twenty (20) years.



C. AML Rules of the Bank Secrecy Act

1. Statutory Reporting / Record-keeping Requirements

a. Domestic financial institutions must file reports on transactions in which U.S. currency is paid, received, or transferred in amounts exceeding \$10,000. Anyone acting on another's behalf must also file reports, identifying "the person for whom the transaction is made."

b. Residents or citizens of the U.S. or people doing business in the U.S. must keep records, file reports, or both, when they have any transaction with a foreign financial agent or "maintain[] a relation for any person with a foreign financial agency."

c. Reports are also required on foreign currency transactions "conducted by a United States person or a foreign person controlled by a United States Person."

d. Reports must be filed when a person knowingly "transports, is about to transport, or has transported monetary instruments of more than \$10,000 at one time" from inside the U.S. to outside of the U.S. or vice versa, or when a person knowingly receives more than \$10,000 that was transported into the U.S. from outside of the U.S. at one time.

e. Financial and certain other institutions must "maintain appropriate procedures to ensure compliance with the Rules or to guard against money laundering."

f. Reports by various entities of any "suspicious transaction relevant to a possible violation of law or regulation" are also required.

g. Financial institutions must establish AML programs.

h. Financial institutions handling accounts for, or on behalf of, non-U.S. persons must implement due diligence (and in some cases enhanced due diligence ("EDD")) policies and procedures for the purpose of detecting and reporting occurrences of money laundering in connection with such account.

i. Certain domestic financial institutions are required to take special measures if the Treasury Secretary determines that there is a specific money laundering concern related to a "jurisdiction outside of the United States, one or more financial institutions operating outside of the United States, or one or more types of accounts," including special rules for payable-through and correspondent accounts.

j. Money transmitting businesses must be registered by the owner/controller of the business with the Treasury Secretary before the 180th day following the date of establishment of the business.



k. If any person receives more than \$10,000 in coins or currency in either one transaction or two or more related transactions during the course of engaging in a trade or business, that person must file a report on such transaction.

## 2. Prohibited Transactions

a. U.S. financial institutions may not participate (with some exceptions) in any transactions involving banks with no physical presence in any country. U.S. financial institutions must also take precautions to avoid providing services to any foreign bank that indirectly provides services to another foreign bank that does not have a physical presence in any country.

b. The Treasury Secretary may prohibit certain correspondent or payable-through accounts if the account is for or related to a foreign banking institution involved in a suspect jurisdiction or institution. Lists of barred foreign financial institutions are published and available.

c. No one may cause a financial institution or person to fail to file reports or keep records, or to file an intentionally incorrect or incomplete report or keep incorrect or incomplete records, on a transaction or transactions for the purpose of avoiding reporting and record keeping requirements.

d. No one may structure, assist in structuring, or attempt to structure a transaction with one or more domestic financial institutions for the purpose of avoiding reporting and record keeping requirements.

e. Financial institutions may not issue bank checks, cashier's checks, traveler's checks, or money orders to individuals in connection with transactions involving amounts of U.S. currency of \$3,000 or more, unless (i) the individual has an account with the financial institution and the financial institution has verified that the client has an account through a signature card or other information, (ii) the financial institution has recorded the "method of verification in accordance with regulations which the [Treasury Secretary] shall prescribe . . .," or (iii) the individual has provided the forms of identification required by the Treasury Secretary and the financial institution has verified the records as prescribed by the Treasury Secretary. Information required to be recorded must be provided to the Treasury Secretary upon request.

## D. Penalties for Violating the Bank Secrecy Act

The penalties applicable to any violation of the Rules are similar to the penalties applicable to a violation of the MLCA. Violators of some of the Rules are subject to penalties that are specific to the Rule violated, and as with violations of the MLCA, both civil and criminal penalties can be imposed for a single violation. Unlike the MLCA, however, the Rules allow the Treasury Secretary to bring an action in federal district court to enjoin violations or enforce compliance with the Rules.



1. Injunctions: The Treasury Secretary may enjoin any past, present, or future violator of any of the Rules from committing the violation or enforce compliance with the Rules.

2. Civil penalties: Willful violators of the Rules are liable to the U.S. government for the greater of \$25,000 or the amount involved in the transaction, up to \$100,000. Additional civil penalties may also be imposed for failure to file reports or upon those who knowingly file materially incorrect or incomplete reports, although these penalties may not exceed the "amount of the monetary instrument for which the report was required." A civil money penalty capped at \$500 may be imposed for a negligent violation of any AML rule, and a penalty not to exceed \$50,000 may be imposed for a pattern of negligent violations of such rules.

3. Criminal penalties: Willful violators of the BSA may face criminal penalties of no more than \$250,000 or imprisonment for no more than five (5) years, or both. Individuals who willfully violate the BSA while also violating another U.S. law or engage in a pattern of illegal activities involving more than \$100,000 in a year, may be fined up to \$500,000, imprisoned for up to ten (10) years, or both.

#### E. Extension of AML Rules

Most of the laws and regulations to date have been imposed on "domestic financial institutions." Currently banks, brokerage houses, and other financial institutions (auction houses, casinos, currency transfer business, and others) must establish AML programs; perform CDD and KYC on all clients and patrons; monitor all customers on an ongoing basis; keep records on customers; and, when appropriate, file SARs on their customers. The FATF wants to extend the foregoing rules and regulations to certain other DNFBPs, including lawyers.

### V. Obligations on Lawyers

#### A. Introduction

As discussed above, the FATF has implemented a multi-faceted process for monitoring the measures member countries have taken to improve their AML systems, including the mutual evaluation process. The U.S. most recently underwent the mutual evaluation process in 2005-2006, which culminated in the FATF's issuance of a 300-page evaluation report containing six (6) appendices (annexes).<sup>24</sup> This document includes a summary report regarding compliance with the 40 + 9 Recommendations. The evaluation report identifies four (4) "grade" levels of compliance: compliant, largely compliant, partially compliant, and non-compliant. U.S. lawyers were listed as non-compliant in the areas of CDD, monitoring of customers, and filing of SARs. The next FATF evaluation of the U.S. is scheduled to take place this year.

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<sup>24</sup> FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM: UNITED STATES OF AMERICA (2006), <http://www.fatf-gafi.org/dataoecd/44/12/37101706.pdf>.



## B. Lawyer Guidance

Treasury is responsible for implementing the FATF recommendations in the U.S. and has made efforts to improve the AML systems since the mutual evaluation in 2006. Part of those efforts included participation in the FATF-sponsored meetings on the subject of the FATF RBA Guidance, approved on October 23, 2008. Treasury has also been in active dialogue with the ABA concerning guidance for lawyers.

Several U.S.-based groups, led by the ABA and acting in consultation with Treasury, formed a Synergy Group in order to collaboratively draft a voluntary good practices guidance for U.S. Lawyers (the "Good Practices Guidance").<sup>25</sup> This group used the FATF RBA Guidance as a high level guide to render a pointed and practical document. The final product is intended to be a useful tool for all levels of the profession, from the sole practitioner in a rural setting to the largest law firm in the biggest city.

The Good Practices Guidance has many of the same AML elements applicable to financial institutions. That is, the Good Practices Guidance includes advice regarding AML programs, policies and procedures, CDD and KYC rules, monitor your client requirements, and obligations to keep records on your clients. However, under the Good Practices Guidance, U.S. lawyers would not be required to file SARs on their clients. To date, Treasury has been supportive of the ABA's position on SARs, STRs, and NTO.

As of November of 2009, the Synergy Group essentially completed the Good Practices Guidance. Both Treasury and the Synergy Group hope to have an array of ABA sections and specialty bar associations endorse and approve the Good Practices Guidance by the time of FATF's next mutual evaluation of U.S. compliance later this year. It is contemplated that not only would these groups approve and endorse the document, but that they would enlist in the effort to train and educate lawyers about the Good Practices Guidance. While the goal is that the process be voluntary and that the profession be self-regulated, actual engagement and participation by the legal community must be comprehensive and serious. Failure to so respond will almost assuredly result in federal legislation, which will be binding on practitioners and perhaps much more restrictive than the provisions of the Good Practices Guidance.

## C. Specifics of the Good Practices Guidance

The following is an overview of relevant provisions of the Good Practices Guidance.

1. Most importantly, not all facets of the practice of law are subject to the Good Practices Guidance. The focus is on the following "Specified Activities." These are the practice areas that are, in fact, subject to the Good Practices Guidance.

a. **Buying and selling real estate;**

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<sup>25</sup> See generally AM. BAR ASS'N TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ET AL., VOLUNTARY GOOD PRACTICES GUIDANCE FOR LAWYERS TO DETECT AND COMBAT MONEY LAUNDERING AND TERRORIST FINANCING (2009).



- b. Management of client money, securities, or other assets;
- c. Management of bank, savings, or securities accounts;
- d. Organization of contributions for the creation, operation, or management of companies; and
- e. Creation, operation, or management of legal persons or arrangements and buying and selling businesses entities.

These are the service areas that the FATF has identified as being at risk for money laundering. Lawyers will have to monitor clients and transactions in these situations.

2. **Identification of risks by category.** The underlying principle of risk based assessment is that efforts to combat money laundering should, for efficiency, focus upon situations where money laundering is more likely. The most commonly used risk criteria are country or geographic risk, client risk, and risk associated with the particular service offered by the legal professional. The weight given to these risk categories (individually or in combination) in assessing the overall risk of potential money laundering or terrorist financing may vary from one client to another, particularly given the size, sophistication, nature, and scope of services offered by the legal professional.

- a. **Country/Geographic Risk.** Factors that may result in a determination that a country or geographic area poses a higher money laundering or terrorist financing risk include:
  - i. Countries subject to sanctions, embargoes, or similar measures by the United Nations or other reputable governmental or non-governmental organizations.
  - ii. Countries identified by the FATF as generally lacking appropriate AML laws, regulations, or other measures.
  - iii. Countries identified by credible sources as providing funding or support for terrorist activities or that have terrorist organizations operating within their borders.
  - iv. Countries identified by credible sources as having significant levels of corruption or other criminal activity.
- b. **Client Risk.** Determining the potential money laundering or terrorist financing risks posed by a client, or category of clients, is critical to the development and implementation of an overall risk-based framework. Categories of clients whose activities may indicate a higher risk include:



- i. Clients conducting their business relationships or requesting services in unusual or unconventional circumstances, such as:
- Significant and unexplained geographic distance between the client and the location of the organization/subject of the work for which the client has retained the legal professional, and/or where there is no logical nexus among the type of work being undertaken, the client, and that organization.
  - Where a client has instructed the legal professional to undertake a single transaction-based service (as opposed to an ongoing advisory relationship), the instructions from the client are not received face to face, and/or the client has not been referred from a reliable source.
- ii. Situations where the structure or nature of the entity or relationship makes it difficult to identify the true beneficial owner or controlling interests in the transaction.
- iii. Clients that are cash (and cash equivalent) intensive businesses including:
- Casinos, betting, and other gambling-related activities.
  - Unregulated businesses that, while not normally cash intensive, generate substantial amounts of cash.
- iv. Charities and other "not for profit" organizations that are not subject to monitoring or supervision by competent authorities (especially those operating on a "cross-border" basis).
- v. Clients using intermediaries who are not subject to adequate AML laws and measures or who are not otherwise adequately supervised by competent authorities.



- vi. Clients who are Politically Exposed Persons ("PEPs")<sup>26</sup> or have a criminal record.
- c. Service Risk. An overall risk assessment should also include a determination of the potential money laundering or terrorist financing risks presented by the services offered by the legal professional. Consideration should be given to such factors as:
- Services where legal professionals acting as financial intermediaries handle the receipt and transmission of cash proceeds on behalf of clients.
  - Services to conceal improperly beneficial ownership from competent authorities.
  - Services requested by the client for which the legal professional does not have the requisite expertise.
  - Transfer of real estate between parties in a time period that is unusually short for similar transactions, with no apparent legal, tax, business, economic, or other legitimate purpose.
  - Services knowingly designed to illegally evade revenue or other government authorities' claims concerning an asset or other property.
  - Payments received by an attorney from unrelated third parties and payments of fees in cash.
  - Transactions where it is readily apparent that there is inadequate consideration.
  - Legal entities and arrangements where a client, controller, or significant legal owner cannot be identified in a timely fashion.
  - Clients who offer to pay extraordinary fees for services which would not ordinarily warrant such a premium.
  - Other unusual, risky, or suspicious transactions.

3. There are variables that may impact risk: e.g., reputation of the client; businesses or companies that are otherwise regulated; lawyer's prior relationship with client. Depending on the circumstances these variables may reduce or increase risk.

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<sup>26</sup> A PEP is an individual who has been entrusted with prominent functions in a country other than the U.S. Examples include heads of state or of government, senior politicians, senior government, judicial, or military officials, senior executives of state owned corporations, or important political party officials.



4. The duties include not only assessment at intake, but also a requirement to monitor clients and activities on an ongoing basis. One suggestion is that unless events dictate a more frequent review, an automatic annual review would be appropriate.

5. Implicit in the RBA is the concept that law firms apply CDC/KYC procedures and train and educate professionals and staff in procedures for CDD, EDD, and periodic reviews of clients.

It is suggested that internal controls include:

- Engagement and focus at the partner or management level.
- Adoption of policies and procedures, including implementation of AML policies and procedures to mitigate risks.
- Appointment of a compliance officer.

6. As in the FATF RBA Guidance, the notion of "beneficial ownership" of an asset or entity is a recurring term and recurring concept in the Good Practices Guidance:

- a. It appears in Paragraph 2.3 of the Good Practices Guidance (dealing with client risk), which discusses how the structure or nature of an entity or relationship may make it difficult to identify the "true beneficial owner."<sup>27</sup>
- b. "Beneficial ownership" is discussed again in Paragraph 3.2 of the Good Practices Guidance (the service risk section) with respect to services designed to "conceal improperly beneficial ownership from competent authorities."<sup>28</sup>
- c. While the term is not pointedly directed at trusts in the Good Practices Guidance, for trust lawyers, the term "beneficial ownership" has a precise connotation. One should keep in mind that the FATF is convinced that trusts have been and will be used to deliberately "obfuscate ownership."

7. Willful ignorance is not an acceptable excuse for overlooking AML and CFT problems.

- a. Consider potential risk in a complex real estate investment where equity and financing are coming from different investors or sources.

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<sup>27</sup> AM. BAR ASS'N TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION ET AL., VOLUNTARY GOOD PRACTICES GUIDANCE FOR LAWYERS TO DETECT AND COMBAT MONEY LAUNDERING AND TERRORIST FINANCING ¶ 2.3 (2009).

<sup>28</sup> *Id.* ¶ 3.2.



- b. Consider potential risk in preparing a will and revocable trust for an investor who owns varying percentages in a number of corporations, LLCs, and partnerships.

## VI. Treasury

In addition to its work with the ABA and the Synergy Group, Treasury has been interacting with the Uniform Law Commissioners ("ULC") to achieve other FATF goals. The FATF has recommended legislation to provide complete transparency with respect to beneficial owners of legal entities. Treasury has asked the ULC to draft uniform legislation that would achieve this goal, and the ULC adopted a model law in July of 2009.<sup>29</sup> It is anticipated that the uniform law would be presented to the various U.S. states for enactment; however, at the time of this writing this effort is on hold by ULC.<sup>30</sup> The key elements of that law are as follows:

- Entities covered by the new law (corporations, limited partnerships, limited liability partnerships, limited liability companies, limited cooperative associations, and statutory trusts) are generally required to include in their initial public organic document ("IPOD") filed in the office of the Secretary of State ("SOS") a statement declaring whether the entity is a "conventional privately-held entity" ("CPE"). Such entities would also be prohibited from issuing certificates of bearer shares.
- A CPE is an entity that has no more than fifty (50) interest holders. In addition to that ownership test, there are several exceptions. The most significant are: (i) highly regulated business entities such as depository institutions, trust companies, insurance companies, public utilities, securities and commodity brokers or dealers, and registered investment companies and investment advisors; (ii) majority owned subsidiaries of those highly regulated entities; (iii) entities in which more than fifty (50) interest holders hold more than 50% of the outstanding interests; and (iv) tax exempt entities that have filed a current Form 990 or 990-EZ with the Internal Revenue Service.
- A CPE must file an initial entity information statement ("EIS") under penalties of perjury in the office of the SOS at the same time the CPE files its IPOD. The EIS must contain the name and business or residential address of the CPE's "record contact" ("RC") and "responsible individual" ("RI"), and be signed by both the RC and the RI.
- The RC must be an individual resident in the United States who can produce on a "timely basis" the names and addresses of the owners ("interest holders")

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<sup>29</sup> See Memorandum from William H. Clark, Jr. to the Drafting Comm. on Record Owners of Bus. Act (Jan. 8, 2008), available at <http://www.docstoc.com/docs/9932633/MEMORANDUM-TO-Drafting-Committee-on-Record-Owners-of-Business> (discussing the proposed substance of the "Uniform Record Owners of Business Act," which was ultimately renamed the "Uniform Law Enforcement Access to Entity Information Act"); for the entire text of the uniform law (as adopted by the ULC), see generally, UNIF. LAW ENFORCEMENT ACCESS TO ENTITY INFO. ACT (2009), <http://www.law.upenn.edu/bll/archives/ulc/roba/2009final.htm>.

<sup>30</sup> UNIF. LAW ENFORCEMENT ACCESS TO ENTITY INFO. ACT, Prefatory Note (2009), <http://www.law.upenn.edu/bll/archives/ulc/roba/2009final.htm>.



and "governors," e.g., officers, general partners, or managers. This information must include a certification as to accuracy under penalties of perjury.

- The RI must be familiar with the entity and participate in control or management. The RI must furnish the RC with a "government issued photographic identification credential, and if the principal residence of the RI is outside the U.S., the photographic ID must be a passport."
- Changes in the RC and RI must promptly be filed with the office of the SOS. The RI and RC must sign the statement of change and these signatures must be notarized and under penalties of perjury.
- There are additional requirements for foreign interest holders, governors, and RIs.
- An entity in existence on the effective date of the legislation will have two (2) years from the effective date to amend its IPOD to state whether it is a CPE, and if it is, to file with the office of the SOS the required information.
- The RC must seek to obtain information about the ownership and control of a CPE upon receiving a subpoena from federal law enforcement or other specified officials. Such a request is known as an "appropriate request".
- The CPE must provide the RC, on a timely basis: the name and last known address of each "interest holder" and "each governor"; as well as other related records and information, all under penalties of perjury.
- The state's attorney general may dissolve a CPE for failure to comply with the law, but the SOS must administratively dissolve an entity for failure to comply.

The theory behind this law is to provide a system under which it will be possible to trace the ownership of an entity back to the ultimate beneficial owners. Law enforcement agencies would be able to obtain this information by subpoena.

## VII. Federal Legislation

Legislation has been introduced, but not enacted, that arguably would advance the FATF agenda. Both bills introduced by Senator Carol Levin, the Stop Tax Haven Abuse Act (S.681) and the Incorporation Transparency & Law Enforcement Assistance Act (S.2956) in the 110<sup>th</sup> Congress, failed to move, but they have been reintroduced in 2009 in the 111<sup>th</sup> Congress as S.506<sup>31</sup> and S.569<sup>32</sup>; respectively. Particularly relevant is Section 203 of the Stop Tax Haven Abuse Act. If enacted in the form in which they were introduced, the bills, in addition to other

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<sup>31</sup> See Stop Tax Haven Abuse Act, S. 506, 111th Cong. (2009).

<sup>32</sup> See Incorporation Transparency and Law Enforcement Assistance Act, S. 569, 111th Cong. (2009). As of the time this paper was submitted, Senator Chris Dodd was considering competing legislation. A discussion draft of Senator Dodd's proposed bill, entitled the "Anti-Money Laundering Information Enhancement Act of 2009," would require the Treasury Secretary to issue final regulations within 270 days of enactment regarding the prevention of the unlawful use of legal persons by money launderers (which is the subject of recommendation 33 of the 40+9 Recommendations). Anti-Money Laundering Information Enhancement Act of 2009, S. \_\_, 111th Cong. (2009) (draft).



sweeping changes, could potentially provide a framework for the federal regulation of lawyers and mandate transparency with respect to beneficial ownership of legal entities. Furthermore, in its definition section, the Consumer Financial Protection Agency Act (H.R.3126)<sup>33</sup> contains similarly problematic language regarding potential regulation.

Most recently, Senator Max Baucus and Congressman Charles Rangel introduced the Foreign Account Tax Compliance Act of 2009 ("FATCA") in both the Senate and the House of Representatives, as S.1934 and H.R.3933, respectively.<sup>34</sup> The FATCA would require a "material advisor" to file an information return when assisting a client in acquiring or forming a foreign entity. It is anticipated that a person will only be considered a material advisor if he derives gross income in excess of \$100,000 for providing such assistance.

#### VIII. Conclusion

To date, the approach to engaging lawyers in the fight against money laundering has been risk based, has avoided the filing of SARs, and has been voluntary. To continue in these directions, the acceptance of the Good Practices Guidance by lawyers in the U.S. needs to be enthusiastic and participatory. The ABA, the various state bars, and the specialty bar organizations should be engaged and supportive. Anything less by lawyers and their organizations is likely to result in burdensome federal regulation.

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<sup>33</sup> See Consumer Financial Protection Agency Act of 2009, H.R. 3126, 111th Cong. (2009).

<sup>34</sup> See Foreign Account Tax Compliance Act of 2009, S. 1936, 111th Cong. (2009); Foreign Account Tax Compliance Act of 2009, H.R. 3933, 111th Cong. (2009).



## **APPENDIX A**

### **ACRONYMS**

ABA:	American Bar Association
ACTEC:	American College of Trust and Estate Counsel
AML:	Anti-Money Laundering
CDD:	Customer (Client) Due Diligence
CFT:	Combating the Financing of Terrorism
DNFBPs:	Designated Non-Financial Businesses and Professions
EDD:	Enhanced Due Diligence
FATF:	Financial Action Task Force
KYC:	Know Your Customer (Client)
NTO:	No Tipping Off
PEP:	Politically Exposed Person
RBA:	Risk-Based Approach
SAR:	Suspicious Activity Report
SRO:	Self Regulating Organization
STR:	Suspicious Transaction Report
TCSP:	Trust and Company Service Providers
ULC:	Uniform Laws Commissioners