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International Anti-Money Laundering and Professional Ethics

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I. Introduction

The year 2005 saw a continuing increase in important international regulatory initiatives, cases and other developments related to the control of money laundering. These issues affected businesses and other direct market participants (in particular financial institutions) and also their professional advisors, including attorneys. Attorneys and other so-called gatekeepers, are often positioned to detect and deter (or, on the contrary, abet and enable) money laundering. These gatekeepers figured prominently in many of this year's Anti-Money Laundering (AML) developments.

II. The Third European Union Directive on Money Laundering

It is commonly assumed that, other things being equal, AML regulation is most effective when it is international. Uniform policies across borders reduce the possibility of regulatory arbitrage and make compliance more feasible for the large internationally-active institutions and organizations that are most important in the global fight against money laundering. The Third European Union (EU) Directive on Money Laundering is an important step toward the goal of harmonized international AML regulation.

On June 7, 2005, the Council of Ministers for Finance and Economic Affairs of the European Union (ECOFIN) approved a new European Directive targeting money laundering. The Third Directive approved by ECOFIN was in the form previously amended by the European Parliament and, accordingly, it will become law directly upon publication. As of this writing all final official translations are not yet released but an unofficial English version was released on August 9, 2005, and is available on the EU website.[1] The Third Directive will bring a greater level of conformity in AML enforcement among the nations of the EU and will track more closely with the Financial Action Task Force's revised 40

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1. Council Directive 2004/0137, 2005 O.J. (L 309) 15 (EU).

Recommendations for the Control of Money Laundering. Most importantly, perhaps, for U.S. practitioners, the Third Directive (through such concepts as the increased use of risk-based approaches) brings the EU approach to AML regulation more in line with that of the United States. While important differences remain, the Third Directive contributes to the ongoing convergence of global AML enforcement standards.

A. Mutual Recognition

Article 11(1) of the Third Directive explicitly provides for mutual recognition of customer identification requirements (known in the United States as Know your Customer or KYC) among the EU states. This removes the uncertainty about the possible need for duplicative KYC procedures in cross-border transactions within the EU.[2]

B. Politically Exposed Persons

Defining the so-called politically exposed persons (PEPs) has been one of the thorniest problems of AML regulation. The regulated institutions (in particular financial institutions) want a clear-cut definition that can be applied without uncertainty. Ideally, this would take the form of a list of names, addresses, dates of birth, and other identifying information. The PEPs for each regulatory jurisdiction should in theory be the same for all institutions subject to the applicable PEP regulation. A vague and general definition coupled with draconian enforcement can serve only as an incentive to institutions to push the scope of the PEP definition up to the limits of practicality or beyond. From the point of view of the regulators, however, the practical obstacles to a more specific PEP definition appear to be currently insuperable. The reasons are not entirely clear but could range from simple lack of resources to the fear (shared of course by the regulated) of under-inclusion.

The Third Directive makes some progress in making the PEP definition more definite and certain, defining PEPs as "natural persons who are or have been entrusted with prominent public functions and immediate family members, or persons known to be close associates, of such persons . . . ."[3] Specifying immediate family members and persons known to be close associates is helpful and implementing legislation might make those definitions even more clear and limited. The definition does not, however, take in other useful features such as a risk-based standard which would eliminate the need for enhanced scrutiny of small and/or inactive accounts. The Third Directive's PEP procedure also continues the policy of defining foreign political figures as those outside the national territory of the member state, as opposed to considering the entire EU as one jurisdiction for this purpose.

C. Risk-Based Approach

Perhaps the most important change in the Third Directive is the explicit adoption of risk-based compliance standards, as commonly employed in U.S. AML regulation. A risk-based approach acknowledges that limited resources available for AML compliance should be allocated toward situations where the actual risk of money laundering is reasonably perceived to be higher. A variety of risk factors need to be taken into account but the basic

2. *Id.* at art. 11(1).
3. *Id.* at art. 3(8).

standards are client characteristics, transaction types, and jurisdictions involved, again following U.S. practice as well as Financial Action Task Force (FATF) recommendations. Risk-based approaches are explicitly endorsed in the Third Directive's discussion of the identification of beneficial owners and of PEPs, as well as in the application of KYC requirements.[4]

D. Beneficial Owners

In the United States, push-back from the regulated community, in particular the financial services industry, was largely successful in avoiding a general requirement for the mandatory identification of beneficial owners of trusts and other legal entities for AML regulatory purposes. EU AML regulation, on the other hand, has long had strong beneficial-ownership identification requirements. This split remains, but the Third Directive changes beneficial-ownership identification requirements to reflect some of the concerns shared by financial institutions in the EU as well as the United States. The essential problem is that the identification of beneficial owners is often not practical because the necessary information may not be available to the financial institution. Also, beneficial ownership once identified might thereafter change through means not evident to the financial institution.

The Third Directive gives some relief on this point by imposing a 25 percent threshold beneficial-ownership percentage amount as the minimum required to trigger the beneficiary-identification requirement. The Third Directive maintains the requirement to identify beneficial owners but defines a beneficial owner as the natural person who ultimately, directly or indirectly, owns, or controls 25 percent or more of the shares or of the voting rights of a legal person.[5] This 25 percent level was set after EU financial institutions objected strongly to the original proposal for a 10 percent test.

E. Shell Banks

The Third Directive prohibits correspondent account relationships with shell banks. The Third Directive definition of a shell bank is "a credit institution, or an institution engaged in equivalent activities, incorporated in a jurisdiction in which it has no physical presence, involving meaningful mind and management, and which is unaffiliated with a regulated financial group"[6] This conforms in substance with the definition in section 313 of the USA PATRIOT Act.[7] The Third Directive and the parallel USA PATRIOT Act also share the challenge of complying with the prohibition against indirect correspondent relationships. The Third Directive does not adopt a certification safe harbor provision similar to that provided for in the implementing regulations for section 313.

F. Tipping Off

The EU AML approach has much broader regulation than the United States against the disclosure to account holders that information concerning their banking activities has been requested by or delivered to governmental entities. In the United States, information con-

4. *Id.* at arts. 8(1)(b), 13(4); *See generally id.* at art. 8.
5. *Id.* at arts. 7(1)(b), 3(6).
6. *Id.* at art. 3(10).
7. USA Patriot Act, Pub. L. No. 107-56, § 313, 115 Stat. 272 (2001) (to be codified at 31 U.S.C. § 5318).

cerning Suspicious Activity Reports (SARs) must not be disclosed, but much other information is not subject to tipping off prohibitions. In most cases, for example, even government subpoenas for the production of account information may, and generally are, disclosed by a bank to its client. Under the Third Directive, the EU practice continues; it is prohibited to disclose to customers that their account or transaction information has been given to government investigators.[8] The Third Directive has, however, adopted provisions similar to those in USA PATRIOT Act section 314(b) for the sharing of information related to money laundering prevention efforts among financial institutions. The EU provisions, however, are more restrictive and only allow for information sharing among commonly-owned financial institutions, as opposed to the broader provisions of section 314. The new EU approach does show some recognition of the real dangers created by letting the fears of tipping off inhibit the flow of useful compliance information among financial institutions. The EU approach also shows the practical importance of information sharing among financial institutions in the fight against money laundering.

A related provision of the Third Directive addresses the concerns that bank staff may have adverse consequences if they report suspicious customer activities, up to and including threats and harassment. In the United States, the secrecy of SAR reporting and the immunity from liability accompanying SARs filed in good faith addresses these real concerns. The Third Directive provides that the EU governments must take appropriate steps to protect bank employees.[9]

III. Riggs Bank

In 2005, the final act of the prosecution of the 160-year old Riggs Bank of Washington, D.C. occurred for lax AML procedures in connection with the banking services it provided to former Chilean dictator Augusto Pinochet and senior political figures of Equatorial Guinea. In January, Riggs pled guilty to one felony count of failure to file SARs and agreed to a fine of $16 million, which comes on top of $25 million in previously assessed civil and criminal penalties.[10] Riggs, once one of the most prestigious names in U.S. banking, was subsequently absorbed by merger into PNC Bank.

In one of the most notorious recent cases finding serious AML compliance violations, Riggs was accused of aiding Pinochet in his efforts to conceal large sums of uncertain origin. The court also found that Riggs failed to monitor properly substantial transactions involving senior political figures (as well as their family members) in Equatorial Guinea. Saudi Arabian activities were also involved. Riggs was cited also for failing to file SARs in connection with large transactions, including very large cash withdrawals, by Saudi officials in Washington, including longtime ambassador Prince Bandar.

Cases such as Riggs, together with related cases turning on the failure to file SARs such as AmSouth Bank of Birmingham, Alabama,[11] are generally thought to have contributed to

8. Council Directive 2004/0137, *supra* note 1, at art. 28.

9. *Id.* at art. 28(3).

10. In re Riggs Nat'l Corp., Docket No. 05-003-B-HC (Bd. of Governors of the Fed. Reserve Sys. Jan. 26, 2005).

11. *See* In re Amsouth Bancorporation & Amsouth Bank, Birmingham, Ala., Docket Nos. 04-021-B-HC, 04-021-B-SM, 04-021-CMP-HS, &04-021-CMP-SM, (Bd. of Governors of the Fed. Reserve Sys. Oct. 12, 2004).

the ever-increasing mountain of SARs being filed by U.S. financial institutions fearful of being second-guessed. Before the Riggs case, it might have been reasonable for bank officials to fail to find anything suspicious about large cash withdrawals by individuals such as Prince Bandar, whose wealth, position, and ongoing pattern of bank activities might well have allowed a banker to conclude that there was nothing particularly suspicious or criminal about his frequent need for large cash withdrawals. After Riggs and related cases, it is unlikely that U.S. financial institutions will back off from the current record (and ever increasing) level of SAR filings unless bank regulators provide clear safe harbor guidelines that will hold up during the bank examination process. Such a development is not reasonably to be anticipated.

IV. AML in Zimbabwe: Lawyers as Gatekeepers

Zimbabwe has long been one of the world's most notorious jurisdictions for money laundering, but in 2005 efforts were at least apparently being made to bring the country closer to world standards. Economic convulsions over the years have led to a substantially cash-based financial system and lax enforcement, coupled with corruption, has also contributed to make money laundering a major national problem. The Reserve Bank of Zimbabwe is creating a Financial Intelligence Unit to work with the few financial institutions to monitor suspicious transactions and to coordinate anti-money laundering efforts. Financial institutions also would be required to appoint a money laundering reporting officer (MLRO). The opening of accounts via the internet or through the postal service would be prohibited and correspondent banking would be regulated in accordance with international standards.[12]

Zimbabwe's efforts to stop money laundering have extended to gatekeepers such as attorneys, which has threatened to create a conflict with an attorney's traditional duties to clients. In January 2005, the Law Society of Zimbabwe mounted a constitutional challenge to Zimbabwe's gatekeeper law, the Bank Use Promotion and Suppression of Money Laundering Act, and on January 18, 2005, petitioned the Supreme Court to find parts of the Act unconstitutional.[13] The Act applies to a lawyer's obligations that are essentially similar to those imposed on financial institutions, including obligations to report suspicious transactions and large cash transactions and prohibitions on tipping off by notifying their clients.

V. Lawyers as Gatekeepers in Belgium

A lawyer's gatekeeper obligations under EU law have also been subject to challenge. The Brussels Bar has initiated a challenge to the EU's AML Directive (initially the Second European Union Anti-Money Laundering Directive, now supplanted by the Third) based on EU human rights law. Since this is a matter of EU law, the Belgian Cour d'Arbitrage has asked the European Court of Justice (ECJ) to review the request by the Belgian Bar. The issue is whether the EU AML Directive infringes on the right to a fair trial as guaranteed by article 6 of the Convention for the Protection of Human Rights and Fundamental

12. *See* Bank Use Promotion and Suppression of Money Laundering Act, ch. 24:24, *available at* http://www.parlzim.gov.zw/Resources/Acts/web%20pages/title24/chapter24.htm (last visited Feb. 27, 2006).

13. Deloitte Financial Services, A Month in Money Laundering (Jan. 2005), *available at* http://www.deloitte.com/dtt/cda/doc/content/UK_AMonthinMoneyLaundering_Jan_2005%283%29.pdf.

Freedoms (and article 6(2) of the Treaty on European Union) insofar as it covers lawyers and hence imposes on them any reporting obligation that might indicate money laundering. The Brussels Bar argues that this obligation seems, in principle, to go against guarantees of the independence of the lawyer—understood as the right to defend her client's sole interests from and above any influence from public authorities—and to the legal professional privileges that are the basis of the right to an efficient defense.

As of this writing, the case is still pending before the ECJ. The American Bar Association, acting through the Section of International Law, has provided the Brussels Bar with a letter in support of its position, prepared with the help of the International Anti-Money Laundering and Professional Ethics Committee.[14]

VI. Lawyers as Gatekeepers in the United Kingdom: Bowman v. Fels

Lawyers in the United Kingdom were concerned about the possible application to their practices of the Proceeds of Crime Act 2002 (POCA).[15] Specifically, the potential exists under section 328 of the POCA for an attorney who simply conducted a normal piece of litigation in an ordinary way to be held as involved in an arrangement requiring reporting to the National Criminal Intelligence Service (NCIS) with the threat of prosecution and potential jail time for violations. *Bowman v. Fels*, decided on March 8, 2005, reversed an earlier case and held that a lawyer acting in the normal course of litigation is not covered by section 328.[16]

The case turned on the discovery by a firm during litigation that a party (not its client) might have violated tax law. The firm filed the report it thought was required under section 328 but informed no one—not its client, not opposing counsel, and not the suspected tax law violator represented by opposing counsel. The court concluded that section 328 did not apply in this case, and, even if it did, it would be overruled by the traditional legal professional privilege. This case did not, however, decide the potential impact of section 328 in normal commercial transactional work (as opposed to litigation) or settle the question of whether an attorney who accepted payment from funds derived from criminal sources would have committed a money laundering violation.

VII. Financial Action Task Force Initiatives

At its February 2005 plenary meeting, the FATF granted the People's Republic of China observer status, with the possibility of admission to full membership in the future. This action by the FATF was made after China's decision to implement the FATF Recommendations, to undergo an AML evaluation, and to play an active role in the fight against money laundering and terrorism.[17]

14. Letter from Michael S. Greco, President, American Bar Association; Michael Byowitz, Chair, ABA Section of International Law; & Edward J. Krauland, Chairperson, ABA Task Force on Gatekeeper Regulations and the Profession, to John Bigwood, Esq. Re: Referral by the Belgian *Cour d'Arbitrage* to the European Court of Justice Concerning Enforceability of the Second European Union Money Laundering Directive (Nov. 11, 2005) (On file with author).

15. Proceeds of Crime Act, 2002, 29 (Eng.).

16. Bowman v. Fels, [2005] EWCA (Civ) 226 (Eng.).

17. *FATF Welcomes China as Observer*, Financial Action Task Force, Feb. 11, 2005, *available at* http://www.fatf-gafi.org/dataoecd/51/2/34423127.pdf.

A primary task of the FATF is the maintenance of the list of Non-Cooperative Countries and Territories (NCCTs). During 2005, the Cook Islands, Indonesia, and the Philippines were removed from the list, following FATF visits to the countries that were effectively implementing appropriate anti-money laundering measures to correct the problems identified by the FATF that had caused them to be placed on the NCCT list. Nauru, one of the original and most notorious NCCT's, was also removed from the NCCT list in 2005 after it abolished the over 400 shell banks organized in the country. At the end of 2005, the NCCT list included only Myanmar and Nigeria.[18]

In addition to countries, the FATF also cooperates with regional bodies working to combat money laundering and terrorist financing. Among the newer groups are the Euroasian Group that was founded in Moscow and includes as founding members Belarus, Kazakhstan, Kyrgyzstan, the People's Republic of China, the Russian Federation, and Tajikistan.[19] Another recent FATF-style regional body is the Middle East and North Africa FATF.[20]

18. Press Release, Financial Action Task Force, FATF will explore the symbiotic relationship among corruption, money laundering and terrorist financing (Oct. 13, 2005), *available at* http://www.fatf-gafi.org/data oecd/13/36/35497629.pdf.

19. *See* Eurasian Group on Combating Money Laundering and Financing of Terriorism, http://www.euro asiangroup.org (last visited Feb. 27, 2006).

20. *See* Middle East & North Africa Financial Action Task Force, http://www.menafatf.org/home.asp (last visited Feb 27, 2006).