

2009

## U.S. and International Anti-Money Laundering Developments

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### Recommended Citation

Nicole M. Healy et al., *U.S. and International Anti-Money Laundering Developments*, 43 INT'L L. 795 (2009)  
<https://scholar.smu.edu/til/vol43/iss2/31>

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# U.S. and International Anti-Money Laundering Developments

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## I. Introduction

This past year has seen significant anti-money laundering (AML) activity. Among other things, 2008 brought a number of developments in AML policy, two Supreme Court opinions interpreting key provisions of the main U.S. AML statute, and noteworthy enforcement activity in the United States and the European Union.<sup>2</sup> In August, the ABA's House of Delegates passed Resolution 300 in response to legislation drafted by the U.S. Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations that would require those involved in company formation to submit to certain AML program requirements.<sup>3</sup> The ABA's Resolution addresses Congress's efforts to impose additional due diligence requirements on attorneys involved in business formation where such requirements would potentially disrupt the attorney-client privilege. The ABA has opposed federalizing this area of law and instead actively supports efforts by various working groups to reform state entity-formation laws.

With input from a variety of interested groups, the Financial Action Task Force (FATF) promulgated its risk-based lawyer guidance to provide attorneys with assistance in conducting appropriate client due diligence without sacrificing client confidentiality.<sup>4</sup> This

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2. See *infra* Part III.

3. See *infra* Part II.A.

4. See *infra* Part II.B.

guidance is significant because it does not mandate a rules-based system for lawyers, nor does it require the identification of beneficial ownership information. Finally, the American Bankers Association has published a paper recommending changes to the Bank Secrecy Act (BSA).<sup>5</sup>

In other developments, the U.S. Supreme Court decided two cases interpreting two separate and significant provisions of the primary U.S. money laundering statute.<sup>6</sup> In the first case, *United States v. Santos*, the Court defined what constituted the “proceeds” of illegal activity, holding that net profits rather than gross receipts constitute illicit proceeds.<sup>7</sup> In the second case, *Cuellar v. United States*, the Court addressed whether the prohibition on the international transportation of the proceeds of illegal activity includes an element of “laundering,” holding that the government had to prove that the defendant’s physical transportation of concealed funds into Mexico was “designed to conceal or disguise” the money’s “nature, location, source, ownership, or control.”<sup>8</sup>

In an unresolved matter that will bear further watching, a U.S. lawyer has been indicted for advising a criminal defendant’s trial attorneys that the source of funds used to pay their fees was legitimate, and thus, not forfeitable.<sup>9</sup> Finally, in September 2008, following an appeal by two persons identified on the U.N. Security Council’s Al Qaeda Taliban Watch List, the European Court of Justice (ECJ), issued a decision requiring the European Union’s Council and EU member states to provide notice and an opportunity for judicial review before imposing sanctions.<sup>10</sup> This decision may have far-reaching implications for AML and anti-terrorism sanctions enforcement within the European Union and elsewhere.

## II. 2008 Policy Developments

### A. ABA ACTIVITY

In 2008, the ABA continued to monitor and respond to proposed legislative and inter-governmental efforts to impose AML gatekeeper requirements on lawyers. Although the ABA fully supports AML and anti-terrorist financing efforts, it remains concerned about the erosion of the attorney-client privilege and ethical dilemmas that would arise from imposing mandatory reporting requirements on lawyers vis-à-vis the activities of their clients, backed by criminal penalties and secrecy obligations. At the same time, the ABA is a strong proponent of professional awareness of and compliance with existing legal and ethical obligations to avoid involvement in money laundering and terrorist financing activities. To that end, client due diligence is an important component of the delivery of legal services.

5. See *infra* Part II.C.

6. See *infra* Part III.A.1.

7. See *United States v. Santos*, 128 S. Ct. 2020 (2008).

8. See *Cuellar v. United States*, 128 S. Ct. 1994, 2000-2001 (2008).

9. See *United States v. Velez*, No. 05-20770-CR-COOKE/BANDSTRA, 2008 WL 5412909 (S.D. Fla. Dec. 30, 2008).

10. See *infra* Part III.B.

## 1. *ABA Resolution 300*<sup>11</sup>

During the ABA's annual meeting in August 2008, the House of Delegates passed Resolution 300 in response to legislation drafted by the U.S. Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations (PSI) (discussed below) and recent efforts by the FATF to promulgate guidance for the legal profession regarding a risk-based approach to client due diligence. Pursuant to Resolution 300, the ABA supports the traditional structure of regulating business formation activities at the state level; urges Congress to refrain from enacting federal legislation that would regulate the legal profession through AML initiatives; states that lawyers should conduct risk-based client due diligence in a manner that does not conflict with ethical requirements and regulations imposed by state authorities on the legal profession; and supports the development of voluntary guidance to the legal profession on conducting appropriate client due diligence to avoid involvement in money laundering and terrorist financing activities.

## 2. *Federal Legislative Developments*

In May 2008, the PSI proposed legislation (S. 2956)<sup>12</sup> to address perceived abuses of certain business entities to conduct illicit activity, and the absence of information relating to beneficial owners of such entities. Specifically, the legislation would impose certain BSA regulatory requirements on those who assist in the formation of unincorporated business entities, trusts, partnerships, and other organizational structures, requiring that they document, verify, and make available to law enforcement authorities the record and beneficial ownership of these business entities. This legislation would impose significant and difficult compliance burdens on company formation agents (including lawyers in some circumstances), state authorities, and others.

The proposed S. 2956 and its predecessor, S. 681,<sup>13</sup> resulted from a series of hearings beginning in 2001 that investigated the role of domestically and internationally formed private companies in U.S. tax evasion, money laundering, and terrorist financing. In each of these hearings, the presumption was that lack of information about underlying beneficial ownership impeded law enforcement investigations.

In response to S. 681, industry groups involved in entity formation (including the ABA's Business Law Section, the ABA Committee on Corporate Laws, the National Conference of Commissioners on Uniform State Law, the National Association of Secretaries of State, the National Conference of State Legislatures, the International Association of Commercial Administrators, and Association of Registered Agents) began working with representatives from the Department of Justice's Asset Forfeiture and Money Laundering Section in the Criminal Division, the Department of the Treasury's Office of Terrorist Financing, the Office of Foreign Assets Control (OFAC), and the Financial Crimes Enforcement

11. See American Bar Association Section of Real Property, Trust, and Estate Law, *Report to the House of Delegates: Task Force On Gatekeeper Regulation and The Profession*, available at [www.abanet.org/leadership/2008/annual/recommendations/ThreeHundred.doc](http://www.abanet.org/leadership/2008/annual/recommendations/ThreeHundred.doc) - 2008-08-05.

12. Incorporation Transparency and Law Enforcement Assistance Act, S. 2956, 110th Cong. (2008), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:s2956is.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s2956is.txt.pdf).

13. Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2008), available at [http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110\\_cong\\_bills&docid=f:s681is.txt.pdf](http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:s681is.txt.pdf).

Network (FinCEN) to discuss entity formation laws, to understand the type of information sought by law enforcement, and to offer to resolve law enforcement's information gathering issues through measures other than federal legislation. These industry groups worked with the Treasury to draft amended state entity formation laws that would require privately held entities to maintain ownership information and make it readily accessible to law enforcement.

Although S. 2956 did not progress through the Congress, similar legislation may be introduced in the next Congress. At the same time, the various organizations noted above are continuing their work to make improvements at the state level to address the concerns of law enforcement agencies.

### 3. *ABA Participation in the FATF Lawyer Guidance*

Members of the ABA Task Force on Gatekeeper Regulation and the Profession, along with representatives from bar associations elsewhere in the world, have continued efforts to work with the FATF in ensuring that AML measures for the legal profession do not adversely impact the core principles and role of lawyers in society. A major effort was undertaken to assist FATF in its preparation of voluntary guidance for legal professionals throughout the globe when conducting risk-based client due diligence. In October 2008, the FATF adopted its risk-based guidance for legal professionals.<sup>14</sup> Pursuant to FATF's guidance, U.S. lawyers should work to develop voluntary risk-based guidance for client due diligence. The ABA, pursuant to Resolution 300, will be engaged in such an effort along with other interested bar groups. Absent this voluntary guidance, federal regulators and lawmakers may impose a rules-based approach on the legal profession and trigger significant issues with regard to the attorney-client privilege, client confidentiality, the attorney-client relationship, and the delivery of legal services.

## B. UPDATE ON GATEKEEPER ISSUES: FATF GUIDANCE FOR LAWYER-CLIENT DUE DILIGENCE

The past year has seen the culmination of lengthy—and often contentious—consultations between the FATF and the private bar—on the domestic and the international level—over whether it is appropriate to require lawyers to institute AML and counter-terrorist financing program requirements. The resulting October 2008 guidance from the FATF directs lawyers to implement a risk-based, rather than a rules-based, approach to combating money laundering and terrorist financing.

### 1. *Background on FATF and Anti-Money Laundering Requirements for Lawyers*

FATF is an inter-governmental policy-making body that develops and promotes “policies to combat money laundering and terrorist financing.”<sup>15</sup> In 1990, FATF issued *Forty Recommendations* designed to provide a complete set of counter-measures against money-

14. FINANCIAL ACTION TASK FORCE, *RBA GUIDANCE FOR LEGAL PROFESSIONALS* (2008), available at <http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf> [hereinafter *LAWYER GUIDANCE*].

15. See Financial Action Task Force website, <http://www.fatf-gafi.org> (last visited Feb. 26, 2009).

laundering.<sup>16</sup> Through a mutual evaluation process, the FATF conducts periodic peer reviews of its member states' AML compliance programs. In June 2006, the FATF conducted a mutual evaluation of U.S. compliance with FATF's *Forty Recommendations*, finding in relevant part that the United States was "non-compliant" with respect to lawyers because they were not subject to customer identification and record-keeping requirements or the "no-tipping-off" rule.<sup>17</sup> Lawyers are not protected from liability when filing suspicious transaction reports (STRs) nor are they required to implement substantial internal controls.

## 2. *Development of Lawyer Guidance*

FATF formulated guidance for the legal profession on implementing the risk-based approach to compliance, as it has done for other sectors, to improve understanding of the recommendations directed at lawyers.<sup>18</sup> The development of the *Lawyer Guidance* was a collaborative effort with the private sector. FATF held five in-person meetings with the private sector over the past year, which were critical in defining the scope and content of the *Lawyer Guidance*.<sup>19</sup>

In the course of these meetings, FATF and private sector representatives agreed on a number of substantive issues. For example, breakthroughs were made on STRs and the "no tipping off" rule. FATF agreed not to impose a mandatory STR regime on lawyers, leaving the decision to individual countries whether to adopt a risk-based or rules-based approach to STRs for legal professionals. The private sector was also instrumental in convincing FATF to issue separate, stand-alone guidance for lawyers. One of the most contentious issues was whether lawyers should be required to identify their clients' beneficial ownership. After considerable debate, FATF agreed with the lawyers' group that beneficial ownership identification should be styled as a risk-based analysis.

The process culminated in October 2008, when FATF adopted the *Lawyer Guidance* at its plenary meeting in Rio de Janeiro.<sup>20</sup>

## 3. *Substance of the Lawyer Guidance*

The *Lawyer Guidance* applies to lawyers only when they "prepare for and carry out" transactions for their client concerning one of five categories of specified activities.<sup>21</sup> The five categories are:

- Buying and selling of real estate;
- Managing of client money, securities or other assets;

16. See FINANCIAL ACTION TASK FORCE, FATF ON MONEY LAUNDERING: THE FORTY RECOMMENDATIONS (2003), available at [http://www.fatf-gafi.org/document/28/0,3343,en\\_32250379\\_32236930\\_33658140\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html).

17. See FINANCIAL ACTION TASK FORCE, THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (2006), available at <http://www.fatf-gafi.org/dataoecd/44/9/37101772.pdf>.

18. LAWYER GUIDANCE, *supra* note 13.

19. The meetings were held in London (Sept. 2007), in Bern (Dec. 2007), in Paris (April 2008), in London (June 2008), and in Ottawa (Sept. 2008).

20. See FINANCIAL ACTION TASK FORCE, CHAIRMAN'S SUMMARY: RIO DE JANEIRO PLENARY 15-17 OCTOBER 2008 (2008), available at <http://www.fatf-gafi.org/dataoecd/31/49/41521461.pdf>.

21. LAWYER GUIDANCE, *supra* note 13, ¶ 12, at 6.

- Management of bank, savings or securities accounts;
- Organisation of contributions for the creation, operation or management of companies; and
- Creation, operation or management of legal persons or arrangements, and buying and selling of business entities.<sup>22</sup>

A lawyer must perform the applicable client due diligence (CDD) only when the lawyer is preparing for or carrying out a specified activity in one of these five categories.

Consistent with the risk matrix published in the FFIEC Bank Secrecy Act Anti-Money Laundering Examination Manual, the lawyer must engage in an appropriate risk-based analysis. The three most commonly used risk criteria are country risk, client risk, and service risk.<sup>23</sup> The *Lawyer Guidance* notes that there is no universal agreement regarding which particular countries or areas represent a higher risk, but it has developed a profile of high-risk countries (including those that are subject to sanctions and identified as having significant levels of corruption, criminal activity, or as a location that supports terrorism). With respect to client risk, the *Guidance* expects lawyers to develop their own risk criteria to determine whether a particular client poses a high risk.<sup>24</sup> The third risk category is the potential risk presented by the specific services offered by a legal professional.

The risk-based approach outlined by FATF allows for a certain amount of flexibility, understanding that each situation is unique and all lawyers are not similarly situated. The *Lawyer Guidance* cautions that “[d]ue regard must be accorded to the vast and profound differences in practices, size, scale and expertise, amongst legal professionals.”<sup>25</sup> But FATF notes that a “significant factor” for all lawyers is “whether the client and proposed work would be unusual, risky or suspicious for the particular legal profession.”<sup>26</sup> Lawyers must evaluate this factor in the context of their specific practices. To take into account the variables that affect the risk determination, the *Lawyer Guidance* identifies factors that may influence the risk assessment, either upward or downward, including the reputation and publicly available information about a client and the regularity or duration of a client relationship. If variables exist, the lawyer may be required to perform enhanced due diligence and monitoring. Conversely, the lawyer’s CDD and monitoring requirements may be reduced or modified (though likely not completely eliminated).

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22. *Id.*

23. *Id.* ¶ 106.

24. The *Lawyer Guidance* identifies twelve situations where a client’s activities may indicate a higher risk: (a) “politically exposed persons” in certain situations, (b) clients conducting their business relationship or requesting services in unusual or unconventional circumstances, (c) clients where the structure or nature of the entity or relationship makes it difficult to identify in a timely fashion the true beneficial owner or controlling interests, (d) clients that are cash intensive businesses, including money services businesses and casinos, (e) charities and other “not for profit” organizations that are not subject to monitoring or supervision by designated competent authorities or self-regulatory organizations (“SROs”), (f) clients using financial intermediaries, financial institutions or legal professionals that are not subject to adequate AML/CFT laws and measures and that are not adequately supervised by competent authorities or SROs, (g) clients having convictions for proceeds generating crimes who instruct the legal professional to undertake specified activities on their behalf, (h) clients who have no address, or multiple addresses without legitimate reasons, (i) clients who change their settlement or execution instructions without appropriate explanation, and (j) the use of legal persons and arrangements without any apparent legal or legitimate tax, business, economic or other reason.

25. *Id.* ¶ 111.

26. *Id.* ¶ 112.

#### 4. *Conclusion*

The issuance of the *Lawyer Guidance* by FATF represents the successful outcome of extended consultation and collaboration with the private sector. But the work of the private sector is not finished. The *Lawyer Guidance* is “high level” guidance intended to provide a broad framework for implementing a risk-based approach for the legal profession. FATF encourages the development of “good practices” for legal professionals. Comprehensive, uniform “good practices” guidance must be developed by the private sector to offer meaningful, practical, and detailed risk-based guidance to lawyers. The ABA Task Force on Gatekeeper Regulation and the Profession will participate in the effort to develop appropriate risk-based guidance.

#### C. THE AMERICAN BANKERS ASSOCIATION’S RECOMMENDATIONS FOR BSA AND AML REFORM

The American Bankers Association (Bankers Association) released its long-awaited recommendations for reform of the BSA in October 2008.<sup>27</sup> The report proposes five main recommendations for improving the BSA: (1) creation of a “gatekeeper” in the federal government responsible for overall administration of AML laws and regulations; (2) explicit acceptance of priority-focused, risk-based compliance; (3) greater feedback and transparency regarding AML issues; (4) streamlining BSA reporting; and (5) limitations on the application of criminal sanctions under the BSA.

##### 1. *Recommendation One: A BSA Gatekeeper*

Responsibility for administration of the BSA is divided between federal and state bank regulators. The Bankers Association recommends that the federal government create a BSA “gatekeeper” that would be responsible for (1) promulgating BSA regulations and procedures; (2) assisting financial institutions in complying with the BSA; and (3) ensuring that BSA requirements do not undermine the operating efficiency of the banking system. The gatekeeper would have no law enforcement functions but would be integrated into the financial/payments system. All reports under the BSA would be transmitted through the gatekeeper to the appropriate regulators and law enforcement agencies. The gatekeeper would also act as an ombudsman between banks and regulators regarding BSA issues, but it would not replace the regulators with respect to BSA compliance.

##### 2. *Recommendation Two: Priority-Focused Approach to Compliance*

The Bankers Association recommends that regulators (and the gatekeeper) issue an inter-agency policy statement explicitly adopting a risk-based approach to compliance. Pursuant to such a policy, if a bank had a “conscientiously established” AML system, it would not be subject to enforcement actions, even if money laundering occurred. This approach would be at odds with OFAC, however, which treats the use of a risk-based system for compliance with U.S. economic sanctions as a mere mitigating factor.

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27. AMERICAN BANKERS ASSOCIATION, A NEW FRAMEWORK FOR PARTNERSHIP: RECOMMENDATIONS FOR BANK SECRECY ACT/ANTI-MONEY LAUNDERING REFORM (2008), available at <http://www.aba.com/aba/documents/press/NewFramework.pdf> [hereinafter NEW FRAMEWORK].

Banks, especially community banks with limited AML resources, could construct individualized AML systems. Deference to banks' judgments would limit regulators' reliance on peer reviews and best practices as a basis for finding a bank to be out of compliance. BSA enforcement would also be priority-focused, with penalties reflecting the seriousness of the infraction.

### 3. *Recommendation Three: Greater Feedback and Transparency*

Although banks provide a great deal of information under the BSA, they do not always know how that information is used. The Bankers Association recommends that regulators and law enforcement agencies discuss with banks the uses of information, including the details of individual cases. The Bankers Association recommends that regulators and law enforcement agencies make greater efforts to communicate to banks the details of the latest developments in efforts by criminals and terrorists to evade AML requirements.

The Bankers Association also recommends that regulators provide more transparency to the AML review process. Regulators should communicate their expectations regarding AML compliance clearly. The BSA Manual should be modified to link legal requirements to specific suggested risk mitigation practices.

### 4. *Recommendation Four: Streamlined Reporting*

The burden of reporting is a major issue in AML compliance. The Bankers Association recommends that banks be accorded greater discretion in deciding when and how to file Currency Transaction Reports (CTRs) and Suspicious Activity Reports (SARs). The Bankers Association proposes that regulators defer to banks' decisions regarding whether to exempt certain customers from CTR reporting and whether to file SARs for individual transactions. The Bankers Association further proposes that the federal government simplify the CTR and SAR filing and exemption process.

### 5. *Recommendation Five: Criminal Sanctions Under the BSA*

The Bankers Association recommends that criminal sanctions for violations of the BSA be applied sparingly. There should be clear standards for taking criminal action under the BSA against banks, and law enforcement agencies should be required to consult with bank regulators before seeking criminal sanctions for AML violations. The U.S. Department of Justice should not use criminal cases as a way to force banks to implement specific AML remedial procedures.

### 6. *Conclusion*

If accepted, the Bankers Association recommendations would change the way banks go about BSA/AML compliance. While true acceptance of a risk-based approach to compliance could give banks more freedom to fashion AML systems, it is doubtful that regulators would give banks the deference they request. The recommendations most likely to be implemented are those regarding feedback and transparency, which may enhance enforcement and compliance without requiring structural changes to the BSA.

#### D. MARKET-DRIVEN BEST PRACTICES FOR UNREGISTERED INVESTMENT COMPANIES

Although much has been made of the FinCEN's October 30, 2008 decision to withdraw proposed AML program rules for unregistered investment companies, many firms, nonetheless, have come to recognize that implementation of a robust AML program is a necessary requirement of doing business and of protecting the firm. Indeed, FinCEN's apparent reversal may have little impact. U.S.-based firms operating in the global marketplace are already subject to criminal laws prohibiting money laundering in the United States and abroad, and many firms have identified procedural safeguards as an appropriate buffer (and, in the unfortunate event that things go wrong, a mitigating factor) against this exposure.

The market is demanding that unregistered investment companies implement AML best practices. Firms without an AML compliance policy or procedures that are consistent with best practices will likely find themselves missing out on opportunities. Counterparties, especially financial institutions subject to the BSA and USA PATRIOT Act (Patriot Act),<sup>28</sup> are increasingly looking to unregistered investment companies for compliance attestations. Due diligence for joint ventures often includes requests that the unregistered investment company affirm that its AML compliance program is consistent with the Managed Fund Association's (MFA) best practices.

##### 1. *What Constitutes Best Practices for AML Compliance?*

In September 2007, the MFA published its best practices for hedge fund AML compliance.<sup>29</sup> These include the requirements imposed on covered financial institutions under the Patriot Act, such as the recommendation that these funds:

- establish a written policy and procedures reasonably designed to prevent the firm from being used for money laundering or the financing of terrorist activities;
- designate an AML compliance officer with authority to enforce the policy and procedures;
- implement Know-Your-Customer (KYC) and source of funds identification procedures;
- engage in independent testing of the program; and
- conduct regular training for employees.

##### 2. *A Risk-Based Approach to AML Compliance*

One-size-fits-all compliance software programs, while good window dressing, do not provide the type of AML and KYC protection firms need. Such programs often generate so much data that it becomes difficult to identify where the firm might be vulnerable to being used for money laundering or terrorist financing activity. In the first instance, conducting a risk assessment can help identify the areas where the firm's relationships or transactions might put the firm at risk. This analysis should include:

- the characteristics of the firm's client base;

28. USA PATRIOT is an acronym for the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001, Pub.L. 107-56, 115 Stat. 272.

29. See MANAGED FUNDS ASSOC., SOUND PRACTICES FOR HEDGE FUND MANAGERS (2007), available at <http://www.managedfunds.org/downloads/Sound%20Practices%202007.pdf>.

- the types of transactions in which the firm frequently engages;
- the jurisdictions in which the firm does business; and
- the manner in which accounts are opened and maintained.

After these assessments have been performed, the firm will be in a position to develop and implement a program tailored to its specific circumstances and requirements.

### 3. *Training for Recognizing “Red Flags”*

As a firm develops or reviews its AML programs, a critical first step is to train “front line” personnel who handle funds or open accounts to understand how to recognize red flags for money laundering activity. It is often at this stage, rather than at the relationship level, where information falls through the cracks. Training personnel to recognize and alert the compliance officer to potential red flags will provide far more protection for the firm than any automated program. Examples of red flags that may warrant further review by compliance personnel for the unregistered investment company include:

- An investment in an unregistered investment company by a check drawn on the account of a third party, or by one or more wire transfers from an account of a third party, unrelated to the investor;
- Investor difficulty in describing the reasons for frequent wire transfers to unfamiliar bank accounts or jurisdictions other than the investor’s home country;
- Frequent purchases of interests in unregistered investment companies followed by redemptions, particularly if the resulting proceeds are wired to unrelated third parties or bank accounts in foreign countries;
- Non-economic transfers, such as the purchase of an interest for a large dollar amount followed by a redemption with indifference as to penalties charged for the redemption;
- Transfers to accounts in jurisdictions where drug trafficking and/or terrorist financing is known to occur or to other high risk countries;
- Transfer of a monetary instrument or an investment interest from a foreign government to a private person.

### 4. *The Compliance Program Protects the Firm*

A demonstrable, good faith commitment to compliance should be a vital component of a firm’s business plan and an important defense if a problem arises. Potential partners will look to a firm’s attestations regarding its AML policy and programs in deciding whether it is a desirable partner. In the event of a problem, regulators will evaluate a firm’s procedures to see if they were reasonable and implemented and enforced in good faith.

## III. Litigation Update

### A. UNITED STATES ANTI-MONEY-LAUNDERING DEVELOPMENTS

#### 1. *U.S. Supreme Court Decisions*

This past year saw two notable U.S. Supreme Court decisions interpreting key provisions of the principal U.S. money laundering statute. Those cases, *United States v. Santos*

and *Cuellar v. United States*, addressed fairly fundamental aspects of the statute, such as how to define “proceeds” of an illegal activity and whether the prohibition on international transportation of proceeds of illegal activity includes an element of “laundering.” In what would appear to be the easier question of what are “proceeds” pursuant to 18 U.S.C. § 1956(a)(1), a badly splintered *Santos* Court could not agree on whether they are the net proceeds from or gross receipts of the illegal activity. In contrast, the seemingly more difficult question of whether the Government had to show that a defendant transporting hidden funds internationally attempted to give the funds the “appearance of legitimate wealth,” was answered in the negative by a solid majority of the *Cuellar* Court, although that majority also required the Government to show more than that the illicit funds were hidden during transportation.

a. *United States v. Santos*<sup>30</sup>

The *Santos* Court was confronted with the question of whether the term “proceeds” in section 1956(a)(1) means “receipts” or “profits.”<sup>31</sup> The defendant, Santos, the operator of an illegal lottery under Indiana law, was convicted of one count of conspiracy to run an illegal gambling business, one count of running an illegal gambling business, one count of conspiracy to launder money, and two counts of money laundering. Santos collaterally attacked his conviction based on a subsequent decision of the Seventh Circuit holding that section 1956(a)(1)’s prohibition on transactions involving criminal “proceeds” means criminal profits, not receipts. Applying that holding, the District Court vacated Santos’s money-laundering convictions because there was no evidence that the transactions on which they had been based (such as Santos’s payments to lottery winners and to his lottery employees) involved profits from his illegal lottery. The case reached the Supreme Court after the Seventh Circuit affirmed the District Court.

The Supreme Court was sharply divided not only on the question of whether “proceeds” should be read as “profits” or “receipts,” but also on the correct application of the statutory canon of construction. Finding that the term “proceeds” could be read as “profits” or “receipts” with equal plausibility in light of the legislative history, a plurality consisting of Justices Scalia, Souter, Ginsburg and Thomas (as to all but Part IV) held that the rule of lenity should apply.<sup>32</sup> The rule of lenity required that “proceeds” be construed as “profits” of the criminal enterprise. Justice Stevens concurred in the judgment, including relying on the rule of lenity, but hedged his opinion to permit “proceeds” to mean “receipts” when the legislative history reflected a congressional intent to do so.<sup>33</sup> Justice Alito, joined by the Chief Justice and Justices Kennedy and Breyer, dissented on the basis

30. *United States v. Santos*, 128 S. Ct. 2020 (2008).

31. 18 U.S.C.A. § 1956 (2008). Section 1956(a)(1) provides that:

Whoever, knowing that the property involved in a financial transaction represents the proceeds of some form of unlawful activity, conducts or attempts to conduct such a financial transaction which in fact involves the proceeds of specified unlawful activity—(A)(i) with the intent to promote the carrying on of specified unlawful activity. . . shall be sentenced to a fine of not more than \$500,000 or twice the value of the property involved in the transaction, whichever is greater, or imprisonment for not more than twenty years, or both.

32. See *Santos*, 128 S. Ct. at 2022, 2025.

33. See *id.* at 2030.

that the “primary definition” of “proceeds” is “the total amount brought in.”<sup>34</sup> Even if deemed to be ambiguous, however, in the context of the instant money laundering statute, Justice Alito found persuasive evidence from other state money laundering statutes and an international treaty that “proceeds” customarily is construed as “receipts.”<sup>35</sup>

The *Santos* Court was split even on the meaning of the Court’s decision. The plurality, Justice Stevens in his concurrence, and even Justice Alito in his dissent, all discussed expressly the effect of Justice Stevens’ concurrence. Although the plurality acknowledged that its holding was limited by Justice Stevens’ narrower opinion, it attempted to construe the Court’s holding as “‘proceeds’ means ‘profits’ when there is no legislative history to the contrary.” Justices Stevens and Alito took issue with this statement, leaving as the only certainty that the convictions were overturned.

b. *Cuellar v. United States*<sup>36</sup>

Although presenting a more complicated question, the Court in *Cuellar* was able to resolve it with minimum disagreement. In *Cuellar*, the defendant was pulled over for erratic driving by a Texas state deputy while traveling south toward Mexico. The deputy determined that Cuellar was acting suspiciously, while giving conflicting explanations about his travels. After the defendant pulled a wad of cash from his pocket that smelled of marijuana, a drug detection dog sniffed the car and alerted on the money from Cuellar’s pocket and the rear of the car, where a hidden compartment holding \$81,000 in bundled and duct-taped cash was found. The rear of the car was covered with animal hair, which the deputies thought was intended to distract the drug dog. Cuellar was indicted for violation of 18 U.S.C. § 1956(a)(2)(B)(i).

The issue presented in *Cuellar* was whether the government had to prove under the international transportation provision of the federal money laundering statute that the defendant had concealed illicit funds with the design to create the appearance of legitimate wealth.<sup>37</sup> A split panel of the Fifth Circuit reversed Cuellar’s conviction on the basis that the government had to show that the purpose of the transportation must be an attempt to create the appearance of legitimate wealth. On rehearing en banc, the full Fifth Circuit reinstated Cuellar’s conviction.

The Supreme Court, in an opinion written by Justice Thomas,<sup>38</sup> held that the statute did not require the government to prove that the defendant had attempted to make the

34. *Id.* at 2035.

35. *See id.* at 2036-37.

36. *See Cuellar v. United States*, 128 S. Ct. 1994 (2008).

37. 18 U.S.C.A. § 1956(a)(2)(B)(i). Section 1956(a)(2), provides in pertinent part that:

Whoever transports, transmits, or transfers, or attempts to transport, transmit, or transfer a monetary instrument or funds from a place in the United States to or through a place outside the United States or to a place in the United States from or through a place outside the United States— . . . (B) knowing that the monetary instrument or funds involved in the transportation, transmission, or transfer represent the proceeds of some form of unlawful activity and knowing that such transportation, transmission, or transfer is designed in whole or in part— . . . (i) to conceal or disguise the nature, the location, the source, the ownership, or the control of the proceeds of specified unlawful activity . . . shall be sentenced to . . . imprisonment for not more than twenty years. . . .

38. *Cuellar*, 128 S. Ct. at 1997.

illegal funds appear legitimate.<sup>39</sup> Nor did the Court accept the government's position, however, that a conviction required proof merely that the defendant hid the funds during transportation. Instead, the Court explained that the Government had to prove that Cuelar's transportation of the money to Mexico was "designed to conceal or disguise" the money's "nature, location, source, ownership, or control." Justice Thomas found that merely hiding money during transportation, even with substantial efforts at concealment, did not violate the statute.

## 2. *Enforcement Action: United States v. Velez (Kuehne)*

The indictment of Benedict P. Kuehne,<sup>40</sup> a long-time member of the Miami criminal defense bar, on charges of money laundering highlights the extent to which new AML requirements for lawyers—whether voluntary, risk-based, contractual (as was the case here), or statutory—may well be here to stay.

Kuehne was retained by Fabio Ochoa Vasquez's defense attorneys to verify that the source of the funds Ochoa was using to pay his defense fees were not the proceeds of illicit activity. Ochoa, the infamous leader of the Medellín Drug Cartel, was on trial on narcotics charges. Under federal law, the government could require his defense attorneys to forfeit legal fees that were derived from an illicit source. Recognizing this risk, the attorneys hired Kuehne to certify that Ochoa's payment for legal services, which ran into the millions, came from legitimate sources. To this end, in 2002 and 2003, Kuehne submitted a series of letters describing the funds as the proceeds of legitimate business ventures in Colombia. Moreover, Kuehne injected himself into the process by collecting the funds and wiring them to the defense attorneys. In the indictment, the government alleges that Kuehne lied about the source of the income and asserts that he knew the money was derived from drug activity. The indictment charged Kuehne with money laundering and obstruction of justice.

While criminal defense attorneys have long been aware of the need for caution when accepting payment from their clients, this case is relevant to other lawyers whose clients also may be involved in industries at risk for money-laundering. Kuehne's prosecution is further evidence of the U.S. Government's trend of imposing a greater level of "know your customer" (or in this case "know your client") responsibility for attorneys. Other harbingers of this trend, as discussed above, include the FATF's *Lawyer Guidance* and recent attempts by Congress to introduce legislation that would incorporate certain groups of lawyers (among other industries) under the BSA regulations. The *Kuehne* case is significant to the debate because of Kuehne's contractual obligation to verify that the source of funds was not illicit. When the opposite was true, Kuehne found himself charged with money laundering.

Whether or not Kuehne was complicit in money laundering, the case nonetheless highlights the difficulties in "knowing your client" under any regime. The attorney representing the criminal client must weigh the client's right to effective counsel against the duty to protect the U.S. financial system and the legal profession against abuse by persons en-

39. *Id.* Justice Alito, joined by the Chief Justice and Justice Kennedy, joined the opinion of the Court and added a brief concurring opinion regarding the deficiency in the Government's evidence.

40. See *United States v. Velez*, No. 05-20770-CR-COOKE/BANDSTRA, 2008 WL 5412909 (S.D. Fla. Dec. 30, 2008).

gaged in money laundering. In the coming months, the ABA Task Force on Gatekeeper Regulation and the Profession will begin the process of developing best practices designed to strike that balance.

## B. EUROPEAN COURT OF JUSTICE: KADI V. COUNCIL AND COMMISSION

On September 3, 2008, the European Court of Justice (ECJ), the European Union's highest court, rendered its decision in *Kadi v. Council and Commission*.<sup>41</sup> The ruling may not only affect the manner in which the European Union imposes targeted sanctions against suspected terrorists but may also influence global efforts to combat terrorist financing.

To implement the U.N. Security Council's terrorist sanctions, the EU Council ("Council") passed a regulation directing EU Member States to automatically apply sanctions to any individual or entity on the U.N.'s Al Qaeda Taliban Watch List. Shortly after the U.N. Security Council placed on its sanctions list Yassin Abdullah Kadi (Kadi), a Saudi Arabian resident, and the Al-Barakaat International Foundation (Al-Barakaat), a money remitter in Sweden, the European Union froze Kadi's and Al-Barakaat's assets and imposed a travel and arms embargo. Kadi and Al-Barakaat challenged the regulation, and the ECJ concluded that the Council's regulation violated the appellants' fundamental rights by denying them notice and a meaningful opportunity for judicial review. The ECJ ordered that the regulation be annulled immediately, but deferred releasing the appellants' assets for ninety days—until December 3, 2008—in order to permit the European Union time to adopt new regulations consistent with the European Union's constitutional principles.<sup>42</sup>

Any new EU sanctions regime must provide notice and judicial review without sacrificing the efficacy of terrorist sanctions. In *Kadi*, the ECJ recognized the inherent tension between "legitimate security concerns" and procedural notice. Nonetheless, the ECJ was troubled that *no information at any time* was provided to the appellants. Thus, it is conceivable that the ECJ would approve a regulation that stipulates that (1) designated parties must be notified (preferably, as is done in the United States, after the assets are frozen) that they have been added to the terrorist freeze list, and (2) those parties must be provided with a basis for such designation. But it remains unclear whether the ECJ would allow Member States to conceal their most sensitive (i.e., classified) evidence, which might result in the disclosure of confidential sources and methods. In the United States, the

41. Press Release, The Court of Justice of the European Communities, The Court Annuls the Council Regulation Freezing Mr. Kaid and Al Barakaat's Funds, (Sept. 3, 2008), available at <http://curia.europa.eu/en/actu/communiqués/cp08/aff/cp080060en.pdf>; Joined Cases C-402/05 P and C-415/05 P, *Kadi v. Council & Commission*, [not yet reported in E.C.R.].

42. On November 28, 2008, the Commission passed Commission Regulation (EC) No 1190/2008, which noted that the Commission had "communicated the narrative summaries of reasons provided by the UN Al-Qaida and Taliban Sanctions Committee" to Kadi and Al-Barakaat and "given them the opportunity to comment on these grounds in order to make their point of view known." See Commission Regulation (EC) No 1190/2008 of 28 November 2008 amending for the 101st time Council Regulation (EC) No 881/2002 imposing certain specific restrictive measures directed against certain persons and entities associated with Usama bin Laden, the Al-Qaida network and the Taliban, 2008 O.J. (L. 322) 25, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:322:0025:0026:EN:PDF>. After receiving and considering their comments, the Commission held that the continued listing of Kadi and Al-Barakaat was justified due to their association with the Al-Qaida network. *Id.*

Treasury Department has addressed this problem voluntarily by publishing press releases regarding designated parties, which provide bare-bones analysis of why the particular target meets the designation criteria. It is not clear whether a similar solution would be acceptable to the ECJ. Disclosure of more sensitive information might deter the European Union from placing some names on its terrorist list and, as a result, affect international efforts to combat terrorist financing.

Regardless of the European Union's response to the ECJ ruling, Kadi and Al-Barakaat will remain on the U.N. list. Unless the European Union revises its regulation sufficiently to comply with the ECJ's due process concerns while also permitting the imposition of effective anti-terrorist sanctions, the ECJ ruling will result in inconsistencies between the U.N. and EU terrorist lists. Such discrepancies may create significant difficulties for international efforts to enforce terrorist sanctions.

