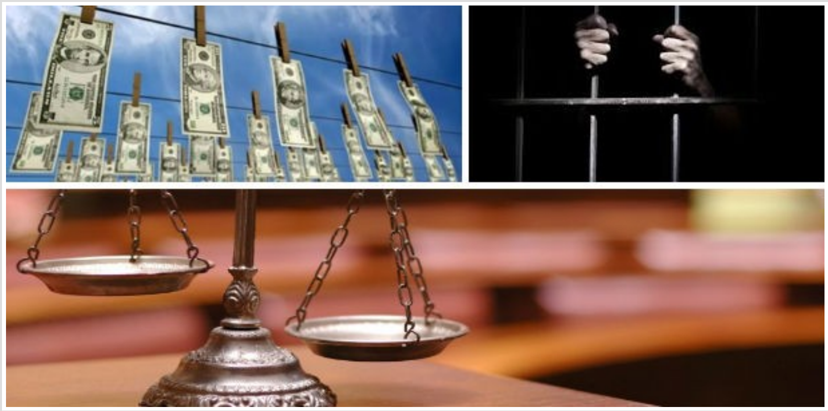
Lawyers navigate rising financial crime risks amid debate over regulation for ‘gatekeepers’



By Daniela Guzman

May 14, 2014

While serving a prison sentence, a convicted drug trafficker in Texas was able to transfer proceeds from his narcotics sales to an account accessed by his associates.

In Nevada, a fraudster funneled $2.3 million through a holding company in order to purchase a currency exchange brokerage, eventually using it to run a $16 million investment fraud scheme.

In Florida, a fraudulent non-profit organization was created solely for the purpose of duping Medicaid and Social Security recipients, stealing $2.8 million.

All three are examples of money laundering cases prosecuted in the US over the past year, but they also share something else in common. In each, attorneys were the ones who set up accounts, handled funds and established the legal entities involved, making legal professionals the linchpins of laundering schemes.

Attorneys have long occupied a unique professional role as so-called “gatekeepers,” with wide-ranging access to the financial system on behalf of clients. From accepting and transferring client funds to opening nominee accounts or forming business entities, lawyers can serve as the entry points to banks and other financial institutions through a variety of channels. While this capacity is a key part of many completely legitimate client services, the gatekeeper function is also what makes legal professionals vulnerable to unwitting involvement, or knowing complicity, in financial crime.

Law enforcement agencies in the US do not appear to track statistics specifically on attorneys implicated in financial crime cases. However, anecdotal evidence and reviews of enforcement actions issued by the Federal Bureau of Investigations, Internal Revenue Service Criminal Investigation division and Department of Justice indicate that the involvement of attorneys is a recurring, and possibly growing, factor in money laundering, fraud and corruption cases.

Despite their gatekeeper status, lawyers in the US and many other jurisdictions operate under a much less formal and arguably less stringent regulatory framework than financial institutions like banks and broker-dealers. In recent years, this approach has come under scrutiny by international standard-setting bodies in the financial crime field, particularly the Financial Action Task Force (FATF), triggering an ongoing debate over who should be keeping watch on the gatekeepers.

In the US, standards for lawyers come under scrutiny

In the US, the legal profession is guided by its own set of robust ethical policies and codes of conduct, but attorneys have no explicit regulatory requirements to conduct customer due diligence, file suspicious activity reports, or undertake other financial crime compliance functions.

The US legal profession is also largely self-regulating. State-level bar associations act as the industry's regulatory agencies, investigating and bringing enforcement actions for professional and ethical misconduct. Though backed by state courts, bar associations are not public-sector bodies, and are funded in large part by attorneys' own membership fees.

The FATF began honing in on gatekeepers, including lawyers, accountants, and notaries, as early as 2002. In its revised 40 Recommendations issued the next year, the FATF would advise that legal professionals should abide by the same customer due diligence and record-keeping requirements as financial institutions when handling customer accounts or assets, forming legal entities for customers, or buying and selling real estate.

That guidance, which was carried over and expanded in the FATF's most recent 40 Recommendations issued in 2012, sparked what is now a long-running dispute over financial crime compliance expectations for attorneys.

In the US, groups representing attorneys, like the American Bar Association, argue that forcing attorneys to abide by compliance standards designed for financial institutions would undermine core tenets of the legal profession. The FATF and regional bodies like the Asia-Pacific Group on Money Laundering assert that legal professionals remain susceptible to exploitation or involvement in financial crime schemes, and more formal regulation is required.

Globally, compliance with FATF guidance for legal professionals is spotty

Neither side of the debate has mustered conclusive empirical evidence of lawyers' vulnerability, or lack thereof, to use in financial crime schemes. In 2012, an FATF task force launched a survey of dozens of nations and jurisdictions on the risks and supervision of legal professionals. 38 nations responded, and the results were compiled into a report titled "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals." The report also includes 123 case studies and 42 red flags identified through questionnaires and research.

The FATF report found that on average in the 38 respondent nations, 3% of all suspicious activity/suspicious transaction reports (SARs/STRs) mentioned the possible involvement of a legal professional.

The report also tracked SAR/STR filings by legal professionals themselves, and found inconsistent results. The FATF's guidance recommends that lawyers should be required to file suspicious transaction reports, yet in 14 of the nations surveyed the number of reports filed was either zero or in the single digits in 2011. The report notes than when SARs were filed in many nations, they were often useful for law enforcement, stating that "Switzerland, Belgium, Italy, Liechtenstein, Ireland and the United Kingdom commented positively on the general quality of the STRs provided by legal professionals."

Citing attorney-client privilege, US bar associations back voluntary guidance

In the US, bar associations have long opposed legislation or regulation that would require attorneys to file SARs, arguing that lawyers should be exempt due to the historical tradition of confidentiality with their clients.

"Requiring lawyers to report such information… would also seriously undermine the attorney-client privilege and the confidential client lawyer relationship by discouraging full and candid communications between clients and their lawyers," the American Bar Association (ABA) stated last year in a letter opposing the Incorporation Transparency and Law Enforcement Assistance Act, a proposed bill introduced by US Senator Carl Levin. Among other measures, the bill would subject attorneys to Bank Secrecy Act regulations and require them to track and report beneficial owners of legal entities they help to create.

In place of regulation, the ABA advocates for voluntary compliance standards. In 2010, it created the Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing. The non-binding standards share many points with FATF recommendations, advising attorneys on a risk-based approach to customer due diligence (CDD), client intake, and ongoing evaluation of client transactions and relationships.

Criminal defense attorney Philip Hilder is co-chair of the ABA section of Criminal Justice's White Collar Crime Committee and practices law in Houston, Texas. As part of the committee, he serves as an expert on how financial crime intersects with the legal profession.

"There are no procedures or written guidelines that an attorney must follow in vetting their clients. It's up to the attorney to conduct their own due diligence that they see fit," Hilder said.

"It's incumbent upon the lawyer to make inquiries and to do due diligence to determine that the [client's] source of funds are legitimate," he adds.

Andrew S. Ittleman is a Founder and Partner of Fuerst, Ittleman, David & Joesph, PL in Miami, focusing on white collar criminal defense and AML. Ittleman argues that there are substantial differences between legal professionals and financial institutions, and therefore shouldn't be subject to the same regulation.

"You can't compare financial institutions with criminal attorneys," Ittleman argues.

"A criminal defendant [attempting to] pay his lawyer is very different than a criminal defendant trying to obfuscate his dirty proceeds by putting them in at a financial institution. The first is just a criminal defendant trying to seek representation; the second is a criminal defendant committing a money-laundering offense," Ittleman says.

Involvement of legal professionals in financial crime spans 'continuum'

Beyond the US, a number of other nations have taken a different approach, imposing explicit CDD and AML regulations on the legal profession. In the UK, for example, solicitors must comply with an anti-money laundering and counter-terrorist financing regulatory regime built around domestic laws, as well as the FATF's recommendations and the European Union's 3rd Money Laundering Directive.

The FATF faces a key challenge when trying to promulgate global standards for the legal profession – the sheer variability of legal systems, and the professionals who practice within them. With 2.5 million legal professionals in the world, their skills, resources, and traditions of attorney-client privilege vary widely.

Albeit thorough, the FATF report is neither a policy manual nor a one-size-fits-all risk analysis for legal professions. An important point made in the report is that there is a grey area when it comes to the lawyer's involvement in financial crime. "From reviewing the case studies and literature as a whole, the involvement of legal professionals in the money laundering of their clients is not as stark as complicit or unwitting, but can best be described as a continuum," it notes.

The report also notes that the increased focus on gatekeepers' role in financial crime may be paying off. While risks have risen, the report indicates that so too has attorneys' awareness.

"The case studies clearly demonstrate that criminals are still seeking to exploit the vulnerabilities that caused the FATF to call for extending AML/CFT obligations to legal professionals."

"However, the case studies also show that, at least in some instances, it is now the legal professional who becomes aware of the attempted misuse of their services and submits an STR that then prompts an investigation."

Education for attorneys on financial crime risks is lacking

While many lawyers in the US believe that the rules and bar oversight of the profession are already stringent enough to combat financial crime, regulation and education are two separate issues.

"Money laundering tactics change so frequently and the scams that are performed on lawyers change so frequently," Ittleman said. Education on financial crime risks is either lacking in substance or entirely missing at law schools, he says. Some state bars require an attorney to receive ethics training in the first five years of practicing law; Ittleman says ideally there should be training every five years to provide consistent and relevant education to attorneys

Criminal defense lawyers aren't the only ones that could be subject to money laundering. Ittleman says that daily transactional activities for real estate attorneys and commercial litigation attorneys could be riskier.

Ittleman, who is a criminal defense attorney himself, says that even though lawyers may be trained in defending a client who is involved in money laundering, they may not be prepared to deal with financial crime when they themselves are the target.

View a full list of red flags for attorneys from the FATF report here.