Government Initiatives Against Money Laundering of Importance to Estate Planners

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Introduction

In response to the September 11, 2001 terrorist attacks on the United States, world governments and international bodies have accelerated efforts to eliminate bank secrecy and foster transparency in international flows of currency. Prior to September 11 most international initiatives combating money laundering affected only banks and financial institutions, and had no special emphasis on combating terrorism. After September 11, however, when the world realized that illegal funds could be made to appear legitimate and then subsequently used to fund terrorism, governments and international bodies responded by increasing the reach of their anti-money-laundering initiatives.

The Financial Action Task Force on Money Laundering (the "FATF"), which released its initial Forty Recommendations To Combat Money Laundering in 1990,[1]

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[1] FATF, The Forty Recommendations of the Financial Action Task Force on Money Laundering, *available at* http://www.fatf-gafi.org/dataoecd/25/61/33635879.pdf. Released in April 1990.

revised those recommendations in 2003.[2] In doing so the FATF extended its regulatory reach to so-called "gatekeepers", a term that may include lawyers that are involved at the early stages of a money launderer's establishment of facilities to transfer money. Additionally, in the United States, the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001[3] (the " USA Patriot Act") also has broadened the reach of U.S. Federal money-laundering regulations from banks and financial institutions to investment advisors, real estate professionals, and an increasing list of professional advisors. The USA Patriot Act significantly extends the previous recordkeeping and reporting required of covered parties in an effort to identify and freeze the accounts of money launderers and supporters of terrorism. The USA Patriot Act does not yet apply to lawyers acting as principals, but the scope of the regulations may extend the Act to lawyers acting in some areas, such as real estate transactions.

All lawyers, and in particular trust and estate lawyers, should have a firm grasp of the growing reach of these international and government initiatives so they can best advise their clients on how these initiatives may affect them and their estate planning transactions. The new initiatives could result in a loss of privacy that many wealthy clients expect banks, trust companies and other related financial institutions to maintain in regard to their financial affairs. In addition, lawyers must be aware that these

[2] FATF, The Forty Recommendations, *available at* http://www.fatf-gafi.org/dataoecd/38/47/34030579.PDF. Released in June, 2003.

[3] Pub. L. No. 107-56, 115 Stat. 272, enacted as amendments to Subchapter II of Chapter 53 of Title 31 of the U.S. Code. The USA Patriot Act as enacted in 2001 was scheduled to expire on December 31, 2005. It was extended until February 3, 2006, and was then extended again until March 10, 2006. Re-enactment is thought likely , in somewhat revised form, as this article is sent to the printer.

initiatives may affect them in their practice as lawyers, and may require them to keep records and make reports to the relevant authorities that they were not previously required to make. Lawyers advising in residential or commercial real estate transactions, providing investment advice to clients, setting up partnerships or limited liability companies, or performing other services for clients which involve the direct or indirect transfer of money all may be included within the reach of these initiatives.

Money Laundering

Generally, money laundering is the process by which criminals disguise the origin of illegally gained money. Money that is "laundered" starts out "dirty" with the taint of illegal activity, but is cleansed through a process that completely disassociates the money with such illegal activity. Money that is laundered is either disguised, changed in form, or moved to a place where it is not likely to draw attention. Criminals whose illegal activities (drug trafficking, prostitution rings, illegal arms sales, etc.) generate large cash profits must launder their money so as to not draw attention to the underlying criminal activity that generates it.[4]

Specifically, money laundering involves a three-step process: placement, layering and integration.[5] In the placement stage, the proceeds of illegal activity are introduced into the financial system. The money may be directly deposited into an account, or monetary instruments like checks or money orders may be purchased and then deposited

[4] FATF, Money Laundering FAQ, *available at* http://www.fatf-gafi.org/document/29/0,2340,en_32250379_32235720_33659613_1_1_1_1,00.html

[5] *Id.*

into an account. The layering stage is where the money is washed of its criminal taint. Here the money launderer moves the funds from their original source in order to distance them from the criminal activity. This may be achieved in numerous ways, including through the purchase of investment instruments, by investing the funds in various apparently legitimate businesses, or by wiring funds from account to account.[6] Finally, during the integration phase, the illegitimate funds re-enter the legitimate economy and are used, among other things, to make purchases, invest in the stock market, and participate in legal business ventures.

Defeating money laundering is a priority for many governments who view quashing money laundering as essential in the fight against criminal enterprises. More recently, fighting money laundering is also seen as a tool to fight terrorism, which is also an extremely high priority for most governments after September 11.

FATF and the 2003 Gatekeeper Initiative

The FATF is an inter-governmental body of 31 member states and two international organizations originally formed to combat money laundering.[7] The primary purpose of the FATF is to implement The Forty Recommendations to Combat Money Laundering (the "Forty Recommendations") first passed in 1990, but significantly revised in 2003. The FATF also announced in its first meeting after September 11, on October 30, 2001, that it would also focus its energy on the world-wide effort to combat terrorist

[6] Juan Manuel Prieto, Presentation on Money Laundering at ACTEC meeting at Amelia Island, Florida, October 23, 2005 (copy on file with the authors and available through ACTEC).

[7] A current list of FATF members, observers and organizational bodies is available at http://www.fatf-gafi.org/document/52/0,2340,en_32250379_32237295_34027188_1_1_1_1,00.html#FATF_Members.

financing.[8] The original Forty Recommendations were not a tax initiative; rather they focused on international reporting, multilateral cooperation, mutual legal assistance, and the criminalization of money laundering. In light of the fact that the FATF possesses no legislative powers, it is important to remember that any initiatives the FATF adopts, including the Forty Recommendations, are not binding upon member states. Rather, the FATF recommends the implementation of policy and enabling legislation to combat money laundering, including sanctions against those countries that do not adhere to its recommendations.

For trust and estate lawyers, the most important aspects of the Forty Recommendations as originally passed were that they barred bank secrecy laws if they inhibited the implementation of money laundering rules;[9] required financial institutions to know their customers, verify information provided by customers, and keep records on all account transactions for at least five years;[10] required bank employees to monitor large and complex transactions with no apparent economic purpose and report to authorities any suspicions of money laundering;[11] and provided legal protection to financial institutions for reporting customers, while correspondingly preventing the

[8] FATF press release, "FATF Cracks Down on Terrorist Financing" (October 31, 2001) *available at* http://www.fatf-gafi.org/dataoecd/45/48/34269864.pdf. In October of 2001 the FATF developed the Eight Recommendations on Terrorist Financing, and a ninth was added in October of 2004. The Nine Special Recommendations on Terrorist Financing are available at http://www.fatf-gafi.org/dataoecd/8/17/34849466.pdf.

[9] Recommendation 4.

[10] Recommendations 5 and 10.

[11] Recommendations 11 and 13.

institution from informing customers that such information was disclosed.[12] The direction of the Forty Recommendations, then, was toward ending bank secrecy, toward making information available internationally concerning large money transactions, and toward requiring financial institutions to inform government authorities if they believed a customer was laundering money. These Recommendations affected, and continue to affect, the clients of trust and estate lawyers because such clients are likely to have and create accounts in financial institutions, in their own names or through trusts or companies, and they may enter into large or complex transactions that would put financial institutions on alert.

Starting in 2001, the FATF began considering whether to include under its purview lawyers, accountants, and other professionals who could be involved (knowingly or unknowingly) in the creation of companies, trusts, partnerships or other vehicles potentially used for money laundering.[13] Many FATF members speculated that money launderers in the current regulatory environment would be forced to devise more complex schemes to thwart existing anti-money-laundering initiatives.[14] The ability to successfully launder money would require criminals to seek out the expertise of certain professionals, so-called "gatekeepers", to assist in the implementation and development of disguises for the origin of their illegally-gained money without detection in such a

[12] Recommendation 14.

[13] FATF, Report on Money Laundering Typologies, 2000-2001, Par. 32 (February 1, 2001) *available at* http://www.fatf-gafi.org/dataoecd/29/36/34038090.pdf

[14] *Id.*

closely monitored environment.[15] The FATF spent the next two years proposing and debating various ways in which the Forty Recommendations might be extended to trustees, lawyers, accountants, notaries, and other professionals.[16] Thus, the Gatekeepers Initiative was born out of the sentiment that the work of various professionals, including lawyers, were aiding money launderers in the successful circumvention of anti-money laundering initiatives.

The FATF adopted The Revised Forty Recommendations (the "Revised Recommendations") in Berlin on July 20, 2003. For trust and estate lawyers the most important change brought about by the Revised Recommendations was the application of the customer due diligence and record-keeping requirements to designated non-financial businesses and professions, including trust companies and trust service providers. Under the Revised Recommendations a trust company or trust service provider is no longer able to keep records anonymously or under fictitious names, and is encouraged to be careful of "non-face to face" relationships.[17] As a result of these "know your customer" rules, it is likely that trust company and trust service providers will require that information about both grantors and beneficiaries of trusts they administer be obtained, information that most clients prefer to keep private. In addition, the Revised Recommendations force covered institutions to closely watch complex and unusually large transactions, and report any suspicions of money laundering to the relevant authorities without notifying the

[15] *Id.*

[16] FATF, Review of the FATF Forty Recommendations, Consultation Paper (May 30, 2002) *available at* http://www.fatf-gafi.org/dataoecd/32/3/34046414.pdf ; FATF, Annual Report 2002-2003 (June 20, 2003) *available at* http://www.fatf-gafi.org/dataoecd/13/0/34328221.pdf.

[17] Recommendations 5, 12 and Glossary.

customer.[18] A client who chooses to make large gifts from a foreign trust, then, could be reported to the authorities on suspicions of money laundering (by a financial institution, not by his lawyer) and not even be aware that his actions are being monitored.

The Revised Recommendations may impact a client's decision as to whether to use a private trust company.

The extension of the customer due diligence and record-keeping requirements to trust companies and trust service providers under the Revised Recommendations is likely to apply to many trust and estate lawyers. The provisions discussed above as applying to trust companies and trust service providers may also apply to lawyers giving legal advice or providing legal services, or, more likely, while acting in other capacities. The Glossary to the Revised Recommendations defines trust companies and trust services providers as all persons or businesses that are not covered elsewhere under the Revised Recommendations, and that provide the following services to third parties: i) acting as a formation agent of legal persons, ii) acting as (or arranging for another person to act as) a director or secretary of a company, a partner of a partnership, or a similar position in relation to other legal persons, iii) providing a registered office, business address or accommodation, correspondence or administrative address for a company, a partnership or any other legal person or arrangement, iv) acting as (or arranging for another person to act as) a trustee of an express trust, and v) acting as (or arranging for another person to act as) a nominee shareholder for another person.[19] Trust and estate lawyers sometimes

[18] Recommendations 13, 14.

[19] Glossary to the Revised Recommendations.

provide the services listed above for their clients, and they *frequently* assist their clients in selecting trustees. The language of this provision in the glossary, particularly subheading (iv), is ambiguous. The American College of Trust and Estate Counsel took the position in its comments filed with the FATF that there should be clear differentiation in reporting requirements between a lawyer acting solely as a lawyer in helping his or her client find a trustee, and a lawyer acting as a trustee, company director, or financial intermediary.[20] The Financial Crimes Enforcement Network of the Treasury Department has accepted this differentiation for U.S. purposes, but trust lawyers, particularly those practicing internationally in EU states (many of which have adopted these regulations), must be careful before they "arrange for another person to act" as their client's trustee.

Of further importance to trust and estate lawyers and their clients is Recommendation 12(d), which applies the customer due diligence and record-keeping requirements of the Revised Recommendations to any lawyer who prepares for or carries out transactions for a client that concern the following activities: i) buying and selling of real estate, ii) managing of client money, securities or other assets, iii) management of bank, savings or securities accounts, iv) organization of contributions for the creation, operation or management of companies, and v) creation, operation, or management of legal persons or arrangements, and buying and selling of business entities.[21] This list, both broad and encompassing, covers so many of the activities that transactional and trust

[20] ACTEC, Report in Response to the Consultation Paper Issued by the FATF on 30 May, 2002 Setting Forth the "Gatekeepers Initiative", *available at* http://72.14.203.104/search?q=cache:afAwRFNoYWUJ:www.fatf-gafi.org/pdf/REV_US-Trust%26Estate Counsel.pdf+ACTEC+money +laundering&hl=en

[21] Recommendation 12.

and estate lawyers perform on a daily basis, that one can expect that most trust and estates lawyers, and almost all large law firms, will become subject to the customer due diligence and record keeping requirements of the Recommendations as they may be enacted in various jurisdictions. Most of us, after all, in our practice represent clients in their purchase or sale of a home, or in the creation of a legal entity such as a limited liability company or a trust. All affected lawyers should be prepared to learn about and follow, and if applicable teach their employees about, the due diligence and record keeping requirements imposed by the Revised Recommendations.

In addition to the due diligence and record keeping requirements imposed upon lawyers under Recommendation 12, Recommendation 16 imposes additional reporting requirements for lawyers. It provides that lawyers, notaries, accountants and other independent legal professionals must report the suspicious activities of their clients to the appropriate authorities if their suspicions have been raised while engaging in any of the financial transactions, on behalf of the client, referenced in Recommendation 12(d) above.[22] For example, if a trust and estate lawyer assisting in a series of residential real estate transactions learns information that leads her to suspect that the client is using such purchases to launder money, and if she was not acting solely as a lawyer, but had client funds for a down payment pass through her firm's client escrow account, the lawyer must report these suspicions to the appropriate authorities. These requirements, however, are

[22] Recommendation 16.

expressly made subject to any privilege or confidentiality rules that apply to lawyers under applicable local law.[23]

It should be noted that attorney-client privilege rules in the United States are far more comprehensive than they are in many European countries, and that lawyers cannot divulge the information required under Recommendations 12 and 16 without violation of the canons of ethics under the current laws of most U.S. jurisdictions. Because their confidentiality rules are typically less protective, in some European countries a lawyer could be required to divulge to the appropriate agencies such confidential information, and therefore, trust and estate lawyers practicing abroad should become aware of the confidentiality rules in any jurisdiction in which their firm has an office.[24] For example, the recent and important decision of the House of Lords in the *Three Rivers* case clarifies the scope of legal advice privilege in the United Kingdom.[25] In his opinion, Lord Scott holds that legal advice privilege extends to advice given for presentational purposes- that is, how a client can put the best case forward in describing what he did- but <u>not</u> to advice on matters of business.[26] A lawyer practicing in the United Kingdom might therefore have to disclose suspicions of money laundering to appropriate UK authorities under the Money Laundering Regulations 2003 if they arise in regard to business or investment

[23] *Id.*

[24] Application of the rules to, for example, a U.S. lawyer who advises a French client at a meeting in London is uncertain at this time.

[25] Three Rivers District Council v. Governor and Company of the Bank of England, [2004] UKHL 48, [2005] 4 All ER 948.

[26] *Id.* at par. 38, pg. 12.

advice.[27] Those regulations impose reporting obligations on those that provide 'legal transactional services'.[28]

The above-mentioned provisions in the Revised Recommendations will only apply to lawyers if enacted into law by the country in which the lawyer practices. The EU has essentially already adopted the Revised Recommendations in EU Directive 2005/60/EC.[29] The Directive is subject to modification by the EU member states, however, so trust and estate lawyers involved in international estate planning must consult their foreign partners or colleagues in foreign firms to determine the reporting and due diligence requirements applicable to them while they advise clients resident in a foreign jurisdiction. For example, the Money Laundering Regulations that implement the EU Directive in the United Kingdom require covered parties to appoint a money laundering reporting officer, train staff, keep records of identification and enumerated transactions, and implement a system to identify money laundering and to report suspicions to the relevant authorities.[30] To date, the United States government has taken no steps to give the Revised Recommendations the force of law in the United States. The

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[27] Money Laundering Regulations 2003, Statutory Instrument 2003 No. 3075, *available at* http://www.opsi.gov.uk/si/si2003/20033075.htm.

[28] *Id.*

[29] Directive 2005/60/EC of the European Parliament and of the Counsel (October 26, 2005), *available at* http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/oj/20 05/l_309/l_30920051125en00150036.pdf. The Introduction to the Directive states: "The Community action should continue to take particular account of the Recommendations of the Financial Action Task Force … which constitutes the foremost international body active in the fight against money laundering and terrorist financing. Since the FATF Recommendations were substantially revised and expanded in 2003, this Directive should be in line with that new international standard." EU nations have until December 2007 to implement the directive.

[30] DAVID WINCH, "Money Laundering Made Simple", 154 NLJ 1720 (2004).

Revised Recommendations, therefore, are not binding upon trust and estate lawyers practicing solely in U.S. jurisdictions and advising on transactions governed by the laws of any U.S. jurisdiction. The United States Treasury, which has been given supervisory responsibility for U.S. anti-money laundering initiatives, has been reluctant to follow the FATF's lead and impose requirements on gatekeepers in general, and on lawyers in particular.

The USA Patriot Act

Congress signed the Patriot Act into law on October 26, 2001, in response to the terrorist attacks of September 11, 2001.[31] Unlike the FATF Forty Recommendations and Revised Recommendations, the Act is Federal law, currently enforced in the United States against banks, financial institutions, investment advisors, real estate professionals, and under Treasury regulations, a gradually expanding list of professional advisors.[32]

The Patriot Act, and in particular the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001 (the "Money Laundering Act"), which constitutes Title III of the Patriot Act, broadens substantially the responsibilities and potential liabilities of U.S. and foreign financial institutions with respect to countering

[31] Pub. L. No. 107-56, 115 Stat. 272, enacted as amendments to Subchapter II of Chapter 53 of Title 31 of the U.S. Code.

[32] See footnote 3. Press reports in mid-February suggest that caucuses had in Congress about several aspects of the Act, in particular those impacting the privacy of American citizens, are being addressed so that reenactment of the Act in somewhat revised form is likely. The provisions of the Act that address money laundering have not been in dispute and will likely remain in their current form.

money laundering and the financing of terrorist activities.[33] In general, it requires financial institutions to establish the due diligence policies, procedures, and controls necessary to detect money laundering in all private accounts opened and maintained in the United States.[34] Such policies include employee training and education to ensure employees are sensitive to customers and transactions that have a risk of money laundering, the adoption of various "best practices" prescribed from time to time by domestic regulatory bodies and trade organizations (such as the New York Clearing House of commercial banks), and extensive customer identification programs that require financial institutions to know their customers. Like the Forty and Revised Recommendations, the goal of the Money Laundering Act is to combat money laundering by ending bank secrecy and by requiring financial institutions to be alert to potential money laundering by monitoring and knowing their customers. Covered financial institutions and their officers, directors, and employees are required to report to the appropriate government agencies any suspicion they may have of money laundering activity in a customer account.[35] The filing of such a suspicious activity report ("SAR") protects the financial institution from any liability under Federal or State law.[36] Similar to the Revised Recommendations, the party who files a SAR is unable to warn customers that the government has been notified of their activities.

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[33] An exhaustive list and explanation of a covered financial institution's responsibilities under the Money Laundering Act is beyond the scope of this article. For more specifics on the requirements imposed see the FINCEN website: http://www.fincen.gov/index.html.

[34] 31 U.S.C. 5318(h) and (i).

[35] 31 U.S.C. 5318(g)(1).

[36] 31 U.S.C. 5318(g)(3).

The Financial Crimes Enforcement Network ("FinCEN") of the Treasury Department regulates and enforces the Patriot Act financial crime provisions. FinCEN has issued regulations that have broadened the scope of the Patriot Act to include within the definition of covered financial institutions entities or persons one would not typically include in such a definition.[37] Banks, for obvious reasons, were the initial focus of the Patriot Act. The list of covered parties is wide, however, and has been broadened over the years to include futures commission merchants, brokers and commodity trading advisors, trust companies, mutual funds, investment advisors, and numerous other participants in the financial services industry.

FinCEN has not yet extended the reach of the Patriot Act to include lawyers acting as principals in its list of covered parties. Regulations issued as of the date of this article have not addressed whether lawyers should be covered by any of the due diligence provisions of the Patriot Act, and certainly have not imposed upon lawyers the obligation to file a SAR with respect to any client's activities. Though it does not currently apply to them, lawyers must have knowledge of the Patriot Act for purposes of advising their clients. In particular, trust and estate lawyers should be familiar with the bank secrecy provisions of the Patriot Act, and how those provisions affect trust accounts and various estate planning transactions involving the transfer of large sums of money. In addition, at least in some areas (for example, real estate transactions) the Patriot Act may include lawyers participating in various transactions.[38] Lawyers must also monitor what services

[37] See, e.g. 68 FR 65392. With this final rule, futures commission merchants and introducing brokers in commodities were included in the definition of financial institutions covered by the Patriot Act.

[38] Notice of Proposed Rulemaking, 68 CFR 17569.

they provide to clients beyond their legal services, and how Patriot Act provisions might apply to them in these roles. It is extremely important for lawyers to monitor the regulations FinCEN issues moving forward in order to ensure that the reach of the Patriot Act is not extended further to cover lawyers acting as principals, or in the numerous other roles in which they act in their efforts to best serve their clients. The penalties for not following the requirements of the Patriot Act are harsh, and therefore it is important to avidly monitor Patriot Act developments.

Though it has not extended the Patriot Act to cover lawyers acting as principals, FinCEN has encouraged the American College of Trust and Estate Counsel ("ACTEC"), the American Bar Association, and other groups working with the U.S. Treasury Department to develop guidelines for their own members consistent with Section 352 of the Patriot Act. This follows the precedent the Treasury Department has set for different participants in the financial services industry, including brokers, casino operators, and cash and money wiring companies, to develop their own guidelines consistent with the requirements of the Patriot Act, based on the theory that those working in an industry are the best qualified to identify and combat money laundering in that industry. ACTEC adopted Recommendations of Good Practices for ACTEC Fellows Seeking to Detect and Combat Money Laundering at the meeting of its Board of Regents on October 24, 2005. The recommendations will be published in the Spring issue of ACTEC Notes. They are intended to provide guidance for trust and estate lawyers seeking to conduct their affairs

consistently with respect to combating money laundering. The Recommendations are only for guidance, however, and are not intended to be proscriptive.

Conclusion

September 11 brought increased attention to the issue of terrorist financing, and governments and international bodies have responded by increasing the reach of various initiatives that combat money laundering. These new rules and regulations have increasingly focused on lawyers and other professionals in their roles as so-called "gatekeepers" because it is believed that lawyers, notaries, accountants and other professionals have the ability to assist clients, knowingly and unknowingly, in moving money through the three phases of money laundering. Under one international initiative, the FATF's Revised Recommendations, enacted in some form in most European jurisdictions, lawyers have relatively broad obligations to perform client due diligence, keep records and in some cases report suspicions of money laundering. Any trust lawyer practicing in a firm with a foreign office should become familiar with these Recommendations.

Regulations promulgated by FinCEN under the USA Patriot Act have not yet swept lawyers acting as principals under the purview of the USA Patriot Act. Lawyers based solely in the United States with a strictly domestic practice, then, may not yet be subject to any requirements that they report suspicions of money laundering, or comply with customer due diligence requirements. All lawyers, however, should closely monitor any changes or developments in this area. Penalties for non-compliance are harsh, so trust and estate lawyers may wish to follow the recently published ACTEC Recommendations of Good Practices, or other guidelines published by the ABA or

similar groups, to ensure they are not assisting with or complicit in the money laundering activities of their clients.