PROFESSIONAL ETHICS AND DUE DILIGENCE

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by Bruce Zagaris

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I. INTRODUCTION

The professional ethics concerning a lawyer and his or her duty to perform due diligence on a prospective or existing clients has and continues to undergo tremendous changes. Throughout the world legislatures and bar associations are having to modernize the legal professions act.

An international initiative known as the Gatekeeper Initiative continues to gain momentum and increasingly impacts professionals, such as lawyers and accountants, who deal with transactions involving the movement of money and the structuring of entities that can be involved in handling money. Gatekeepers are persons who deal with transactions involving the movement of money and therefore are deemed to have a special role in identifying, preventing, and reporting money laundering. The idea behind the initiative is to broaden anti-money laundering due diligence beyond banks and financial institutions to certain non-designated professionals.

The Gatekeeper Initiative originated at the Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime in 1999 in Moscow. The Gatekeeper Initiative simultaneously threatens professionals with criminal penalties for failing to adhere to emerging standards of anti-money laundering (AML) due diligence and provides opportunities for lawyers to expand the practice area of due diligence. The convergence of emerging threats and opportunities poses challenges for bar associations. In June 2006, the FATF issued a report on U.S. compliance with international AML requirements. The report found the U.S. non-compliant with the AML gatekeeper requirements.

American lawyers are caught between adhering to the anti-money laundering (AML) and counter-terrorist financing (CTF) laws of foreign, especially, European governments, which have criminal penalties for not identifying and making suspicious activity reports concerning their clients, and adhering to the professional ethical rules of their states, which require them to obey the requirements of client confidentiality and zealously represent their clients. Similarly, clients are finding that, depending on the jurisdiction in which they employ legal professionals to undertake certain services, such clients can secure a higher level of confidentiality and that the law and ethics standards require different conduct from legal professionals. Legal professionals and their clients find increasingly that the law and ethics applying to a wide range of services fall into a gray area.

This short paper addresses questions on professional ethics and due diligence suggested in the conference guidelines to the panelists.

II. THE ROLE OF THE LAWYER AS THE CONFIDENTIAL ADVISER TO A CLIENT

Clearly the traditional role of the lawyer as the confidential adviser to a client has changed and is currently undergoing a significant change. Although a lawyer has always owed a duty to not only his client, but also the legal system and his regulator/government, globalization is exerting tremendous pressure on the different obligations of a lawyer.

The differing standards of secrecy and financial privacy that results from differing laws and cultures make advising clients in international matters a challenge. International conventions and initiatives by international organizations increasingly require governments to apply gateways to override secrecy and financial privacy. For example:

Article 7(5) (Mutual Assistance) of the 1988 U.N. Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, which provides as follows:

> A Party shall not decline to render mutual legal assistance under this article on the ground of bank secrecy.

The 1990 40 Recommendations of FATF, provides that:

> Financial institution secrecy laws should be conceived so as not to inhibit implementation of the recommendations of the group (Principle 2).
>
> Financial institutions should not keep anonymous accounts or accounts in obviously fictitious names... (Principle 12)
>
> Financial institutions should take reasonable measures to obtain information about the true identity of the persons on whose behalf an account is opened or transactions on their behalf, in particular, in the case of domiciliary companies (i.e. institutions, corporations, foundations, or trusts, that do not conduct any commercial or manufacturing business or any other form of commercial operation in the country where their registered office is located) (Principle 13).

Similarly, FATF requirements obligate financial institutions and other covered persons to identify customers and make suspicious activity reports (SARs) to Financial Intelligence Units (FIUs), while requiring FIUs to both on request and spontaneously exchange SARs information. The Revised FATF Recommendations further consolidate the requirements to increase transparency and information exchange. They provide far greater detail concerning know your customer and related due diligence measures such as identifying and reporting SARs.[2]

More recently the OECD has issued reports on improving access to bank information for

[2] FATF, The Forty Recommendations (June 20, 2003).

tax purposes[3] and on the misuse of corporate vehicles for illicit purposes.[4] The latter report focuses on the misuse of corporate vehicles for money laundering, bribery/corruption, improper insider dealing, illicit tax practices, and other misconduct. It focuses on the development of mechanisms for regulators/supervisors and law enforcement authorities in the so-called tax havens to obtain information on beneficial ownership and control (for companies), and on the identity of settlors (and protectors and beneficiaries) for trusts. The report discusses possible mechanisms for information sharing between tax authorities, including those in the so-called tax havens.

In 1998 and 2000 the Edwards Report[5] and the KPMG Report,[6] commissioned by the United Kingdom, recommended increasing the authority of the regulatory bodies and other authorities in so-called tax havens to investigate companies and trusts, and share information with other authorities through information "gateways."

Starting in 1998, the OECD initiated its harmful tax competition initiative. The report focused on geographically mobile activities such as financial services. Its purpose was to counter the erosion of tax bases in many countries due to alleged improper tax competition through a lack of transparency and the availability of preferential tax regimes, such as zero or low tax rates. Two of the principal components in the initiative were increased transparency and increased exchange of tax information among national tax authorities. While part of the initiative was reduced at the strong request of the Bush Administration, the components on transparency and exchange of information remain. In that regard, the OECD started the Global Tax Forum and developed model exchange of information agreements.

Meanwhile, international organizations, including the OECD, Council of Europe, the U.N., and the Organization of American States have elaborated anti-corruption conventions that also call for, *inter alia*, increased transparency and gateways on financial confidentiality in order to cooperate internationally.

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3 OECD, *Improving Access to bank Information for Tax Purposes*, April 12, 2000 (available at www.oecd.org//daf/fa/evasion/accessbankinf.htm).

4 OECD Steering Group on Corporate Governance, *Misuse of Corporate Vehicles for Illicit Purposes* (May 2001) (for more information on the report see www.oecd.org).

5 Review of Financial Regulation in the Crown Dependencies (also known as the Edwards Report) (Nov. 1998). The review was done to reassure ministers and others as to whether the Crown dependencies were respectable financial centers. For background *see* Tim Bennett, INTERNATIONAL INITIATIVES AFFECTING FINANCIAL HAVENS 37 (2001).

6 Review of Financial Regulation in Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Montserrat, and Turks & Caicos (known as the KPMG Report) (Nov. 2000).

Increasingly, both in the late 1990s and more recently, the IMF and World Bank Group have called for greater transparency. They have argued for more transparency in response to problems including the contagion effect of financial abuses and crises, corruption issues, and the new international financial architecture. More recently, they have explicitly cited anti-money laundering as a reason for increasing transparency.[7]

The above provisions show that since the early 1990s international conventions and international standards have required gateways to overcoming secrecy. Even where these requirements are only "soft law," international organizations, such as FATF and the IMF have developed initiatives, such as black lists and requirements whereby financial institutions must give enhanced scrutiny to transactions from countries whose anti-money laundering systems and standards do not conform to international standards. The combination of soft and hard law mean that real sanctions exist for countries, financial institutions, and categories of transactions or laws that do not meet international standards.

Much of the loss of financial confidentiality and secrecy emanates from national laws. For instance, in 2000, the U.S. Department of Treasury proposed a new U.S. withholding tax regime – the Qualified Intermediary Rules – which took effect January 1, 2001.[8] The new regulations supplant the "last address" system for receiving dividend and interest payments. Instead, the recipients must fully disclose to either the IRS or a Qualified Intermediary (QI) the name, address, and other details of the "beneficial owner" of U.S. financial assets held offshore.

An important exception to the disclosure obligations occurs when the international bank or financial institution effectively assures the IRS that they and their jurisdiction can be trusted, and is then accorded QI status. A bank or financial institution becomes a QI when it concludes a six-year QI agreement with the IRS to undertake certain due diligence with its customers. In return, the IRS substantially reduces disclosure and reporting requirements. In addition, the QI can keep the identity of its non-U.S. customers and account holders confidential from the IRS. The QI regime indicates one of the recent unilateral initiatives to override financial secrecy and confidentiality. These are discussed further in the following section.

The enactment of the Sarbanes-Oxley Act in the U.S. requires the management of public companies to detect and precisely report material changes in the financial mechanisms of their corporations. This law imposes new pressures to detect, correct and report defects in a company's accounting, tax, anti-money laundering, and anti-corruption programs, as well as other programs affecting good governance.

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7 *See*, e.g., Paul Allan Schott, REFERENCE GUIDE TO ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM (World Bank 2003)

8 *See*, e.g., IRS Notices 2001-4, Notice 2001-11, and IRS Announcements 2000-48 and 2001-15.

The European Union has adopted instruments to protect individuals with regard to the processing and transfer of personal data. In particular, Common Position (EC) No./ 95 adopted by the Council on February 20, 1995 with a View to Adopting Directive 94/ /EC of the European Parliament and of the Council on the Protection of Individuals with Regard to the Processing of Personal Data and on the Free Movement of Such Data, Directive 95/ /EC of the European Parliament and of the Council of On the Protection of Individuals with regard to the Processing of Personal Data and on the Free Movement of Such Data, and Directive 95/46/EC of the European parliament and of the Council of October 24, 1995 on the Protection of Individuals with regard to the Processing of Personal Data and on the Free Movement of Such Data are examples of the steps taken in the EU to protect personal data.

The EU has clashed with the Bush Administration over violations to the privacy directive, especially in the context of violations by the Bush Administration in surveillance of the SWIFT data exchanged. Since February 2007, negotiators from the U.S. and EU have negotiated and largely agreed on draft language for twelve major issues central to a "binding international agreement" which would clarify that it is lawful for European governments and companies to transfer personal information to the U.S. and *vice versa*.[9]

III. THE ROLE OF LAWYERS IN THE FIGHT AGAINST MONEY LAUNDERING AND AN EXPLANATION OF THE NEW DUTIES ON LAWYERS IN THE U.K. AND THE U.S.

Much of the approach to anti-money laundering due diligence is set forth in the action of the American Bar Association (ABA). In a resolution the ABA recognized that anti-money laundering and anti-terrorist financing initiatives are important and that law enforcement authorities believe more tools are needed to combat criminal money laundering and terrorist financing activities. Specifically, given the increasing complexity of anti-money laundering laws and international business transactions, the ABA believes a significant role exists for the organized bar in promoting education of the profession regarding the legal requirements, risks, "red flags" and ways to avoid inadvertent involvement in illicit activity. In this regard, the ABA has made a collaborative effort with U.S. government officials, other non-governmental organizations, and other bar associations (within the United States and elsewhere) to increase awareness and understanding of legal professionals throughout the world on these issues.

The ABA embraces the concept of providing reasonable compliance training to legal professionals and ensuring opportunities for legal professionals to seek advice regarding compliance. Of course, as in any training and compliance situation, the nature and content of such training needs to take into account the circumstances of individual practitioners, in terms of their practice specialty, the risk of money laundering activity in their client representations, the existing ethical rules to which they are subject, their economic circumstances, and the

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[9] Charlie Savage, *U.S. and Europe Near Agreement on Private Data*, N.Y. TIMES, June 28, 2008, at A1, col. 6.

institutional structure of their practice. In this regard, the ABA also believes that lawyers should conduct reasonable due diligence on their clients, consistent with existing ethical rules and practice within the profession, to minimize the risk of involvement in any illegal money laundering activity.

Finally, the ABA believes that bar associations, professional ethics committees, and the courts should continue to have the responsibility for policing the professional conduct of lawyers. The practice of law requires ethical conduct by the members of the profession. The ABA has long upheld the highest ethical standards for lawyers licensed to practice within the United States. According to the ABA, no demonstrable need exists to deviate from this tradition and system of oversight in the area of money laundering. Existing laws that are fully applicable to individual members of the profession provide a compelling incentive to lawyers to comply with U.S. government anti-money laundering requirements. Combined with high ethical standards, education, training, and continuing use of disciplinary procedures within the profession, there is little likelihood of the legal profession becoming a weak link in the fight against international money laundering and terrorist financing.

In addition to the FATF revised recommendations, U.S. legal professionals are challenged by a series of developments in the United States. The U.S. Government Accountability Office (GAO) has issued reports showing problems with incorporation procedures in all U.S. states. The report found that inadequate procedures existed in obtaining and verifying information about beneficial ownership of business entities and that when foreign governments request assistance from the U.S. in criminal cases, the U.S. is unable to help because state corporate registries do not have the information.

Notwithstanding the ABA resolution and stand, members of Congress have introduced legislation on corporate transparency that would force states that are in charge of registering corporations to require minimum standards of transparency and maintenance of records on corporate formation agents, who often are lawyers.

IV. THE PROCESSES THAT LAWYERS IN THE U.K. AND U.S. HAVE TO UNDERTAKE WHEN "TAKING ON" NEW CLIENTS

On almost a daily basis lawyers throughout the U.S. are approached to help with sending money abroad, advising on transnational securities or real estate transactions, establishing or advising a non-profit organization whose purposes may include helping foreign affiliates. U.S. lawyers and all businesses on a daily basis are asked to advise on transactions that may violate the prohibition of dealing with persons on the Special Designated National list of the Office of Foreign Asset Control, U.S. Department of the Treasury (OFAC). The list includes not only individuals, but entities. The OFAC regulations prohibit all U.S. businesses, including lawyers and legal professionals, from engaging in transactions with certain specified persons (individuals and entities). These include persons (e.g., terrorists, drug traffickers, and nuclear proliferators) and countries (e.g., Cuba and Syria). However, the individuals often have foreign names with multiple spellings; the companies often have myriad branches and affiliates. Depending on the precise name and location of their headquarters or place of business, the U.S. lawyers may have enforcement problems of their own. Indeed, the esoteric and complicated areas of AML and CTF regulatory and enforcement laws are increasingly overlapping and converging.

Title III of the USA PATRIOT Act, enacted in October 2001, contains a provision requiring the Treasury Department to promulgate anti-money laundering requirements for persons involved in certain real estate transactions. Regulations pertaining to the real estate industry have been delayed as the Treasury Department is continuing to consult with industry and determine how best to implement this portion of the statute.

U.S. lawyers must comply with the requirements of the Sarbanes-Oxley Act. Sarbanes-Oxley Act of 2002, 15 U.S.C. §§ 7201 *et seq*., mandates the Securities and Exchange Commission ("SEC") to prescribe minimum standards of professional conduct for attorneys appearing and practicing before the SEC. These standards are to include a rule requiring an attorney to report evidence of a material violation of U.S. securities laws or breach of fiduciary obligation duty or similar violation by a corporate issuer to the chief in-house legal counsel or chief executive officer; and in some circumstances to report to the board of directors or a subcommittee of the board. On December 2, 2002, the SEC published a proposed rule regarding this aspect of the Sarbanes-Oxley Act. See 67 Federal Register 71669-71707 (Dec. 2, 2002).

U.S. jurisprudence, as discussed below, means that pursuant to the requirements and implications of *Pasquantino v. United States* ((03-725) 544 U.S. 349 (2005); 336 F.3d 321, affirmed), U.S. lawyers can be prosecuted for helping persons commit crimes against foreign tax law.

A. Suspicious Activity Reports

A major difference between the U.S. and the U.K. AML regimes is that U.S. lawyers do not have to make suspicious activity reports (SARs).

One of the essential elements of the American legal system is the independence of the legal profession from government regulatory and enforcement authorities. The United States Supreme Court has repeatedly underscored the importance of the legal profession, and its independence, to the administration of justice in the United States.[10] "An independent judiciary

[10] *See, e.g., In Re McConnell*, 370 U.S. 230 (1962) (reversing the conviction of an attorney for criminal contempt); *see also, Sacher v. United States*, 343 U.S. 1, 39 (1952) ("Our whole conception of justice according to the law, especially criminal justice, implies an educated, responsible, and independent Bar.") (Frankfurter, J., dissenting).

and a vigorous, independent bar are both indispensable parts of our system of justice."[11] Indeed, the Supreme Court has noted that the vitality of our judicial system and our judges depends in part on informed and independent lawyers. As Chief Justice Warren Burger and then-Justice William Rehnquist observed: "The very independence of the lawyer from the government on the one hand and the client on the other is what makes law a profession....It is as crucial to our system of justice as the independence of judges themselves."[12]

Lawyers in the United States are not, and cannot be, agents of the U.S. government. Rather, they are independent professional positioned between the state and the persons under its jurisdiction. However, lawyers effectively will be transformed from trusted counselors into potential government informants if the U.S. government mandates that they report any suspicious activities or transactions of their clients, even when those clients may be coming to the lawyer to seek legitimate legal advice to ensure compliance with the law.

The relationship of trust between an attorney and a client is expressed in numerous existing laws and ethical rules, including the ABA Model Rules of Professional Conduct ("Model Rules") and the ethical rules adopted by the states to govern lawyers' professional conduct. These laws and rules govern the attorney-client relationship and prescribe the limited instances in which disclosure of confidential information relating to a client is permissible.

Two duties essential to the trust relationship between the attorney and the client are the lawyer's duty of loyalty and the obligation of confidentiality to the client. Each of these is expressed in the Model Rules. The lawyer's duty of loyalty to the client is expressed in Model Rule 1.2, which requires an attorney to abide by the client's decisions and represent the client's interests above all else unless the attorney knows the client's conduct is unlawful or unethical. The duty of loyalty is also expressed in Model Rules 1.7 through 1.11, which prohibit attorneys from representing clients in the face of conflicts of interest. Clearly, to require a lawyer to disclose client information based on an undefined concept of "suspicion." particularly where the lawyer is facing criminal sanctions for failure to report and cannot even inform the client of any such disclosure, flies in the face of the duty of loyalty, creates conflicts, and therefore necessarily compromises the independence of the bar vis-à-vis the state.

Similarly, the attorney's obligation of confidentiality is expressed in Model Rule 1.6. This rule prohibits an attorney from revealing "information relating to representation of a client unless the clients consents after consultation" subject to certain limited exceptions set forth in subsection (b) of the rule. This obligation of confidentiality extends well beyond the notion of

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[11] *In Re McConnell*, 370 U.S. at 236. *See also Legal Services Corporation v. Velaquez*, 531 U.S. 533, 545 (2001) ("An informed, independent judiciary presumes an informed, independent bar.").

[12] *Application of Griffiths*, 413 U.S. 717, 732 (1973) (Burger, C.J. & Rehnquist, J., dissenting).

"privileged" information. And the exceptions to the obligation are based on an attorney's "knowledge" of intended unlawful activity of a grave nature, where fraud is being perpetrated on a tribunal of the law, or where the attorney is entitled to necessary representation.

The comments to Model Rule 1.6 explain the basis for this rule:

> "A fundamental principle in the client-lawyer relationship is that [in the absence of the client's informed consent] the lawyer maintain confidentiality of information relating to the representation.... The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter….Almost without exception, clients come to lawyers in order to determine what their rights are and what is, in the maze of laws and regulations, deemed to be legal and correct. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld."[13]

In 2000, the ABA liberalized Rule 1.6. It considered but did not adopt provisions that would permit disclosure "to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another" if the lawyer's services have been used in furtherance of that activity, or to "prevent, mitigate, or rectify" such financial or property damage "that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services."[14]

A lawyer can voluntarily make disclosures under these circumstances. Additional efforts to liberalize Rule 1.6 engendered controversy. Opponents of revising the rules contended lawyers would incur increased liability and legal inquiries into whether the lawyer "should have known" of the crime or fraud when in reality the lawyer is likely to have knowledge only after the fact. In addition, the proposed rule has a whistle-blower element to the ethics rules that may result in a lawyer disclosing for fear of guessing wrong about the client's activities or intentions. Another problem is that expanding the circumstances in which the lawyer could disclose client confidences would create an additional impediment to trust between lawyer and client, reducing the likelihood that the lawyer would be able to counsel the client to comply with the law.[15]

The obligation of confidentiality is also expressed in the attorney-client privilege. As the oldest common law privilege for confidential communications, dating back well before the U.S. Constitution to 16th century England, the privilege is indispensable to the lawyer's function as advocate on the theory that the advocate can adequately prepare a case only if the client is free to

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13 MODEL RULES OF PROF'L CONDUCT, RULE 1.6, comments 3, 4, and 9 (1983).

14 *Id.*, Proposed Rule 1.6 at 42.

15 *Id.*, Minority Report at 8.

disclose everything.[16] However, the importance of the privilege extends well beyond litigation and advocacy of a client's interests. Just as important, the privilege ensures that the "legal counselor can properly advise the client what to do" since this requires that the client is "free to make full disclosure" to his/her counselor.[17] The Supreme Court explained in its seminal decision concerning the attorney-client privilege that the purpose of the privilege is to "encourage full and frank communication between attorneys and their clients, [which in turn] promote[s] broader public interests in the observance of law and administration of justice."[18]

The ABA believes that a requirement that lawyers report suspicious transactions or activities regardless of the interests of their clients will undermine the essential confidentiality of communications between clients and lawyers, and thereby adversely affect the administration of justice and the interests of society in promoting adherence to the rule of law. Even if the Gatekeeper Initiative were to include an exception for "privileged" communications, such an exception would not extend to the full panoply of information provided by a client to an attorney for purposes of representation or seeking advice. The attorney would be duty-bound to inform the client, at the outset of a representation, that some quantum of information, which may raise a "suspicion" in the attorney's mind, could be disclosed to the government. This will lead to apprehension in clients -- clients who are seeking advice for current and prospective compliance with the law, clients who may have engaged in activity that violated the law but wish to obtain advice on their exposure and possible remedial actions, clients who are under investigation or fear prosecution and need appropriate representation -- and cause such clients to forego legal advice and representation. As the Court of Appeals for the Ninth Circuit has observed:

"[The] valuable social service of counseling clients and bringing them into compliance with the law cannot be performed effectively if clients are scared to tell their lawyers what they are doing, for fear that their lawyers will be turned into government informants."[19]

This is all the more true today, as the world becomes increasingly complex and interdependent; as the laws in the United States and elsewhere become more pervasive and complicated in dealing with the intricacies of commerce, new social issues, and the rights of individuals; and as the U.S. government and other governments promote the rule of law throughout the world as the preferred method for dealing with relationships among individuals, entities and governments.

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16 John Henry Wigmore, EVIDENCE IN TRIALS AT COMMON LAW, § 2290, at 542 (McNaughton Rev. 1961).

17 Geoffrey C. Hazard, Jr., <u>An Historical Perspective on the Attorney-Client Privilege</u>, 66 CAL. L. REV. 1061, 1061 (1978).

18 *Upjohn Co. v. United States*, 449 U.S. 383, 389 (1981).

19 *United States v. Chen*, 99 F.3d 1495, 1500 (9th Cir. 1996).

The attorney-client privilege and the integrity of the attorney-client relationship have both foundation and support in various aspects of the Constitution. The Sixth Amendment to the Constitution guarantees individuals effective assistance of counsel in criminal proceedings, for example, as noted above, in permitting a client faced with potential criminal prosecution to secure adequate legal advice on the best course of conduct to follow. Government mandates that intrude on the confidentiality of the attorney-client relationship may, in some circumstances, raise legitimate Sixth Amendment concerns. Indeed, in discussing the issue of whether a lawyer can be required to check a box on IRS Form 8300 (a form that requires U.S. persons, including lawyers, to report receipt of over $10,000 in cash) to indicate if the receipt of the cash was "suspicious", the U.S. Court of Appeals for the Eighth Circuit noted "the serious Sixth Amendment implications of [the] claim that an attorney becomes a de facto agent for the government when compelled to offer an opinion as to whether a particular cash payment was a 'suspicious transaction'."[20]

There also are potential Tenth Amendment concerns with any U.S. government mandate that lawyers file STRs with the federal government. As has been noted by the Supreme Court:

> "Since the founding of the Republic, the licensing and regulation of lawyers has been left exclusively to the States and the District of Columbia within their respective jurisdictions. The States prescribe the qualifications for admission to practice and the standards of professional conduct. They also are responsible for the discipline of lawyers."[21]

In view of the above, if the U.S. government were to issue anti-money laundering requirements applicable to lawyers, especially a requirement that could conflict with a state-administered ethical requirement pertaining to maintaining client confidences and privileged information, there could be an issue under the Tenth Amendment to the Constitution. The federal government has successfully asserted regulatory jurisdiction over lawyers in various instances. The Supreme Court has ruled on several occasions that lawyers can fall within the regulatory ambit of the federal government.[22] However, these cases have concerned situations

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[20] *United States v. Sindel*, 53 F.3d 874, 877 (8th Cir. 1995). It is noteworthy that the Court was only addressing the issue of checking a box to indicate a "suspicious transaction." Form 8300 does not require any disclosure of information regarding the suspicious transaction, as would be required in the context of the Gatekeeper Initiative. *See also In re Grand Jury Subpoenas*, 906 F.2d 1485, 1488 (10th Cir. 1990).

[21] *Leis v. Flynt*, 439 U.S. 438, 442 (1979) (per curiam).

[22] *See*, *e.g.*, *Goldfarb v. Virginia State Bar*, 421 U.S. 773 (1975) (noting that a county bar association is subject to federal anti-trust regulation in its commercial activities); *Sperry v. State of Florida*, 373 U.S. 379 (1963) (holding that while a non-lawyer's practice of patent law may constitute the unauthorized practice of law within Florida, a federal statute nonetheless authorized a Florida non-lawyer person to practice before the federal Patent Office).

where the lawyer's conduct was commercial in nature and indistinguishable from other non-lawyer personnel subject to the same regulatory policy. These cases do not explicitly address federal regulation that intrudes a core authority of the state vis-à-vis the attorneys it licenses to practice within its jurisdiction, especially where the state authority pertains to ethical requirements pertaining to the integrity of the attorney-client relationship.

Independent of the serious legal and public policy concerns with imposing a mandatory STR requirement on lawyers, there are a number of important practical considerations that have not been addressed by the U.S. government or otherwise given sufficient attention. First, as noted earlier, there is not likely to be any specific or clear definition of when information received by an attorney raises a "suspicion" of possible money laundering or other criminal activity. The concept of "suspicion" is a malleable one, and is likely to be left to the individual interpretation of each lawyer subject to any such requirement. As such, it will result in uneven application and interpretation across the legal profession. The U.S. government may even consider that lawyers report instances where they "should have been" suspicious based on information received from a client. Imposing an objective notion of "suspicion" on lawyers will mean only more difficulty for attorneys trying to adhere in good faith to any such disclosure requirement.

Second, the anti-money laundering laws of the United States are complex and comprehensive. There are over 100 criminal offenses that constitute predicate acts of "specified unlawful activities" ("SUAs") that can trigger a money laundering offense. In all likelihood, the list of SUAs will continue to grow. Attorneys not intimately familiar with the nuances of U.S. anti-money laundering law will be at risk of criminal prosecution or civil liability if they fail to identify all possible permutations of a money laundering offense in each client representation they undertake. In effect, lawyers have increasingly been a target of prosecution for money laundering offenses even though they do not have STR requirements.

Third, the vague and imprecise notion of "suspicion" along with the breadth and complexity of U.S. anti-money laundering laws likely will cause many lawyers to decline representations due to unknown personal risks under any mandatory STR regime backed up by criminal sanctions. This will cause clients to lose access to lawyers, including even for advice on anti-money laundering and related matters. In the alternative, lawyers will "over report" information acquired from their clients – adding to the already substantial number of suspicious activity reports ("SARs") filed each year with the Financial Crimes Enforcement Network, and which largely go ignored or without further action.

Fourth, there are many unanswered questions regarding what an attorney should do if he/she files an STR regarding a client. Should the lawyer withdraw from the representation, without explanation which would be required under the "no-tipping off" rule? Would withdrawing, even without explanation, constitute "tipping off"? What if the lawyer withdraws from the representation, causing the transaction or representation to proceed in a manner adverse to the client – would the lawyer be liable for breach of contract or malpractice, particularly if the

U.S. government takes no action on the STR or otherwise determines that the information does not raise a risk of money laundering? What if the lawyer remains engaged in good faith with the client, and the U.S. government later determines that the client was engaged in money laundering – is the lawyer at risk of money laundering complicity based on his/her "suspicion" as evidenced by the STR?

Fifth, there is the issue of cost for the legal profession and the clients, as well as the cost and availability of insurance in the event of a mandatory STR regime. Government regulators involved in the Gatekeeper Initiative often point to banks as entities that have accepted and managed STR (or SAR) requirements. However, the vast majority of lawyers in the United States are solo practitioners or work in small law practices. Unlike the large banks, they do not have the institutional resources to implement extensive anti-money laundering requirements, such as those pertaining to STRs. Unlike banks, most law firms do not have an independent commercial need for sophisticated data transfer networks and software that can track and correlate hundreds of pieces of information to determine whether a particular transaction is "suspicious." Even if possible, the costs of these requirements will likely impact the cost of legal services, making such services more expensive, less available to the disadvantaged or less fortunate, and perhaps uninsured for some practitioners.

Finally, there has been little if any assessment by the FATF, international organizations, U.S. government or other regulatory authorities of the costs and benefits of the STR requirement as applied to the legal profession. Information regarding the deliberate or accidental involvement of lawyers in money laundering activities is scarce and virtually all anecdotal. As noted earlier, lawyers can be and have been prosecuted, convicted and disbarred for money laundering activity and complicity. There has been little explanation of the objectives or additional benefit to be achieved by applying an STR requirement to lawyers, and there has been no assessment of the economic, social, and client-related consequences of any such requirement. In short, for as serious and sweeping a proposal as this presents to the administration of justice, the breadth and level of analysis is clearly inadequate.

In sum, the ABA believes that many difficult questions, potential costs, and unintended trade-offs or consequences would arise if the U.S. government were to impose a mandatory STR requirement on the profession. The absence by the FATF, international organizations, or U.S. government has undertaken any meaningful examination, consideration, or cost-benefit analysis of these issues. Any such effort would take a substantial amount of time and dialogue with the legal profession throughout the United States. At a minimum, this should be done before the U.S. government formulates any policy on the Gatekeeper Initiative. Overcoming the practical problems with an STR requirement does not necessarily mean that mandatory reporting advances the broader public interest. Indeed, any such cost-benefit analysis concerning the practical difficulties must be sensitive to the fact that mandatory disclosure could lead to less compliance with U.S. law and a weakening of the system of justice within the United States.

B. Self-Regulatory Organizations

A difference between the U.S. and British approaches to "Know Your Client" (KYC) and due diligence generally is in the efforts of the self-regulatory organization (SROs). In every country between the regulators and the lawyers is an SRO. In the U.K., the Law Society of England and Wales was both regulator and representative body for English and Welsh solicitors. The newly formed Solicitors Regulation Authority (SRA) has independently taken on the Law Society's regulatory role. There are over 250 pages of due diligence requirements.

An enormously important issue in the United States is whether the U.S. can locate, fund, and develop capacity for SROs. Until now, the self-regulatory organization in the U.S. has been the state bar. State bars license, oversee the conduct, and, if complaints arise with respect to the conduct of their members, bar associations investigate and convene hearings to determine if any wrongdoing occurred by members of the bar, and, if so, the discipline if any that should be imposed. SROs are also the disseminators of regulatory information who help educate and conduct training. Until now, the ABA and state bars have mainly monitored the FATF standards and have held seminars to advise their members of the legal and ethical issues. The ABA has developed a policy recommendation on the FATF standards and sent representatives to the meetings held with FATF. The U.S. government has interacted closely with the ABA with respect to the FATF standards and the role of lawyers and bar associations. More recently, the ABA has emulated the American College of Trust and Estate Counsel in preparing good practice standards. However, the ABA has not yet hired any staff to deal with the AML/CTF standards even though they continue to proliferate and require very specific and detailed due diligence policies for law firms.

V. EXAMPLES OF SUCCESSES AND FAILURES AND EXAMPLES OF THE WAY THE RULES ON KNOWING YOUR CLIENT HAVE IMPACTED THE CLIENTS AND LAW FIRMS THEMSELVES

Law firms who properly utilize KYC procedures are able to eliminate representation of clients whose purposes are criminal. These procedures allow law firms to avoid criminal prosecution, regulatory action, and potential ethics issues. Conversely, a number of law firms or lawyers in the U.S. who have not properly conducted KYC have been prosecuted and some have been convicted. U.S. prosecutors do not hesitate to prosecute lawyers who knowingly engage in money laundering.

Many of the U.S. lawyers who have been convicted of money laundering helped defendants in criminal cases to conceal that the funds used to pay the lawyers came from illegal proceeds. Many of the cases have been drug trafficking cases. For example, solo practitioner Luis Flores in Queens, New York established corporations and bank accounts, listing himself as president, signing checks and arranging transfers of funds on behalf of his client, German Altamirano-Leon, in amounts just short of the $10,000 limit that would trigger federal reporting requirements. Most of the money ended up in the hands of Colombian drug cartels.

Circuit Judge Thomas Ambro, joined by fellow appeals judge Marjorie Rendell and Norma Shapiro, of the Eastern District of Pennsylvania found that fake Social Security numbers, the structuring of the cash transfers and other evidence "created in Flores an objective awareness of the high probability that Altamirano was involved in money laundering."

In October 2004, Flores was convicted of money laundering, conspiracy to launder money and conspiracy to structure transactions. U.S. District Judge Anne Thompson sentenced him to 32 months in jail and a $17,000 fine in January 2005.

One of Flores' arguments on appeal was that the prosecution had to prove he was aware that the money was being laundered from a specific illegal activity – in this case, drug trafficking. The appeals court said it was enough that Flores "knew of or was willfully blind to the fact that the funds originated in some form of unlawful activity." It also upheld the sentence, noting that the sentencing guidelines called for a presumptive 70- to 87-month term.[23]

Another example is the March 12, 2008 resignation of New York Governor Eliot Spitzer, which arose out of his making a number of cash transactions that triggered suspicious transactions reports by the banks receiving his deposits and were ultimately linked by the U.S. FIU with offshore shell companies that received the money.[24] As a result of the investigation, four individuals had a criminal complaint filed against them. Two were charged with a conspiracy to violate federal laws related to prostitution. The other two face charges of prostitution and money laundering.[25] Spitzer is at risk over allegedly transferring funds via interstate commerce and thus helping to further a criminal enterprise. Prostitution charges are possible under state law.[26] The Spitzer incident indicates the value of the use of suspicious transactions, the analysis of such data by the FIU, and then the transfer to and further investigation by law enforcement to prosecute a multi-state prostitution ring, using offshore shell companies and receive and conceal payments by wealthy customers.

The Spitzer incident is perhaps the example simultaneously of success and failure. The success is the utility of requiring cash reporting, suspicious transactions, and cooperation between the FIU and law enforcement. Another success is that, despite Spitzer's powerful position, he quickly resigned from office and still faces likely prosecution. The failure is that,

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23 Mary P. Gallagher, *3rd Circuit Upholds Lawyer's Conviction in Scheme to Launder Drug Money* NEW JERSEY LAW JOURNAL, Aug. 7, 2006

24 Michael M. Grynbaum, *Spitzer Resigns, Citing Personal Failings*, N.Y. TIMES, Mar. 12, 2008.

25 Alan Feuer, *Four Charged With Running Online Prostitution Ring*, N.Y. TIMES, Mar. 7, 2008.

26 Brian Baxter, *What's Next for Spitzer?, New York governor facing legal challenges for alleged ties to prostitution ring*, THE AMERICAN LAWYER, Mar. 10, 2008

notwithstanding draconian laws, even the highest level politicians have limitations and engage in wrongdoing.

A success in the gatekeeper initiative is that a legal professional for a public company under investigation under Sarbanes-Oxley noticed that his company was paying one of its vendors in a former Soviet country through offshore entities. The question arose whether this arrangement, which was common in the industry, violated the laws of that country, especially since it was undergoing a number of anti-corruption and tax compliance reforms. The legal professional convened meetings of its U.S. and U.K. lawyers. Interestingly, the U.K. lawyers opined that, notwithstanding U.K. proceeds of crime law, the continuation of the arrangement was proper. I concluded that because of the *Pasquantino* case and the ongoing Sarbanes-Oxley investigation that, if the arrangement was a crime in the former Soviet country, the U.S. public company had potential criminal liability. We could not obtain a solid opinion about the legality of the arrangement in the former Soviet country. As a result, the U.S. public company determined to stop the arrangement even though it would suffer adverse commercial consequences.

The U.S. regulatory regime against Specially Designated Nationals (SDNs) is very extensive, byzantine, and not well known outside Washington, D.C. More and more frequently in my practice I have to represent U.S. lawyers who became ensnared unwittingly in criminal and administrative penal investigations because they run afoul of these laws. For instance, my firm receives many calls from Florida lawyers asking about transactions dealing with Cuba. They are surprised when we ask them do they already have a license from the U.S. Department of Treasury to act on behalf of clients with Cuban assets.

VI. HOW THE "KNOW YOUR CLIENT" AND DUE DILIGENCE RULES WORK IN SYRIA AND COMPARING THE DIFFERENT LEGAL ENVIRONMENTS

Although this section discusses KYC and due diligence rules in Syria, I hesitate to comment about the laws of another country.

One of the limitations of Syrian AML legislation is that there are thirteen crimes that are predicate offenses for money laundering, including narcotics offenses, fraud, and the theft of material for weapons of mass destruction. As mentioned above, the international standard is that all serious crimes should be covered. As a result, the scope of due diligence is less than it would be under an "all serious crimes" standard.

The fact that Syria has had private banks only since 2004 means that they are still having to develop the requisite human resources, infrastructure, and training for effective systems, including in the KYC and AML areas generally.

According to some reports, nonbank financial institutions are not as familiar with the requirements to file SARs. The Anti-Money Laundering Commission, which was established in

May 2004, is properly working to organize workshops for these institutions.

The Syrian economy is primarily cash-based; Syrians use money changers, some of who serve as hawaladars, for many financial transactions. The Moneychangers Law in 2006 regulates the sector. Although moneychangers are required to apply for a license and become regulated, effective regulation of this sector in Syria and much of the world is difficult. Proper regulation of moneychangers and hawaladars requires a mixture of education, regulatory resources, training, and enforcement. In preparing new international standards against financial crimes – registration, licensing, reporting, and record-keeping requirements – financial authorities also must consider the settlement process between hawala operators and the economic and regulatory implications of hawala-type systems.[27] It appears that Syria is following the international norm in its effort to regulate money changers while simultaneously trying to foster and support the growth of the modern banking system.

VII. HOW MONEY LAUNDERING RULES ARE BEING USED FOR OTHER PURPOSES (E.G., TAX INVESTIGATIONS) AND TRACING AND RECOVERING MONEY ACROSS BORDERS

The use of AML rules for other enforcement purposes derives from the fact that the international standard requires countries to apply the crime of money laundering to all serious offenses, with a view to including the widest range of predicate offenses. FATF Rec. 1. As a result, money laundering rules apply to the widest possible offenses.

One phenomenon of anti-money laundering regimes is the establishment of FIUs throughout the world. FATF provides in Rec. 26 that each country should establish an FIU. Further, FATF urges countries to impose measures of financial institutions and certain non-financial businesses and professionals requiring them to maintain records an the identities of their clients and their transactions, and to report any suspicious transactions. Information generated by these reporting and record keeping requirements is to be reported to the country's FIU and is used to reconstruct transactions, to establish the link between individual clients and particular business, to prove the "state of mind" of an individual, and finally, to identify the role of an individual in a criminal or terrorist financing activity.

Information reporting and record keeping requirements generate substantial financial data, much of which is not easily useable by competent authorities without further analysis. Many countries have reliable, efficient systems to process, analyze, and disseminate this information.

This data can be used by law enforcement to detect and investigate a variety of crimes, such as frauds, drug trafficking, corruption, tax, terrorist financing, etc. FIUs often analyze the

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[27] Mohammed El Qorchi, Samuel Munzele Maimbo, and John F. Wilson, *Informal Funds Transfer Systems: An Analysis of the Informal Hawala System* 26 (IMF 2003).

databases that receive records generated by banks, financial institutions and certain non-financial businesses and professionals.

If an FIU suspects money laundering or the financing of terrorism, it normally has the authority to share, or route, financial information and intelligence to other domestic authorities for investigation or action. It is normally authorized to cooperate and coordinate its actions with other domestic authorities devoted to the detection, prevention and prosecution of money laundering and terrorism financing.

The importance of timely information sharing with the proper authorities is critical for developing leads to potential criminal activities that warrant further investigation. The FIU should be an essential partner in domestic coordination and coordinating with regulators and supervisors of the financial sector, the police, the judicial authorities, and other relevant ministries or administrations.

A core feature of an FIU is its ability to cooperate in an efficient and rapid manner with all of its foreign counterparts. Information sharing at the international level should occur through direct and secure communication with competent foreign authorities.

One of the most important recent U.S. AML developments was the U.S. Supreme Court's 2005 *Pasquantino* decision, which makes U.S. professionals who help foreigners commit tax crimes potentially liable for wire and mail fraud in the U.S.[28]

Some of the early cases concerned drug-related proceeds. However, in the *Bank of New York* case, for example, Lucy Edwards and Peter Berlin pleaded guilty to money laundering for mail and wire fraud. The underlying crimes were helping persons evade Russian income tax. As a result, U.S. gatekeepers should no longer treat giving international and even domestic tax and business advice as routine. Even the dividing line between domestic and international may be gray. For example, if a U.S. taxpayer makes a domestic transaction, but receives the source of funds from a foreigner, the transaction should treated as an international transaction.

From a practical perspective, U.S. laws and ethical canons on foreign tax avoidance are murky. If U.S. counsel is merely helping a person avoid a foreign tax, he should be compliant with U.S. laws and ethics. Indeed, ethical canons require that counsel zealously represent clients. The difficulty is distinguishing between foreign tax crimes and tax avoidance. As noted above, U.S. persons have been convicted of U.S. money laundering violations using the predicate crimes of wire and mail fraud.

VIII. ANALYSIS

In terms of law practice, lawyers already working in crime prevention and due diligence

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[28] *Pasquantino v. United States* ((03-725) 544 U.S. 349 (2005); 336 F.3d 321, affirmed).

may find counseling and defending lawyers in regards to anti-money laundering law to be growth areas. Bar associations are challenged to engage actively with the U.S. and state governments as well as international organizations and other bar associations for SROs have an important role in helping implement the FATF standards and helping their members comply. To the extent SROs are not proactive, the onus falls increasingly on governments to apply the standards. For instance, until now, the ABA has relied entirely on volunteer services to deal with the gatekeeper initiative and anti-money laundering and counter-terrorism financial issues while other bar association outside the U.S. have hired full-time professionals to manage the issues. In every country, including Syria, the gatekeeper and AML regime puts pressure on the SROs.

To the extent that FATF and regulators seek continued participation from the private sector, they need to enlarge the private sector's role in the process.

The legality and legitimacy of financial regulatory and law enforcement officials from 34 countries making AML/CFT policy and implementing is highly questionable. The legality is further weakened, in the eyes of the private sector, because only a few bar associations participated in the two informal hearings held by FATF before it adopted the 2003 revised standards. Then the officials met behind closed doors and without any record whatsoever of their deliberations promulgated standards that ignored most of the submissions of the bar associations. Just as important, medium- and small-size governments who are not members of FATF have had insufficient input into the process and many believe that the FATF process fails to provide a level playing field and gives a competitive advantage to large countries and members of the FATF.

Unless the world community creates a Financial Regulatory and Enforcement Organization, an international organization of universal membership to make and implement AML/CFT policies, the haphazard implementation of the AML standards is likely to continue. Just as important, the effort to continually broaden the scope of AML to embrace CFT has exerted undue pressure on medium- and small-size nations and their private sectors. They were struggling to effectively implement AML. The resources and know-how to enact and effectively implement all these standards across the spectrum of legal and financial systems and cultures is beyond the task set by the few countries which control the FATF.

Another important aspect of the gatekeeper initiative is that, notwithstanding the non-compliance by the U.S. government and U.S. private sector with the gatekeeper standards, the U.S. Congress is considering bills, such as S. 681 (The Stop Tax Haven Abuse Act) to blacklist a host of jurisdictions because of their status as bank secrecy or tax haven countries. The bills with blacklists are constructed in a clearly arbitrary and discriminatory manner because the anti-money laundering and tax/corporate transparency laws show that many of the targeted countries meet international standards, especially with respect to the gatekeeper provisions, while the U.S. does not. In this connection, in light of the U.S. government's protracted non-compliance of the WTO ruling in the online gaming case filed by Antigua and Barbuda, the Caribbean trade delegation in the WTO Doha negotiations also shared their concerns about the enforcement of the rights of small and vulnerable economies in the multilateral trading system. Enactment of the anti-tax haven bills is likely to land the U.S. in another WTO case in which the U.S. is likely to be unsuccessful.

The gatekeeper initiative has many policy implications for governments, the private sector, and international organizations. The initiative has competitive and macro-economic implications as well as the aforementioned legal and ethical issues. Legal professionals and bar associations in the U.S. will need to become much more proactive in the initiative. The demands of globalization and the information revolution will make the initiative increasingly important. Criminal lawyers who master the gatekeeper and related standards will be at a premium.