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THE GATEKEEPER INITIATIVE AND THE RISK-BASED APPROACH TO CLIENT DUE DILIGENCE

To combat money laundering and terrorist financing, in 2008, the Financial Action Task Force adopted a risk-based guidance for lawyers' due diligence at client intake and monitoring. This was followed in 2010 when the ABA adopted a voluntary "good practices" guidance to help lawyers appraise the risk that a prospective client may be involved in such activities. The author traces the development of these standards, addresses the "specified activities" and types of risks that they cover, and discusses their application to a commercial real estate transaction. On February 15, 2012, the Financial Action Task Force adopted revised standards, which may trigger the need to revise the ABA's guidance.

By Kevin L. Shepherd *

Most lawyers view client due diligence as an administrative exercise to confirm the client's ability to pay the lawyer's fees and the absence of ethical conflicts. If the client passes muster during the intake stage, the lawyer then performs the legal services desired by the client. This process has served the legal profession well for decades, but there is something missing from this equation.

Although the lawyer has performed the level of client due diligence ("CDD") that most lawyers would perform under similar circumstances, the lawyer has not undertaken a risk-based analysis of the client to assess whether that client presents a risk of money laundering or terrorist financing. At first blush, that may seem to be a far-fetched notion. But efforts by the international community and federal authorities to impose anti-money laundering ("AML") and counter-terrorist financing ("CFT") obligations on lawyers portend significant

changes in their client intake and monitoring, and potential encroachments on the attorney-client relationship, including the attorney-client privilege, and the duty of client confidentiality. These efforts are referred to as the "Gatekeeper Initiative."

This article will describe briefly the background and status of the Gatekeeper Initiative, trace the development of risk-based guidance for the legal profession, review the development of voluntary, risk-based good practices guidance for the U.S. legal profession, and analyze the application of the good practices guidance to a typical commercial real estate transaction. This article will highlight the need for transactional and other lawyers to embrace the voluntary good practices guidance, both from the perspective of performing responsible and effective CDD and deflecting federal legislative efforts to impose onerous AML and CFT obligations on the legal profession. This article will conclude by assessing

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the likely impact recent revisions to the international AML standards will have on the voluntary, risk-based guidance for the legal profession.

FATF AND THE FATF RECOMMENDATIONS

World leaders created the Financial Action Task Force (“FATF”) in 1989 to develop and promote national and international policies to combat money laundering and terrorist financing. Less than a year after its formation, FATF issued in 1990 a comprehensive action plan for combating money laundering known as the Forty Recommendations. Since 1990, FATF has revised the Forty Recommendations several times. Shortly after the September 11, 2001 terrorist attacks in the United States, FATF expanded its mandate to address terrorist financing and issued eight (later nine) Special Recommendations on Terrorist Financing. The Forty Recommendations and the Nine Special Recommendations are sometimes collectively referred to as the “40+9 Recommendations.”

On February 15, 2012, FATF adopted a major revision to the 40+9 Recommendations by updating and renumbering the 40+9 Recommendations.¹ Now referred to simply as the “FATF Recommendations” or the “FATF Standards” (the FATF Standards refer collectively to the FATF Recommendations, Interpretative Notes, and Glossary), they represent the international standard for AML and CFT. The FATF Recommendations, which now number 40, represent the basic framework for AML efforts and are designed to be of universal application. For ease of reference, this article will refer to the new numbering of the FATF Recommendations but will refer to the former numbering in parentheses.

Recommendations 9 through 25, 26, and 28 (formerly Recommendations 4 through 25) describe the measures financial institutions and designated non-financial businesses and professions (“DNFBPs”), which includes

lawyers, should take to prevent money laundering and terrorist financing. These measures address customer due diligence and record-keeping.

Recommendation 20 (formerly Recommendation 13) deals with suspicious transaction reporting (“STR”). This Recommendation, which articulates the general STR rule, states that if a financial institution suspects or has reasonable grounds to suspect that funds are the proceeds of a criminal activity or are related to terrorist financing, the financial institution must report its suspicions to the appropriate authority by filing an STR. Recommendation 21 (formerly Recommendation 14) embodies the corollary “no tipping off” or “NTO” rule. Under the NTO rule, if the financial institution files an STR, it cannot inform its customer that it has made such a report. The STR requirement and the NTO rule have been a controversial aspect of the application of the FATF Recommendations to the legal profession.

BACKGROUND OF GATEKEEPER INITIATIVE

Now entering its second decade of existence, the Gatekeeper Initiative traces its origin to the Moscow Communiqué issued at the 1999 meeting of the G-8 Finance Ministers. It calls on countries to consider various means to address money laundering through the efforts of professional gatekeepers of the international financial system, including lawyers, accountants, company formation agents, and others. Following the Moscow Communiqué, FATF created a working group that identified several professions as “gatekeepers” (including lawyers and accountants) with respect to money laundering. On May 31, 2002, FATF identified several areas where possible changes could be made to FATF’s AML framework. The broad topics covered concern CDD and STRs, beneficial ownership and control of corporate vehicles, and the application of AML obligations to DNFBPs, including the legal profession.

The American Bar Association’s Task Force on Gatekeeper Regulation and the Profession (“Gatekeeper Task Force”) was formed in February 2002 to address certain issues arising from the Gatekeeper Initiative. At the time the Gatekeeper Task Force was established, its principal focus with regard to federal AML policy was whether the federal government would impose a

¹ Officially styled as the “International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation: The FATF Recommendations,” they can be found at <http://www.fatf-gafi.org/dataoecd/49/29/49684543.pdf>. All URLs cited in this article were last visited on February 19, 2012.

mandatory STR requirement on lawyers, *i.e.*, filing with federal government regulators or law enforcement personnel reports on suspicious activity by clients, and being prohibited from informing clients that such a report had been filed. This would have made lawyers subject to reporting obligations that are similar to what banks and other financial institutions have for reporting suspicious financing transactions to Treasury's Financial Crimes Enforcement Network ("FinCEN"). In more recent years, the focus of the Gatekeeper Task Force has turned to the risk-based approach to combat money laundering and terrorist financing, and to address efforts by federal legislators to impose mandatory AML obligations on the legal profession. To date, the Gatekeeper Task Force has been instrumental in seeking the adoption of three ABA House of Delegates resolutions on Gatekeeper Initiative issues. House of Delegates Resolution 104 was adopted in 2003, Resolution 300 was adopted in 2008, and Resolution 116 was adopted in 2010.

Resolution 104 supported the enactment of reasoned and balanced initiatives to detect and prevent money laundering and terrorist financing, but also opposed any law or regulation that would compel lawyers to disclose privileged or confidential information to government officials based on "suspicious" activity of the client, or otherwise compromise the attorney-client relationship or independence of the bar.

Resolution 300 provided that states, and not the federal government, should retain the authority to regulate those who form certain business entities. Resolution 300 also urged U.S. lawyers to develop voluntary risk-based guidance for client due diligence, and directed the ABA to develop this guidance and to engage with the federal government and other interested parties in this process.

Pursuant to Resolution 116, the ABA adopted as its official policy the voluntary good practices guidance that is the subject of this article.

RISK-BASED APPROACH AND DEVELOPMENT OF LAWYER GUIDANCE

The risk-based approach is grounded in the premise that the limited resources (both governmental and private sector) available to combat money laundering and terrorist financing should be employed and allocated in the most efficient possible manner so that the sources of the greatest risks receive the most attention. A risk-based approach is intended to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified,

thereby facilitating an efficient allocation of this limited pool of resources. By contrast, a "rules-based" approach ignores risk and mechanically applies the governing standards in a rote, box-ticking manner.

The proportionate nature of the risk-based approach means that higher risk areas should be subject to enhanced risk-based procedures, such as enhanced CDD and enhanced transaction monitoring. By contrast, simplified, modified, or reduced risk management procedures may apply in lower risk areas. An effective risk-based approach involves identifying and categorizing money laundering and terrorist financing risks, and establishing reasonable controls based on the risks identified.

FATF has been active in developing risk-based guidance for financial institutions and DNFBPs, including legal professionals. In June 2007, FATF adopted risk-based guidance for financial institutions. Three months later, in September 2007, FATF and representatives from the DNFBPs agreed to develop risk-based guidance for their respective sectors, using the same structure and style as that for the financial institution guidance. During the course of over a year, representatives from the legal profession from around the world met with FATF to develop the risk-based guidance. After intensive negotiations between the legal profession and FATF, FATF adopted the "RBA [Risk-Based Approach] for Legal Professionals ("Lawyer Guidance") at its October 2008 plenary in Rio de Janeiro. Guidance for each of the other DNFBP sectors was published separately in 2008.² The newly adopted FATF Recommendations expressly incorporate the risk-based approach.³

The Lawyer Guidance, which contains 126 separately numbered paragraphs, is a complex document that addresses different audiences (*e.g.*, private sector and public authorities), undertakes to identify the AML/CFT issues specific to the legal profession, and outlines the risk factors that lawyers need to consider in developing a risk-based system. It is "high level" guidance intended

² For a detailed analysis of the development of the Lawyer Guidance, *see* Kevin L. Shepherd, "Guardians at the Gate: The Gatekeeper Initiative and the Risk-Based Approach for Transactional Lawyers," *REAL PROPERTY TRUST AND ESTATE LAW JOURNAL* (Winter 2009).

³ Recommendation 1 states, in part, that "countries should apply a risk-based approach (RBA) to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified." *See* <http://www.fatf-gafi.org/dataoecd/49/29/49684543.pdf>.

to provide a broad framework for implementing a risk-based approach for the legal profession. It does not offer detailed direction on the application of this approach to specific factual situations, nor does it take into account the practical realities of the practice of law in an increasingly complex environment or attempt to address jurisdictional variations among FATF member countries. For those reasons, the Guidance urges the legal profession generally, or in different countries, to develop “good practice in the design and implementation of an effective risk-based approach.”

Importantly, the Lawyer Guidance is limited to those lawyers who “prepare for and carry out specified activities.” The Guidance focuses on the services performed by the lawyer, meaning that all lawyers are not automatically subject to the Guidance. It does not define “prepare for and carry out,” but it does define “specified activities,” as described below. Thus, even if the lawyer is subject to the Guidance, CDD may not be required because of the particular nature of the proposed engagement.

The “specified activities” consist of the following five categories: (a) buying and selling of real estate, (b) managing of client money, securities, or other assets, (c) management of bank, savings, or securities accounts, (d) organization of contributions for the creation, operation, or management of companies, and (e) creation, operation, or management of legal persons or arrangements, and buying and selling of business entities. The Guidance does not further define the specified activities, thereby creating ambiguity about the scope and coverage of each specified activity. If a lawyer performs or carries out one or more of the specified activities, that lawyer is subject to the Guidance.

RISK CATEGORIES

The Lawyer Guidance identifies three major risk categories with regard to legal engagements: (a) country/geographic risk, (b) client risk, and (c) service risk. Lawyers need to determine their exposure to each of these risk categories. The relative weight to be given to each category in assessing the overall risk of money laundering and terrorist financing will vary from one lawyer or firm to another because of the size, sophistication, location, and nature and scope of services offered by the lawyer or the firm. Based on their individual practices and judgments, lawyers will need to assess independently the weight to be given to each risk factor. These factors are subject to variables that may increase or decrease the perceived risk posed by a particular client or type of work.

With respect to the first major risk category, country/geographic risk, no universally adopted listing of countries or geographic areas that are deemed to present a lower or higher risk exists. The Lawyer Guidance itself identifies the profile of those countries that in FATF’s view pose a higher risk of money laundering. These higher risk countries include those that are subject to sanctions, embargoes, or similar measures issued by certain bodies, such as the United Nations and those identified by credible sources as having significant levels of corruption or other criminal activity, or a location from which funds or support are provided to terrorist organizations.

The second major risk category, client risk, entails an analysis of various factors to assess the potential money laundering or terrorist financing risk posed by a client. Clients encompass a broad spectrum, ranging from individuals to global enterprises. This breadth of clients presents challenges to the lawyer to determine whether a particular client poses a higher risk and, if so, the level of that risk and whether the application of any mitigating factors influences that determination. The Lawyer Guidance identifies about a dozen categories of potentially higher risk clients, such as politically exposed persons (“PEPs”). Not all high level political officials are PEPs; rather, PEPs are high level political officials in *foreign* countries.⁴ Other categories of potentially higher risk clients include (a) clients conducting their relationship or requesting services in unusual or unconventional circumstances (as evaluated in light of all the circumstances of the representation), (b) legal structures that make it difficult to identify in a timely manner the true beneficial owner or controlling interests, (c) clients having convictions for “proceeds generating crimes” (such as embezzlement) who instruct the lawyer (who has actual knowledge of these convictions) to undertake specified activities on their behalf, and (d) the use of legal entities and arrangements without any apparent legal or legitimate tax, business, economic, or other reason.

The third major risk category, service risk, identifies those services at higher risk for money laundering and terrorist financing. Typically those services involve the movement of funds and/or the concealment of beneficial ownership. For example, a lawyer who “touches the money” while performing or carrying out a specified activity creates a higher risk for potential money

⁴ In an important development, the newly adopted FATF Recommendations extend the definition of PEPs to *domestic* PEPs. See FATF Recommendation 12 (formerly Recommendation 6).

laundering if the lawyer does not know the sources and destination of the funds. Other services considered to present a higher risk of money laundering or terrorist financing include (a) services that conceal improperly beneficial ownership from competent authorities, (b) services requested by the client for which the client knows the lawyer does not have expertise except where the lawyer refers the request to an appropriately trained professional for advice, and (c) transfer of real estate between parties in a time period that is unusually short for similar transactions with no apparent legal, tax, business, economic, or other legitimate reason.

Once a lawyer performs CDD based on the factors identified within the three major risk categories described above, the lawyer needs to take into account a number of risk variables. These variables may either require the lawyer to perform enhanced due diligence or lead the lawyer to conclude that standard CDD can be reduced. In FATF's view, however, every client, without exception, presents some level of potential money laundering or terrorist financing. This view has been the subject of considerable criticism.

The risk variables include (a) the nature of the client relationship and the client's need for the lawyer to provide specified activities, (b) the level of regulation or other oversight or governance regime to which a client is subject, (c) the reputation and publicly available information about a client, (d) the regularity and duration of the relationship, and (e) the proportionality between the magnitude or volume and longevity of the client's business and its use of the lawyer for its legal requirements, including the nature of the professional services sought.

DEVELOPMENT OF GOOD PRACTICES GUIDANCE

The Lawyer Guidance, self-styled as "high level guidance," offers little practical guidance to U.S. lawyers. The risk factors lack elaboration, the Guidance itself is laced with often impenetrable jargon, and no practical insights are offered into the application of the risk factors to real life CDD scenarios. In light of these shortcomings, and taking a cue from the Guidance suggesting that the legal profession develop good practices guidance, the Gatekeeper Task Force and representatives from other ABA sections and specialty bar associations collaborated to develop a paper entitled "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing" ("Good Practices Guidance").⁵ Dated

April 23, 2010, the Good Practices Guidance is designed to implement the Lawyer Guidance by providing practical and understandable guidance to the legal profession for the development of a risk-based approach to CDD. The goal of the Good Practices Guidance is to assist members of the legal profession in the United States in designing and implementing effective risk-based approaches consistent with the broad contours of the Lawyer Guidance. The ABA House of Delegates, the policy making body of the ABA, endorsed the Good Practices Guidance as official ABA policy at the 2010 annual meeting in San Francisco.

It is important to understand the premise underlying the Good Practices Guidance. The Good Practices Guidance is not intended to be a statement of the standard of care governing the activities of lawyers in implementing a risk-based approach to combat money laundering and terrorist financing. Rather, given the vast differences in practices, firms, and lawyers throughout the United States, the Good Practices Guidance seeks only to serve as a resource that lawyers can use in developing their own voluntary risk-based approaches. At the same time, the Good Practices Guidance is not intended to be an academic exercise. The federal government is under pressure from FATF and others to adopt legislation implementing some or all of the provisions of the Lawyer Guidance. An overarching purpose of the Good Practices Guidance is to encourage and empower lawyers to develop and implement voluntary, but effective, risk-based approaches consistent with the Lawyer Guidance, thereby negating the need for federal regulation of the legal profession.

The first section of the Good Practices Guidance provides an overview of the mechanics of money laundering and terrorist financing so that practitioners can better understand and achieve the goals of the United States' and FATF's AML/CFT efforts. The sections that follow then describe the risk-based approach and recommended CDD, identify those lawyers who are subject to the Lawyer Guidance, describe the specified activities that are addressed by the Lawyer Guidance, list and analyze the risk categories and risk variables, and conclude with a suggested protocol for client intake and assessment, and a discussion of the importance of on-going education and continuing legal education efforts in this area.

The Good Practices Guidance is best viewed as "gloss" on the Lawyer Guidance. The Good Practices Guidance distills the concepts and principles of the Lawyer Guidance in easy to understand language, which is particularly helpful given the sometimes syntactically challenged nature of the Lawyer Guidance. The

⁵ See www.americanbar.org. ("Good Practices Guidance").

“practice pointers” appearing throughout the text, which take the form of hypothetical fact patterns to highlight specific issues or points, are designed to provide practical guidance and insights to practitioners. They may also elaborate on a statement or concept contained in the Lawyer Guidance.

In an unprecedented action, U.S. Treasury issued a statement in support of the Good Practices Guidance. Treasury views the Good Practices Guidance as a significant step in implementing an effective risk-based approach for legal professionals in the United States. Federal legislators have encouraged the ABA to issue guidance to its members prohibiting the use of any financial account to accept suspect funds involving PEPs, conceal PEP activity, facilitate suspect transactions involving PEPs, or circumvent AML or PEP controls at U.S. financial institutions. The Good Practices Guidance is an effort to address these concerns.

APPLICATION OF GOOD PRACTICES GUIDANCE TO CDD

The Lawyer Guidance applies to lawyers when they “prepare for or carry out specified activities.” The Guidance does not define “prepare for and carry out,” but it does define “specified activities” as including the buying and selling of real estate and the creation of legal persons and arrangements.

The first, and perhaps most fundamental task, of any lawyer’s CDD process is to identify the client and verify its identity. Beyond obtaining the prospective client’s name, address, and telephone number, it may be necessary to obtain additional information on the new client. This information may include some or all of the client’s employment background, place of birth, prior residential addresses, current residential address, business address, phone numbers, date of birth, marital status, names of prior or current spouses and/or names of children, dates of birth and social security numbers of any such spouses and/or children, the name and contact information of the client’s certified public accountant, prior criminal convictions, pending lawsuits, and status of tax filings with governmental authorities. Obviously, all of this information may not be necessary to verify the client’s identity, but it reflects the scope of possible sources of inquiry to enable a lawyer to verify the client’s identity.

As part of the lawyer’s risk-based CDD protocols, the lawyer should as a matter of course check the client’s name against the Specially Designated Nationals and Blocked Persons list (“SDN List”), maintained by

Treasury’s Office of Foreign Assets Control (“OFAC”).⁶ The lawyer may also conduct an Internet search of the client’s name to see if that yields any additional insights. Depending on the information the lawyer knows about the client, there may not be a need for the lawyer to conduct a more exhaustive analysis of the client, such as obtaining a background check.

APPLICATION OF GOOD PRACTICES GUIDANCE

The following will illustrate how to perform a risk-based assessment during the CDD process based on a hypothetical real estate transaction. Kristen, a junior partner with a 90-lawyer law firm in a Midwest city, specializes in commercial real estate and corporate law. Her clients are principally local real estate developers with a sprinkling of domestic institutional pension funds. Kristen receives a call from Brittany, a former law school classmate on the West Coast, who wants to refer a potential client to Kristen to handle a real estate transaction in Kristen’s city. In a dour economy, Kristen is thrilled to receive the referral. Brittany relates to Kristen that Brittany has been representing the client, an operator of a local warehouse distribution center, for a few months in labor and employment law matters, but now the client wants to acquire a strip shopping center in Kristen’s city. Brittany informs Kristen that the potential client has a good payment record with Brittany’s firm and thinks that Kristen and the potential client would be good match for the new real estate matter. Brittany mentioned in passing that the client is somewhat of a local celebrity because his spouse is the daughter of a high ranking cabinet minister of a South American country. Brittany noted that she does not know too much about the client’s other businesses or investments, and is mildly curious why the client would like to acquire a real estate investment in the Midwest. Kristen thanks Brittany for the referral and tells Brittany that she will call the potential client as soon as she runs a conflicts check. To assist Kristen in that effort, Brittany e-mails the potential client’s name, address, and telephone number to Kristen.

The conflicts check is clear, and Kristen promptly calls the potential client. Kristen inquires into the name of the shopping center owner so that she can complete her conflicts check. The potential client indicates that a domestic insurance company now owns the shopping center pursuant to a foreclosure that occurred last year. Kristen immediately runs the owner’s name through conflicts and confirms that no conflict exists. Kristen

⁶ <http://www.ustreas.gov/offices/enforcement/ofac/sdn/>.

then informs the client that the conflicts are clear and that Kristen’s firm can handle the new engagement.

Kristen and her client then discuss the terms of the proposed shopping center acquisition. Kristen learns the deal is on a fast-track and that she is to review the draft contract of sale later that day, which the client will immediately forward to her. The client informs Kristen that a new entity will need to be formed to enter into the contract and to take title to the asset, and Kristen and the client discuss the pros and cons of the various forms of entities before deciding on a limited liability company (“LLC”). The LLC will be managed by the client but will have a number of “silent” investors. The client insists that the LLC be formed in Nevada, but does not offer much of an explanation. Kristen assures the client that she can form the entity quickly and prepare a standard member-managed operating agreement. Kristen does not push the client to identify the investors in the LLC or to form the LLC in the state in which Kristen and the real estate are located. Kristen concludes the call by expressing her appreciation for the client’s business and that she looks forward to working with him on this transaction.

The above scenario has played out countless times with transactional lawyers across the United States. Kristen is pleased to have the new business and the client is delighted to have a lawyer recommended by Brittany, his regular attorney. Kristen feels she has discharged her ethical obligations by running the standard conflicts check. Based on Brittany’s assurances that the client is creditworthy, Kristen waived the need for a credit report on the client or the need for a retainer.

But what is wrong with this scenario? Although Kristen has performed the level of CDD that most lawyers would perform under similar circumstances, she has not undertaken a risk-based analysis to assess whether that client presents a risk of money laundering or terrorist financing. The following will analyze the risk-based CDD assessment Kristen should have adopted at the inception of the new client relationship.

The Lawyer Guidance applies to lawyers when they “prepare for or carry out specified activities.” The Guidance does not define “prepare for and carry out,” but it does define “specified activities” as including the buying and selling of real estate and the creation of legal persons and arrangements. Here, Kristen will be preparing for or carrying out the specified activity of buying and selling real estate (*i.e.*, the shopping center) and the specified activity of creating a legal arrangement

(*i.e.*, the formation of the new LLC that will own the shopping center).⁷

The first, and perhaps most fundamental task, of any lawyer’s CDD process is to identify the client and verify its identity. Brittany, the lawyer who referred the new client to Kristen, provided Kristen with the potential client’s name, address, and telephone number. Based on that elementary information, Kristen performed no other analysis to verify the identity of the client. Kristen has never met the client in person and her only contact with the client has been through a telephone call. She knows from her discussions with Brittany that Brittany and the client have worked together for a relatively short time period, about five months. She recalls that Brittany remarked favorably on the client’s payment track record with Brittany’s firm. Thus, this is not a situation where a potential new client enters a lawyer’s office without any referrals or recommendations. Because the referral was from a trusted source (*i.e.*, Brittany), Kristen likely would have no need to obtain additional information on the new client. But there are a few aspects of the client that should be of concern to Kristen.

As discussed in greater detail below, the client is a PEP, or politically exposed person. As such, Kristen needs to conduct a more exhaustive analysis of the client. As part of Kristen’s risk-based CDD protocols, she should as a matter of course check the client’s name against OFAC’s SDN List. Kristen may also conduct an Internet search of the client’s name to see if that yields any additional insights. Kristen also plans to call Brittany to obtain more information about the client.

After having verified the identity of the new client, from a risk-based perspective, should Kristen identify the beneficial owners of the new LLC and verify their identity? Based on the information Kristen has obtained from Brittany and from the client, Kristen may ask the client to identify the other members of the LLC so that she can confirm that no conflicts of interest exist. But is this enough? Assuming the client will provide this information, should Kristen then seek to verify the

⁷ Note, though, that if the client engaged Kristen to handle the leasing work at the shopping center, it is not clear whether that work, standing alone, would constitute performing or carrying out one of the five enumerated specified activities. Buying and selling real estate is a specified activity, but the Lawyer Guidance does not address whether the leasing of real property would fall within the ambit of one of the specified activities. See Financial Action Task Force, RBA Guidance for Legal Professionals (2008), <http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf>, ¶ 12.

identity of the “silent investors” in the new LLC? The cost and time to perform these activities may be significant and, in some instances, verification may be difficult to achieve.⁸ From a risk perspective, Kristen should investigate the identity of the other members of the LLC. Although the transaction is a relatively straightforward commercial real estate deal, including the need to form a typical member-managed LLC to take title to the asset, Kristen should not ignore identifying and verifying the identity of the other members of the LLC. Particularly since her client is a PEP, Kristen needs this information to ensure no conflicts of interest exist and to understand whether any of the other investors are PEPs.

In light of the Good Practices Guidance, how should Kristen perform CDD on her new client? Once Kristen has identified and verified the identity of her client, Kristen should then evaluate the new client based on the three major risk categories (*i.e.*, country/geographic risk, client risk, and service risk) and the risk variables set forth in the Lawyer Guidance to determine whether the client is higher risk and, if so, perform enhanced CDD. As far as Kristen knows, the client is a U.S. citizen with a domicile in Brittany’s home state. These facts do not point to any meaningful country/geographic risk.

Client risk, the second major risk category, merits critical attention by Kristen. The client’s father-in-law is a high ranking cabinet member of a South American country. The father-in-law is thus a PEP. PEPs include senior politicians of foreign countries as well as their

family members. The FATF Recommendations do not define the contours of “family members,” but the relationship here is not attenuated or distant.⁹ The Lawyer Guidance is clear that the representation of PEPs inherently poses a greater risk of money laundering or terrorist financing. In dealing with PEPs, such as the client, Kristen needs to perform a more exacting level of CDD. She needs to know the foreign country involved and its reputation for political corruption. Kristen should also seek to understand the level of scrutiny to which the PEP would be subjected in the PEP’s home country.¹⁰ Based on discussions with the client and with Brittany, and a review of a website maintained by Transparency International,¹¹ Kristen learns that the client’s father-in-law serves in a politically stable South American country that does not have a reputation for political corruption.

Her client is an individual and has asked Kristen to form a new LLC to take title to the shopping center. From an ethics standpoint, Kristen needs to make clear whether she will be representing the interests of the individual or the LLC in the proposed transaction. Kristen does not suspect the client is using a member-managed LLC structure to mask beneficial ownership, and the structure itself is not particularly complicated or convoluted, but Kristen wonders why the client insists on using a Nevada LLC. Kristen asks the client why he

⁸ The provisions governing the identification and verification of beneficial ownership are contained in Recommendation 24 (formerly Recommendation 33), and currently represent one of the most controversial provisions in the FATF Recommendations. Many FATF countries consistently fall short of complying fully with this Recommendation. Most recently, in February 2010, FATF gave Germany a “non-compliant” rating for Recommendation 33 in connection with FATF’s mutual evaluation of that country. *See* Mutual Evaluation Report, Anti-Money Laundering and Combating the Financing of Terrorism, <http://www.fatf-gafi.org/dataoecd/44/19/44886008.pdf>. Federal legislators have introduced a bill obligating the identification of beneficial ownership information for certain entities. S. 1483, The Incorporation Transparency and Law Enforcement Assistance Act, 112th Cong. (2011). The ABA opposes S. 1483 on a number of grounds. *See* letter dated December 16, 2011 from ABA President Wm. T. (Bill) Robinson, to The Honorable Joseph Lieberman and The Honorable Susan Collins, *available at* http://www.americanbar.org/content/dam/aba/uncategorized/2011/gao/2011dec16_incorptransparency_1.

⁹ In the newly adopted FATF Recommendations, FATF did not accept the invitation to define “family members.” The FATF explained that “the definition of family member and close associates of PEPs could differ substantially with the culture and risks in a country, and that any useful definition has to be sufficiently broad and flexible for countries, financial institutions, and DNFBSs to adapt to the appropriate local circumstances and the precise nature of the business relationships. The decision was taken, therefore, not to define these terms as part of the revised Recommendations.” *See* FATF’s Response to the Public Consultation on the Revision of the FATF Recommendations, ¶ 25, <http://www.fatf-gafi.org/dataoecd/50/26/49693324.pdf>.

¹⁰ The Financial Action Task Force of South America Against Money Laundering (“GAFISUD”) may be able to shed light on this issue. *See* http://www.fatf-gafi.org/document/35/0,3746,en_32250379_32236869_34355875_1_1_1_1,00.html.

¹¹ Since 1995, Transparency International has published a Corruption Perceptions Index (“CPI”) that ranks about 200 countries by their perceived levels of corruption, as determined by expert assessments and opinion surveys. Here is a link to Transparency International’s website for the CPI: http://www.transparency.org/policy_research/surveys_indices/cpi.

wants to form the LLC in Nevada, and the client responds by stating that his other business interests are formed under Nevada law and he would prefer, from an administrative standpoint, to deal with a single state for formation purposes. Kristen is satisfied with that response.

Kristen has no knowledge of whether the client has any criminal convictions for proceeds generating crimes, such as embezzlement. Based on a review of the client risk factors, and after evaluating the background and nature of the father-in-law's PEP classification and need to use a Nevada LLC, Kristen does not discern that the client presents a higher risk of money laundering or terrorist financing.

Service risk, the third major risk category, focuses on those services involving the movement of funds or the concealment of beneficial ownership. Kristen plans to use an escrow agent to hold the earnest money deposit and to act as the closing agent, meaning that Kristen and her firm will not be "touching the money" in the shopping center transaction. In some jurisdictions, however, it is customary for lawyers to hold the deposit and to receive and transmit the settlement proceeds. Lawyers in those jurisdictions need to make sure that, in this higher risk scenario, they know the source and disposition of the settlement funds. Because a single transfer of the shopping center is contemplated, this is not a situation where a higher risk scenario arises because of accelerated transfers of real estate. Based on Kristen's knowledge, there is nothing unusual or out of the ordinary involving this transaction, other than the client investing in real estate distant from his home state. The client appears knowledgeable about commercial real estate transactions, investments, and protocols, and states that he feels this investment opportunity allows him an opportunity to diversify his assets.

Kristen's evaluation of the client in light of the three major risk categories leads her to conclude that the client does not present a higher risk of money laundering or terrorist financing. Still, Kristen must assess her client based on the risk variables contained in the Lawyer Guidance to determine whether the client or the proposed work would be unusual, risky, or suspicious. One risk variable is the nature of the client relationship. Kristen is dealing with a new client referred to her from Brittany, a trusted source. Given the lack of any prior relationship with this client, it may be prudent for Kristen to run a Google search on the client's name and any known investors in the transaction. Another risk variable deals with the "one shot" transaction, meaning that the client has instructed the lawyer to undertake a single transaction-based service (as opposed to an

ongoing advisory relationship) and one or more other risk factors are present.¹² To be sure, the client has engaged Kristen to perform a single transaction, but Kristen has evaluated the other risk factors and has obtained a comfort level that the client's PEP status does not present a higher risk of money laundering or terrorist financing. By way of contrast, suppose the client had requested Kristen to form a limited liability company for the sole purpose of receiving the funds from the proceeds of a sale. That narrow representation, which is described in one of the Practice Pointers in the Good Practices Guidance, may pose a higher risk factor.¹³

Kristen has not met the new client in person, but rather has spoken with him on the telephone and has corresponded with him via e-mail. This situation, which is not at all unusual in our technologically dependent profession and economy, calls into play risks that may arise from the use of new or developing technologies that permit non-face-to-face relationships that could be used to favor or promote anonymity.¹⁴ FATF perceives that anonymity in specified activities is conducive to potential money laundering and terrorist financing risks. Here, Kristen's electronically facilitated communications with her client are typical and do not suggest any nefarious activity. Finally, one risk variable focuses on the origination of the referral.¹⁵ Brittany, a law school classmate of Kristen's, referred the client to Kristen. Kristen trusts Brittany's judgment, which militates in favor of performing a standard CDD process for the client, but the client's status as a PEP warrants an enhanced level of CDD.

Once Kristen has performed the CDD, she should document her findings and maintain the records. FATF Recommendation 10 directs that financial institutions and DNFBPs maintain these records for a period of at least five years after the business relationship is ended. The scope and degree of documentation will vary case to case, and Kristen may find it prudent to summarize her risk assessment process in those situations where she has performed enhanced CDD.

¹² Lawyer Guidance ¶ 112 (ninth bullet).

¹³ Good Practices Guidance § 4.9.

¹⁴ *See id.* (tenth bullet).

¹⁵ *See id.* (eleventh bullet).

RECENT REVISIONS TO THE FATF RECOMMENDATIONS MAY TRIGGER REVISIONS TO GOOD PRACTICES GUIDANCE AND LAWYER GUIDANCE

The revisions to the FATF Recommendations adopted in February 2012 by FATF will likely lead to a revision of the Good Practices Guidance as well as the Lawyer Guidance. The FATF noted in a paper issued simultaneously with the adoption of the revised FATF Recommendations that FATF remains committed to continuing its engagement with the private sector and that this engagement may take the form of “updating the relevant guidance to the specific sectors[.]”¹⁶ The reorganization and renumbering of the FATF Recommendations will obviously entail revisions to the Good Practices Guidance and the Lawyer Guidance, but it remains to be seen the extent to which FATF otherwise desires to modify the Lawyer Guidance. But

the revised FATF Recommendations are consistent with the Good Practices Guidance and the Lawyer Guidance by their strong emphasis on the risk-based approach.

CONCLUSION

U.S. lawyers should embrace the Good Practices Guidance and implement it in their client intake, CDD, and on-going client monitoring processes. This common sense approach will signal to FATF and federal regulators and legislators that the legal profession can take steps to ensure that the services they provide will not promote or facilitate money laundering or terrorist financing, thereby obviating the need for a federally imposed, rules-based AML/CFT regime. Such a regime could dangerously encroach on the attorney-client relationship, including the attorney-client privilege and the duty of client confidentiality. ■

¹⁶ See FATF’s Response to the Public Consultation on the Revision of the FATF Recommendations, ¶ 44, <http://www.fatf-gafi.org/dataoecd/50/26/49693324.pdf>.

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