

GUARDIANS AT THE GATE: THE GATEKEEPER INITIATIVE AND THE RISK-BASED APPROACH FOR TRANSACTIONAL LAWYERS

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Editors' Synopsis: In this Article, the author outlines the history and development of the Financial Action Task Force on Money Laundering's Gatekeeper Initiative and Lawyer Guidance. The author analyzes the requirements the Lawyer Guidance imposes on U.S. transactional lawyers and urges lawyers' associations to develop their own good practices in an attempt to avoid legislative regulation in this area.

“Risk comes from not knowing what you’re doing.”¹

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¹ ROBERT G. HOGSTROM, JR., THE WARREN BUFFET WAY 95 (1994).

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I. INTRODUCTION

Twenty years ago French President Francois Mitterrand hosted a spectacular celebration commemorating the 200th anniversary of the

French Revolution. President Mitterrand, joined by leaders from thirty-two countries, viewed a Bastille Day parade along the Champs-Élysées, Paris's grand ceremonial boulevard, that featured tanks, 5,000 troops, and a mobile nuclear missile unit.² Later that afternoon, President Mitterrand, joined by President George H.W. Bush and leaders from other Western democracies,³ repaired to the newly built I.M. Pei-designed pyramid at the Louvre to kick off the G-7 World Economic Summit.⁴ Known formally as the Summit of the Arch,⁵ the leaders met to discuss a number of pressing economic issues.

After meeting for two days, the leaders issued a fifty-six paragraph Economic Declaration covering topics such as international monetary developments and coordination, trade issues, environmental matters, and

² See R.W. Apple, Jr., *Day of Wine and Bunting: 200th Anniversary for France*, N.Y. TIMES, July 15, 1989, at L1.

³ The leaders of these democracies were Prime Minister Brian Mulroney (Canada), Chancellor Helmut Kohl (West Germany), Prime Minister Ciriaco De Mita (Italy), Prime Minister Sosuke Uno (Japan), Prime Minister Margaret Thatcher (United Kingdom), and Jacques Delors (President of the Commission of the European Communities). See *Summit of the Arch*, DEP'T ST. BULL., Sept. 1989, at 4. [hereinafter STATE DEP'T BULLETIN].

⁴ The G-7 (also known as the Group of Seven) summit originated fourteen years earlier in November 1975 when French President Valéry Giscard d'Estaing invited government heads from West Germany (Helmut Schmidt), Italy (Aldo Moro), Japan (Takeo Miki), the United Kingdom (Harold Wilson), and the United States (Gerald R. Ford) to a summit in Rambouillet, the summer residence of the presidents of France. These leaders agreed to an annual meeting organized under a rotating presidency, forming the Group of Six (G-6). In 1976, President Gerald R. Ford invited Canada to join the group, thereby forming the G-7. See *President Ford Got Canada into G7*, <http://www.cbc.ca/canada/story/2006/12/27/ford-canada.html?ref=rss> (last visited Mar. 15, 2009). The United Kingdom invited the European Union to attend the annual economic meetings with the G-7 leaders beginning in 1977. The President of the European Commission and the leader of the country that holds the Presidency of the Council of the European Union represent the European Union. See *EU Participation in G8 Summits*, http://ec.europa.eu/external_relations/g7_g8/intro/index.htm (last visited Mar. 15, 2009). President Bill Clinton invited Russia to join this informal alliance of states in 1998, thereby creating the Group of Eight (G-8). See *G8 Information Centre, What Is the G8?*, http://www.g7.utoronto.ca/what_is_g8.html (last visited Mar. 15, 2009).

⁵ The G-7 summit was referred to as the Summit of the Arch because of the newly constructed four-dimensional hypercube in Paris known variously as the Arche de la Défense and La Grande Arche. Built to resemble a 20th century version of the Arc de Triomphe, the monument was nearly complete in time for the 1989 Bastille Day parade. See STATE DEP'T BULLETIN, *supra* note 3, at 1.

drug issues.⁶ Toward the end of the lengthy Economic Declaration, the G-7 leaders agreed to the creation of a Financial Action Task Force on Money Laundering (FATF), primarily for the purpose of coordinating efforts to prevent money laundering in international and domestic financial systems.⁷

A decade after FATF's creation, the G-8 interior and justice ministers⁸ met during three snowy days in Moscow in mid-October 1999 and adopted what is known as the Moscow Communiqué.⁹ United States Attorney General Janet Reno represented the United States at this "little-noticed conference,"¹⁰ which was hosted by Russian Prime Minister Vladimir V. Putin.¹¹ The Moscow Communiqué, which specifically em-

⁶ See *id.* at 13–17. Environmental issues consumed about a third of the paragraphs contained in the Economic Declaration, thereby underscoring the importance of environmental issues at the G-7 summit in Paris.

⁷ See *id.* at 16. The provision pertinent to the creation of FATF is in paragraph 53 and states as follows:

Convene a financial action task force from Summit Participants and other countries interested in these [drug] problems. Its mandate is to assess the results of cooperation already undertaken in order to prevent the utilization of the banking system and financial institutions for the purpose of money laundering, and to consider additional preventive efforts in this field, including the adaptation of the legal and regulatory systems so as to enhance multilateral judicial assistance. The first meeting of this task force will be called by France and its report will be completed by April 1990.

G-7 Summit: Paris, July 14–16, 1989, Economic Declaration, para. 53, <http://www.g8.utoronto.ca/summit/1989paris/communique/drug.html> (last visited Mar. 15, 2009).

⁸ The G-7 became the G-8 when Russia formally became involved in the summit process starting with the 1998 Birmingham Summit. The G-7 Group of Finance Ministers and Central Bank Governors continues to operate separately from the G-8. See EU Participation in G8 Summits, *supra* note 4.

⁹ See The National Money Laundering Strategy for 2000, <http://www.ustreas.gov/press/releases/docs/ml2000.pdf> (last visited Mar. 15, 2009); Ministerial Conference of the G-8 Countries on Combating Transnational Organized Crime (Moscow, October 19–20, 1999) Communiqué, <http://www.g8.utoronto.ca/adhoc/crime99.htm> (last visited Mar. 15, 2009) [hereinafter Moscow Communiqué]; Rebecca Gregory, *The Lawyer's Role: Will Uncle Sam Want You in the Fight Against Money Laundering and Terrorism?*, 72 UMKC L. REV. 23, 31–33 (2003) (describing the Gatekeeper Initiative and the Moscow Communiqué).

¹⁰ Editorial, *What About Russia?*, WALL ST. J., Oct. 27, 1999, at A18.

¹¹ See Judith Ingram, *Russia Joins U.S. to Fight Bank Crime, Reno Says*, MIAMI HERALD, Oct. 21, 1999, at 1.

ployed the term “gatekeeper,” gave rise to the Gatekeeper Initiative.¹² The Gatekeeper Initiative, as discussed in greater detail in this Article, is an effort by governmental authorities to enlist the support of gatekeepers to combat money laundering and terrorist financing.¹³ Gatekeepers include lawyers, notaries, trust and company service providers (TCSPs),¹⁴ real estate agents, accountants, auditors and other designated nonfinancial businesses and professions (DNFBPs) who assist with transactions involving the movement of money in domestic and international financial systems.¹⁵

The grand celebration in Paris in July 1989 seems an incongruous and inauspicious beginning of a chain of events that eventually cast a long and ominous shadow over the American legal system. The Paris and Moscow meetings, separated by a decade but rooted in the core desire to combat money laundering, together spawned a multi-faceted effort by foreign and domestic governmental authorities to impose obligations on the legal profession with respect to anti-money laundering (AML) and combating the financing of terrorism (CFT).¹⁶ This effort took on increased urgency in reaction to the cataclysmic terrorist attacks on the United States on September 11, 2001.

¹² See BRUCE ZAGARIS, THE GATEKEEPER INITIATIVE: AN EMERGING CHALLENGE FOR PROFESSIONAL ADVISORS OF INTERNATIONAL BUSINESS AND TAX MATTERS 3 (2002), available at <http://www.abanet.org/crimjust/taskforce/articles/gatekeeper2.pdf>.

¹³ Paragraph 32 of the Moscow Communiqué contains the gatekeeper provision:

32. We recognize that many money-laundering schemes involve the corruption of financial intermediaries. We will therefore consider requiring or enhancing suspicious transaction reporting by the “gatekeepers” to the international financial system, including company formation agents, accountants, auditors and lawyers, as well as making the intentional failure to file the reports a punishable offense, as appropriate.

Moscow Communiqué, *supra* note 9, para. 32. See John W. Brooks & Roberta Vassallo, *Attorney Cathy’s Continuing Quandary, or, Can the Gatekeeper Initiative Be Reconciled with the Multi-Jurisdictional Practice of Law?*, 41 INT’L LAW. 59, 59–60 (2007) (providing an overview of the Gatekeeper Initiative).

¹⁴ The Gatekeeper Initiative and FATF employ the extensive use of acronyms. Appendix A contains a glossary of the acronyms used in this Article.

¹⁵ See Kevin L. Shepherd, *USA PATRIOT Act and the Gatekeeper Initiative: Surprising Implications for Transactional Lawyers*, PROB. & PROP., Sept.-Oct. 2002, at 26, 29; Bruce Zagaris, *Gatekeepers Initiative: Lawyers and the Bar Ignore It at Their Peril*, 23 CRIM. JUST. 28, 30 [hereinafter *Lawyers and the Bar*].

¹⁶ CFT is sometimes referred to as counter-terrorist financing, or CTF. For consistency, this Article uses the acronym CFT.

Why, then, should any of this concern transactional lawyers in the United States? Although FATF has no authority to impose laws on any jurisdiction, the group exerts international political pressure on its member states to enact its AML and CFT recommendations. FATF's efforts create unprecedented challenges to the sanctity of the attorney–client privilege, the duty of client confidentiality, and the delivery of legal services generally in the American legal system.¹⁷ The lapses in the transparency of FATF's outreach to the private sector compound these difficulties.¹⁸ Congress has not enacted gatekeeper-type legislation yet, despite ongoing efforts to do so.¹⁹ The legal profession's efforts to adopt voluntary good practices guidance implementing a risk-based approach, combined with private and government sector working groups' uniform promotion of certain amendments to state laws,²⁰ may dissuade legislators from pursuing the enactment of gatekeeper-type legislation.

This Article examines FATF's origins and purpose; the development of certain recommendations FATF has issued since its creation; the Gatekeeper Initiative's origin and development; FATF's engagement with the legal profession; the development of a risk-based approach for DNFBPs, including lawyers, to money laundering and terrorist financing; the challenges of adopting a risk-based approach for American transactional lawyers; and suggested risk-based guidance for transactional lawyers.

¹⁷ See *infra* Part IV.

¹⁸ See *infra* Part VI.

¹⁹ The U.S. Committee on Homeland Security and Governmental Affairs' Permanent Sub-Committee for Investigations held a series of hearings as far back as 2001 focusing on weaknesses in the U.S. financial sector ostensibly stemming from the lack of beneficial ownership information. At least two bills have been introduced that require, among other things, those involved in corporate formation (including lawyers) to identify beneficial owners and conduct certain due diligence checks on relevant transactions. See The Incorporation Transparency and Law Enforcement Assistance Act, S. 2956, 110th Cong. (2008); Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007).

²⁰ The ABA and the National Conference of Commissioners on Uniform State Laws (NCCUSL), together with additional private and public organizations (including tacit approval by the U.S. Department of Treasury), actively are developing alternative solutions to address the beneficial ownership issue. Primarily, these solutions include a proposed uniform law entitled "Uniform Law Enforcement Access to Entity Information Act." See NAT'L CONFERENCE OF COMM'R ON UNIF. STATE LAWS, UNIF. LAW ENFORCEMENT ACCESS TO ENTITY INFORMATION ACT 1 (2009), http://www.law.upenn.edu/bll/archives/ulc/roba/2009mar_clean.htm (last visited Apr. 1, 2009).

II. GENESIS AND PURPOSE OF FATF

AML and CFT lie at the heart of the Gatekeeper Initiative and FATF's existence. By way of background, money laundering "is the criminal practice of filtering ill-gotten gains, or 'dirty' money, through a series of transactions; in this way the funds are 'cleaned' so that they appear to be proceeds from legal activities."²¹ Money laundering involves three distinct stages: the placement stage, the layering stage, and the integration stage.²² Funds from illegal activity, or funds intended to support illegal activity, first are introduced into the financial system during the placement stage.²³ The layering stage involves disguising and distancing the illicit funds from their illegal source through the use of a series of frequently complex financial transactions.²⁴ The layering stage may include the creation of tiered entities and complicated entity structures designed to conceal the illicit funds.²⁵ The integration phase of money laundering results in the illicit funds, now laundered, returning to "a sta-

²¹ COMPTROLLER OF THE CURRENCY ADM'R OF NAT'L BANKS, BANK SECRECY ACT, ANTI-MONEY LAUNDERING 2 (2000), available at <http://www.occ.treas.gov/handbook/bsa.pdf>. The Federal Financial Institutions Examinations Council is comprised of the five federal banking agencies: Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision. See Steven V. Melnik, *The Inadequate Utilization of the Accounting Profession in the United States Government's Fight Against Money Laundering*, 4 N.Y.U. J. LEGIS. & PUB. POL'Y 143, 146 (2000–2001). See also Cuellar v. United States, 128 S. Ct. 1994, 2000 (2008) (defining the common meaning of money laundering as taking steps to make funds appear legitimate).

²² See Christopher Boran, *Money Laundering*, 40 AM. CRIM. L. REV. 847, 848 (2003) (explaining three stages of money laundering); Mariano-Florentino Cuellar, *The Tenuous Relationship Between the Fight Against Money Laundering and the Disruption of Criminal Finance*, 93 J. CRIM. L. & CRIMINOLOGY 311, 324–30 (2003); Money Laundering FAQ, <http://www.fatf-gafi.org> (follow "Money Laundering FAQ" hyperlink) (last visited Mar. 15, 2009).

²³ See George A. Lyden, *Note: The International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001: Congress Wears a Blindfold While Giving Money Laundering Legislation a Facelift*, 8 FORDHAM J. CORP. & FIN. L. 201, 206 (2003); History of Anti-Money Laundering Laws, http://www.fincen.gov/news_room/aml_history.html (last visited Mar. 15, 2009) (explaining the three stages of money laundering).

²⁴ See Lyden, *supra* note 23, at 207–08.

²⁵ See *id.*

tus of expendability in the hands of the organized crime group that generated them.”²⁶

FATF is an intergovernmental policy making body formed to develop and promote national and international policies to combat money laundering and terrorist financing.²⁷ FATF, which is based in Paris, by its own admission seeks to “generate the necessary political will to bring about legislative and regulatory reforms” in the money laundering and terrorist financing areas.²⁸ FATF thus has no independent ability to enact laws but instead relies on its political muscle to achieve reforms in these areas.²⁹ Since the organization’s creation in 1989, FATF has focused its efforts on three main activities: setting standards, ensuring effective compliance with those standards, and identifying money laundering and terrorist financing threats.³⁰ The organization attempts to set standards, ensure compliance, and identify threats by conducting Mutual Evaluations on member countries and by rating each country on compliance with relevant standards.³¹

FATF consists of thirty-four members, comprised of thirty-two countries and territories and two regional organizations.³² The United States, along with the United Kingdom, France, Italy, and Germany are charter

²⁶ *Id.* at 208.

²⁷ See What Is the FATF?, <http://www.fatf-gafi.org> (follow “About the FATF” hyperlink; then follow “What is the FATF?” hyperlink) (last visited Mar. 15, 2009).

²⁸ *Id.*; see Andrew de Lotbinière McDougall, *International Arbitration and Money Laundering*, 20 AM. U. INT’L L. REV. 1021, 1029–30 (2005) (discussing origins of FATF).

²⁹ See McDougall, *supra* note 28.

³⁰ See FINANCIAL ACTION TASK FORCE, FATF REVISED MANDATE 2008–2012 (2008), para. 2, at 1, <http://www.fatf-gafi.org/dataoecd/3/32/40433653.pdf> (last visited Mar. 15, 2009) [hereinafter FATF MANDATE].

³¹ See FINANCIAL ACTION TASK FORCE, METHODOLOGY FOR ASSESSING COMPLIANCE WITH THE FATF 40 RECOMMENDATIONS AND THE FATF 9 SPECIAL RECOMMENDATIONS, para. 1, at 1 (2008), <http://www.fatf-gafi.org/dataoecd/16/54/40339628.pdf> (last visited Mar. 15, 2009) [hereinafter FATF METHODOLOGY].

³² Argentina, Australia, Austria, Belgium, Brazil, Canada, China, Denmark, the European Commission, Finland, France, Germany, Greece, the Gulf Cooperation Council, Hong Kong, China, Iceland, Ireland, Italy, Japan, the Kingdom of the Netherlands (comprised of Netherlands, the Netherlands Antilles, and Aruba), Luxembourg, Mexico, New Zealand, Norway, Portugal, the Russian Federation, Singapore, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States. See FINANCIAL ACTION TASK FORCE, FATF ANNUAL REPORT 2007–2008, at 2 (2008), <http://www.fatf-gafi.org/dataoecd/58/0/41141361.pdf> (last visited Mar. 15, 2009) [hereinafter FATF ANNUAL REPORT].

members of FATF along with eleven other members.³³ In the early 1990s, FATF nearly doubled its membership from the original sixteen members to twenty-eight members.³⁴ Between 2000 and 2007, FATF gradually increased its membership by adding six new members.³⁵ India and the Republic of Korea serve as observers to FATF along with three FATF-style regional bodies.³⁶ Five organizations are FATF associate members.³⁷ FATF members must commit in writing to endorse and support FATF's recommendations and policies at the political level and agree to undergo periodic mutual evaluations and attain acceptable ratings.³⁸

A president who serves for a one-year term leads the FATF.³⁹ A high-level government official from one of the FATF jurisdictions holds this position.⁴⁰ The FATF Secretariat—based at the Organisation for Economic Co-operation and Development (OECD)⁴¹ headquarters in

³³ See FINANCIAL ACTION TASK FORCE, ABOUT THE FATF, <http://www.fatf-gafi.org> (follow "About the FATF" hyperlink) (last visited Mar. 15, 2009).

³⁴ See *id.*

³⁵ See *id.* Argentina, Brazil, and Mexico were added in 2000; Russia and South Africa in 2003; and China in 2006. For a list of all FATF members, see FATF ANNUAL REPORT, *supra* note 32.

³⁶ The three FATF-style regional organizations are the Eurasian Group, the Eastern and Southern Africa Anti-Money Laundering Group, and the Intergovernmental Action Group against Money-Laundering in Africa. See FATF ANNUAL REPORT, *supra* note 32.

³⁷ The Asia/Pacific Group on Money Laundering, the Caribbean Financial Action Task Force, the Council of Europe Select Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism, the Financial Action Task Force on Money Laundering in South America, and the Middle East and North Africa Financial Action Task Force are associate members. See *id.* at 2–3.

³⁸ See FINANCIAL ACTION TASK FORCE, FATF MEMBERSHIP POLICY (2008), <http://www.fatf-gafi.org/dataoecd/25/48/41112798.pdf> (last visited Mar. 15, 2009).

³⁹ The FATF President for the period July 1, 2008, to June 30, 2009, is Antonio Gustavo Rodrigues, the head of Brazil's Council for Financial Activities Control, which is Brazil's financial intelligence unit (FIU) and an AML/CFT financial policy agency. See FINANCIAL ACTION TASK FORCE, PRESIDENCY & SECRETARIAT, <http://www.fatf-gafi.org> (follow "About the FATF" hyperlink; then follow "Presidency & Secretariat" hyperlink) (last visited Mar. 15, 2009) [hereinafter FATF PRESIDENCY & SECRETARIAT].

⁴⁰ See *id.*

⁴¹ The OECD, comprised of thirty members, is an international organization designed to assist governments in tackling the economic, social, and governance challenges of a globalized economy. See Organisation for Economic Co-operation and Development Homepage, <http://www.oecd.org> (last visited Mar. 15, 2009).

Paris—supports the work of FATF and the organization’s president.⁴² This work includes interacting with FATF working groups and ad hoc groups to ensure coordination and consistency.⁴³ FATF, however, is an independent international body, and the OECD funds FATF’s operations with member contributions in line with OECD contribution formulas.⁴⁴ For fiscal year 2008, FATF’s annual budget was over €2.5 million.⁴⁵ FATF organizationally does not have an unlimited mandate or duration. Unless member states otherwise agree, FATF is scheduled to sunset in December 2012.⁴⁶

In its most recently issued mandate, FATF states that the organization seeks to build a stronger partnership with the private sector.⁴⁷ FATF acknowledges that “[t]he private sector is at the front line of the international battle against money laundering and terrorist financing and other illicit financing threats.”⁴⁸

III. FORTY RECOMMENDATIONS AND NINE SPECIAL RECOMMENDATIONS

A. *Forty Recommendations*

In 1990, less than a year after the G-7 directed FATF’s formation, FATF issued a comprehensive action plan for combating money laundering known as *Forty Recommendations*.⁴⁹ *Forty Recommendations* represents the basic framework for AML efforts and is designed to be applicable universally.⁵⁰ In FATF’s view, *Forty Recommendations* is “neither complex nor difficult, nor do they compromise the freedom to engage in legitimate transactions or threaten economic development.”⁵¹ *Forty Recommendations* consists of four major sections: (1) the role of national

⁴² See FATF PRESIDENCY & SECRETARIAT, *supra* note 39.

⁴³ See FATF MANDATE, *supra* note 30, para. 24, at 5.

⁴⁴ See *id.* para. 25, at 5.

⁴⁵ See FATF ANNUAL REPORT, *supra* note 32, at 17. As of September 21, 2008, this amount equated to over \$3.7 million.

⁴⁶ See FATF MANDATE, *supra* note 30, para. 3, at 1.

⁴⁷ See *id.* para. 14, at 4.

⁴⁸ *Id.*

⁴⁹ See THE FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, THE FORTY RECOMMENDATIONS (2004), <http://www.fatf-gafi.org/dataoecd/7/40/34849567.pdf> (last visited Mar. 15, 2009) [hereinafter FORTY RECOMMENDATIONS].

⁵⁰ See *id.*

⁵¹ The 40 Recommendations, <http://www.fatf-gafi.org/> (follow “40 Recommendations” hyperlink) (last visited Mar. 15, 2009) [hereinafter The 40 Recommendations Website].

legal systems in combating money laundering, (2) the role of financial systems in combating money laundering, (3) the measures necessary to combat money laundering and terrorist financing, and (4) international cooperation.⁵²

Specific recommendations are referred to as a “Recommendation.” For example, Recommendation 1 provides that countries should criminalize money laundering.⁵³ Recommendations 2 and 3 continue the theme of how each country should adapt its legal system to AML/CFT measures.⁵⁴ Recommendations 4 through 25 describe the measures financial institutions and DNFBPs should take to prevent money laundering and terrorist financing.⁵⁵ These measures include customer due diligence and record keeping.⁵⁶

Recommendations 13 through 16 deal with suspicious transaction reporting (STR).⁵⁷ Recommendation 13, which articulates the general STR rule, states that “[i]f 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 notify the appropriate Financial Intelligence Unit (FIU) of its suspicions by filing an STR.⁵⁸ Recommendation 14 embodies the corollary “no tipping off” (NTO) rule.⁵⁹ Under the NTO rule, if the financial institution files an STR with the FIU, the financial institution cannot inform its customer

⁵² See FORTY RECOMMENDATIONS, *supra* note 49.

⁵³ See *id.* para. 1, at 1.

⁵⁴ See *id.* paras. 2–3, at 1–2.

⁵⁵ See *id.* paras. 4–25, at 2–8.

⁵⁶ See *id.* para. 5, at 2–3 (describing customer due diligence measures), para. 12, at 5 (describing application of customer due diligence and record keeping measures to DNFBPs in certain situations).

⁵⁷ See *id.* paras. 13–16, at 5–6. The equivalent requirement under the Bank Secrecy Act is the “Suspicious Activity Report” (SAR). Federal law requires depository institutions in the United States to file SARs on transactions or attempted transactions involving at least \$5,000 that the financial institution knows, suspects, or has reason to suspect (1) involve money derived from illegal activities, (2) are intended or conducted to hide or disguise funds or assets derived from illegal activity, (3) are designed to evade requirements under the Bank Secrecy Act or other financial reporting requirements, or (4) have no business or apparent lawful purpose. See 12 C.F.R. § 21.11 (2008).

⁵⁸ FORTY RECOMMENDATIONS, *supra* note 49, para. 13, at 5. A FIU is “a national centre for receiving (and, as permitted, requesting), analysis and dissemination of STR and other information regarding potential money laundering or terrorist financing.” *Id.* para. 26, at 8.

⁵⁹ *Id.* para. 14, at 5–6.

that it made such a report.⁶⁰ The STR requirement and the NTO rule have been a controversial aspect of *Forty Recommendations*' application to the legal profession.⁶¹

Recommendations 33 and 34 focus on the need to ensure the transparency of legal arrangements and on the unlawful use of legal persons to prevent money laundering and terrorist financing.⁶² Recommendation 33 provides in pertinent part that

[c]ountries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.⁶³

Recommendation 34 states that “[c]ountries should take measures to prevent the unlawful use of legal arrangements by money launderers.”⁶⁴ The remaining Recommendations focus mainly on international assistance and cooperation on AML issues and the role of financial systems in combating money laundering.⁶⁵

FATF revised *Forty Recommendations* for the first time in 1996.⁶⁶ FATF most recently revised *Forty Recommendations* in 2004, including the addition of Interpretative Notes “designed to clarify the application of specific Recommendations and to provide additional guidance.”⁶⁷ FATF

⁶⁰ See FORTY RECOMMENDATIONS, *supra* note 49, para. 14(b), at 5–6. Recommendation 14(b) states in pertinent part that “[f]inancial institutions, their directors, officers and employees should be . . . [p]rohibited by law from disclosing the fact that a [STR] or related information is being reported to the FIU.” *Id.* The Interpretative Notes indicate, however, that tipping off does not occur when a lawyer seeks to dissuade a client from engaging in illegal activity. See Interpretative Notes to the 40 Recommendations of the FATF, http://www.fatf-gafi.org/document/28/0.3343,en_32250379_32236920_33988956_1_1_1_1,00.html (last visited Mar. 15, 2009) [hereinafter Interpretative Notes].

⁶¹ See generally *infra* Part VI.

⁶² See FORTY RECOMMENDATIONS, *supra* note 49, paras. 33–34, at 9.

⁶³ *Id.* para. 33, at 9.

⁶⁴ *Id.* para. 34, at 9.

⁶⁵ For example, Recommendation 27 states that countries “should ensure that designated law enforcement authorities have responsibility for money laundering and terrorist financing investigations.” *Id.* para. 27, at 8.

⁶⁶ See The 40 Recommendations Website, *supra* note 51.

⁶⁷ *Id.* FATF last revised *Forty Recommendations* on October 22, 2004. See *id.*

perceived a need to revise *Forty Recommendations* in 2004 because the organization “noted increasingly sophisticated combinations of techniques, such as the increased use of legal persons to disguise the true ownership and control of illegal proceeds, and an increased use of professionals to provide advice and assistance in laundering criminal funds.”⁶⁸ More than 180 jurisdictions endorse the most recently revised version of *Forty Recommendations*, and this version represents the international AML standard.⁶⁹

B. *Nine Special Recommendations*

A month after the September 11, 2001 terrorist attacks in the United States, FATF expanded its mandate to address terrorist financing and issued *Special Recommendations on Terrorist Financing*.⁷⁰ *Special Recommendations*, originally comprised of eight recommendations intended to complement *Forty Recommendations*, is designed to combat the funding of terrorist acts and terrorist organizations.⁷¹ FATF added a ninth special recommendation in October 2004 to address the concerns with cash couriers, thereby constituting *Nine Special Recommendations*.⁷² *Forty Recommendations* and *Nine Special Recommendations* sometimes are referred to collectively as *40+9 Recommendations*.⁷³ In sum, *40+9 Recommendations*, “together with their interpretative notes, constitute the international standards for combating money laundering and terrorist financing.”⁷⁴

IV. GATEKEEPER INITIATIVE

A. Engagement of the Private Sector: The 2002 Consultation Paper

After the G-8 issued the Moscow Communiqué in 1999, FATF created a working group that identified several professions as gatekeepers

⁶⁸ 40 Recommendations, Long Abstract, http://www.fatf-gafi.org/LongAbstract/0,3425,en_32250379_32237257_34849568_1_1_1_1,00.html (last visited Mar. 15, 2009).

⁶⁹ See FATF ANNUAL REPORT, *supra* note 32, at ii (statement of Rick McDonell, FATF Executive Secretary).

⁷⁰ See *id.* para. 2, at 1. FATF adopted the original eight Special Recommendations on October 22, 2001. See *id.*

⁷¹ See *id.* para. 4, at 1.

⁷² See 9 Special Recommendations (SR) on Terrorist Financing (TF), <http://www.fatf-gafi.org> (follow “9 Special Recommendations” hyperlink) (last visited Mar. 15, 2009).

⁷³ See FATF ANNUAL REPORT, *supra* note 32, para. 4, at 1.

⁷⁴ *Id.* para. 10, at 4.

with respect to money laundering.⁷⁵ On May 30, 2002, FATF published a Consultation Paper that identified several areas in which FATF could make changes to the AML framework.⁷⁶ FATF proposed that its framework cover legal professionals with several coverage options.⁷⁷ These options dealt with the coverage of lawyers,⁷⁸ customer due diligence, STRs and increasing diligence, beneficial ownership and control of corporate vehicles, and the application of AML obligations to nonfinancial businesses and professions, including the legal profession.⁷⁹ FATF pointed to an “increasing concern” that money laundering schemes involve the use of professionals (for example, gatekeepers) “by organised crime and other criminals to assist them to launder their funds by acting as financial intermediaries or providing expert advice.”⁸⁰ These professionals include lawyers, notaries, and accountants.⁸¹

⁷⁵ These professions consisted of seven sectors: casinos and other gambling businesses, dealers in real estate and high value items, company and trust service providers, lawyers, notaries, accountants and auditors, and investment advisors. *See* FINANCIAL ACTION TASK FORCE ON MONEY LAUNDERING, REVIEW OF THE FATF FORTY RECOMMENDATIONS: CONSULTATION PAPER para. 13, at iii (2002), <http://www.fatf-gafi.org/dataoecd/32/3/34046414.pdf> (last visited Mar. 15, 2009) [hereinafter CONSULTATION PAPER].

⁷⁶ *See id.*

⁷⁷ *See id.* para. 280, at 98.

⁷⁸ *See id.* para. 288, at 100. For example, Option 1 states that lawyers and independent legal professionals should be covered in all their activities. Option 2 indicates that lawyers and independent legal professionals should be covered, “but only where they are acting as financial intermediaries on behalf of or for the benefit of the client.” *Id.* Option 3 proposes that lawyers and independent legal professionals would be covered “where they are involved in the planning or execution of financial, property, corporate or fiduciary business for the client.” *Id.*

⁷⁹ *See id.* para. 10, at 3.

⁸⁰ *Id.* para. 5, at 1.

⁸¹ *See id.* para. 5, at 3. Professionals such as lawyers, accountants, and financial advisors

are believed to be in a unique position to observe transactions and identify potential suspicious activities that may indicate money laundering, terrorist financing, or other unlawful conduct. These gatekeeper professionals, however, are often subject to confidentiality commitments, professional secrecy, or legal privileges that underlie the very professional relationships that allow them to perform these necessary gatekeeping roles.

Aaron R. Hutman, et al., *Money Laundering Enforcement and Policy*, 39 INT’L LAW. 649, 660 (2005).

FATF requested that non-FATF members and the private sector provide comments on the Consultation Paper for FATF's consideration in the review process.⁸² Nearly three months after the Consultation Paper's issuance the ABA submitted comments in response to FATF's request.⁸³ The ABA expressed its appreciation for having the opportunity to provide comments on the Consultation Paper, but at the same time, "advocate[d] the urgent need for enhanced due process prior to finalizing the Consultation Paper."⁸⁴ The ABA criticized the consultative process and the Consultation Paper in several respects, such as the lack of an opportunity for lawyers "to participate fully in the identification and assessment of the alleged problems . . . giv[ing] rise to the proposed Recommendations" to include gatekeepers.⁸⁵ The ABA criticized the absence of input from the legal profession itself on "the roles and work of the legal profession and the importance of access by all members of the public to justice."⁸⁶ The ABA contended that the group the revised Recommendations directly affected—lawyers—should have a seat at the table in the

⁸² FATF explained the open nature of the review process, the goal to make the review process transparent, and the desire to convene meetings with appropriate persons or entities once FATF received written comments on the Consultation Paper:

The review process is widely based, and is intended to allow FATF members, FATF-style regional bodies, other international organisations, non-FATF countries and jurisdictions, the financial and other affected sectors, and other interested parties to participate directly in the review process. Moreover, the process is an open one, and any person may provide comments to the FATF on the issues raised in this consultation paper. Following this consultation the FATF will hold meetings with appropriate persons or entities, and then take into account the comments that have been made when preparing more precise proposals for changes to the FATF framework. This consultation will take place both at a national level by FATF members, and by the FATF itself at an international level.

CONSULTATION PAPER, *supra* note 75, para. 12, at 3. The review process itself has been the subject of criticism because of FATF's perceived unwillingness to give serious consideration to the input received from interested parties. *See Lawyers and the Bar*, *supra* note 15, at 34.

⁸³ *See* AMERICAN BAR ASSOCIATION TASK FORCE ON GATEKEEPER REGULATIONS AND THE LEGAL PROFESSION, COMMENTS ON GATEKEEPER PROVISIONS OF FATF CONSULTATION PAPER (2003), <http://www.abanet.org/crimjust/taskforce/actions/gatekeeper.pdf> (last visited Mar. 15, 2009) [hereinafter ABA COMMENTS ON CONSULTATION PAPER].

⁸⁴ *Id.* at 1.

⁸⁵ *Id.*

⁸⁶ *Id.* at 1–2.

revision process so that their views could counterbalance the views of governmental authorities.⁸⁷

Exactly two months after the ABA's comment submission, FATF issued a revised set of *Forty Recommendations* on June 23, 2003.⁸⁸ In the period between the ABA's comment submission and the issuance of the revised *Forty Recommendations*, FATF did not meet with ABA representatives or otherwise engage with the organization.⁸⁹

The revised *Forty Recommendations* expanded the universe of persons responsible for performing AML customer due diligence and recordkeeping to include gatekeepers, known as DNFBPs.⁹⁰ Recommendation 12 states as follows:

The customer due diligence and record-keeping requirements set out in Recommendations 5, 6, and 8 to 11 apply to designated non-financial businesses and professions in the following situations:

. . . .

(d) Lawyers, notaries, other independent legal professionals and accountants when they prepare for or carry out transactions for their client concerning the following activities:

- buying and selling of real estate;
- managing of client money, securities or other assets;
- management of bank, savings or securities accounts;
- organisation of contributions for the creation, operation or management of companies;
- creation, operation or management of legal persons or arrangements, and buying and selling of business entities.⁹¹

As one commentator wryly noted, "when the FATF decided to include gatekeepers and especially legal professionals within the

⁸⁷ See *id.* at 1–2; *Lawyers and the Bar*, *supra* note 15 (criticizing FATF's processes for developing AML standards for gatekeepers, including the exclusion of major stakeholders from the decision making process and lack of transparency in the decision making process).

⁸⁸ See FORTY RECOMMENDATIONS, *supra* note 49.

⁸⁹ See *id.*

⁹⁰ See *id.*

⁹¹ *Id.* para. 12, at 5.

AML/CFT standards, it did so without empirical evidence that money laundering by gatekeepers and legal professionals was a major problem.”⁹² The inclusion of lawyers within the sweep of *40+9 Recommendations* was a watershed event. FATF incorporated lawyers into its regime of covered parties, but without meaningful dialogue with the private sector as to causation or appropriate, tailored, and targeted solutions.⁹³

B. Mutual Evaluation Process

40+9 Recommendations envisions a monitoring and evaluation process of each country’s AML systems to determine whether they are in compliance with FATF’s standards.⁹⁴ Referred to as “mutual evaluations,” FATF and FATF-style regional bodies periodically monitor and evaluate each country’s compliance with FATF’s standards to ensure that *40+9 Recommendations* are implemented effectively by all countries.⁹⁵ This mutual evaluation process is “a key component of the FATF’s work as it is through this process that the FATF monitors the implementation of the *40+9 Recommendations* in its member jurisdictions, and assesses the overall effectiveness of AML/CFT systems.”⁹⁶

FATF employs a four-level grading system to rate compliance with FATF’s standards.⁹⁷ These compliance levels consist of (1) compliant, (2) largely compliant, (3) partially compliant, and (4) noncompliant.⁹⁸

⁹² *Lawyers and the Bar*, *supra* note 15, at 32.

⁹³ *See generally infra* Part VI.

⁹⁴ *See* FATF METHODOLOGY, *supra* note 31.

⁹⁵ *See id.* FATF produced a handbook to assist the teams performing mutual evaluations. *See* FINANCIAL ACTION TASK FORCE, AML/CFT EVALUATIONS AND ASSESSMENTS, HANDBOOK FOR COUNTRIES AND ASSESSORS (2007), <http://www.fatf-gafi.org/dataoecd/7/42/38896285.pdf> (last visited Mar. 15, 2009).

⁹⁶ FATF ANNUAL REPORT, *supra* note 32, para. 23, at 12.

⁹⁷ *See* FATF METHODOLOGY, *supra* note 31, para. 11, at 3.

⁹⁸ *See id.* A compliant rating means that the country is observing fully the Recommendation with respect to all “essential criteria.” *Id.* A largely compliant rating means that there are “minor shortcomings, with a large majority of the essential criteria being fully met.” *Id.* A partially compliant rating indicates that a “country has taken some substantive action and complies with some of the essential criteria.” *Id.* Finally, a noncompliant rating means “[t]here are major shortcomings, with a large majority of the essential criteria not being met.” *Id.* para. 11, at 4. In exceptional circumstances a Recommendation also may be rated as not applicable. *See id.* para. 11, at 3. A not applicable rating means that all “or part of a requirement does not apply, due to structural, legal or institutional features of a country.” *Id.* para. 11, at 4. Essential criteria means

Because the Mutual Evaluation Teams are comprised of different representatives, laws and practices in one country commonly may receive a passing grade, but fail in another.⁹⁹

The United States most recently was the subject of a mutual evaluation in 2006.¹⁰⁰ FATF rated the United States noncompliant on Recommendation 12 for lawyers, accountants, dealers in precious metals and stones, and real estate agents because members of these professions “are not subject to customer identification and record keeping requirements that meet Recommendations 5 and 10.”¹⁰¹ FATF also rated the United States noncompliant on Recommendation 16 because lawyers, among others, are not subject to STR requirements or the NTO rule, nor are they protected from liability when they choose to file an STR, and they are not required to implement adequate internal controls, as contemplated by Recommendations 13 through 15 and 21.¹⁰² The United States fared slightly better when FATF rated it partially compliant in the area of regulation, supervision, and monitoring of DNFBPs (Recommendation 24), even though FATF concluded that “no regulatory oversight [exists] for AML/CFT compliance for” lawyers and other DNFBPs.¹⁰³ FATF al-

“those elements that should be present to demonstrate full compliance with the mandatory elements of each of the Recommendations.” *Id.* para. 10, at 3.

⁹⁹ A comparison of the recent Mutual Evaluations of China, the United Kingdom, Australia, and the United States illustrates this phenomenon. *Compare* FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, AUSTRALIA (2005), <http://www.fatf-gafi.org/dataoecd/22/38/35509034.pdf> (last visited Mar. 15, 2009), *with* FINANCIAL ACTION TASK FORCE, SUMMARY OF THE FIRST MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, PEOPLE’S REPUBLIC OF CHINA (2007), <http://www.fatf-gafi.org/dataoecd/24/45/39148209.pdf> (last visited Mar. 15, 2009); FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (2007), <http://www.fatf-gafi.org/dataoecd/33/20/38917272.pdf> (last visited Mar. 15, 2009); *and* FINANCIAL ACTION TASK FORCE, SUMMARY OF THE THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM, UNITED STATES OF AMERICA (2006), <http://www.fatf-gafi.org/dataoecd/44/12/37101706.pdf> (last visited Mar. 15, 2009) [hereinafter U.S. MUTUAL EVALUATION].

¹⁰⁰ *See* U.S. MUTUAL EVALUATION, *supra* note 99, at 2. The mutual evaluation was a joint evaluation by FATF and the Asia Pacific Group.

¹⁰¹ *Id.* at 13.

¹⁰² *See id.*

¹⁰³ *Id.* at 14.

lowed the United States until the summer of 2008 to correct its failings or risk possible expulsion from FATF.¹⁰⁴

V. DEVELOPMENT OF RISK-BASED APPROACH

The FATF Recommendations encourage countries to develop a risk-based approach to AML/CFT efforts.¹⁰⁵ The theoretical and practical underpinning of the risk-based approach is to ensure that limited resources to combat money laundering and terrorist financing are employed and allocated in the most efficient manner possible so that the greatest risks receive the highest attention.¹⁰⁶ In this fashion, the risk-based approach differs fundamentally from a rules-based approach. Under a rules-based approach, a lawyer is required to comply with particular laws, rules, or regulations irrespective of the underlying quantum or degree of risk.

¹⁰⁴ Some commentators use the *U.S. Mutual Evaluation* to promote new legislation that would sweep lawyers and others involved in the corporate formation process under the Bank Secrecy Act regulations administered by U.S. Department of Treasury's Financial Crimes Enforcement Network (FinCEN). FinCEN is the U.S. FIU. *See, e.g., infra* notes 307, 311 (discussing Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007), and The Incorporation Transparency and Law Enforcement Assistance Act, S. 2956, 110th Cong. (2008)).

¹⁰⁵ *See* FINANCIAL ACTION TASK FORCE, RBA GUIDANCE FOR LEGAL PROFESSIONALS (2008), <http://www.fatf-gafi.org/dataoecd/5/58/41584211.pdf> (last visited Mar. 15, 2009) [hereinafter LAWYER GUIDANCE].

¹⁰⁶ *See id.* at 6. The heart of the risk-based approach is captured in paragraph 18 of *Lawyer Guidance*:

By adopting a risk-based approach, it is possible to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate with the risks identified. This will allow resources to be allocated in the most efficient ways. The principle is that resources should be directed in accordance with priorities so that the greatest risks receive the highest attention. The alternative approaches are that resources are either applied evenly, or that resources are targeted, but on the basis of factors other than risk. This can inadvertently lead to a "tick box" approach with the focus on meeting regulatory requirements rather than on combating money laundering or terrorist financing efficiently and effectively.

Id. para. 18, at 8; *see Lawyers and the Bar, supra* note 15, at 33 ("A risk-based process allows a designated legal professional to proportionately focus the organization's resources and attention on those clients and types of work that potentially pose the greatest risk of money laundering.").

VI. EVOLUTION OF GUIDANCE FOR LEGAL PROFESSIONALS

FATF's development of risk-based guidance for the legal profession evolved over the course of a year-long engagement with the private sector.¹⁰⁷ However, *Lawyer Guidance* was not developed in a vacuum nor by writing on a blank slate. *Lawyer Guidance* derives in large part from the inaugural risk-based guidance produced by a collaboration between FATF and financial institutions.¹⁰⁸ *Financial Institution Guidance* served as a template for the risk-based guidance papers for the various DNFBP sectors, including lawyers.¹⁰⁹

In June 2007, FATF issued *Financial Institution Guidance*.¹¹⁰ FATF collaborated with representatives of the banking and securities industries

¹⁰⁷ The development of a risk-based approach for the legal profession arguably began in earnest at an FATF meeting held on November 7–8, 2006, in Amsterdam. At this meeting, FATF consulted with lawyers, notaries, accountants, and TCSPs about the practical difficulties of applying *Forty Recommendations* to these private sectors. Shortly after the Amsterdam meeting, FATF identified eight areas of possible further examination and asked the legal profession to identify its top three priority items. By letter dated December 12, 2006, the legal profession identified its top three priority issues, including a further examination of the risk-based approach. See Letter from the Council of Bars and Law Societies of Europe (CCBE), Japan Federation of Bar Associations (JFBA), Law Council of Australia, Gatekeeper Task Force, Federation of Law Societies of Canada, Law Society of Hong Kong, International Bar Association (IBA), New Zealand Law Society, and ACTEC to FATF (Dec. 12, 2006) (hereinafter "Dec. 2006 Letter") (on file with author). In a subsequent letter from the private sector to FATF dated May 14, 2007, the private sector noted that "[i]t is apparent from what we have said that we do not see the way forward as being the drafting of an additional chapter on the FATF guidance." Letter from CCBE, JFBA, Law Council of Australia, Gatekeeper Task Force, Federation of Law Societies of Canada, Law Society of Hong Kong, IBA, ACTEC, and UIA International Association of Lawyers (Union Internationale des Avocats) to FATF (May 14, 2007) (on file with author). Rather, the private sector proposed face-to-face meetings with FATF to develop a risk-based approach for the legal profession. This letter and interaction between FATF and the private sector paved the way for the September 11, 2007 meeting in London. See *supra* text accompanying notes 82–93 and *infra* text accompanying notes 115–16.

¹⁰⁸ See FINANCIAL ACTION TASK FORCE, GUIDANCE ON THE RISK-BASED APPROACH TO COMBATING MONEY LAUNDERING AND TERRORIST FINANCING: HIGH LEVEL PRINCIPLES AND PROCEDURES (2007), <http://www.fatf-gafi.org/dataoecd/43/46/38960576.pdf> (last visited Mar. 15, 2009) [hereinafter FINANCIAL INSTITUTION GUIDANCE].

¹⁰⁹ See *id.*

¹¹⁰ See *id.*

in developing *Financial Institution Guidance*,¹¹¹ which is comprised of three main sections: section one, which provides an overview of the guidance and identifies the guidance's purposes and goals; section two, which deals with guidance for public authorities; and section three, which focuses on the specific guidance to financial institutions for implementing the risk-based approach.¹¹²

After *Financial Institution Guidance*'s issuance, FATF continued to pursue its contacts with representatives of the DNFBPs to determine whether they would be interested in working with FATF to develop risk-based guidance for DNFBPs modeled after *Financial Institution Guidance*.¹¹³ FATF's outreach effort was part of an overall effort to work more closely with the private sector.¹¹⁴ These representatives expressed a desire to engage in a consultative process with FATF to flesh out the contours and content of *Lawyer Guidance*.

To that end, the second meeting between private sector representatives and FATF was held in London on September 11, 2007, with subsequent meetings held in Bern, Switzerland (December 2007), Paris (April 2008), London (June 2008), and Ottawa (September 2008).¹¹⁵ These meetings were critical in defining and narrowing the universe of issues and exploring possible solutions to the scope and content of *Lawyer Guidance*. A summary of each meeting is set forth below, with an emphasis on identifying the key decisions made at each meeting, the concessions and trade-offs inherent in a consultative process, the evolution of the focus and orientation of *Lawyer Guidance*, and how those key decisions shaped and influenced the final version of *Lawyer Guidance*.

¹¹¹ See *id.* at 1. These representatives included BNP Paribas, Bank of America, CIBC, UBS, HSBC, JP Morgan Chase & Co., the New York Stock Exchange, and the London Investment Banking Association. See *id.* at 42.

¹¹² See FINANCIAL INSTITUTION GUIDANCE, *supra* note 108.

¹¹³ See FATF ANNUAL REPORT, *supra* note 32.

¹¹⁴ See *id.* at 1. As a key priority during his term, Sir James Sassoon, FATF President for the period July 1, 2007, to June 30, 2008, sought the development of:
a more open and constructive working partnership with the private sector in order to raise awareness of the FATF's work, to inform FATF policymaking and to encourage more effective implementation of AML/CFT measures. We have made significant progress on this front, including the . . . establishment of a private sector consultative forum so that the FATF has an open dialogue with private sector stakeholders on AML/CFT issues

Id.

¹¹⁵ See *infra* Parts VI.A–VI.E.

A. 2007 London Meeting

On September 11, 2007, three months after the adoption of *Financial Institution Guidance*, FATF convened a meeting of representatives of the DNFBPs in London at the offices of the United Kingdom's Financial Services Authority.¹¹⁶ Representatives from the DNFBP sectors attended this meeting, including lawyers,¹¹⁷ accountants,¹¹⁸ notaries,¹¹⁹ real estate agents,¹²⁰ casino operators,¹²¹ TCSPs,¹²² and dealers in precious metals and stones.¹²³ In addition to representatives from the DNFBPs, public sector representatives attended as well.¹²⁴

¹¹⁶ Memorandum from Kevin L. Shepherd summarizing the London meeting (Sept. 14, 2007) (on file with author) [hereinafter LONDON 2007 MEMO].

¹¹⁷ Representatives from ABA, ACTEC, CCBE, and IBA attended the London meeting. *See id.*

¹¹⁸ Representatives from the European Federation of Accountants and the International Federation of Accountants attended the London meeting. *See id.*

¹¹⁹ Representatives from the Council of the Notariats of the European Union, the Swiss Notaries Association, the Swiss Bar Association, and the Federation of the European Bar attended the London meeting. *See id.*

¹²⁰ A representative from the International Consortium of Real Estate Associations attended the London meeting. *See id.*

¹²¹ Representatives from the European Casino Association and the Remote Gambling Association attended the London meeting. *See id.*

¹²² Representatives from the Society of Trust and Estate Practitioners (STEP) and the Institute of Chartered Secretaries and Administrators attended the London meeting. No U.S. representatives attended the meeting. *See id.* This proved to be problematic because FATF's guidance for this particular sector initially did not acknowledge differences between jurisdictions in the treatment of trust companies, nor did FATF's guidance reflect certain privacy-related objections to beneficial ownership disclosure. FATF did not solicit U.S. participation in this guidance until a few weeks before the June 2008 meeting, and relevant industry groups, including the Association of Registered Agents (ARA) and the National Public Records Research Association (NPRRA), registered reservations with the end product. The ARA and NPRRA provided FATF with initial comments to the guidance on May 20, 2008.

¹²³ Representatives from the Jewelers Vigilance Committee, the World Jewellery Confederation, the International Precious Metals Institute, and the Conseil Supérieur Diamonds attended the London meeting. *See id.*

¹²⁴ The public sector representatives included those from FATF, FATF member states (including representatives from Canada, the European Commission, Netherlands, Switzerland, and the United Kingdom), FATF-style regional bodies and international organizations (including representatives from the International Monetary Fund, the Offshore Group of Banking Supervisors, and The World Bank). The U.S. Government did not attend the September 11, 2007 meeting. *See id.*

The London meeting's purpose was to determine whether the DNFBPs would have an "appetite" in moving forward with the development of risk-based guidance for DNFBPs.¹²⁵ Private sector representatives expressed an interest in proceeding with the collaborative exercise with FATF, but the legal profession's representatives lodged several concerns. First, the lawyers noted that the legal profession is fundamentally different from traditional financial institutions; therefore, *Financial Institution Guidance* cannot be applied mechanically.¹²⁶ Second, the lawyers requested FATF provide evidence regarding whether lawyers are being used unwittingly in money laundering or terrorist financing schemes.¹²⁷ Third, the lawyers observed that many of the risk factors for financial institutions set forth in *Financial Institution Guidance* do not apply to the legal profession, such as the risks attendant to the handling of large sums of cash.¹²⁸ Finally, the lawyers indicated that guidance for the legal profession would need to be subject to principles governing the attorney-client privilege and the duty of client confidentiality.¹²⁹ Although FATF and the private sector representatives agreed to cooperate in the development of risk-based guidance for DNFBPs, the need for development of guidance for each specific DNFBP rather than an omnibus guidance applicable to all DNFBPs because of the substantive differences among the DNFBPs was clear at the London meeting.¹³⁰

B. 2007 Bern Meeting

Three months after the London meeting, FATF and representatives of DNFBPs reconvened in Bern, Switzerland, on December 11, 2008, at the offices of the Swiss Federal Finance Administration to continue their

¹²⁵ *Id.*

¹²⁶ *See id.*

¹²⁷ *See id.* The paucity of typologies describing situations in which lawyers have been used unwittingly in money laundering schemes is a particularly pointed criticism. As of the date of this Article, FATF has not produced to the legal profession typologies in which lawyers have been unwitting accomplices in money laundering schemes.

¹²⁸ *See id.*

¹²⁹ *See id.*

¹³⁰ *See id.* For example, casino operators and lawyers typically do not share the same risk factors given their business, industry profile, and operations. For that reason, developing guidance, even at a high principle level, that could accommodate adequately the divergent risk factors applicable to each sector appeared impracticable.

dialogue on the development of risk-based guidance for DNFbps.¹³¹ Representatives from the “legal professional sector,” comprised of lawyers,¹³² notaries,¹³³ and TCSPs,¹³⁴ attended the Bern meeting. Unlike the 2007 London meeting, representatives from the U.S. government attended the Bern meeting.¹³⁵

The Bern meeting was the first and only FATF/private sector meeting during 2007–2008 that included a “case study” of one country’s experience with the risk-based approach for the legal profession.¹³⁶ This presentation highlighted the considerable challenges in implementing a risk-based approach for the legal profession. Dina Beti, Head of the Swiss AML Control Authority, discussed the experience of Switzerland’s public sector with the risk-based approach for DNFbps. The Swiss government introduced the risk-based approach in 2003 and obligated all financial intermediaries in Switzerland to comply with the new risk-based approach from January 2005 forward.¹³⁷ Under the Swiss risk-based approach, all financial intermediaries are obligated to (1) establish a list of risk criteria both for customers and transactions, (2) develop an efficient process of monitoring customers and transactions based on

¹³¹ See Memorandum from Kevin L. Shepherd summarizing the Bern meeting (Dec. 14, 2007) (on file with author) [hereinafter BERN 2007 MEMO].

¹³² Representatives from ABA, ACTEC, CCBE, IBA, the Law Society of England and Wales, and the Federation of Law Societies of Canada attended the Bern meeting. *See id.*

¹³³ Representatives of the Council of the Notariats of the European Union, the Chamber of Notaries, Spain, and Swiss Notaries Association (also representing the Swiss Bar Association and the Federation of the European Bar) attended the Bern meeting. *See id.*

¹³⁴ Representatives from STEP, Hong Kong Institute of Company Secretaries, and the Institute of Chartered Secretaries and Administrators attended the Bern meeting. *See id.* Representatives from other DNFbps also attended the Bern meeting, including representatives from the following sectors: accountants; casinos—land based and remote; real estate agents; and dealers in diamonds, precious metals, and stones. *See id.*

¹³⁵ Governmental representatives from Australia, Canada, the European Commission, Gibraltar, Italy, Japan, Netherlands, Nigeria, Peoples Republic of China, South Africa, Switzerland, the United States, and the United Kingdom attended the Bern meeting. *See id.*

¹³⁶ The country was Switzerland. *See id.*

¹³⁷ See FINANCIAL ACTION TASK FORCE, THIRD MUTUAL EVALUATION REPORT ON ANTI-MONEY LAUNDERING AND COMBATING THE FINANCING OF TERRORISM SUMMARY, SWITZERLAND (2005), <http://www.fatf-gafi.org/dataoecd/60/30/35529139.pdf> (last visited Mar. 15, 2009) (discussing Swiss model).

these criteria, and (3) increase the level of due diligence with respect to higher risk customers.¹³⁸

Beti made clear that the Swiss intended to avoid a “box ticking” approach for categorizing risk.¹³⁹ Beti reviewed the risk categorization for customers and clients under the Swiss risk-based approach. Politically exposed persons (PEPs)¹⁴⁰ are a mandatory risk criterion.¹⁴¹ Other risk categories for customers include the nature and location of the business, the absence of personal contact, the type of requested services or products, the amount of the assets deposited, the amount of incoming and outgoing funds, and the countries from which or to which frequent payments are made. The mandatory risk category criteria for transactions center on the amount of a deposit or withdrawal or the amount of a money transfer transaction. Other transaction risk categories include the amount of the incoming and outgoing funds and any significant divergence from the type, volume, or frequency of transactions that would be usual in the context of a business relationship.¹⁴²

Under the Swiss risk-based approach for DNFBCPs, each of Switzerland’s approximately 6,500 financial intermediaries is subject to an annual audit. Of these financial intermediaries, about 18% are lawyers or notaries.¹⁴³ Beti noted that the first evaluation of the risk categorization during 2005 pointed out that the financial intermediaries did not under-

¹³⁸ *See id.*

¹³⁹ *See* BERN 2007 MEMO, *supra* note 131. In this context, “box ticking” is a derisive term referring to a rote or mechanical exercise of categorizing risks attendant in a particular engagement rather than undertaking a rigorous and meaningful examination of the applicable risk factors in light of specific facts.

¹⁴⁰ FATF defines PEPs as follows:

[I]ndividuals who are or have been entrusted with prominent public functions in a foreign country, for example Heads of State or of government, senior politicians, senior government, judicial or military officials, senior executives of state owned corporations, important political party officials. Business relationships with family members or close associates of PEPs involve reputational risks similar to those of PEPs themselves. The definition is not intended to cover middle ranking or more junior individuals in the foregoing categories.

The 40 Recommendations Website, *supra* note 51, at “Glossary” (internal quotations omitted).

¹⁴¹ *See* BERN 2007 MEMO, *supra* note 131.

¹⁴² *See id.*

¹⁴³ *See id.*

stand fully their legal responsibilities. For example, some financial intermediaries lacked any risk categorization. Others had vague risk criteria.¹⁴⁴ In 2006, the Swiss experience improved because of increasing acceptance and understanding of the risk-based approach. However, the audits continue to reveal systemic issues with the risk-based approach among the DNFBPs. Beti observed that for small financial intermediaries (for example, a “one person show”) the risk-based approach often is perceived as artificial and does not guarantee a more efficient AML system. Beti said that she perceives the Swiss risk-based approach for the DNFBPs to be effective, but she had no qualitative data to support her belief.¹⁴⁵

After Beti’s presentation, the lawyers, notaries, and TCSPs met with FATF and other governmental representatives in a break-out session designed to identify how best to proceed with the development of risk-based guidance for these sectors. FATF made clear that it strongly preferred that the DNFBPs hew closely to the form and format of *Financial Institution Guidance*, and that section 3 of *Financial Institution Guidance* would be the main area of departure. FATF cautioned the private sector not to revisit the existing FATF definitions. In FATF’s view, the key would be identifying the variables that may affect the risks.¹⁴⁶

To facilitate communication between FATF and the private sector in developing their guidance papers and to enhance transparency in this collaborative process, FATF invited private sector representatives to participate in an electronic web-based discussion group.¹⁴⁷ FATF would host the website and post drafts to promote participants’ comments. These comments would be posted on the secure website and available for re-

¹⁴⁴ See *id.*

¹⁴⁵ See *id.*

¹⁴⁶ See *id.*

¹⁴⁷ This group is known as the Electronic Advisory Group, which was created by the Working Group on Evaluation and Implementation (WGEI). See FATF ANNUAL REPORT, *supra* note 32, para. 5, at 15. FATF touted its “significantly increased” engagement with the private sector, through “soliciting private sector input to the typologies process, and through the establishment of a new private sector consultative forum. Looking forward, [FATF] will deepen its engagement with the private sector.” FATF MANDATE, *supra* note 30, para. 14, at 4. FATF also promised to “maintain high levels of transparency in its work, through direct communication, outreach and awareness-raising across all stakeholders, and making use of all available channels of communication.” *Id.* para. 15, at 4.

view by all participants. The attendees agreed that the private sector would generate an initial draft of the guidance by February 10, 2008.¹⁴⁸

At the Bern meeting, the lawyers explained to FATF that the guidance for the legal profession needed appreciation and respect for the role and limited resources of sole and small firm practitioners, many of whom lack the expertise and resources to adopt and implement an effective risk-based approach. The Bern meeting signaled the first time the lawyer group and FATF engaged in a substantive discussion on the critical issues presented by the STR requirement and the NTO rule. Lawyers from the United States lodged their strong opposition to any form of guidance that would impose an STR obligation or NTO rule on the legal profession.¹⁴⁹ These lawyers pointed to a policy the ABA adopted on this issue in February 2003.¹⁵⁰

After the Bern meeting, representatives of the legal professionals sector prepared an initial draft of the guidance paper based on the overall template of *Financial Institution Guidance*. Similar to *Financial Institution Guidance*, the legal professionals' draft was comprised of three sections. Section 1 places the guidance in context and explains the purpose of the risk-based approach. Section 2 sets forth guidance to public authorities, and Section 3 provides guidance to legal professionals on implementing a risk-based approach.

The initial draft of the legal professionals guidance represented an attempt to define the distinctions between legal professionals and financial institutions and the rationale for making the legal professionals draft responsive to the unique concerns of legal professionals. For that reason, sections 1 and 3 of the draft represent areas of substantive departure from *Financial Institution Guidance*. For example, section 1 highlights the important distinctions between legal professionals and financial institutions and recognizes that FATF cannot treat legal professionals as on the same plane as financial institutions. Section 1 also explains the unique role that legal professionals play in society and the importance of the rule

¹⁴⁸ See BERN 2007 MEMO, *supra* note 131.

¹⁴⁹ See *id.*

¹⁵⁰ See AMERICAN BAR ASSOCIATION, TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION, <http://www.abanet.org/crimjust/taskforce/actions.html> (last visited Mar. 15, 2009) (Resolution 104 adopted by the ABA House of Delegates in Feb. 2003). Resolution 104 states in pertinent part that the ABA "opposes any law or regulation that, while taking action to combat money laundering or terrorist financing, would compel lawyers to disclose confidential information to government officials or otherwise compromise the lawyer-client relationship or the independence of the bar." *Id.*

of law. Section 3 continues the theme section 1 expresses of the imperative to treat legal professionals differently than financial institutions.

The legal professionals group submitted the initial draft of its guidance to FATF in February 2008. A representative of the Financial Services Authority of the United Kingdom expressed a number of substantive concerns with the draft. To address these concerns and to review the initial draft in detail, FATF and the lawyer group agreed to meet in Paris to work toward a resolution of these concerns and to discuss areas of disagreement. FATF circulated its revisions to the guidance to the lawyer group immediately before the Paris meeting.¹⁵¹

Shortly before the Paris meeting, FATF¹⁵² informed the lawyer group that TCSP representatives proposed the development of a separate risk-based guidance for TCSPs.¹⁵³ Thus, TCSPs sought to remove themselves from the legal professionals guidance. Without the TCSPs, the legal professionals guidance would cover only lawyers and notaries. Representatives of the lawyer groups did not object to the development of separate risk-based guidance for TCSPs. The withdrawal of TCSPs from the lawyer guidance gave rise to concerns as to which guidance (for example, lawyers guidance or TCSP guidance) would govern if a lawyer performed services covered under both the TCSP guidance and the lawyer guidance. This issue ultimately was resolved at the Paris meeting, as discussed below.

C. 2008 Paris Meeting

FATF and representatives from the private sector met in Paris on April 24, 2008, to discuss a number of substantive issues contained in the draft *Lawyer Guidance*.¹⁵⁴ These substantive issues involved STRs and

¹⁵¹ FATF posted its comments on the lawyer guidance draft on April 21, 2008, on the WGEI website. The Paris meeting occurred on April 24, 2008.

¹⁵² References in this Article to FATF often refers to the Secretariat, as distinguished from the entire organization, including its members. Unless the context otherwise indicates, the references to FATF in this Article refer to the Secretariat.

¹⁵³ On April 2, 2008, a representative of the United Kingdom's Financial Services Authority posted the following note on the WGEI website: "The FATF Secretariat and the chair of the lawyers/notaries group have agreed that separate TCSP guidance will be prepared." Colin Powell, chairman of the Offshore Group of Banking Supervisors, volunteered to undertake the preparation of this separate guidance on behalf of the TCSP sector.

¹⁵⁴ Private and public sector groups represented at the Paris meeting included the following: (1) public sector groups: FATF Secretariat, Belgium CTIF-CFI, European

the NTO rule, the need to develop separate stand alone guidance for the legal profession, the impact of the withdrawal of TCSPs from *Lawyer Guidance*, and the lack of meaningful information on terrorist financing so as to enable the legal profession to draft appropriate guidance on this risk.¹⁵⁵ The Paris meeting represented a breakthrough on these seemingly intractable issues.¹⁵⁶

1. STR and NTO

Importantly for lawyers, the Paris meeting led to a resolution, if not an uneasy truce, on the contentious STR issue.¹⁵⁷ The lawyer groups steadfastly refused to agree to the inclusion of any provision in *Lawyer Guidance* that would impose an STR requirement on lawyers. The lawyers explained that the imposition of an STR obligation on lawyers would run afoul of the attorney–client privilege and the duty of client confidentiality and would prove injurious to the attorney–client privi-

Commission, The Netherlands Ministry of Finance, The Switzerland Ministry of Finance, and the United Kingdom Financial Services Authority; and (2) private sector groups: IBA, ABA, ACTEC, CCBE, and the Law Society of England and Wales. See Memorandum from Edward Manigault summarizing the Paris meeting (April 29, 2008) (on file with author) [hereinafter PARIS 2008 MEMO].

¹⁵⁵ See *id.* Terrorist financing differs substantively from money laundering. Paragraph 40 of *Lawyer Guidance* recognizes this fact by stating that “the characteristics of terrorist financing make its detection difficult and the implementation of mitigation strategies may be challenging due to considerations such as the relatively low value of transactions involved in terrorist financing, or the fact that funds can be derived from legitimate as well as illicit sources.” LAWYER GUIDANCE, *supra* note 105, para. 40, at 12. As the 9/11 Commission noted with respect to the financing of the September 11, 2001 terrorist attacks, “[c]ontrary to persistent media reports, no financial institution filed a Suspicious Activity Report (SAR)—which U.S. law requires banks to file within 30 days of a suspicious transaction—with respect to any transaction of any of 19 hijackers before 9/11. . . . Nor should SARs have been filed. The hijackers’ transactions themselves were not extraordinary or remarkable.” THE 9/11 COMMISSION REPORT: FINAL REPORT OF THE NATIONAL COMMISSION ON TERRORIST ATTACKS UPON THE UNITED STATES 528 n.116 (2004).

¹⁵⁶ See PARIS 2008 MEMO, *supra* note 154. The attendees at the Paris meeting also tackled other issues, including those relating to the identification of beneficial ownership of a client, the unique role of local counsel in transactional practices, referrals, and the absence of face-to-face interaction between a lawyer and client. See *infra* notes 195–201 and accompanying text for a more detailed discussion of these issues.

¹⁵⁷ See PARIS 2008 MEMO, *supra* note 154.

lege.¹⁵⁸ FATF, in response, contended that *Forty Recommendations* mandated the imposition of STRs on lawyers and that FATF could not agree to guidance that ignored *Forty Recommendations*.¹⁵⁹ FATF observed that the guidance for the other DNFBP sectors would include an STR obligation and did not want the guidance papers for each DNFBP sector to deviate on this point.¹⁶⁰

After considerable debate, FATF and the lawyers resolved the issue by acknowledging that STRs are not part of risk assessment; rather, STRs represent a response mechanism once a suspicion of money laundering has been identified.¹⁶¹ Because of the risk-based approach orientation of *Lawyer Guidance*, FATF agreed to language that would not impose a mandatory STR obligation on legal professionals.¹⁶² However, in those jurisdictions in which a law or regulation mandates the filing of an STR report, the risk-based approach does not apply and the legal professional must comply with the rule (the so-called rules-based approach).¹⁶³ FATF thus leaves to individual countries whether to adopt either a risk-

¹⁵⁸ See *id.* In a demonstration of solidarity on the STR issue, lawyers from the United Kingdom supported the position of United States lawyers even though United Kingdom lawyers already were subject to an STR obligation under United Kingdom law. See Council Directive 2005/60/EC, Prevention of the Use of the Financial System for the Purpose of Money Laundering 2005 O.J. (L309) 15, 17, available at <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2005:309:0015:0036:EN:PDF>. As the author notes, an STR requirement “would invert the attorney–client privilege. Lawyers are not governmental informants, and the imposition of such a reporting requirement would be contrary to every state or federal law or state bar rules of professional conduct.” Kevin L. Shepherd, *The USA Patriot Act: The Complexities of Imposing Anti-Money Laundering Obligations on the Real Estate Industry*, 39 REAL PROP. PROB. & TR. J. 403, 426 (2004) [hereinafter COMPLEXITIES]. See Edward J. Krauland & Benjamin Coats, *International Regulation of the Legal Profession: An Impending Possibility?*, GP|SOLO MAG., Mar. 2005, at 38, available at <http://www.abanet.org/genpractice/magazine/2005/mar/international.html> (discussing ethical issues affecting an STR requirement and the NTO rule).

¹⁵⁹ See PARIS 2008 MEMO, *supra* note 154. FATF pointed to Recommendation 16 of *Forty Recommendations*, which states in pertinent part that the STR requirement under Recommendation 13 applies “to all [DNFBPs], subject to the . . . qualification [that] [l]awyers . . . should be required to report suspicious transactions when, on behalf of or for a client, they engage in a financial transaction in relation to the activities described in Recommendation 12(d).” The *Forty Recommendations Website*, *supra* note 51.

¹⁶⁰ See PARIS 2008 MEMO, *supra* note 154.

¹⁶¹ See *id.*

¹⁶² See *id.*

¹⁶³ See *id.*

based or rules-based approach on STRs for legal professionals. Paragraph 120 in *Lawyer Guidance* provides as follows:

This Guidance does not address FATF Recommendations relating to suspicious transaction reporting (STR) and the proscription against “tipping off” those who are the subject of such reports. Different countries have undertaken different approaches to these Recommendations of the FATF. Where a legal or regulatory requirement mandates the reporting of suspicious activity once a suspicion has been formed, a report must be made and, therefore, a risk-based approach for the reporting of the suspicious activity under these circumstances is not applicable. STRs are not part of risk assessment, but rather reflect a response mechanism—typically to an SRO or government enforcement authority—once a suspicion of money laundering has been identified. For those reasons, this Guidance does not address those elements of the FATF Recommendations.¹⁶⁴

The STR requirement, however, applies without exception to the other DNFBP sectors, but the formulation differs among the DNFBP sectors. For example, TCSPs must report a suspicious transaction “when the

¹⁶⁴ LAWYER GUIDANCE, *supra* note 105, para. 119, at 33. By contrast, guidance papers for other DNFBPs include a mandatory STR obligation. For example, the relevant STR provisions contained in the guidance for TCSPs are set forth below:

116. The reporting of suspicious transactions or activities is critical to a country’s ability to utilise financial information to combat money laundering, terrorist financing, and other financial crimes. Countries’ reporting regimes are laid down in national law, requiring institutions to file reports when the threshold of suspicion is reached. A TCSP’s requirement to report a suspicious transaction will arise when the TCSP engages in a transaction for a client, or on behalf of a client, in relation to the activities referred to in the Glossary to the FATF Recommendations. (See paragraphs 12-13.)

117. Where a legal or regulatory requirement mandates the reporting of a suspicious activity once the suspicion has been formed, a report must be made and, therefore, a risk-based approach for the reporting of a suspicious activity under these circumstances is not applicable.

FINANCIAL ACTION TASK FORCE, RBA GUIDANCE FOR TRUST AND COMPANY SERVICE PROVIDERS (TCSPs) (2008), paras. 116–17, at 25, <http://www.fatf-gafi.org/dataoecd/19/44/41092947.pdf> (last visited Mar. 15, 2009) [hereinafter TCSP GUIDANCE].

TCSP engages in a transaction for a client, or on behalf of a client, in relation to the activities referred to in the Glossary to the FATF Recommendations. (See paragraphs 12–13).”¹⁶⁵ The accountancy sector guidance (*Accountant Guidance*) takes a more reserved approach to STRs.¹⁶⁶ In determining whether to make an STR, *Accountant Guidance* requires the accountant to consider several factors, such as whether the activities in question “consist of instances of reportable (suspected) money laundering or terrorist financing in the country concerned.”¹⁶⁷ Another factor under *Accountant Guidance* deals with “[w]hether the information was obtained in circumstances where they are subject to professional secrecy or legal professional privilege.”¹⁶⁸

2. *Stand-Alone Guidance*

The attendees at the Paris meeting agreed to the issuance of separate, stand alone guidance for lawyers and notaries.¹⁶⁹ FATF expressed a strong desire to issue sector-specific guidance in section 3 but have sections 1 and 2 apply globally to all DNFBPs. The lawyer group objected to this cumbersome format, principally because the final guidance draft, covering lawyers and nonlawyers, would be confusing to lawyers.¹⁷⁰ For instance, guidance covering both lawyers and casinos would be a fertile ground for confusion given the disparate nature of the two DNFBP sectors. The lawyers contended that they would accept the draft more readily if it were clear and specific to the legal profession and embodied in a self-contained document.¹⁷¹ FATF agreed to this approach, thereby laying the groundwork for the issuance of separate guidance for each of the DNFBP sectors.¹⁷² The issuance of separate guidance for each DNFBP

¹⁶⁵ *Id.* para. 116, at 25.

¹⁶⁶ See FINANCIAL ACTION TASK FORCE, RBA GUIDANCE FOR ACCOUNTANTS, paras. 130–34 (2008), <http://www.fatf-gafi.org/dataoecd/19/40/41091859.pdf> (last visited Mar. 15, 2009) [hereinafter ACCOUNTANT GUIDANCE].

¹⁶⁷ *Id.* para. 132, at 27.

¹⁶⁸ *Id.*

¹⁶⁹ See PARIS 2008 MEMO, *supra* note 154.

¹⁷⁰ See *id.*

¹⁷¹ See *id.*

¹⁷² See *id.* At the FATF plenary meeting held in London on June 17, 2008, FATF issued guidance for the following DNFBP sectors: Dealers in Precious Metals and Stones, Real Estate Agents, Accountants, and TCSPs. See Memorandum from Kevin L. Shepherd summarizing the London meeting (July 3, 2008) (on file with author) [hereinafter LONDON 2008 MEMO]. Because of unresolved issues involving *Lawyer Guidance* and the guidance for the casino industry, FATF did not press seeking approval of these guidance

sector also alleviates the need to issue supplements to a generic DNFBP guidance document, thereby facilitating the acceptance of the sector-specific guidance.¹⁷³

3. TCSPs

The creation of separate guidance for TCSPs created a concern that lawyers providing services covered by *TCSP Guidance* would be subjected to the provisions of that guidance, including the STR obligation.¹⁷⁴ *TCSP Guidance* expressly notes that in some countries TCSPs may be predominately lawyers.¹⁷⁵ Both lawyers and TCSPs often perform trust and company services, such as forming legal entities.¹⁷⁶ *TCSP Guidance* covers company formation activity.¹⁷⁷ In forming a company, would a lawyer be subject to *TCSP Guidance*, *Lawyer Guidance*, or both? The lawyers contended that they should not be subject to two sets of guidance with different rules.¹⁷⁸ Subjecting lawyers to different rules injects confusion into an already complex area and likely would frustrate attempts to comply with each guidance set.

FATF resolved this potential dilemma by including language in *TCSP Guidance* and *Lawyer Guidance* addressing this issue.¹⁷⁹ *TCSP Guidance* states that “[t]he FATF definition of TCSP relates to providers of trust and company services that are not covered elsewhere by the FATF Recommendations, and therefore excludes financial institutions, lawyers, notaries, other independent legal professionals and accountants.”¹⁸⁰ Because lawyers are covered expressly by *Lawyer Guidance*, lawyers should not be governed by *TCSP Guidance* even though they

papers at the June 2008 plenary meeting in London; rather, FATF approved these two guidance papers at its October 2008 plenary in Rio de Janeiro. See FINANCIAL ACTION TASK FORCE, RBA GUIDANCE FOR CASINOS (2008), <http://www.fatf-gafi.org/dataoecd/5/61/41584370.pdf> (last visited Mar. 15, 2009); LAWYER GUIDANCE, *supra* note 105.

¹⁷³ See PARIS 2008 MEMO, *supra* note 154.

¹⁷⁴ See *id.*

¹⁷⁵ See TCSP GUIDANCE, *supra* note 164, para. 16, at 3.

¹⁷⁶ See *id.* paras. 10, 12, at 2–3.

¹⁷⁷ See *id.* para. 12, at 2–3.

¹⁷⁸ See LONDON 2008 MEMO, *supra* note 172.

¹⁷⁹ See LAWYER GUIDANCE, *supra* note 105, at 2–4; TCSP GUIDANCE, *supra* note 164, para. 10, at 2.

¹⁸⁰ TCSP GUIDANCE, *supra* note 164, para. 10, at 2. Paragraph 10 also states that “all those engaged in TCSP activities may also wish to refer to the TCSPs guidance, as it is more specifically tailored to TCSP services.” *Id.*

may be providing services described in *TCSP Guidance, Lawyer Guidance*, however, cautions lawyers offering TCSP services to hew to *Lawyer Guidance* but to be attentive to the specialized service risks that arise when offering TCSP services.¹⁸¹ These service risks include the unexplained use of express trusts;¹⁸² the use of “[s]hell companies, companies with ownership through nominee shareholding, and control through nominee and corporate directors”;¹⁸³ and “[s]ervices that deliberately have provided or purposely depend upon more anonymity in the client identity or participants than is normal under the circumstances and experience of the legal professional.”¹⁸⁴

To address FATF’s concern that lawyers who form separate businesses or entities to perform TCSP-type services should not be able to avoid compliance with *TCSP Guidance, Lawyer Guidance* states that “[l]egal persons that, as a separate business, offer TCSP services should have regard to the TCSP Guidance, even if such legal persons are owned or operated by legal professionals.”¹⁸⁵

4. *Lack of Meaningful Information on Terrorist Financing*

A consistent theme running through the FATF/private sector engagement process is the request by the private sector for FATF to produce typologies,¹⁸⁶ highlighting situations in which lawyers unwittingly facilitated the criminal designs of money launderers and terrorists, or to provide meaningful guidance for detecting terrorist financing.¹⁸⁷ Acknowledging that “[t]he ability of legal professionals to detect and identify potential terrorist financing transactions without guidance on terrorist financing typologies or unless acting on specific intelligence provided by the authorities is significantly more challenging than is the case for po-

¹⁸¹ See *LAWYER GUIDANCE*, *supra* note 105, para. 111, at 29.

¹⁸² Trusts are the subject of considerable attention as a service risk in performing or providing TCSP services. For example, another service risk involving express trusts includes “an unexplained relationship between a settlor and beneficiaries with a vested right, other beneficiaries and persons who are the object of a power.” *Id.* para. 111, at 29.

¹⁸³ *Id.*

¹⁸⁴ *Id.*

¹⁸⁵ *LAWYER GUIDANCE*, para. 109, at 26–28.

¹⁸⁶ “Typologies” means “the study of the methods and trends associated with money laundering.” FINANCIAL ACTION TASK FORCE, MONEY LAUNDERING & TERRORIST FINANCING TYPOLOGIES 2004–2005 1 (2005), <http://www.fatf-gafi.org/dataoecd/16/8/35003256.pdf> (last visited Mar. 15, 2009).

¹⁸⁷ See, e.g., Dec. 2006 Letter, *supra* note 107.

tential money laundering and other suspicious activity,” FATF conceded that *Lawyer Guidance* could “not comprehensively address[] the application of a risk-based process to terrorist financing.”¹⁸⁸

D. 2008 London Meeting

In the two-month period between the 2008 Paris and London meetings, the lawyer group transformed *Lawyer Guidance* so that it constituted a separate stand alone document in accordance with the agreement reached at the 2008 Paris meeting.¹⁸⁹ FATF and the lawyer group met in London on June 30, 2008, to review this draft and to identify any major remaining issues in advance of the September 2008 intersessional meeting in Ottawa and the FATF plenary meeting in October 2008 in Rio de Janeiro.¹⁹⁰

The two overarching substantive issues discussed at the London meeting dealt with the identification of beneficial ownership and lawyers’ obligation to conduct client due diligence (CDD)¹⁹¹ when acting as local counsel or conducting walk-up clinics.¹⁹² FATF and the private sector were unable to reach an agreement on the identification of beneficial ownership issue at the London meeting, and did not reach an accord on that issue until after the Ottawa meeting in September 2008.¹⁹³ By contrast, the parties developed a framework for resolving lawyers’ obligation to conduct CDD when acting as local counsel or conducting walk-up clinics.¹⁹⁴ This portion of the Article will detail the positions taken by

¹⁸⁸ LAWYER GUIDANCE, *supra* note 105, paras. 42, 44, at 12.

¹⁸⁹ See LONDON 2008 MEMO, *supra* note 172.

¹⁹⁰ Private and public sector groups represented at the London meeting included the following: public sector groups—FATF Secretariat, Belgium CTIF-CFI, European Commission, Netherlands Ministry of Finance, Switzerland Ministry of Finance, and United Kingdom Financial Services Authority—and private sector groups—IBA, ABA, ACTEC, CCBE, the Law Society of England and Wales, and the Council of the Notariats of the European Union. *See id.*

¹⁹¹ *See id.* CDD is also known as “customer due diligence.” *Lawyer Guidance* explains that “[b]ecause legal professionals typically refer to those benefiting from their services as ‘clients’ rather than ‘customers’, that term is thus generally used throughout this paper, except where specific terms of art such as ‘customer due diligence’ and ‘know your customer’ are used (in such cases a customer can be equated to a client).” LAWYER GUIDANCE, *supra* note 105, para. 10, at 5.

¹⁹² See LONDON 2008 MEMO, *supra* note 172. A walk-up clinic is a legal clinic designed to serve those with limited financial means.

¹⁹³ *See infra* Part VII.

¹⁹⁴ See LONDON 2008 MEMO, *supra* note 172.

both FATF and the private sector at the London meeting on the issue of identifying beneficial ownership so that the resolution of that issue reached after the Ottawa meeting can be better understood.

1. Identification of Beneficial Ownership

A source of considerable discord between FATF and the private sector deals with the issue of whether the identification of beneficial ownership is a mandatory obligation imposed on the legal profession. Stated differently, must a lawyer who performs due diligence on the identity of the client at the intake stage of the engagement process also identify the beneficial owners of the client? FATF contends that Recommendation 5 mandates that the lawyer identify and take reasonable measures to verify the identity of beneficial owners of a client. By contrast, the private sector believes that the identification of beneficial ownership is risk-based, not rules-based, and finds support for that position in Recommendation 5 as well. As a result, the lawyer needs to assess whether the risks of the overall client relationship and the transaction for which the lawyer is providing advice warrant the lawyer identifying the beneficial ownership of the client.

The source of this disagreement lies, in part, with the confusing language used in Recommendation 5, thereby allowing both FATF and the private sector to support their respective positions by pointing to specific language in that Recommendation. FATF contends that Recommendation 5(b) specifically and unequivocally requires that CDD measures include “[i]dentifying the beneficial owner, and taking reasonable measures to verify the identity of the beneficial owner such that the financial institution is satisfied that it knows who the beneficial owner is.”¹⁹⁵ The private sector, while acknowledging the language in Recommendation 5(b), posits that other language in Recommendation 5 envisions that the extent of the CDD measures (including the identification of beneficial ownership) be determined “on a risk sensitive basis depending on the type of customer, business relationship or transaction.”¹⁹⁶ The private sector points to this language as the basis for contending that the identification of beneficial ownership is risk-based, not rules-based.¹⁹⁷

¹⁹⁵ FORTY RECOMMENDATIONS, *supra* note 49, para. 5(b), at 3.

¹⁹⁶ *Id.*

¹⁹⁷ The private sector’s argument loses force, though, if the same logic is extended to the other CDD measures set forth in Recommendation 5(a), (c), and (d). For instance, that FATF intended that client identification (as opposed to beneficial ownership identification) under Recommendation 5(a) be a risk-based analysis is unlikely. The

FATF's definition of a beneficial owner injects additional ambiguity into this issue. *Forty Recommendations* defines beneficial owner as "the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement."¹⁹⁸ The Interpretative Notes to Recommendation 5 elaborate on the definition of beneficial owner and what measures "normally" are needed to perform satisfactorily the function of identifying a client's beneficial owner.¹⁹⁹

Although these definitions seem reasonable in theory and, at least to a few law enforcement officials, in practice, the concept is not easy to implement. Moreover, more targeted solutions may exist that achieve the same added protection to the financial sector—and without the undue burden.

An example better illustrates the practical difficulties and potentially onerous burdens placed on a lawyer who is required to identify the beneficial ownership of a client in nearly all cases (with the exception of certain clients, such as public companies). Assume Attorney Brittany receives a call from a college friend who manages a major privately owned hedge fund. The hedge fund manager asks Brittany to advise her on an aspect of corporate governance in acquiring another business asset. As part of Attorney Brittany's standard client intake review process, she determines the precise name of the client (for example, the hedge fund), performs a conflicts check based on that information, runs a credit check on the client through the firm's accounting group, and scans a national

concept under the Recommendations is that lawyers must know the identity of their clients. *See id.* This requirement should not present an issue since lawyers need this information to discharge their ethical obligations on client conflicts.

¹⁹⁸ FORTY RECOMMENDATIONS, *supra* note 49, at 12.

¹⁹⁹ Interpretative Note to Recommendation 5 provides in pertinent part as follows:

Identify the beneficial owners, including forming an understanding of the ownership and control structure, and take reasonable measures to verify the identity of such persons. The types of measures that would be normally needed to satisfactorily perform this function would require identifying the natural persons with a controlling interest and identifying the natural persons who comprise the mind and management of the legal person or arrangement. Where the customer or the owner of the controlling interest is a public company that is subject to regulatory disclosure requirements, it is not necessary to seek to identify and verify the identity of any shareholder of that company.

Interpretative Notes, *supra* note 60.

database to determine whether the client's name appears on the list of Specially Designated Nationals and Blocked Persons (SDN List)²⁰⁰ or the Denied Persons List (DPL).²⁰¹ Brittany's client intake results are satisfactory and, given the modest dollar value of the assigned task, Brittany does not seek a retainer. Assume further that the hedge fund's investors are a number of private wealthy individuals who entrusted Brittany's college friend to make investments on their account and behalf. Assume further that these wealthy owners, who comprise the client's beneficial ownership, instruct the manager not to disclose their identities to anyone.

Based on these assumptions, the issue is whether Brittany must identify the client's beneficial owners before accepting the proposed engagement. If Brittany insists that the manager divulge this information as a condition to her accepting the engagement, the manager will be taking an action contrary to the beneficial owners' expressed desires and instructions. Even if the manager discloses this information to Brittany, Brittany then needs to take reasonable measures to verify the identity of the beneficial owners under Recommendation 5(b). These measures could entail additional analyses, especially if the beneficial owners own their interests in the client through trusts or tiered ownership structures. Ultimately, Brittany will expend considerable resources (for which she likely will not be compensated) that are, from an objective standpoint, disproportionate to the potential risk of money laundering or terrorist financing emanating from the advice on the corporate issue. Even more critical is that she runs a serious risk of turning the attorney-client relationship into an adversarial relationship, which is inimical to that protected relationship.

FATF and the private sector were unable to resolve satisfactorily the identification of beneficial ownership issue at the London meeting but agreed to work on it in advance of the October 2008 plenary meeting in Rio de Janeiro.²⁰² FATF indicated that it planned to submit *Lawyer Guidance*, as well as the risk-based guidance of the casino industry, at the October plenary.²⁰³ As more fully discussed below, FATF and the

²⁰⁰ See Office of Foreign Assets Control, Specially Designated Nationals and Blocked Person (2008), <http://www.ustreas.gov/offices/enforcement/ofac/sdn/t11sdn.pdf> (last visited Mar. 15, 2009).

²⁰¹ See U.S. Department of Commerce, Bureau of Industry and Security, Denied Persons List (2008), <http://www.bis.doc.gov/dpl/default.shtm> (last visited Mar. 15, 2009).

²⁰² See LONDON 2008 MEMO, *supra* note 172.

²⁰³ See *id.*

private sector resolved the identification of beneficial ownership issue in advance of the October 2008 plenary meeting.²⁰⁴

2. *Dilemma of Local/Special Counsel*

A concern permeating the development of *Lawyer Guidance* deals with the propriety of imposing CDD obligations on local or special counsel.²⁰⁵ In many, if not most, situations, primary counsel engages local or special counsel to address a limited and specific issue or matter relating to the transaction in question.²⁰⁶ These services range from confirming the zoning classification of a parcel of commercial property, to issuing an enforceability opinion, to performing localized due diligence for the acquisition of a real estate asset. The roles and services of local or special counsel vary in scope and intensity, but all share the common thread that the role is limited and, in nearly all cases, the local counsel has no direct contact with the actual client.

E. 2008 Ottawa Meeting

Because of a number of unresolved issues on *Lawyer Guidance* existing in advance of the October 2008 plenary meeting, FATF scheduled an intersessional meeting on September 14, 2008, in Ottawa, Ontario, Canada, between FATF and the private sector so that they could resolve those issues (as well as a number of issues unrelated to *Lawyer Guidance*) before the plenary meeting.²⁰⁷ Similar to the Bern meeting, the Ottawa meeting included delegations from many FATF member states.²⁰⁸

FATF and the private sector extensively debated the identification of beneficial ownership issue at the Ottawa meeting, but were unable to reach agreement on the precise language.²⁰⁹ FATF adhered to its position

²⁰⁴ See *infra* notes 209–17 and accompanying text.

²⁰⁵ See LONDON 2008 MEMO, *supra* note 172.

²⁰⁶ See *id.*

²⁰⁷ See Memorandum from Kevin L. Shepherd summarizing the Ottawa meeting (Sept. 19, 2008) (on file with author) [hereinafter OTTAWA 2008 MEMO]. Private and public sector groups represented at the Ottawa meeting included the following: public sector groups—FATF Secretariat, Belgium, Canada, China, CTIF-CFI, Denmark, European Commission, France, Germany, IMF, Italy, Japan, Korea, Mexico, The Netherlands Ministry of Finance, Offshore Group of Banking Supervisors, Russian Federation, South Africa, Spain, Switzerland, United States, United Kingdom, and World Bank—and private sector groups—IBA, ABA, and the CCBE. A representative from the Council of the Notariats of the European Union did not attend. See *id.*

²⁰⁸ See *id.*

²⁰⁹ See *id.*

that this issue was rules-based, not risk-based, while the private sector continued to embrace its view that this issue was risk-based.²¹⁰ The private sector proposed that FATF agree to the inclusion of the beneficial ownership identification language from *Financial Institution Guidance*, which provides that reasonable measures be taken to identify, as well as verify, beneficial ownership.²¹¹ Although FATF had agreed to the inclusion of that standard in *Financial Institution Guidance*, one FATF representative stated that this standard was a mistake and could not be perpetuated in guidance papers for other DNFBP sectors. At the same time, FATF did not agree specifically to revisit the use of that standard in *Financial Institution Guidance*.²¹² The private sector was not willing to include language in *Lawyer Guidance* that was rules-based, especially when the ABA recently had adopted a policy at the 2008 annual meeting specifically adopting a risk-based approach.²¹³ Thus, the private sector and FATF were at an impasse on the beneficial ownership identification issue and did not reach a resolution of this issue until late September 2008.

After the Ottawa meeting, FATF reached out to the private sector in an effort to resolve the issue in advance of the October 2008 plenary. After considerable discussion and exchange of drafts, FATF and the private sector agreed that beneficial ownership identification would be styled as follows:

b) Identify the beneficial owner, and take reasonable measures to verify the identity of the beneficial owner such that the legal professional is reasonably satisfied that it knows who the beneficial owner is. The general rule is that clients should be subject to the full range of CDD measures, including the requirement to identify the beneficial owner in accordance with this paragraph. The purpose of identifying beneficial ownership is to ascertain those natural persons who exercise effective control over a client, whether by means of ownership, voting rights or otherwise. Legal professionals should have regard to this purpose when identifying the beneficial owner. They may use a risk-based approach when de-

²¹⁰ *See id.*

²¹¹ *See id.*

²¹² *See id.*

²¹³ *See infra* notes 307–10 and accompanying text.

termining the extent to which they are required to identify the beneficial owner, depending on the type of client, business relationship and transaction and other appropriate factors in accordance with Recommendation 5 and its Interpretative Note, § 9–12.²¹⁴

Although the resulting language at first blush appears prescriptive, taken as a whole the test for beneficial ownership identification is risk-based. The first clause requires the identification of the beneficial owner,²¹⁵ but the last sentence informs the first clause by making clear that legal professionals may use a risk-based approach to identify the beneficial owner.²¹⁶ The legal professional needs to consider appropriate factors in the professional's risk-based analysis, including the type of client, business relationship, and transaction.²¹⁷

Other issues debated at the Ottawa meeting included the role of local counsel and a more clear articulation of who is covered by *Lawyer Guidance*.²¹⁸ These issues are discussed in detail in Part VII.A below.

VII. OVERVIEW OF *LAWYER GUIDANCE*

FATF approved *Lawyer Guidance* at the October 2008 plenary meeting in Rio de Janeiro.²¹⁹ *Lawyer Guidance* contains 125 separately numbered paragraphs and organizationally tracks *Financial Institution Guidance* that served as a template for the DNFBP guidance papers.²²⁰ *Lawyer Guidance* is a complex document addressing different audiences (for

²¹⁴ *LAWYER GUIDANCE*, *supra* note 105, para. 114, at 31–32.

²¹⁵ *See id.* para. 114, at 31.

²¹⁶ *See id.* para. 114, at 32.

²¹⁷ During the negotiations on this paragraph, FATF insisted that the word “also” be inserted in the first clause of the last sentence as follows: “They may *also* use a risk-based approach when determining the extent to which they are required to identify the beneficial owner” The private sector argued against the inclusion of the word “also” because the inclusion of that word effectively would transform the risk-based orientation of the last sentence to an optional approach to the identification of beneficial ownership and would fail to inform the purpose of identifying beneficial ownership, for example, to ascertain those natural persons who exercise effective control over a client, whether by means of ownership, voting rights, or otherwise. FATF ultimately agreed to delete the offending word “also.” *See id.*

²¹⁸ *See OTTAWA 2008 MEMO*, *supra* note 207. *See infra* notes 222–33 for a discussion of the resolution of this issue.

²¹⁹ *See LAWYER GUIDANCE*, *supra* note 105, para. 5, at 4.

²²⁰ *See supra* note 109 and accompanying text.

example, private sector and public authorities), outlining the risk factors that lawyers need to take into account in developing a risk-based system and undertaking to identify the issues specific to the legal profession.²²¹ A thorough understanding of *Lawyer Guidance* is necessary to the development of an effective risk-based approach.

A. Who and What Is Covered by *Lawyer Guidance*?

First and foremost, *Lawyer Guidance* does not apply to every form of legal representation or legal advice.²²² Instead, *Lawyer Guidance* applies to lawyers only when they “prepare for and carry out transactions for their client concerning” one or more of the five categories of transaction-oriented activities specified in *Lawyer Guidance* and, by reference, to Recommendation 12 of *Forty Recommendations (Specified Activities)*.²²³ Specified Activities consist of the following categories:

- Buying and selling of real estate.
- Managing of client money, securities or other assets.
- Management of bank, savings or securities accounts.
- Organisation of contributions for the creation, operation or management of companies.
- Creation, operation or management of legal persons or arrangements, and buying and selling of business entities.²²⁴

As a result, a lawyer is required to perform the applicable CDD requirements on a client only when the lawyer prepares for or carries out a transaction for the client, and that transaction concerns one or more of

²²¹ *Lawyer Guidance* also covers notaries, but this Article does not address that component of *Lawyer Guidance*. See generally LAWYER GUIDANCE, *supra* note 105.

²²² This point was re-emphasized at the Ottawa meeting, principally to dispel the notion some member state delegations apparently held that *Lawyer Guidance* applied to all lawyers’ activities. See OTTAWA 2008 MEMO, *supra* note 207.

²²³ See LAWYER GUIDANCE, *supra* note 105, para. 12, at 6–7. Earlier drafts of *Lawyer Guidance* used the phrase “regulated activities” when referring to the Specified Activities. FATF replaced the “regulated activities” formulation with the “Specified Activities” formulation to avoid conveying the impression that *Lawyer Guidance* “regulated” the legal profession.

²²⁴ *Id.*

the Specified Activities.²²⁵ This two-step analysis is critical to understanding the scope and application of *Lawyer Guidance*.

Neither *Lawyer Guidance* nor *Forty Recommendations* defines “prepare for or carry out” a transaction concerning the Specified Activities. *Forty Recommendations* uses the same formulation in defining when the CDD and record keeping requirements apply to TCSPs,²²⁶ but, oddly enough, *Forty Recommendations* employs different language in describing when the CDD and record keeping requirements apply to the other DNFBPs. For example, the CDD and record keeping requirements apply to real estate agents “when they are *involved* in transactions for their client concerning the buying and selling of real estate,”²²⁷ but to casino operators “when customers *engage* in financial transactions equal to or above the applicable designated threshold.”²²⁸

For real estate lawyers, two of the Specified Activities are of immediate concern. Although the buying and selling of real estate is a Specified Activity, neither *Lawyer Guidance* nor *Forty Recommendations* defines what is meant by “buying and selling real estate.”²²⁹ This language does not address whether the financing of real estate transactions falls within the ambit of buying and selling real estate. The same concern ex-

²²⁵ See *id.* The mechanical application of the two-step analysis leads to practical issues. For example, suppose a client engages the firm to represent her in a litigation matter. Later, the client asks her lawyer various questions about a real estate transaction, which is wholly unrelated to the litigation matter. At that point, must the lawyer perform the CDD on that client on the basis that she may be preparing for or carrying out a Specified Activity? Of course, lawyers perform a basic level of CDD during the client intake stage that may replicate all or part of the CDD measures performed had the client engaged the lawyer to prepare for or carry out a Specified Activity at the inception of the engagement.

²²⁶ Recommendation 12(e) states that the CDD requirements set forth in Recommendations 5, 6, and 8 to 11 apply to TCSPs “when they *prepare for or carry out* transactions for a client concerning the activities listed in the definition in the Glossary.” FORTY RECOMMENDATIONS, *supra* note 49, para. 12(e), at 5 (emphasis added).

²²⁷ *Id.* para. 12(b), at 5 (emphasis added). This language is eerily reminiscent of language used in the Bank Secrecy Act, as amended by the USA PATRIOT Act, that basic AML obligations would apply to “persons involved in real estate closings and settlements.” See COMPLEXITIES, *supra* note 158, at 419. The federal government’s attempt to develop regulations for this category of financial institution under the Bank Secrecy Act drew an immediate and sharp rebuke from the legal profession and the real estate industry.

²²⁸ FORTY RECOMMENDATIONS, *supra* note 49, para. 12(a), at 5 (emphasis added).

²²⁹ See generally FORTY RECOMMENDATIONS, *supra* note 49; LAWYER GUIDANCE, *supra* note 105.

tends to leasing activities. To illustrate this concern, under *Lawyer Guidance* a lawyer who prepares for and carries out the sale of a parcel of real estate needs to perform the CDD and record keeping requirements envisioned by *Forty Recommendations*.²³⁰ But that same lawyer who prepares and negotiates leases for a shopping center or office complex presumably would not be preparing for or carrying out a transaction concerning the buying and selling of real estate.

Perhaps the difference in treatment between financing and leasing, on the one hand, and acquisitions, on the other, stems from a concern that the potential risk of money laundering and terrorist financing is greater in the buying and selling of real estate than in other real estate transactions. Whether the CDD and record keeping requirements apply to the financing of real estate presents a closer call. If the financing is incident to the acquisition of real estate the financing activity likely concerns the buying of real estate. But if the financing involves a refinance of an existing loan secured by real estate, whether a lawyer handling the refinancing for a borrower needs to perform the CDD and record keeping requirements envisioned by *Forty Recommendations* is more tenuous.²³¹

Forty Recommendations does not draw a distinction between transactions concerning the buying and selling of commercial versus residential real estate. Lawyers who prepare for and carry out transactions concerning the buying and selling of real estate will need to perform the CDD and record keeping requirements on their clients regardless of the type of real estate being sold or the dollar amount of the sales transaction.²³²

The other Specified Activity of immediate concern to real estate and other transactional lawyers is the requirement that they perform the CDD and record keeping requirements when they prepare for or carry out transactions concerning the “creation, operation or management of legal persons or arrangements, and buying and selling of business entities.”²³³ A lawyer forming an entity to hold title to real estate presumably will

²³⁰ See *LAWYER GUIDANCE*, *supra* note 105, para. 13, at 7.

²³¹ See FINANCIAL ACTION TASK FORCE, *MONEY LAUNDERING & TERRORIST FINANCING THROUGH THE REAL ESTATE SECTOR* (2007), <http://www.fatf-gafi.org/dataoecd/45/31/40705101.pdf> (last visited Mar. 15, 2009). This paper postdates the issuance of *Forty Recommendations*, but reinforces the focus on real estate financing, such as complex loans or credit finance, use of monetary instruments, and use of mortgage schemes. See *id.* para. 12, at 7.

²³² See *id.*

²³³ *Id.* para. 12(d), at 5.

trigger the CDD and record keeping requirements under *Forty Recommendations*, including the obligations to identify the beneficial owners of the entity and take reasonable measures to verify the beneficial ownership.²³⁴

B. Risk Categories, Risk Factors, and Variables That Affect Risk

Forty Recommendations addresses risk in three principal areas for legal professionals: CDD; the internal control systems for legal professionals and firms; and the approach to oversight and monitoring of legal professionals.²³⁵ For CDD, the three “most commonly used risk criteria are: country or geographic risk; client risk; and risk associated with the particular service offered.”²³⁶

1. Country Risk

Lawyer Guidance notes that designated competent authorities, self regulatory organizations (SROs),²³⁷ and legal professionals have not agreed on whether a transaction’s ties to a particular country or geographic area represent a higher risk.²³⁸ The client’s domicile, the transaction’s location, and the funding’s source are simply a few sources from which a money laundering risk can arise.²³⁹ *Lawyer Guidance* identifies the profile of those countries that pose a higher risk of money laundering.²⁴⁰ 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 sources²⁴¹ as having

²³⁴ See *id.* para. 5(b), at 3.

²³⁵ See FORTY RECOMMENDATIONS, para. 12(d), at 5.

²³⁶ LAWYER GUIDANCE, *supra* note 105, para. 106, at 25. FATF acknowledges that no universally accepted set of risk categories exists. See *id.*

²³⁷ An SRO is a body that represents a profession and is comprised of member professionals, has a role in regulating the persons who are qualified to enter into and who practice in the profession, and performs certain supervisory or monitoring-type functions. SROs may include state and local bar associations. See FATF METHODOLOGY, *supra* note 31.

²³⁸ See LAWYER GUIDANCE, *supra* 105, para. 108, at 26.

²³⁹ See *id.*

²⁴⁰ See LAWYER GUIDANCE, *supra* note 105, para. 108, at 26.

²⁴¹ “Credible sources” refers to information generated from reputable and well known bodies that make such information publicly and widely available. FATF considers credible sources to include national government bodies, nongovernmental organizations, supranational or international bodies such as the IMF, the Egmont Group of Financial Intelligence Units, and the FATF and FATF-style regional bodies. See *id.* FATF-style

significant levels of corruption²⁴² or criminal activity, or from which funds or support are provided to terrorist organizations.²⁴³ For example, a lawyer representing a client acquiring a business located in Zimbabwe would be involved in a transaction that represents a higher risk based on the geographic location of the business being acquired.²⁴⁴

2. *Client Risk*

Client risk is another risk category under *Lawyer Guidance*, and “[d]etermining the potential money laundering or terrorist financing risks posed by a client, or category of clients, is critical to the development and implementation of an overall risk-based framework.”²⁴⁵ *Lawyer Guidance* envisions that a lawyer will develop her own risk criteria to determine whether a client poses a higher risk. If the lawyer determines

regional bodies include the Eurasian Group, the Eastern and Southern Africa Anti-Money Laundering Group, and the FATF Members & Observers. See FATF Style Regional Bodies, Intergovernmental Action Group against Money-Laundering in Africa, <http://www.fatf-gafi.org/> (follow “About the FATF” hyperlink, follow “Members & Observers” hyperlink) (last visited Mar. 15, 2009). The Egmont Group consists of 108 FIUs from around the world. See THE EGMONT GROUP, FINANCIAL INTELLIGENCE UNITS OF THE WORLD (2008), http://www.egmontgroup.org/list_of_fius.pdf (last visited Mar. 15, 2009).

²⁴² Transparency International, a global civil society organization formed to fight corruption, developed a jurisdiction-specific corruption perceptions index that ranks countries based on the degree to which corruption is perceived to exist among public officials and politicians. See Transparency International FAQ, What Is the Corruption Perceptions Index (CPI)?, http://www.transparency.org/policy_research/surveys_indices/cpi/2007/faq#general1 (last visited Mar. 15, 2009). At least one law society points out the value of referring to this index when dealing with clients from other countries. See *Anti-Money Laundering Practice Note*, Law Society of England and Wales, § 11.2 (Feb. 22, 2008), <http://www.lawsociety.org.uk/productsandservices/practicenotes/aml.page> (last visited Mar. 15, 2009).

²⁴³ See LAWYER GUIDANCE, *supra* note 105, para. 108, at 26.

²⁴⁴ Zimbabwe is subject to certain sanctions imposed by a series of Executive Orders issued by President George W. Bush. See Exec. Order No. 13,288, 68 Fed. Reg. 11,457 (Mar. 7, 2003) (imposing sanctions against specifically identified individuals and entities in Zimbabwe); Exec. Order No. 13,391, 70 Fed. Reg. 71,201 (Nov. 23, 2005) (expanding the list of sanctions targets to include immediate family members of any designated individual of the Zimbabwe sanctions as well as those persons providing assistance to any sanctions target); Exec. Order No. 13,469, 73 Fed. Reg. 43,841 (July 25, 2008) (expanding further the list of sanctions targets).

²⁴⁵ LAWYER GUIDANCE, *supra* note 105, para. 109, at 26.

that a client poses a higher risk, the lawyer then will need to determine whether any mitigating factors potentially affect that determination.²⁴⁶

Lawyer Guidance identifies a dozen situations in which a client's activities may indicate a higher risk.²⁴⁷ These higher risk activities include PEPs in certain situations;²⁴⁸ “[c]lients conducting their business relationship or requesting services in unusual or unconventional circumstances (as evaluated in all the circumstances of the representation);²⁴⁹ “[c]lients where the structure or nature of the entity or relationship makes it difficult to identify in a timely fashion the true beneficial owner or controlling interests, such as the unexplained use of legal persons or legal arrangements, nominee shares or bearer shares”;²⁵⁰ “[c]lients that are cash (and cash equivalent) intensive businesses, including money services businesses . . . and casinos”;²⁵¹ “[c]harities and other not for profit organizations . . . that are not subject to monitoring or supervision (especially those operating on a cross-border basis) by designated competent authorities or SROs”;²⁵² “[c]lients using financial intermediaries, financial institutions or legal professionals that are not subject to adequate AML/CFT laws and measures and that are not adequately supervised by competent authorities or SROs”;²⁵³ “[c]lients having convictions for proceeds generating crimes [such as embezzlement] who instruct the legal professional (who has actual knowledge of such

²⁴⁶ See *id.*

²⁴⁷ See *id.* para. 109, at 26–28.

²⁴⁸ See *id.* para. 109, at 26–27.

²⁴⁹ *Id.* para. 109, at 27.

²⁵⁰ *Id.*

²⁵¹ *Id.* Money services businesses include “remittance houses, currency exchange houses, casas de cambio, centros cambiarios, remisores de fondos, bureaux de change, money transfer agents and bank note traders or other businesses offering money transfer facilities.” *Id.*

²⁵² *Id.* Charities and nonprofit organizations especially are vulnerable to terrorist financing abuse. The lack of close governmental regulation of nonprofits makes them attractive to terrorist organizations. The tax-exempt nature of nonprofits removes them from close scrutiny by the IRS and allows them to retain more money than for-profit organizations. Because volunteers serve as directors of nonprofit organizations, board oversight of the nonprofit's activities is limited. Many charities raise money within the United States but then transfer the funds overseas, including the target areas of conflict. Many individuals assume nonprofit organizations, especially charities, are legitimate. See Jennifer Lynn Bell, *Terrorist Abuse of Non-Profits and Charities: A Proactive Approach to Preventing Terrorist Financing*, 17 KAN. J.L. & PUB. POL'Y 450, 456 (2008).

²⁵³ LAWYER GUIDANCE, *supra* note 105, para. 109, at 27.

convictions) to undertake specified activities on their behalf”;²⁵⁴ “[c]lients who have no address, or multiple addresses without legitimate reasons”;²⁵⁵ “[c]lients who change their settlement or execution instructions without appropriate explanation”;²⁵⁶ and “[t]he use of legal persons and arrangements without any apparent legal or legitimate tax, business, economic or other reason.”²⁵⁷

PEP representation presents potentially difficult issues. In its most basic form, *Lawyer Guidance* requires enhanced due diligence if the client “is a PEP . . . or a PEP is the beneficial owner of the client” because PEPs are considered higher risk clients.²⁵⁸ *Lawyer Guidance* provides insight into those situations in which a PEP does not fall within either of those categories but is nonetheless involved with a client.²⁵⁹ *Lawyer Guidance* states that, in these situations, the lawyer needs to analyze the risk in light of all relevant circumstances.²⁶⁰ These circumstances include “the nature of the relationship between the client and the PEP,” “the nature of the client” (public or privately owned), and “the nature of the legal services sought.”²⁶¹ *Lawyer Guidance* notes that “lower risks may exist in which a PEP is not the client but a director of a client that is a public listed company and the client is purchasing real property for adequate consideration.”²⁶²

3. Service Risk

Service risk is the third risk category under *Lawyer Guidance*.²⁶³ Service risk means “the potential risks presented by the services offered by a legal professional.”²⁶⁴ *Lawyer Guidance* recognizes that lawyers “provide a broad and diverse range of services,” thereby underscoring the one size does not fit all nature of the risk-based approach.²⁶⁵ *Lawyer Guidance* identifies eighteen separate factors that a lawyer should take

²⁵⁴ *Id.*

²⁵⁵ *Id.*

²⁵⁶ *Id.*

²⁵⁷ *Id.* para. 109, at 28.

²⁵⁸ *Id.* para. 109, at 26.

²⁵⁹ *See id.*

²⁶⁰ *See id.* at 27.

²⁶¹ *Id.*

²⁶² *Id.*

²⁶³ *See id.* para. 110, at 28–29.

²⁶⁴ *Id.* para. 110, at 28.

²⁶⁵ *Id.*

into account in assessing the risks involved in providing one of the Specified Activities; however, no one factor, standing alone, may constitute a high-risk circumstance.²⁶⁶ High-risk circumstances can be determined only by the careful evaluation of a range of factors that . . . after taking into account any mitigating circumstances [cumulatively] would warrant increased risk assessment.”²⁶⁷

For transactional lawyers, several service risk factors particularly are relevant.²⁶⁸ For instance, one risk factor includes “[s]ervices where legal professionals, acting as financial intermediaries, actually handle the receipt and transmission of funds through accounts they actually control in the act of closing a business transaction.”²⁶⁹ This “financial intermediaries” or “touching the money” factor presumably would apply to real estate lawyers acting as escrow agents in real estate transactions. Although not *per se* a high-risk circumstance under *Lawyer Guidance*, a lawyer needs to take this factor into account with the other service risk factors to determine whether the provision of the services constitutes a high-risk circumstance.

Another service risk factor of relevance to real estate lawyers is “[s]ervices to conceal improperly beneficial ownership from competent authorities.”²⁷⁰ This factor arises in situations in which a real estate developer seeks to assemble a number of adjoining parcels in a discrete fashion. The developer and the developer’s lawyer decide to acquire the parcels through fictitious names to avoid price run-ups by the landowners, especially if the landowners knew that the beneficial owner of the

²⁶⁶ See *id.* para. 110, at 28–29.

²⁶⁷ *Id.*

²⁶⁸ Additional service risk factors deal with express trusts and beneficiaries of trusts. This Article, which focuses on the real estate transactional aspects of *Lawyer Guidance*, will not discuss trust-related aspects of *Lawyer Guidance* as that is beyond the scope of this Article.

²⁶⁹ LAWYER GUIDANCE, *supra* note 105, para. 110, at 28. This formulation of the financial intermediaries standard originated with the Gatekeeper Task Force in 2003. See Letter dated June 9, 2003, from Edward J. Krauland, Chair, Gatekeeper Task Force, to Financial Crimes Enforcement Network, at 8, available at http://www.fincen.gov/statutes_regs/fm/comment_letters/old_comment_files/krauland.pdf. The Gatekeeper Task Force articulated the financial intermediaries standard in responding to FATF’s May 30, 2002 Consultation Paper. “The [Gatekeeper] Task Force supports ABA cooperation with governmental authorities on the adoption of reasonable proposals that would subject attorneys who serve as financial intermediaries—those who receive or transmit funds on behalf of a client—to certain FATF recommendations.” *Id.* at 10.

²⁷⁰ LAWYER GUIDANCE, *supra* note 105, para. 110, at 28.

title acquiring entities had deep pockets. Certainly nothing is untoward or improper in the use of these entities to shield the beneficial ownership from local or state governmental authorities and, indirectly, the general public. FATF declined to add language the private sector proposed that would have clarified this risk factor by stating, parenthetically, that these services should be distinguished from those intended legitimately to screen ownership, such as for privacy or other reasons.²⁷¹

A service risk factor specific to real estate includes a “[t]ransfer 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*.”²⁷² The purpose of the last eleven words of this risk factor is to afford lawyers latitude in assessing whether the transaction is bona fide and does not involve money laundering or terrorist financing.²⁷³

One service risk factor requires the lawyer to make an assessment as to the adequacy of the consideration involved in a transaction falling within the purview of a Specified Activity. *Lawyer Guidance* describes this service risk factor as “[t]ransactions where it is readily apparent to the legal professional that there is inadequate consideration, such as when the client does not identify legitimate reasons for the amount of the consideration.”²⁷⁴ *Lawyer Guidance* does not elaborate on what would constitute readily apparent inadequate consideration and suggests that the lawyer may be required to insist that the client identify legitimate reasons for the amount of the consideration. In some business transactions that fall within the Specified Activity category, a lawyer’s ability to assess the adequacy of consideration may be difficult. Whether *Lawyer Guidance* intends this readily apparent determination to be made on an objective or subjective basis (so as to take into account the relative business acumen of the lawyer involved) remains unclear.

Another service risk factor calls on the lawyer to assess whether a client’s expressed desire for anonymity is unusual or abnormal. *Lawyer Guidance* characterizes this service risk as “[s]ervices that deliberately have provided or purposely depend upon more anonymity in the client

²⁷¹ See *id.* (reflecting draft prepared by FATF dated Sept. 3, 2008, and identified as revision 14).

²⁷² *Id.* (emphasis added).

²⁷³ This formulation also is used in discussing a variable risk factor involving the structure of a client or transaction. See *id.* para. 112, at 30–31.

²⁷⁴ *Id.* para. 110, at 28.

identity or participants than is normal under the circumstances and experience of the legal professional.”²⁷⁵ The creation of tiered ownership structures for the purpose of legitimate tax and liability insulation reasons may be normal to sophisticated transactional counsel, but under *Lawyer Guidance* may be considered a risk factor for less sophisticated counsel with limited experience in these tiered structures.

4. Variables That May Affect Risk

Once a lawyer identifies and assesses the country, client, and service risk factors, the lawyer then must take into account whether any variables affect the risk assessment. *Lawyer Guidance* cautions that “[d]ue regard must be accorded to the vast and profound differences in practices, size, scale and expertise, amongst legal professionals.”²⁷⁶ Legal practices range from multinational global law firms to sole practitioners. FATF recognizes the impracticality and unreasonableness of a one size fits all approach to an effective risk-based system.²⁷⁷ For this reason, *Lawyer Guidance* acknowledges that sole practitioners are not expected to devote an equivalent amount of resources as are large law firms to create, implement, and manage a reasonable risk-based approach.²⁷⁸ At the same time, though, FATF notes that all lawyers are required to assess “whether the client and proposed work would be unusual, risky or suspicious for

²⁷⁵ *Id.* para. 111, at 29.

²⁷⁶ *Id.* para. 111, at 29. *Lawyer Guidance* makes other references to the wide variation in legal practices. *See, e.g., id.* para. 9, at 5 (“Legal professionals provide a range of services and activities that differ vastly, such as in their methods of delivery and in the depth and duration of the relationships formed with clients.”).

²⁷⁷ *See id.* para. 111, at 29. *Lawyer Guidance* is sensitive to the implementation and monitoring burdens a risk-based system imposes on sole practitioners and small law firms. *Lawyer Guidance* makes repeated references to the unique practice profile of sole practitioners. *See, e.g., id.* (customary services rendered by a sole practitioner on a local basis to a client in the local community who does not otherwise present risks would not constitute high-risk work necessarily); *id.* para. 117, at 33 (“[A] sole practitioner would not be expected to devote an equivalent level of resources as a large law firm; rather, the sole practitioner would be expected to develop appropriate monitoring systems and a risk-based approach proportionate to the scope and nature of the practitioner’s practice.”); *id.* para. 124, at 34 (“Legal professionals operate within a wide range of differing business structures, from sole practitioners to large partnerships.”).

²⁷⁸ *See id.* para. 117, at 33.

the particular” lawyer.²⁷⁹ Lawyers must evaluate this factor in the context of the lawyer’s individualized and specific practice.²⁸⁰

To take into account the variables affecting the risk determination, *Lawyer Guidance* identifies thirteen factors that may influence the risk assessment either upward or downward.²⁸¹ If one or more of the variables exist, the lawyer may be required to perform enhanced due diligence and monitoring, or conversely, the lawyer’s “CDD and monitoring may be reduced, modified, or simplified.”²⁸² These risk variables apply specifically and individually to the particular client and the type of work in question.²⁸³

A risk variable that reduces the risk posed by a particular client or type of work is “[t]he reputation and publicly available information about a client. Legal persons that are transparent and well known in the public domain and have operated for a number of years without being convicted of proceeds generating crimes may have low susceptibility to money laundering.”²⁸⁴

The regularity or duration of a client relationship also is a risk variable.²⁸⁵ Presumably, a long-standing relationship involving frequent client contact poses less risk. *Lawyer Guidance* recognizes that lawyers typically have client relationships with a strong element of duration and frequent client contact. This type of close advisory relationship arguably allows a lawyer to identify potential AML issues early in the process. By contrast, client relationships of a transitory or short duration may suggest more risk, but this risk variable should not apply mechanically.²⁸⁶ For example, a short-term relationship whereby the lawyer renders legal services to a public company should not alone result in a determination of higher risk.

A related risk variable involves “[t]he proportionality between the magnitude or volume and longevity of the client’s business and its legal requirements, including the nature of professional services sought.”²⁸⁷

²⁷⁹ *Id.* para. 112, at 29.

²⁸⁰ *See id.*

²⁸¹ *See id.* at 29–31.

²⁸² *Id.* para. 112, at 29. *Lawyer Guidance* does not suggest that the risk may be so low as to negate the need for any level of CDD and monitoring.

²⁸³ *See id.*

²⁸⁴ *Id.*

²⁸⁵ *See id.* at 30.

²⁸⁶ *See id.* at 29–31.

²⁸⁷ *Id.*

For example, this risk variable may come into play in a situation in which a real estate lawyer historically provided legal services to her client in the buying, leasing, and selling of mid-value residential properties as investments. Suddenly, the client requests her lawyer to assist her with the purchase of several offshore businesses using shell companies. This dramatic change in the legal services being sought may increase the risk of representing this client, unless the client proffers a satisfactory explanation for the sudden departure in her business investment profile and activities.

A lawyer serving as “local or special counsel may be considered [to represent] a low risk factor” under *Lawyer Guidance*.²⁸⁸ *Lawyer Guidance* does not define the contours of a local or special counsel’s role, other than to note that lawyers who “provid[e] advice or services (e.g. a local law validity opinion) peripheral to the overall transaction who are not preparing for or carrying out the transaction may not be required to observe the applicable CDD and record-keeping obligations.”²⁸⁹

An example best may illustrate the dilemmas that may arise in applying *Lawyer Guidance* to actual local counsel issues. Suppose Attorney Dwight, a real estate partner at a major New York City law firm, handles the purchase of a multistate real property portfolio for one of his clients, Big Realty LLC, a closely held family real estate enterprise he has represented regularly for twenty years. Dwight knows the members of Big Realty LLC and, in fact, his partners have represented these members in estate planning matters for well over a decade. The portfolio transaction involves properties located in ten states spread throughout the United States, and Dwight considers it important to engage local counsel to advise him and Big Realty LLC on local recordation and transfer tax issues, land use constraints, and title coverage matters. Attorney Dwight contacts a law school classmate and real estate lawyer, Attorney Kristen, to advise Dwight and Big Realty LLC on the local law issues in California, Kristen’s home state. Kristen never represented Big Realty LLC or met any of the company’s members, managers, principals, or owners. Kristen sends her invoice to Dwight to pass along to Big Realty LLC at the appropriate time for payment. Despite this lack of face-to-face interaction, Kristen nonetheless runs the customary conflict check on Big Realty LLC and the names of the members Dwight passed along to her. The

²⁸⁸ *Id.*

²⁸⁹ *Id.* para. 13, at 7.

conflict check is satisfactory and Kristen begins to respond to Dwight's local law issues.

Based on these facts, the issue is whether Kristen, the real estate lawyer serving as one of several local counsel on a major multistate real estate transaction, should be required to verify the beneficial ownership of Big Realty LLC before proceeding. Because Kristen is providing only a peripheral or facilitative role in the transaction, she takes the position that she is not preparing for or carrying out the transaction and thus is not required to verify the beneficial ownership of Big Realty LLC.²⁹⁰

In an era in which electronic forms of communication make it unnecessary for lawyers to interact with their clients face to face, *Lawyer Guidance* acknowledges that "non-face to face interaction between [lawyers] and clients should not, standing alone, be considered a high risk factor."²⁹¹ FATF expressed concern that money laundering and terrorist financing risks may arise from technologies that facilitate non-face-to-face relationships and could favor anonymity.²⁹² The increased prevalence of e-mail communication between lawyers and their clients, especially with those clients located in geographically distant locations, tempers the need for face-to-face meetings. Although a lawyer and her client may never meet face to face, that factor by itself should not constitute a high risk factor.

Client referrals and client origination are risk variables under *Lawyer Guidance*.²⁹³ A prospective client referred by a "trusted source" to a lawyer is a "mitigating risk factor."²⁹⁴ The trusted source apparently need not be another lawyer; rather, the referring source must be subject to an AML/CFT regime that is aligned with FATF standards.²⁹⁵ *Lawyer Guidance* draws a distinction between such a referral and one in which a prospective client contacts a lawyer "in an unsolicited manner or without common or customary methods of introduction or referrals."²⁹⁶ In the latter situation, the risk is higher.

Deal complexity, standing alone, is not a variable that elevates risk.²⁹⁷ *Lawyer Guidance* identifies as a risk variable "[t]he structure of a

²⁹⁰ See *infra* Part VIII.C.3.

²⁹¹ LAWYER GUIDANCE, *supra* note 105, para. 112, at 30.

²⁹² See *id.*

²⁹³ See *id.*

²⁹⁴ *Id.*

²⁹⁵ See *id.*

²⁹⁶ *Id.*

²⁹⁷ See *id.*

client or transaction.”²⁹⁸ *Lawyer Guidance* notes that lawyers “often design [deal] structures (even if complex) for legitimate . . . reasons.”²⁹⁹ In that case, the risk of money laundering is reduced.³⁰⁰ By contrast, the factors that increase risk are deal “[s]tructures with no apparent legal, tax, business, economic or other legitimate reason.”³⁰¹

5. Controls for Higher Risk Situations

Situations may exist in which a lawyer’s risk assessment analysis indicates that the client may be higher risk. *Lawyer Guidance* identifies measures or controls appropriate to mitigate the potential money laundering and terrorist financing risk for higher risk clients.³⁰² Among those measures is the paramount need to train lawyers and their staff to identify and detect changes in the client’s activity based on the risk-based criteria.³⁰³ Other measures include increasing the level of CDD for higher risk situations and seeking additional internal review and approval if performing legal services for higher risk clients.³⁰⁴ Because the same measures and controls may address more than one of the identified risk criteria, a lawyer does not necessarily have to establish specific controls targeting each distinct risk criterion.³⁰⁵

VIII. DEVELOPMENT OF RISK-BASED GUIDANCE FOR U.S. TRANSACTIONAL LAWYERS

The heart of *Lawyer Guidance*, and the reason *Lawyer Guidance* is of importance to transactional lawyers, is its emphasis on the need for the legal profession to develop “good practice in the design and implementation of an effective risk-based approach.”³⁰⁶ As discussed below, ABA policy is consistent with *Lawyer Guidance* on the development of risk-based guidance for the legal profession.

²⁹⁸ *Id.*

²⁹⁹ *Id.* at 30–31.

³⁰⁰ *See id.* at 31.

³⁰¹ *Id.*

³⁰² *See id.* para. 113, at 31.

³⁰³ *See id.*

³⁰⁴ *See id.*

³⁰⁵ *See id.*

³⁰⁶ *Id.* para. 6, at 4.

A. ABA Policy

At the ABA annual 2008 meeting in New York City, the ABA House of Delegates, the ABA's policy making body, adopted a recommendation opposing federal legislation that would bring persons (including lawyers) involved in the corporate formation process under the Bank Secrecy Act regulations and support efforts by states to amend corporate formation laws.³⁰⁷ The resolution also promotes state and local bar associations in the development of risk-based guidance for the legal profession.³⁰⁸ Known as Resolution 300, this policy urges state and local bar associations, and other appropriate constituencies within the legal profession, with the assistance of the Gatekeeper Task Force, "to develop appropriate guidance on adopting voluntary risk-based approaches to client due diligence that will inform legal professionals of the risks of money laundering and terrorist financing, and assist them in taking appropriate steps for compliance with anti-money laundering and anti-terrorist financing legal requirements."³⁰⁹

One impetus behind Resolution 300's adoption was the growing realization that the ABA needs to exhibit leadership in the development of nongovernmentally imposed risk-based guidance for U.S. lawyers.³¹⁰

³⁰⁷ See AMERICAN BAR ASSOCIATION, TASK FORCE ON GATEKEEPER REGULATION AND THE PROFESSION: EXEC. SUMM. RES. 300, at 3 (2008), <http://www.abanet.org/leadership/2008/annual/recommendations/ThreeHundred.doc> (last visited Mar. 15, 2009) [hereinafter RESOLUTION 300]. The ABA House of Delegates adopted Resolution 300. This recommendation also deals with proposed legislation and international policy initiatives intended to impose obligations on company formation agents, including lawyers, to undertake extensive due diligence on clients, and to determine beneficial owners when assisting in the formation of nonpublicly traded business entities and trusts. See *id.* A driving force behind Resolution 300 was the introduction on May 1, 2008, of S. 2956, a bill by Senator Levin (D. Mich.), that would, among other things, create a new category of "financial institution" under the Bank Secrecy Act for persons involved in forming a corporation, limited liability company, partnership, trust, or other legal entity. See The Incorporation Transparency and Law Enforcement Assistance Act, S. 2956, 110th Cong. (2008). S. 2956 would require the U.S. Treasury Department to mandate corporate formation agents to establish AML programs to ensure that the persons forming these entities are not doing so for money launderers. See *id.*

³⁰⁸ See *id.*

³⁰⁹ LAWYER GUIDANCE, *supra* note 105, para. 6, at 2.

³¹⁰ See RESOLUTION 300, *supra* note 307. The report states in pertinent part that "[a] key component contained in [Lawyer Guidance] is recognition of the need for the legal profession (and not a third party or governmental entity) to develop guidance for its members that is specifically tailored to address any risks that might arise." *Id.*

Absent the development of risk-based guidance for U.S. lawyers based on *Lawyer Guidance*, the Gatekeeper Task Force was concerned that Congress would enact legislation designed to impose a rules-based system on U.S. lawyers.³¹¹

B. Existing Good Practices

Lawyer Guidance encourages the development of “good practices” for legal professionals to assist in implementing a risk-based approach.³¹² *Lawyer Guidance* does not refer to the development of “best practices” guidance.³¹³ The private sector was concerned that the characterization of nongovernmentally developed risk-based guidance as “best practices” would create a standard of care expected of all legal professionals. To avoid this characterization and its potential adverse impact, *Lawyer Guidance* refers to “good practices.”³¹⁴

³¹¹ S. 2956 exacerbated this concern. See The Incorporation Transparency and Law Enforcement Assistance Act, S. 2956, 110th Cong. (2008). S. 2956 would, among other things, require privately held entities to provide more extensive beneficial ownership information to state governments and law enforcement authorities. See *id.* An earlier bill introduced by Senator Levin in 2007, S. 681, would have imposed similar requirements. See Stop Tax Haven Abuse Act, S. 681, 110th Cong. (2007).

³¹² See LAWYER GUIDANCE, *supra* note 105, paras. 30, 32, at 9–10.

³¹³ However, FATF published “best practices” guidance. See, e.g., FINANCIAL ACTION TASK FORCE, BEST PRACTICES PAPER ON TRADE BASED MONEY LAUNDERING (2008), <http://www.fatf-gafi.org/dataoecd/9/28/40936081.pdf> (last visited Mar. 15, 2009); FINANCIAL ACTION TASK FORCE, DETECTING AND PREVENTING THE CROSS-BORDER TRANSPORTATION OF CASH BY TERRORISTS AND OTHER CRIMINALS: INTERNATIONAL BEST PRACTICES (2005), <http://www.fatf-gafi.org/dataoecd/50/63/34424128.pdf> (last visited Mar. 15, 2009).

³¹⁴ The federal government, however, issued best practices guidance for U.S.-based charities. See U.S. DEP’T OF TREASURY ANTI-TERRORIST FINANCING GUIDELINES: VOLUNTARY BEST PRACTICES FOR U.S. BASED CHARITIES (2006), available at <http://www.ustreas.gov/press/releases/reports/0929%20finalrevised.pdf>. These best practices have been criticized because they are “inconsistent with common non-profit organization practices,” Bell, *supra* note 252, at 461 n.68, “are too vague and ambiguous to be of any real assistance to U.S.-based charities,” and are “rigid.” Joseph W. Younker, *The U.S. Department of Treasury’s Anti-Terrorist Financing Guidelines: Voluntary Best-Practices for U.S. Based Charities: Sawing the Leg off the Stool of Democracy*, 14 TRANSNAT’L L. & CONTEMP. PROBS. 865, 866, 885 (2004) (advocating a risk-based test more attuned to the reality of the nonprofit sector; a risk-based approach would take into account the actual risk that a specific grant could be diverted to terrorist groups when determining proper due diligence). As emphasized in the title to the federal government’s

Before *Lawyer Guidance*'s adoption in October 2008, some specialty bar associations and law societies developed "good practices" for their members in the area of AML and CFT.³¹⁵ For example, nearly four years ago, ACTEC developed a set of "good practices" (*ACTEC Good Practices*) for its Fellows.³¹⁶ *ACTEC Good Practices*, which is not styled as "best practices," consists of three major sections: education, know your client, and know the purpose of the transaction for which the lawyer is engaged.³¹⁷ *ACTEC Good Practices* has elements of a risk-based approach (such as a "know your client" requirement), but uses the word "risk" only once.³¹⁸ In light of the issuance of *Lawyer Guidance* and *TCSP Guidance*, ACTEC may revisit its good practices guidance.

C. Development of Good Practices for Transactional Lawyers

Lawyer Guidance represents a collaborative effort by the private sector, FATF, and FATF member states to encourage the private sector's voluntary adoption of risk-based guidance for its constituents and to educate them about the risks of money laundering and terrorist financing.³¹⁹ The alternative, not necessarily cast in terms of an overt threat but rather as a possibility looming ominously on the horizon, is the adoption by Congress of a rules-based, or prescriptive, approach. Federal intervention, in the form of a statutory or regulatory implementation of *Lawyer*

best practices, they are voluntary and no penalty exists for noncompliance. See Bell, *supra* note 252, at 462.

Although the federal government's best practices for U.S.-based charities are styled as "voluntary," some scholars believe that the practices are beginning to attain "quasi-legal status." See Bell, *supra* note 252, at 464. The concern is that the federal government may draw a negative inference if an organization does not comply completely with the best practices guidance. See Younker, *supra*, at 877.

³¹⁵ See *Anti-Money Laundering Practice Note*, *supra* note 242.

³¹⁶ See American College of Trust and Estate Counsel, Recommendations of Good Practices for ACTEC Fellows Seeking to Detect and Combat Money Laundering (Oct. 25, 2005), http://www.actec.org/public/Governmental_Relations/FATFBestPractices.asp (last visited Mar. 15, 2009) [hereinafter *ACTEC Good Practices*]. ACTEC is a nonprofit association of lawyers established in 1949, and its members are elected to the association by demonstrating the highest level of integrity, commitment to the profession, competence, and experience as trust and estate counselors. See American College of Trust and Estate Counsel, About ACTEC, <http://www.actec.org/public/AboutACTEC.asp> (last visited Mar. 15, 2009).

³¹⁷ See ACTEC GOOD PRACTICES, *supra* note 316.

³¹⁸ See *id.*

³¹⁹ See generally LAWYER GUIDANCE, *supra* note 105.

Guidance, would be an unwelcome development and an unwarranted intrusion and likely would imperil the sanctity of the attorney–client privilege and the duty of client confidentiality. For that reason, the federal government appears inclined to collaborate with the private sector in the development of voluntary risk-based guidance based on *Lawyer Guidance*.

Lawyer Guidance is “high level” guidance intended to provide a broad framework for implementing a risk-based approach for the legal profession.³²⁰ By contrast, guidance developed by the private sector would detail the practical application of *Lawyer Guidance* to the legal profession and would offer meaningful and detailed risk-based guidance to lawyers, taking into account the practical realities of the practice of law in an increasingly complex environment.³²¹

Section 3 of *Lawyer Guidance* sets forth a practical roadmap to the implementation of a risk-based approach.³²² The starting point for the development of any good practices guidance by the private sector begins with an assessment of the private sector’s vulnerabilities to money laundering and terrorist financing.³²³ Each sole practitioner or law firm should assess its vulnerabilities.³²⁴

A law firm should determine its exposure to the three major risk categories: country risk, service risk, and client risk. Parties charged with the development of any good practices guidance for the legal profession should evaluate these risk categories and fashion practical and meaningful guidance to transactional lawyers. In doing so, the good practices guidance should address the following points of particular interest to transactional lawyers. This discussion is not intended to propose a prototype for good practices guidance; rather, the points are designed to foster further discussion on specified issues that will arise in the development of good practices guidance for transactional lawyers.

³²⁰ *Id.*

³²¹ By contrast, commentators have criticized the voluntary best practices guidance for U.S.-based charities developed by the federal government because its suggestions are “onerous, unrealistic, beyond the capabilities of most non-profits, and unlikely to divert funds from terror financing.” See Bell, *supra* note 252, at 463.

³²² See LAWYER GUIDANCE, *supra* note 105, at 25–35.

³²³ See *id.* para. 103, at 25.

³²⁴ See *id.* para. 106, at 25.

1. *Country Risk*

Transactional lawyers should ascertain the client's domicile, the location of the transaction, and the source of funding. Lawyers should pay particular attention to those countries posing a higher risk of money laundering or terrorist financing, such as those countries subject to sanctions, embargoes, or similar measures issued by certain bodies, such as the United Nations and those identified by credible sources.³²⁵ Lawyers need to identify where the client resides or has its principal place of business, the situs of the transaction, and who is providing the funding to close the transaction. Transactions occurring wholly within the United States do not increase the risk, but an extraterritorial transaction may elevate the risk factor depending on the location of the transaction.

2. *Service Risk*

Lawyer Guidance lists eighteen separate factors that a lawyer should consider in assessing the risks involved in providing one of the Specified Activities.³²⁶ To minimize the service risks arising out of these factors, lawyers should take into account the following in providing legal services:

- Lawyers acting as financial intermediaries should seek to avoid or minimize the handling of cash in connection with a transaction involving a Specified Activity. For example, a real estate lawyer who “touches the money” by serving as an escrow agent in disbursing the closing proceeds is engaging in activity that may warrant increased scrutiny simply by virtue of facilitating the transmission of closing funds. Acting as a financial intermediary does not, standing alone, constitute a high-risk circumstance, but may rise to that level in light of other factors.
- Transactions arising out of a Specified Activity that have no apparent legal, tax, business, economic, or other legitimate reason should trigger increased scrutiny by the lawyers. In the vernacular, this is the “smell test,” meaning that the lawyer should be attuned to transactions that do not “smell” right. For example, the transfer of commercial properties by parties within a time period that is unusually short for similar transactions without legitimate

³²⁵ See *id.* para. 108, at 26.

³²⁶ See *id.* para. 110, at 28–29.

reason may call for increased scrutiny. Lawyers should not ignore transaction structures or timeframes that fail the smell test.

- Based on the lawyer's experience with the client, a lawyer should assess whether the client's desire for anonymity is abnormal. When a client suddenly desires anonymity, a lawyer should inquire into the rationale for this newly expressed desire.
- A lawyer should analyze the source of funds for the transaction and the client's source of wealth. Under *Lawyer Guidance*, the "source of funds is the activity that generates the funds for a client, while the source of wealth describes the activities that have generated the total net worth of a client."³²⁷

3. *Client Risk*

Client intake is a critical point in identifying the risk of money laundering or terrorist financing. First and foremost, lawyers need to identify the client—to assess both potential conflicts and the risk of money laundering or terrorist financing.

Lawyers need to run the prospective client's name through the SDN List the U.S. Treasury Department's Office of Foreign Assets Control maintains and the DPL the U.S. Department of Commerce maintains.³²⁸

Serving as local counsel on a transaction presents challenges. The local counsel first needs to determine whether the assistance comes within the reach of "preparing for or carrying out" a Specified Activity. *Lawyer Guidance* notes that local counsel often perform a role that is "peripheral to the overall transaction."³²⁹ For ethical reasons and to ensure that the local counsel is not representing a client on a governmental watch list, local counsel should identify the client. Local counsel then should make the following determinations to assess whether the engagement requires identification and performing CDD on the client's beneficial owner:

- Determine whether the scope of representation by the local counsel involves a Specified Activity.

³²⁷ *Id.* para. 110, at 28.

³²⁸ The SDN List is a comprehensive list of individuals and entities that the federal government has designated pursuant to both country-based and list-based OFAC administered programs. U.S. persons and entities are prohibited from dealing with any of the parties included on the SDN List. *See* Bell, *supra* note 252, at 462 n.71; Jeremy S. Friedberg & Andrew L. Cole, *Office of Foreign Asset [sic] Control: Do You Know Who Your Borrower Is?*, BUS. L. TODAY, May-June 2008, at 59, 61.

³²⁹ LAWYER GUIDANCE, *supra* note 105, para. 13, at 7.

- Determine whether the local counsel is “preparing for or carrying out” a Specified Activity.

The degree of the local counsel’s involvement is a significant factor in the second determination. For example, the lawyer should determine whether the engagement is comparatively fleeting or, at the other end of the spectrum, is work intensive and entails considerable interaction between the local counsel and the referring counsel or requires the local counsel to prepare and negotiate critical transactional documents. At some point along the continuum, the local counsel’s role may move from a peripheral role to a pivotal one in the transaction. In the latter situation, the local counsel may be preparing for or carrying out the transaction that is the subject of the Specified Activity. As a result, the local counsel would need to employ risk-sensitive measures to determine the identity of the client’s beneficial owner.

Several examples illustrate the range of a local counsel’s involvement. At one end of the range is a local counsel who is asked to obtain a zoning confirmation letter from the local zoning office. This letter is needed to complete due diligence for a multistate acquisition. In this example, the local counsel contacts the zoning office to obtain the standard zoning verification letter. On receipt of the verification letter, the local counsel sends it to the referring counsel. The overall effort and involvement of the local counsel on this transaction is peripheral to the larger transaction, and as a result, the local counsel is not preparing for or carrying out a transaction that is the subject of a Specified Activity.

Further along the continuum is a local counsel who is requested to prepare and deliver an enforceability opinion for a purchase money mortgage in connection with a multistate asset acquisition that includes real property in the local counsel’s jurisdiction. The local counsel needs to review the underlying loan documents, review the organizational documents for the client/borrower, and obtain written certifications specified by the local counsel from the client/borrower to support the delivery of the local counsel opinion. Local counsel needs to negotiate the letter with the lender’s counsel and discuss the letter with the referring counsel. Obviously, the local counsel’s role is greater than in the first example above, yet the local counsel’s role remains peripheral to the overall transaction. The local counsel’s role is defined narrowly (for example, prepare and issue a specific legal opinion) and circumscribed. Again, the local counsel is not preparing for or carrying out a transaction that is the subject of a Specified Activity.

Toward the other end of the spectrum is a local counsel who becomes intimately and extensively involved in a single asset transaction. The local counsel may negotiate various documents relating to the acquisition (for example, purchase and sale agreement, deed, assignment of leases, bill of sale, assignment of service contracts, and the like), deal with the seller and the seller's counsel, perform and report on various due diligence activities, resolve title and survey issues, and perform ongoing advisory services from the date of engagement until closing. In this situation, the local counsel's role is intensive and pivotal, not peripheral. Consequently, the local counsel may be preparing for or carrying out a transaction.

The line may not be bright when a local counsel is performing services peripheral to the overall transaction. The inquiry into whether those services constitute preparing for or carrying out is fact specific and made on a case-by-case basis. The quantum and scope of the local counsel's involvement in relation to the overall transaction is to be an overarching consideration.

D. Role of State, Local, and Specialty Bar Associations

Lawyer Guidance is not aimed at only ABA members; rather, *Lawyer Guidance* applies to all lawyers performing or carrying out Specified Activities on behalf of a client. The scope and breadth of *Lawyer Guidance* compels lawyers involved at the national, state, and local levels to become engaged in the development of the specific guidance for the legal profession. Bar associations would provide a valuable service to their membership by formulating good practices guidance for the implementation of a risk-based approach.

To minimize conflicting guidance, these associations should collaborate and cooperate with each other in the development of the guidance for their members. The sharing of ideas and approaches goes far in achieving a uniform set of good practices to combat money laundering and terrorist financing. Given its lengthy involvement in the Gatekeeper Initiative, the ABA ideally is suited to assume a leadership role in the development of good practices guidance that may serve as a model for other bar associations.

IX. CONCLUSION

Lawyer Guidance can trace its lineage to a meeting of world leaders in Paris two decades ago and to another meeting of foreign ministers in Moscow a decade ago. In the last decade, the Gatekeeper Initiative slowly has gathered steam and momentum through the guiding hand of

FATF. The war on terror added a sense of urgency to the global implementation of the Gatekeeper Initiative.

Astonishingly broad in concept, the Gatekeeper Initiative, roiled the legal profession because of its encroachment and intrusion on the attorney–client privilege and the duty of client confidentiality. The legal profession waged an admirable battle against FATF and its member states in an attempt to curb the excesses of the Gatekeeper Initiative. *Lawyer Guidance* is far from perfect, and its imperfections likely will become magnified as lawyers begin to understand and work with it in the coming years. Lawyers need to develop their own good practices to stave off federal intervention and intrusion into this area. In doing so, lawyers are able to shape the good practices so that these practices conform with the general tenets of *Lawyer Guidance*, but at the same time are attuned to the unique nature of the attorney–client relationship and the business realities of a global economy.

APPENDIX

Set forth below is a list of acronyms used in this Article.

ABA	American Bar Association
ACTEC	American College of Trust and Estate Counsel
AML	Anti-Money Laundering
ARA	Association of Registered Agents
CDD	Client Due Diligence
CFT	Combating the Financing of Terrorism
DNFBPs	Designated Nonfinancial Businesses and Professions
FATF	Financial Action Task Force
FIU	Financial Intelligence Unit
NPRRA	National Public Records Research Association
NTO	No Tipping Off
NCCUSL	National Conference of Commissioners on Uniform State Laws
OECD	Organisation for Economic Co-Operation & Development
OFAC	Office of Foreign Assets Control
PEP	Politically Exposed Person
SAR	Suspicious Activity Report
SDN	Specially Designated Nationals
SRO	Self-Regulatory Organization
STEP	Society of Trust and Estate Practitioners
STR	Suspicious Transaction Report
TCSPs	Trust and Company Service Providers