Stop criminals misusing legal services

Although affecting only a relatively small proportion of transactions, new laws may unintentionally have made legal services and trust accounts more attractive to criminal activity, and made it more difficult for lawyers to avoid being implicated; but there are pragmatic ways to protect your business.

Ten issues facing most law firms

From 30 June 2013, new laws require finance businesses to reduce their vulnerability to money laundering and terrorist financing.

Most law firms are exempt from the extensive process and systems requirements of the Anti-Money Laundering and Countering Financing of Terrorism Act 2009 (NZLS is monitoring the planned removal of the exemption), but the new law reinforces current duties and adds new elements:

1. Dealings with banks involve lawyers in the new legislation

Banks may seek client details on a "per transaction" basis; or, to help streamline financial transactions, the regulations allow banks to seek blanket warranties on trust accounts. When lawyers agree to hand over client details and means of verification, lawyers in effect underwrite their clients' veracity on banks' behalf.

2. Acting as trustees and agents

Banks dealing with professionals acting as trustees or agents now require detailed information on the identity of beneficiaries and clients. Again, law firms may in effect perform some of the due diligence checks needed to meet banks' own obligations under the Act.

3. Some client care processes may need updating

Do your processes adequately explain to clients new circumstances in which you may divulge their details? Any potential insurance "gaps" may also need divulging, although probably only for a few firms.

4. Money laundering offences remain

Being temporarily exempt from the new legislation doesn't mean lawyers or their clients are immune from prosecution. The AML CFT Act proscribes detailed systems and processes to reduce vulnerabilities, but the main money laundering offences are contained in laws which apply universally, such as s243 of the Crimes Act 1961.

5. The bar has been raised

Unlawfully dealing with funds derived from serious crime doesn't require actual knowledge of the criminal source of funds. "Reckless" lack of knowledge is sufficient. Other offence elements include "possession" and "dealing" with property, and "enabling" or "assisting" others to do so. This means that lawyers can be exposed to money laundering involvement more easily than offences requiring higher thresholds, as some overseas legal professionals have learned the hard way.

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In place since 2009 and now covering the entire financial services sector, the new Act has "raised the bar" in financial transactions. Even to meet existing reporting duties, lawyers should be aware of money laundering – and ways to detect and deter it – whether or not temporarily exempt from the additional process requirements of the new Act. Failure to "lift the lid" on transactions that any reasonable businessperson would investigate further may increasingly be regarded as negligent or reckless.

Coincidentally, as the new Act came into force, global standards on lawyers' money laundering vulnerability abandoned a traditional separation between "unwitting" and "complicit" involvement. A continuum now applies. This means that even well-intentioned lawyers may no longer be dismissed as "unwitting". When known "red flags" are missed, or their significance misunderstood and questions unasked, a continuum of "unwitting" can merge almost seamlessly into "wilful blindness" and "recklessness"; expanding the scope of culpability.

6. Existing duties to report suspicious transactions

Lawyers receiving funds to deposit or invest, or to settle real estate transactions, remain subject to the Financial Transactions Reporting Act 1996; with duties to identify and report suspicious transactions. Enforcement officials confide that reporting has been "patchy". Some firms do so diligently, others

Can you safely assume lawyers will stay 'under the radar'?

At a recent conference of anti-money laundering professionals, a senior Police official spoke about the forfeiture of a drug dealer's houses, farm and vehicles, valued at nearly $6 million. The assets were unencumbered, and purchased with cash.

"Who was the real estate agent?" he asked. "Who did the conveyancing? I'd like to speak with them. [New Zealand's big criminal enterprises] can't operate these schemes without professional help. If there's wilful blindness, that's where it resides. The legal profession isn't covered by the legislation. It astounds me that professionals like that can be involved and not see what's going on. It's a reality we can't ignore any more."

What is money laundering?

Money laundering is not confined to criminals or offshore funds.

Basically, money laundering transforms the proceeds of criminal activity into legitimate funds. Processes obscuring the true ownership of criminal funds include transfers, loans and asset sale and purchase.

Between $1.5 and $10 billion is laundered annually in New Zealand.

It may involve legitimate businesses and "gatekeeper" professionals – lawyers, accountants and real estate agents – facilitating financial transactions.

in similar circumstances not at all.

7. Hidden professional conduct and insurance risks

"Raising the bar" may lead to ethics and insurance implications. In the modern context, if lawyers fail to spot "red flags" or ask questions on transactions that any other reasonable businessperson would investigate further, will the Police, Law Society or judge accept ignorance as a defence? Will insurers honour claims?

8. Confluence of factors increase trust account risks

Since at least 2005, the government noted increasingly sophisticated methods using "gatekeeper" professionals such as lawyers and accountants. Legal services and trust accounts are known ways of laundering criminal proceeds, but their attractiveness as "washing machines" for local and international criminal operations has moved up a notch due to a series of factors:

- more popular money laundering routes – such as banks, casinos and money remitters – now have extensive systems and close supervision, unlike those for lawyers; and criminal funds typically divert to any remaining perceived weak links;
- a "substitution effect" away from trust and company services providers now supervised under the Act, towards lawyers and accountants offering the same services, largely unmonitored;
- trust account audit processes that don't examine the source of funds;
- the ease of instantaneous money transfer;
- ironically, the credibility and respectability of trust accounts adds to their money laundering allure, along with perceptions that transactions involving lawyers are scrutinised less closely;
- legal professional privilege and confidentiality are recognised as attractive to sophisticated criminal networks due to perceptions that these protections prevent or obstruct investigation when they use a lawyer's services; and
- lawyers and staff may not always know what to look for. A natural but unintended consequence of a temporary exemption under the new Act is that some firms may not yet have updated staff training for the additional pressures on existing detection, due diligence and reporting duties.

9. Structuring transactions attracts criminal sanction

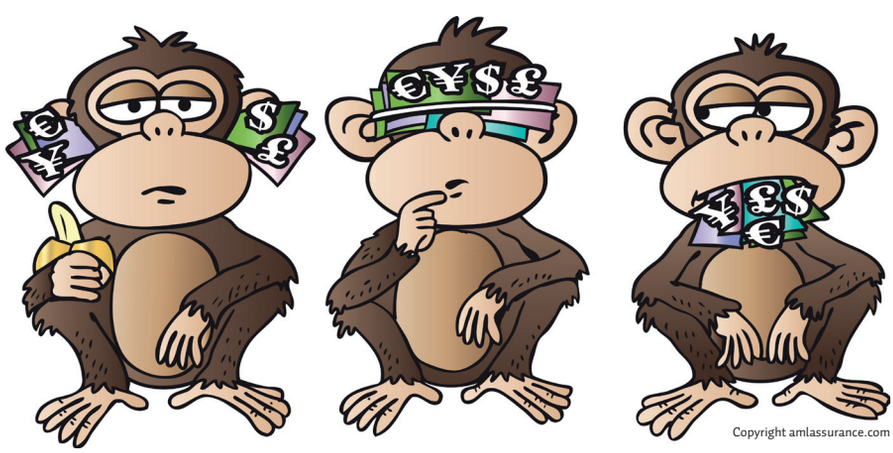
Professional advisers routinely help structure transactions not to breach relevant legislation. It is, however, an offence to structure transactions to avoid application of AML CFT Act requirements. Conceivably, advice resulting in clients not being subject to the legislation could render advisers culpable, even complicit.

10. Business reputation risks

For professional services firms, and their professions, business reputation risks are at least as important as financial penalties or other sanctions. A serious money laundering transgression or any terrorist financing facilitated by a professional services firm will have an obvious impact on the business reputation of the people and firm involved; and on the political and public perception of the profession – particularly by any firm claiming to have "unwittingly" missed its obligation to file suspicious transaction reports in the face of obvious "red flags".

If such an event also affects New Zealand's international reputation, the potential impact on the continuation and scope of lawyers' temporary exemption is equally obvious.

Ron Pol and Ashley Balls are from specialist consultancy amlassurance.com.



How big is the risk?

Risk management processes assess risk on a combination of likelihood and consequence factors.

For any particular firm, the likelihood of being found to be involved in money laundering is probably small (although higher for some firms, particularly those operating trust accounts, or offering services such as conveyancing, commercial property, criminal defence, or trust and company creation and administration).

The consequence of such an event, however, is much greater. For a lawyer or firm, it may herald the end of a career or business; as evidenced overseas.

Firms all have varying levels of exposure, but the risk profiles of most law firms have already changed. The real issue for each firm is to address any current risks, monitor the existing change process, and decide how and when to address the pending new obligations.

Lawyers' professional obligations

Lawyers must comply with fundamental obligations to uphold the rule of law, and to facilitate the administration of justice (Lawyers and Conveyancers Act 2006, s4). A lawyer must take all reasonable steps to prevent any person perpetrating a crime or fraud through the lawyer's practice (Rules of Conduct and Client Care, R11.4).