

Anti-money laundering: What really matters most?

Dr Ron Pol, AMLassurance.com

This session will guide you to a better understanding of what to be alert to when ensuring that your transactions are clean, and your practice doesn't slip between the gaps of tick-box compliance and real-life practice. The legislation, and programmes based on the legislation, have gaps that don't always reflect New Zealand practice. But there is empirical evidence how New Zealand lawyers are used to facilitate money laundering, often unwittingly. Given the recent AEOI-CRS implementation, and with trusts, companies and real estate transactions linked with crime proceeds locally and overseas, there are key issues to consider, including how criminals compartmentalise knowledge to use lawyers, and what it really means to miss the most important red flags.

A new perspective: Strategic, 'beyond compliance'

This session offers practitioners a different view about anti-money laundering compliance, helping facilitate decision-making from a strategic business viewpoint. It offers a global perspective, places New Zealand in that context, and reveals publicly for the first time some of the results of in-depth empirical research identifying how lawyers are used to launder the proceeds of crime in New Zealand.

It also outlines some of the gaps that firms might inadvertently miss if, in the urgency of time pressures to introduce AML/CFT systems, they look only through the big lens of the telescope, inadvertently restricting their view to the details of the looming compliance obligations. Viewing the issue also from the lens offering a broader viewpoint can help firms make better decisions for their practice.

Delivering practical value: An overview

There are five main ways a session like this might add value:

1. The global perspective: How effective have AML controls proven to be, globally, and in countries with AML controls fully, partly or not applicable to 'facilitator' professions?
2. New Zealand focus: How does New Zealand compare? What does the empirical evidence say about New Zealand's AML effectiveness since 1996? What's the likely impact of extending AML/CFT obligations to lawyers?
3. Meeting the new compliance requirements.
4. THE most important strategic decision for lawyers about to implement AML/CFT systems.
5. Using the evidence for practical benefit: How are lawyers used to launder criminal funds, in practice, in New Zealand?

This day is practical, so **#1-2** will be brief. (For those interested in more in-depth analysis, they are covered in depth in forthcoming articles).

This session is brief, so I won't touch on **#3**. Nearly every consultant in the industry is busy trying to sell their products, systems and software to lawyers. This session offers an independent perspective, to help firms make better sense of what those systems can achieve, and what they can't. And to help busy practitioners make strategic decisions about how best to implement new systems and training.

The core message is **#4**. It is seldom stated; easily lost in the 'noise' of working frantically to ensure compliance with new obligations. It is, however, I believe the single most important question that every law firm leader needs to ask.

For practical value at a 'detail' level as well as the strategic, **#5** draws from real case studies illustrating how lawyers have been used to launder criminal funds. They are not generic examples based on overseas cases. Nor limited to cases where lawyers were prosecuted. Cases were drawn from transaction documents over more than 20 years; from extensive research that found new ways to

identify, locate, examine and assess every available transaction in a defined area where lawyers (and accountants and real estate agents) facilitated financial transactions with proven proceeds of crime.

But first, a sense of déjà vu

Banks, lawyers and other professionals have been required since 1996 to undertake checks and report suspicious transactions in specific circumstances. For lawyers, those circumstances include real estate transactions and receiving funds for deposit or investment. When the AML/CFT Act introduced more comprehensive money laundering controls on banks and other financial institutions in 2013, lawyers were exempt. The general narrative at the time was that lawyers' exemption meant business as usual.

I wrote an article for *LawTalk* outlining a contrary view. It listed a series of ways that the new regulations increased the risks on lawyers' businesses, notwithstanding lawyers' then exemption.

The Law Society conferred a great privilege on my article. Unusually, it affixed a disclaimer. Even more remarkably, not resting with "not necessarily the views", it was expressed as *not* the Society's view.

Soon afterwards, however, senior managers engaged personally in genuinely open, evidence-informed discussion on the issues. I was impressed when they agreed that the views expressed were not 'alarmist', as the then-prevailing narrative might have suggested. Indeed, in some respects, the article was understated, constructively informing practitioners that all was not as it seemed. To their very great credit, in my respectful opinion, the Law Society published many more articles, from many sources. Lawyers now have the benefit of a significant body of advice and guidance.

With the recent extension of money laundering controls to lawyers, I find myself again expressing views that lawyers might not readily discern from the industry narrative, notably in items 1-2 and 4-5 above. That is the point of this session's sub-title, "What really matters most?"

This session doesn't repeat the standard compliance message firms can get pretty much anywhere. Focused on practical business considerations, it seeks to offer firms a strategic context sometimes missing from the implementation imperative. If a few elements in today's session might again be considered contrary to an industry narrative, it is firmly evidence-based.

Important reminder: It's not just AML/CFT

In the rush to comply with AML/CFT obligations, amidst a sea of AML/CFT marketing, it's easy to overlook that it is *not* sufficient simply to comply with the new AML/CFT obligations.

Lawyers have other responsibilities; in some respects, more extensive than AML/CFT obligations.

- **Professional.** Lawyers have at least six professional responsibilities and obligations under the Lawyers and Conveyancers Act and Code of Conduct that apply to a wider range of activities, including facilitating financial transactions with criminal proceeds, than the specific circumstances of AML/CFT obligations.

Practical issue: Has your firm factored into its systems and training program the additional professional requirements, beyond the specific and in some cases arbitrary areas for which lawyers have compliance obligations under AML/CFT?

- **Historical AML/CFT.** For more than 20 years (since 1996), firms receiving funds for the purposes of deposit, investment or settling real estate transactions lawyers have been required to undertake checks and verify information, and to report suspicious transactions.

Practical issue: Does your firm have extant but unknown risks in relation to past transactions? (I have yet to meet a firm that does not, or one that did not first believe genuinely to the contrary). The empirical research sheds some light on this question.

- **Criminal.** Section 243 of the Crimes Act is, in my view, unnecessarily intricate, mirroring an industry renowned for cloaking simple concepts with supposed complexity and arcane terminology. But, it potentially poses risks for lawyers, risks perhaps inadvertently masked by its complexity, its presumed lack of relevance to the ordinary activities of honest lawyers, and firms' current laser-like focus on looming AML/CFT compliance obligations.

Practical issue: The confluence of “enabling or assisting”, “directly or indirectly” and “being reckless as to whether or not property is the proceeds of an offence” potentially creates issues much wider than the specific areas for which lawyers will soon have AML/CFT compliance obligations. The research sheds light on the potential scale and scope of this risk for lawyers.

Top practical ‘takeaway’: The new AML/CFT obligations are not a code, and compliance systems no panacea, for addressing lawyers' business issues and risks in this area. They are a very important subset of those issues, but it is not sufficient simply to comply with the new AML/CFT obligations.

Moreover, the AML/CFT regulations also contain manifold gaps, addressed below, after the following sections place the new obligations in a broader context.

1. The global perspective: How effective are AML controls?

‘Facilitator’ professions are often excluded from the first tranche of money laundering controls, initially applied to banks and other financial institutions. The professions are typically added afterwards. It is said that ‘closing loopholes’ will have significant additional impact as to justify regulatory expansion.

If there is a significant impact, as often asserted, it suggests a testable hypothesis. In a forthcoming peer-reviewed article I suggested that “if AML/CFT policy initiatives have the claimed impact, it should be empirically observable in [effectiveness] indicators.” To test such claims, it is necessary to identify an effectiveness measure. Then, if results between jurisdictions demonstrate differences, the next step would isolate how much of the observed differences in the impact of money laundering controls can properly be attributed between jurisdictions that apply full, partial, or no money laundering controls to professional facilitators, and those which apply controls to some professions but not others.

So, what did that analysis find? How effective is the anti-money laundering regime, globally, and in each of those countries, including New Zealand?

2. The New Zealand focus: How effective are AML controls in NZ, and the likely impact of their extension to lawyers?

- What did the empirical research also reveal as to the effectiveness of New Zealand's money laundering controls in a specified area, by another measure, empirically?
- What do these findings suggest the likely impact of extending AML/CFT obligations to lawyers?
- What was the recent extension of money laundering controls to lawyers based on? How did the cost-benefit analysis justify extension of money laundering controls to lawyers? What is the new regulatory guidance for lawyers based on, and what does all this mean, in practice?

These findings may be interesting, but this session is practical. Irrespective their intention, soundness or potential effectiveness, the regulations are looming, and lawyers must comply with them. Any gaps between the assumptions on which the regulations were based and the reality of practice are arguably no longer important, except to help guide implementation.

4. The key strategic decision for lawyers

The AML/CFT regulations don't necessarily mirror legal practice in New Zealand. With gaps (identified and identifiable, and likely others presently unknown) between the reality of law firm practice and risks facilitating criminal transactions, and the new regulations intended to address such risks, systems and training programs designed to meet firms' AML/CFT obligations will inevitably miss any gaps inadvertently built into the system itself.

In practical terms, this means that, when law firm leaders instruct those responsible for managing firms' AML/CFT obligations, selecting providers, implementing AML/CFT programs, and developing and delivering training, they have a strategic choice. This might be expressed in several ways:

- a) "We will meet our AML/CFT compliance obligations"; or
- b) "We don't want our business to be attractive to criminals seeking to launder the proceeds of serious profit-motivated crime."

These choices are not mutually exclusive, but the uncomfortable truth is that (a) is not the same as (b).

This raises an interesting research topic:

- To what extent does an AML/CFT 'compliance' culture contribute to perceptions that lawyers' businesses are *protected* from criminal misuse, thereby inadvertently creating blind spots *enabling* criminal misuse of lawyers' businesses?

But, for more immediate practical purposes for practitioners...

The key 'takeaway'...

- Lawyers may be AML/CFT compliant, but that does *not* mean that their businesses are protected from criminal misuse.

....and its likely corollary

- The more assiduously firms adopt an AML/CFT 'compliance' focus without a corresponding crime-prevention focus, the greater likelihood that firms remains open to criminal misuse. (The empirical evidence offers illustrative insights, with examples where a 'compliance' focus left firms perfectly positioned for repeated criminal misuse).

5. What does the evidence reveal?

Evidence of lawyers' involvement? The idea that there's little or no evidence that lawyers are used to launder criminal proceeds is usually based on a perceived paucity of prosecutions, with just one well known case of a lawyer prosecuted, many years ago, 'only' for failing to report suspicions. However:

- There have been other prosecutions of lawyers and accountants facilitating or enabling financial transactions with proceeds of crime.
- Nonetheless, to what extent do these (still relatively few) prosecutions of professionals present a reliable indicator of lawyers enabling financial transactions with proceeds of crime?
 - Did the empirical evidence identify ‘below the waterline’ cases, where lawyers’ actions were not prosecuted, under-investigated, or not investigated at all?
 - Did it uncover evidence of more cases, further below the waterline, eg ‘known unknowns’?

Gaps between regulations and reality that a ‘compliance’ focus might miss? If there are gaps between regulations and reality, practitioners need to be aware of them. Otherwise, any such gaps may leave firms open to misuse, notwithstanding the intention of money laundering controls.

- Do gaps between the legislated areas of compliance and the empirical evidence present opportunities for criminals to continue using lawyers to launder illicit funds?
- How might lawyers be used to help launder the proceeds of serious crime in other ways not covered by AML/CFT compliance obligations?

What about business risks beyond non-compliance with the new AML/CFT rules? It is well-known that breach of AML/CFT obligations leads to administrative/civil sanction, and knowingly or recklessly breaching some requirements carries criminal sanction under AML/CFT.

With huge pressure to meet an impossible deadline, it might be understandable if some firms remain focused on the new AML/CFT rules. But, in addition to AML/CFT:

- Negligence in this area potentially carries professional sanction, including in areas wider than those to which AML/CFT obligations apply. (To which, presumably, proof of compliance with AML/CFT obligations is arguably no defence).
- Being reckless as to whether property is the proceeds of crime features in the (Crimes Act) money laundering offence. Nor are these provisions limited to the specific and sometimes arbitrary areas to which AML/CFT obligations apply. Moreover, since amendments (after an accountant claimed not to know the specific crime the money came from), it is not necessary to prove knowledge of any particular offence or type of offence generating illicit funds, and being ‘reckless’ whether the funds derived from crime is treated the same as knowledge.

In practical terms, if ‘reckless’ is similar to ‘wilful blindness’, and if there are gaps between some of the assumptions on which AML/CFT compliance obligations were based and the methods that criminals have been found, in reality, to use lawyers’ services to facilitate laundering, how might this affect lawyers’ businesses?

- Law firm leaders might assume that partners and staff would see the red flags and ask the right questions. Some might be missed inadvertently, but, presumably, wilful blindness – closing one’s eyes to obvious red flags – is rare?
- What does the evidence say about professionals unwittingly facilitating illicit transactions? And the proportion found wilfully blind?

Bonus value ...if there's time

More case studies: How are New Zealand lawyers *really* used to launder criminal funds?

Drawn from the most extensive research project of its kind conducted in New Zealand, these are real case studies where individual criminals, organised crime groups and elements of local and international criminal networks used lawyers, accountants and real estate agents, in firms of all sizes, in cities and towns throughout New Zealand, to help enable and facilitate financial transactions with proceeds of crime.

Case studies include the involvement of professionals assessed across all categories, ie where they were found:

- **innocently duped**, with no red-flag indicators of potential criminality when presented with transactions later found to have involved proceeds of crime;
- **unwittingly used**, with relatively few red-flags, whose significance was (reasonably) missed or misunderstood;
- **wilfully blind**, or as behavioural scientists might suggest, wishfully blind, failing adequately or fully to inquire further, or at all, notwithstanding multiple observable criminal indicators; and
- **complicit**, allowing their services to be used to facilitate criminal transactions, with knowledge of the underlying criminality.

The case studies also reveal '**slippery slope**' examples, such as lawyers used in one transaction innocently or unwittingly, in later transactions assessed wilfully blind.

Some key learnings from the case studies: What do the cases reveal about criminal techniques for using lawyers to help launder the proceeds of crime in New Zealand?

- **Revealed: The single most effective way to launder the proceeds of serious crime using lawyers.** In this situation, lawyers are less likely to observe red flags or question them, because it creates a smoke screen enabling even the dumbest criminals to evade lawyers' attention with relative ease.
- **Revealed: The second-best way to launder criminal funds through New Zealand lawyers.** This requires a modicum of criminal 'smarts', to engineer a few simple circumstances sufficiently to ensure that lawyers facilitate financial transactions with criminal proceeds without demur.
- **Revealed: A key attribute that criminals seek in your staff members.** The research didn't explore criminal motivations, but it revealed likely indicators. If I was part of a criminal network generating illicit funds, this is the single most important attribute that I would look for in your staff members. The evidence revealed multiple instances where criminals appeared encouraged to develop relationships with some firms, and not others. There were many instances where firms displaying this attribute became an important part in helping protect, advance and expand criminal enterprises in New Zealand.

About the presenter

Dr Ronald F Pol, AMLassurance.com

PhD (PolSci, ML), LLB (Hons), BCom (Econ)

With more than 25 years' experience as a lawyer, legal consultant, writer and speaker in New Zealand and overseas, Dr Pol is one of New Zealand's leading contributors to public discourse in this area, combining critical-thinking with evidence-based practical application; for better outcomes. Dr Pol previously directed Telecom's major litigation, led New Zealand's corporate lawyers' association, and was appointed to NZLS Council. His doctoral thesis identified how lawyers, accountants and real estate agents are used to facilitate criminal transactions in New Zealand. It identified key indicators of professionals innocently, unwittingly, wilfully blind and knowingly facilitating financial transactions with proceeds of crime. At the international level, Dr Pol has assessed the AML/CFT complex for effectiveness, globally and in New Zealand. He also completed the first independent assessment of the new global methodology for evaluating the effectiveness of AML/CFT regimes. Dr Pol has helped train police, customs and other enforcement officers from New Zealand, Australia and elsewhere.

Articles

Articles referred to in this presentation, and many others affecting lawyers and money laundering, are listed, and most are freely available, at AMLassurance.com.