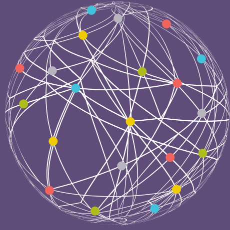

THE GLOBAL INITIATIVE AGAINST TRANSNATIONAL ORGANIZED CRIME

Not above the law?

Charles Goredema

The role of lawyers in combating money laundering and illicit asset flows

POLICY NOTE

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'For it is absolutely clear that criminals organize their activities in the interstices of the legitimate society, and will exploit—*if they have the necessary skills and connections*—any opportunities they are given. The trick of regulation is to minimize the illegitimate exploitation without wrecking the economic dynamism.'[1]

– Michael Levi

Summary

Lawyers frequently find themselves caught between their obligations to governmental authorities and their fidelity to their clients. This becomes particularly problematic when, as intermediaries in business transactions, they become aware of, or are requested to facilitate, illicit financial flows (IFFs). Lawyers can become complicit in, or even initiate, economic crime, as the case studies in this report show. They may become complicit through negligence. The extent to which this occurs on a global scale was revealed by the Panama and Paradise papers, but it is of particular concern for developing economies, where such crimes can have especially devastating effects. Recognizing the dilemma lawyers face when caught between an oath to client confidentiality and a responsibility to report financial misconduct, this report suggests ways in which they might contribute to anti-money-laundering (AML) measures, in particular stressing the importance of client due diligence (CDD), the involvement of lawyers in national risk assessments and the need to tailor combating strategies to judicial environments.

Key points

By its nature, the legal profession places lawyers in a special position, from which they are able to facilitate and mediate significant economic and financial transactions. For this reason, AML policies and strategies generally require that lawyers understand and comply with certain obligations. The nature and extent of these obligations continues to be the subject of debate in many parts of the world. At the same time, the pressure on lawyers to assist governmental authorities is likely to grow, as the role of law firms in facilitating IFFs through offshore financial centres emerges.

- Lawyers play a gatekeeping role in the financial sector by intermediating transactions that could be used in money laundering. Thus, they should uphold their responsibility to undertake CDD in dealings with clients.
- Certain challenges may arise in instances where the services requested by clients combine both 'designated' and 'non-designated' transactions. Lawyers should be advised to disclose to their clients their obligations to undertake due diligence and to report suspicious transactions fairly early in the relationship.
- National money-laundering risk assessments are important to the business-level risk assessments that should be conducted by lawyers. National assessments may alleviate the difficulty of striking a balance between discharging compliance obligations and serving the interests of clients.
- A causative connection between money laundering and IFFs makes it essential to enlist the support of lawyers in combating these illicit flows. Revelations in the Panama and Paradise papers indicate that lawyers can facilitate IFFs through offshore financial centres.
- Given the impact of IFFs on economies, and the dependence of the legal profession on healthy economies, it is in the long-term interest of legal professionals to help combat money laundering.

Introduction

Initiatives to encourage lawyers to be more actively involved in stemming the illicit flow of resources that takes place through money laundering have sparked debate in many countries. While obligations derived from global standards to suppress money laundering and the financing of terrorism continue to be rolled out, controversy swirls around the expectations of regulatory authorities and the impact of compliance with AML obligations on the ability of lawyers to carry out their work pragmatically.

The Financial Action Task Force on Money Laundering (FATF) has set out what it regards as the obligations of lawyers in its recommendations 22 and 23.[2] The resulting policies and laws require lawyers to undertake CDD and, on the basis of this, to report any transactions that might indicate money laundering. According to Recommendation 22, CDD and reporting obligations arise when lawyers

> 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; organization 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.[3]

Other services that may also raise reporting obligations are the administration of deceased estates and the provision of insolvency- or tax-advisory services.

From a regulatory perspective, these functions (listed above) are designated intermediation services. Many of them involve the use of lawyers' trust accounts, managed through financial institutions. Because trust accounts embed lawyers within the financial system, lawyers act as gatekeepers to the system. The possibility of illegitimate transactions being facilitated through trust accounts raises the risk of money laundering in the course of rendering intermediation services.[4] In particular, legal entities established with the help of lawyers, such as companies and trusts, can be used in placing the proceeds of crime into the financial system, which is generally considered to be the initial step in conventional money laundering.

By requiring lawyers to be vigilant to attempts to contaminate the system with the proceeds of crime, regulators are asking them to help combat crime.

Regulatory authorities contend that the purpose of rolling out onerous AML measures is to safeguard the integrity of both domestic and global financial systems. The two are so closely linked that if one is affected, so is the other. By requiring lawyers to be vigilant to attempts to contaminate the system with the proceeds of crime, regulators are asking them to help combat crime.

One of the standard responses by lawyers to the demand that they work with government regulators has been that they occupy a unique position, in that their core business is to help clients establish and assert their rights. Clients voluntarily present information to their lawyers in order to access professional advice. Discussions between lawyers and their clients are confidential and should not be shared with third parties. The same confidentiality rule covers conversations between a lawyer and a third party relating to a client's pending, proposed or ongoing litigation.[5] While the lawyer has the duty to not disseminate the content of discussions, the client has the right to prevent the lawyer from doing so. As the client is the holder of the right, only he or she can waive it.

However, an important limitation to the right to confidentiality is that it should not allow the lawyer to assist a client in committing a crime. The CDD compliance and AML reporting obligations required by the FATF are therefore potentially incompatible with lawyer–client confidentiality. If fully implemented, AML reporting obligations may destroy the confidentiality of these communications and be detrimental to the lawyer–client relationship. Furthermore, they may negate the independence of the legal profession. In the words of one newspaper editorial:

> A cursory layman's understanding of this law is that lawyers are being conscripted to act as state agents, contrary to their client's interests. They are being positioned as whistleblowers on clients seeking advice.
>
> Your legal practitioner is being asked to send incriminating information about you to the police, which information you would have given the lawyer in confidence. That same lawyer can still stand up for you in court because you will never know that he was the whistleblower. He is not allowed by law to tell you that he is passing on confidential information to the law enforcers.[6]

This raises a number of points. The first is that lawyers have an interest in the health of the economies in which they live and work. After all, the profession is best sustained by a vibrant economy,[7] and economic crime can

imperil economies. A second point is that lawyers are sworn to ensure that their clients are treated with fairness, particularly in cases where their rights are under threat. Although clients come in different forms, and with varying strengths and credentials, they should be treated with equal respect. Related to this, a third point is that the larger corporate clients are capable of exerting considerable influence on the professional conduct of lawyers and on the profession as a whole. This is particularly true of corporations with a significant footprint in domestic, international and global markets, whose influence often extends into the arenas of politics, economics and governance. In some instances, powerful clients wield immense influence over the decisions of their lawyers, despite the fact that lawyers are technically independent.[8] Such a power imbalance could eventually impede lawyers' compliance with AML disclosure obligations.

This paper surveys how these conflicting interests intersect with the aim of determining the interventions that can reasonably be required from lawyers. It begins by accounting for the pressure exerted on lawyers, followed by a discussion of the role that lawyers are expected to play in the 'target hardening' of financial and economic systems against illicit asset transfers, specifically those involving money laundering. It then suggests methods by which the burden of compliance may be eased, concluding with several recommendations. The observations in this paper are based on experiences from the developing world, but they could be applied globally.

Are lawyers involved in money laundering?

Various arguments have been put forward to explain why, generally speaking, lawyers may be reluctant to be part of AML regimes. That lawyers should be involved to the extent envisaged by the FATF is contested, partly because in some jurisdictions evidence of lawyers' complicity or inadvertent collusion in money laundering has not been presented. It is argued that governments have not fully articulated the motivation behind including lawyers in AML frameworks.

Moreover, it is often not easy for lawyers to undertake due diligence on their clients. The primary source of information for lawyers is their clients, and the information given by the client is only sufficient to enable the lawyer to undertake simple due diligence. If the lawyer obtains any supporting documents, he or she must take the veracity of these at face value. Should lawyers be required to conduct enhanced due diligence, they might not have access to the necessary material. AML regulations conceive of enhanced due diligence as:

> […] gathering additional information to verify the customer's identity or source of income or perhaps an adverse media check. The checks should be relative and proportionate to the level of risk identified and provide confidence that any risk has been mitigated and that the risk is unlikely to be realised.[9]

But it is not always clear whether due diligence is required – and, if so, when. The balance that often has to be struck between the obligation to report a transaction and the privilege of the client is a difficult one.[10] This is because designated intermediation between lawyers and their clients does not always occur separately from other, undesignated transactions. A client whom a lawyer assists in estate planning, property transfer or structuring offshore investments could also be facing criminal charges. While the first three types of transactions are designated, and therefore invite CDD, assisting the client in criminal proceedings does not require that the lawyer conduct CDD. If the client initially requests to be represented in the criminal case and, at the request of the lawyer, deposits money with the lawyer as a deposit to cover professional fees, is the lawyer obliged to inquire about the source of the deposited money? If not, does the position change if the client subsequently requests the lawyer to assist with a transfer of real estate between the client and a third party?

The balance that often has to be struck between the obligation to report a transaction and the privilege of the client is a difficult one.

Lawyers in real-estate transactions

Transactions for the sale or purchase of real estate are considered the most susceptible to money laundering through intermediaries such as lawyers. Immovable assets, and various categories of rights to them, are attractive to money launderers in terms of both the placement of proceeds of crime and the integration of laundered proceeds. Lawyers regularly get involved in drawing up agreements for the acquisition or disposal of real estate. Real estate is often linked to money laundering because of the ease with which beneficial ownership can be separated from nominal or legal ownership. Moreover, the transactions through which assets are transferred often do not reveal the reasons underlying them.

A case study cited in the FATF's Typologies Report (2013) involved a lawyer who had just secured bail for his client on a drug-trafficking charge. Fearful of the risk of losing his assets, some of which was real estate, the client instructed his lawyer to indirectly transfer the assets to his brother and sister, using a power of attorney granted by the client to his girlfriend. The power of attorney granted her control of all of the client's assets, as well as the power to dispose of them. The lawyer then drew up a deed of transfer in terms of which the girlfriend transferred all the immovable assets to the client's brother and sister. It is quite likely that the lawyer was aware of the illicit motivation underlying the transactions.

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Generally, sales of real estate that deceive tax-collection authorities and facilitate the laundering of proceeds of crime are endemic to poorly regulated property markets. In a typical instance, a property is sold at a price that is less than its market value. The agreed price, which is the value used in calculating transfer duty, is paid to the seller. The balance between that nominal price and the market value is then privately transferred between the two parties. Afterwards, the property is resold at the market value, enabling the purchaser to break even or make a profit, should the market price have increased. The lawyer assisting the initial purchaser (i.e. the seller in the second transaction) would certainly be aware of the nature of the entire series of transactions and probably also aware of the source of the funding. In slightly more complex schemes requiring the facilitation of lawyers, legal entities may be set up offshore to collect the proceeds of tax evasion – for example, an offshore company may transfer funds purporting to be a loan to be used in acquiring real estate. The ostensible loan repayments can then be used by the borrower to reduce their own tax liability in their country of tax residence.[11]

Lawyers managing securities and other assets

Lawyers do not have a monopoly on the setting up and management of complex investment structures, as accountants, financial institutions and asset-management firms also provide these services. In providing them, lawyers expose themselves to the same money-laundering risks as other professional intermediaries. The management of investments, securities and other assets can facilitate money laundering,[12] notably through the so-called structuring of financial affairs, which is essentially the concealment of potentially taxable income.[13]

One of the roles of lawyers is to set up and register shell corporations, investment companies and trusts. The FATF's report on the vulnerabilities of lawyers cites the case of Teodoro Nguema Obiang Mangue, a politically exposed person (PEP) from Equatorial Guinea, who apparently used his lawyers to conceal his interests in transactions with financial institutions.[14] Obiang, son of the president of Equatorial Guinea, was implicated in grand corruption while serving as Minister of Agriculture. It was revealed that his family had been implicated in money-laundering activity through the US-based Riggs Bank. Obiang allegedly engaged the services of two attorneys in the US to form shell corporations and launder millions of dollars through accounts held by these corporations. The funds were used to acquire real estate, pay living expenses and make other high-value purchases.

Through these shell corporations, Obiang was able to conceal his beneficial interests. He also used his attorneys' trust accounts to receive wire transfers from Equatorial Guinea. As banks became aware of Obiang's connection to the shell companies and closed them down, the attorneys would simply open new accounts with different institutions. The United States Department of Justice successfully filed civil forfeiture actions in two district courts in Los Angeles and Washington to declare forfeit the proceeds of foreign corruption and other domestic offences laundered through the US. In the last quarter of 2017, Obiang, who had since been elevated to vice president, was convicted of corruption, abuse of trust and money laundering by a French court.[15]

Legal professionals play prominent roles in offshore investment. Two law firms featured prominently among the questionable offshore financial dealings reported in the Panama and Paradise papers, respectively: Mossack Fonseca and Appleby. Panama-based Mossack Fonseca featured prominently in the transactions detailed in the 2016 Panama Papers, while Appleby, whose head office is in Bermuda, crafted a significant proportion of the transactions covered in the Paradise Papers, publicized in the second half of 2017. The reported activities of Mossack Fonseca and Appleby make for interesting case studies, as they draw attention to a virtual industry that has developed around global law firms whose advisory services facilitate cross-jurisdictional income shifting.[16]

The *Financial Times* notes of these global law firms: 'Over the past two decades the offshore law sector has expanded rapidly. From operating mostly in their home jurisdictions, the top offshore firms, like many elite equivalents onshore, have opened offices in multiple locations, spreading across the Caribbean or the Channel Islands to Hong Kong and Singapore.'[17]

This elite group of offshore-practice law firms is referred to as the 'offshore magic circle', and their clients include PEPs in their personal capacity or indirectly as shareholders in corporate entities. Appleby, for instance, had more than 150 PEPs on its books. The offshore magic circle's intermediation services are enabled by a somewhat anachronistic international tax regime, which often finds expression through double-taxation treaties (DTTs). These treaties offer significant advantages to global corporations that establish a presence in offshore financial jurisdictions or centres, by enabling them to drastically reduce their tax liability. A common strategy is to set up subsidiaries in offshore financial jurisdictions, to which income is transferred as payment for various services. A subsidiary that is tax resident in an offshore financial jurisdiction might own property onshore and lease it to a subsidiary that is tax resident there. The offshore subsidiary could also lease equipment to the onshore subsidiary on payment terms that transfer significant income offshore.

In India, for example, the sale of an asset that has been held by a company for less than 12 months would normally attract a capital-gains tax of 20 per cent. If the asset has been on the company's books for longer, that tax increases to 40 per cent. A company wanting to avoid this level of taxation may set up a presence in Mauritius through a subsidiary that holds at least five per cent equity in the India-based company. Upon the sale of an asset in India, the income is then deemed to have accrued to the Mauritian company. The DTT between Mauritius and India exempts the Mauritian company from capital-gains tax, resulting in a saving of up to 40 per cent.[18]

By mid-2018, Mauritius had entered into DTTs with Belgium, Botswana, China, Cyprus, France, Germany, India, Indonesia, Italy, Kuwait, Lesotho, Luxembourg, Madagascar, Malaysia, Mozambique, Namibia, Nepal, Oman, Pakistan, Russia, Singapore, South Africa, Sri Lanka, Swaziland, Sweden, Thailand, the UK and Zimbabwe. As a result of recent changes, the DTT between Mauritius and South Africa contrasts sharply with that between India and Mauritius on the provisions relating to capital-gains tax.[19]

Law firms advising on global treaty shopping

Some legal professionals advise clients on mergers and acquisitions, structuring corporations and investment agreements. This area of work often brings lawyers into proximity with the drivers of IFFs, the greater proportion of which are facilitated by intra-group business transactions. The commonly held belief that foreign direct investment

is key to development enhances the bargaining power of global corporations and enables them to benefit from harmful tax competition among countries. The advisory role of lawyers in corporate tax arbitrage is reflected in some well-known investment transactions.

In 2011 Appleby advised Standard Bank of South Africa on the extension of a loan of US$70 million for the refinancing of Zambia Sugar Plc, a subsidiary of Illovo Sugar Ltd.[20] Illovo is a part of Associated British Foods, which has structured its subsidiaries so as to minimize its tax exposure in the developing countries in which it produces sugar. The loan repayments were routed through the Republic of Ireland, thus exempting Illovo from paying withholding tax by virtue of a DTT between Zambia and Ireland. As the international NGO Action Aid subsequently reported, the Zambian government suffered an estimated loss of US$3 million in withholding taxes as a result of Illovo taking advantage of the treaty, a practice referred to as 'treaty shopping'.[21] According to Action Aid, Illovo transferred US$7.4 million to its bank accounts held in Ireland as management fees, even though the Illovo office in that country had no employees.[22]

The mining industry is also notoriously susceptible to cross-jurisdictional income shifting. The only marginal tax contribution paid by some large mines, as a result of transfer mispricing, has been well reported. Over the years, concerns have arisen about the content and impact of agreements existing within global mining houses, and between mining houses and host governments. The tax dispute between Glencore and Zambia is a prominent reminder of the kind of mischief that occurs, but it is by no means an isolated incident; similar case studies can be found in the Democratic Republic of Congo, Guinea, Malawi, Niger and South Africa. Significant issues persist in the quality of mining agreements. Some of these issues have been exposed through the advisory work supported by the African Legal Support Facility in a number of countries since 2009. And as a result of renegotiation processes, clauses that permitted illicit income transfers have been removed.

Lawyers involved in creating and managing other legal entities

Trusts and foundations are valuable to clients who intend to disguise their ownership and/or control of assets acquired from the proceeds of crime or corruption. In common-law jurisdictions, legal professionals assist clients in setting up trusts or foundations. The advantage of trusts is that through them beneficial interests in assets can be separated from legal or apparent interests. While legal ownership belongs to a trustee, beneficial ownership can be retained by the settlor who created the trust. Through the terms of the trust deed, the settlor can retain the right to determine the management of the trust assets by the trustee. Should he or she require anonymity, the settlor may create and position a structure, such as an investment management company, between himself or herself and the trustee. The management company might be tasked with advising the trustee on the management of the trust assets. The investment management company may reside in one jurisdiction, while the trust asset is in another. There are many such companies resident in secrecy jurisdictions such as Guernsey, Bermuda and the British Virgin Islands.

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The services of an investment management company could be useful in the following situation: A PEP – such as the head of the army – secures a bribe from an arms-supplying company based in a foreign country. To prevent exposure of the corruption, the army general ensures that the funds are not sent directly to his bank account, but instructs that payment be made to an investment management company that his lawyer has registered in the British Virgin Islands. He further instructs, through a directive to the trustee, that the company transfers a portion of the payment to a trust created for him. The trustee is thereafter requested to transfer funds to named beneficiaries, for example the general's wife and daughter. The general can then benefit at the end of the chain with little risk of detection.[23] He could use the proceeds to acquire real estate in the name of the trust, for example, and the registry of deeds would not reflect the beneficial interest of the general in the trust asset.

Lawyers as launderers

Membership of the legal profession lends its practitioners a veneer of integrity and respectability, which can be abused to defraud clients. Some of the most widely reported cases occurred in South Africa, perhaps the largest of these being linked to the pyramid-type scam carried out by Barry Tannenbaum and his business partners, lawyers Dean Rees and Darryl Leigh, between 2007 and 2009. Rees and Leigh allegedly conspired with Tannenbaum to defraud investors into making large deposits to fund what they were told was a venture to import active pharmaceutical ingredients for the manufacture of antiretroviral medication. The active pharmaceutical ingredients were reportedly to be resold to large drug manufacturers. Tannenbaum was familiar with the way the pharmaceutical industry worked, as his family had been involved in building renowned pharmaceutical company Adcock Ingram. The venture was marketed as lucrative, offering returns of up to 210 per cent per annum. Investors subsequently lost as much as R12.5 billion (approximately US$1.2 billion at 2009 rates) in what turned out to be a gigantic pyramid scheme. In this instance, the lawyers played the role of confidence tricksters, taking advantage of their perceived respectability to persuade investors of the integrity and legitimacy of the scam. As of mid-2018, both Tannenbaum and Rees had yet to be prosecuted and were living outside South Africa.

The lawyer in *S v Price* [24] used his trust account to deposit a stolen cheque, after which he tried to use the trust account of a junior colleague to deposit a second stolen cheque. After the first cheque had been deposited, the lawyer issued a cheque from his trust account in favour of a certain company, which he handed over to an accomplice, who was part of that company. The lawyer then created false documentation to indicate that the cheque was a refund for an aborted real-estate transaction.

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In *S v Pillay*, the lawyer assisted a client who had come into possession of a large sum of money from an armed robbery in investing some of it in purchasing a nightclub.[25] The client was a police officer, and wanted to conceal his involvement in the purchase. The lawyer drew up documents in which the name of the seller was fictitious and the purchase price substantially under-reported. The lawyer then falsified his own trust-account records to ensure that the purchaser was not identified in them. On conviction, he was sentenced to five years' imprisonment.

In *S v Hattingh*,[26] the lawyer was charged with fraud, theft and money laundering arising from a property scheme in which he defrauded four South African banks of R55 million (the equivalent of US$5.2 million at the time). Hattingh had apparently run into financial problems as a result of gambling. Having suffered a massive loss, he hatched a scheme in a bid to make a financial recovery by defrauding the banks for which he had been contracted as a conveyancer. The scheme included registering two mortgage bonds from two different banks against the same property. The charge of money laundering emanated from the fact that he had used his trust account to deposit funds illegitimately received from one or more of the banks. He subsequently withdrew them for personal use. In this way, Hattingh used his trust account as a vehicle through which to launder the proceeds of his unlawful activities. On conviction, he was sentenced to 20 years' imprisonment.

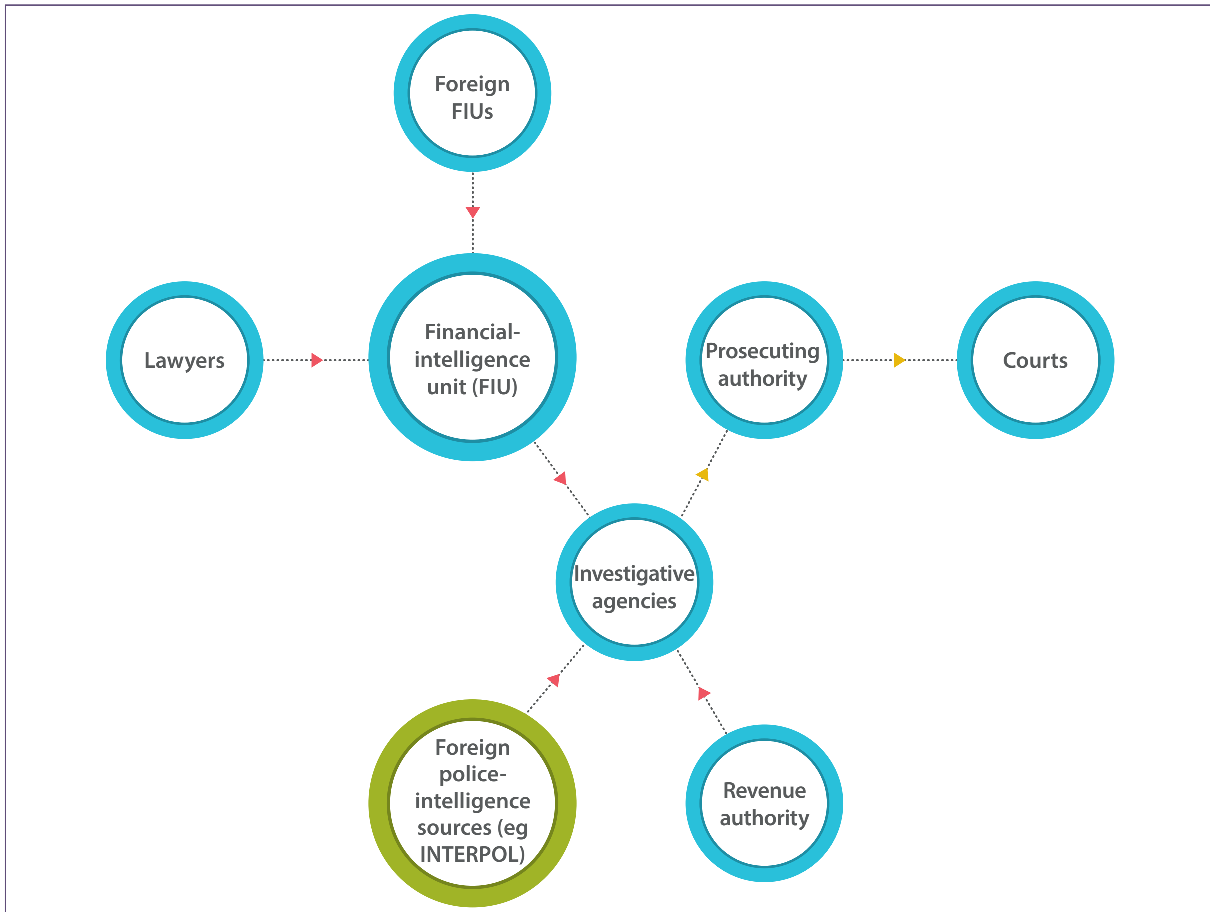
What is required of lawyers?

The requirement that lawyers play a supportive role in stemming money laundering has long been a contentious issue, with some arguing for greater involvement and others for none at all. This argument persists in jurisdictions such as Zimbabwe, where the central bank – a regulatory authority and host of the financial-intelligence unit (FIU) – believes that lawyers should play a more active role. In August 2017, the bank's governor, Dr John Mangudya, articulated the bank's position:

> The lawyers need to know the source of funds and source of wealth of their clients. If someone goes to their lawyers to buy a house and wants to transfer the money, they need to know the client's source of [the funds], otherwise they become conduits for money laundering.[27]

The implication here is that, if the source of funds has been disclosed to be illegal, the transaction should be reported in sufficient detail to enable the regulators to act. Within a framework in which communication with regulatory authorities takes place through an administrative-type FIU, the channel through which communication goes may be as illustrated in Figure 1.

Figure 1: AML framework centred on an administrative-type FIU



Client due diligence

In the framework shown in Figure 1, suspicious-transaction reports (STRs) from lawyers are directed to the financial-intelligence unit. The submission of STRs assumes that the lawyer has the cognitive competence to detect risky transactions on the basis of client instructions and the outcome of CDD. The lawyer's responsibility to conduct CDD goes beyond establishing the identity of the client during or after the first meeting. The lawyer also needs to verify the credentials presented. In the case of corporate clients, beneficial ownership needs to be clarified and verified as soon as possible. Beneficial owners are natural persons who, directly or indirectly, ultimately own or control at least 25 per cent equity or voting power in the client corporation.[28] Carrying out due diligence is likely to be particularly challenging when it comes to corporate clients and PEPs,[29] partly because of the complexity of their ownership structures and partly on account of the financial power and influence they wield.

Additionally, it is not always clear at what point it is optimal to undertake CDD. The practice in some jurisdictions is to conduct it before entering into a business relationship with a client. This reduces the risk of taking on undesirable

clients.[30] Elsewhere, CDD may be conducted after the lawyer–client relationship has already been established (at least by the lawyer receiving a deposit and taking initial instructions). However, since the requirement to undertake CDD only pertains to designated transactions, and the nature of the transactions is only established after instructions are taken, the better approach would seem to be the second one, where CDD is initiated with the establishment of the lawyer–client relationship. The issue of recovering the cost of CDD is an additional consideration, one that supports the contention that CDD should follow after some form of payment is made.

The extents to which a lawyer is required to go will be influenced by their assessment of the potential money-laundering risk presented. It may therefore be either routine (as in simple due diligence) or enhanced. PEPs invariably require enhanced due diligence.

It is important to define the role of lawyers in structuring businesses with extensive multi-outlet footprints, such as global corporations. In such instances, CDD requires that the lawyer verify the bona fides of complex cross-jurisdictional, high-value investment transactions. As a result of the recurrent exposure of aggressive tax-avoidance schemes that have prejudiced several African economies, there is a greater sensitivity today to structures that are set up to circumvent regulatory obstacles than there was a few years ago. Civil society is inclined to hold those lawyers who advise clients how to gain from such corruption to be complicit in this corruption and in the laundering of its proceeds.

Lawyers should be wary of colluding in tax evasion

A 2013 report of the International Bar Association (IBA), entitled Tax Abuses, Poverty and Human Rights, concluded that, if lawyers are to have an impact against IFFs, they should balance their obligations to their clients with diligence to the negative impact of IFFs on developing economies. In a similar vein, the 2015 Lima Declaration on Tax Justice and Human Rights called on

> suppliers of schemes which may put government revenues at risk (in particular tax lawyers, accountants and financial intermediaries) to avoid colluding in tax abuse, to recognize their particular human rights responsibilities, to conduct human rights due diligence, and to redress any harmful activities.[31]

In addition to reporting based on suspicion, several jurisdictions have adopted cash-threshold reporting.[32] According to Guidance Note 5A issued by South Africa's Financial Intelligence Centre in March 2016, cash-threshold reporting 'provides the Centre with a mechanism to proactively monitor and report on cash transactions which may be linked to money laundering activities so that potential proceeds of crime are timeously identified and investigated.'[33]

Cash-transaction reporting (CTR) requires a transaction to be reported when cash that exceeds the relevant threshold is received from or paid out to a client. As CTR does not depend on any assessment by the lawyer, it effectively overrides lawyer–client privilege. Moreover, such a report is not preceded by or caused by prior CDD, nor need it emanate from a designated transaction. Because payments from a client may be made either directly to the lawyer or indirectly into the lawyer's trust account held at a bank, it is conceivable that two CTRs may be made of a single transaction. It is also conceivable that both a cash-transaction report and a suspicious-transaction report may emanate from a single transaction.

The challenges that lawyers face

Contesting the views of Dr Mangudya, several Zimbabwean lawyers were emphatic that this violated the lawyer's relationship of trust with their client. They were only prepared to concede the right of public institutions to invade the lawyer–client relationship in the event of the lawyer furthering illicit enterprise. They believed that submitting their business transactions to regular audits sufficiently ensured that they did not assist in criminality.[34] However, annual audits of trust accounts cannot prevent or detect the complicity of lawyers in money-laundering transactions because the audits are really directed at ensuring the professional management of trust accounts rather than at overseeing compliance with AML obligations. This is evident from the disclosure stipulations of

audits: the origin of deposits made into the trust account does not have to be disclosed, nor do the nature and purpose of transactions out of the account.

The dilemma faced by lawyers should be understood against the risk of their losing potentially lucrative relationships with clients if they are perceived to be officious and cynical.

The significance of lawyers' contentions becomes clear when one considers the broader scope of reporting obligations. South African legislation exemplifies a wide conceptualization of such obligations. According to section 28 of South Africa's 2001 Financial Intelligence Centre Act, lawyers are obliged to report all transactions in which at least R25 000 in cash is paid either by or to the credit of a client. Section 29 then sets out lawyers' reporting obligations with respect to suspicious transactions. Hamman and Koen summarize the import of section 29 as follows:

> Knowledge and suspicion are the operational triggers for section 29 and thus require some consideration. The knowledge criterion is binary: it is 'real' or 'constructive' according to whether the person who is required to file the STR knew of or reasonably ought to have known of the money laundering [motive] of the transaction in question. Section 1(2) delineates real knowledge to include both positive or actual knowledge and negative knowledge constituted by wilful ignorance; that is, a conscious election to turn a blind eye to an adulterated transaction in order to fabricate an absence of knowledge. Section 1(3) is concerned with constructive knowledge and approaches it [in objective terms]. It provides […] that a person reasonably ought to have known that a business transaction was tainted if the conclusions he ought to have drawn would have been the conclusions of a reasonably diligent and vigilant person with his attributes and in his position.[35]

It is often difficult for a law firm to map comprehensively the footprints of a global corporation. Indeed, unless the firm is itself part of a global practice, this can be a formidable challenge. Some of this difficulty derives from the fact that most lawyers rely on data made available to them by public authorities or by their law society or association. For this reason, it has been argued that public authorities should impose obligations on the subsidiaries resident in their jurisdictions to disclose the beneficial ownership, identities and residences of enterprises with which they are associated.[36] The disclosed information can then be used in creating and updating an accessible database for use by reporting entities and law-enforcement authorities.[37]

The risk-based approach to AML requires each jurisdiction to assess the level of risk to which its economy is exposed. The assessment is an estimation of the threat of becoming involved in money laundering, taking into account the vulnerabilities of the AML preventive infrastructure. Two factors underscore the importance of risk assessment. The first is that the drivers of money laundering, as well as the methods by which money is laundered, are dynamic phenomena, and our information on them has to be periodically updated. The second is that implementing AML measures is taxing on resources, and it is therefore essential that these resources are efficiently and effectively targeted.

Within each jurisdiction, reporting entities are required to assess the money-laundering risk that is generally pertinent to their environment or specifically applies to their practices. The FATF recommends that such entities, which include financial institutions and designated non-financial businesses and professions, take appropriate steps to identify and assess the sources of risk in the specific environments in which they operate. The expectation is that they should then work to mitigate the identified risks.

The risk assessment carried out by reporting entities should be informed by the risk assessment conducted at national level. It follows that in cases where such an assessment has not been concluded it is difficult for lawyers to undertake their own assessment. It is, however, possible for lawyers to rely on reports such as the World Bank's corruption and fraud blacklist as sources of data for use in CDD. Government departments involved in procurement processes often use the report; in fact, it would probably be reckless to overlook it.[38]

Evidently, there is still much room for collaboration between legal professionals and multilateral development financial institutions.

What is currently being done?

Some of the significant changes occurring in AML initiatives have been prompted by concerns about the detrimental effect of IFFs on African economies. In the past decade, African lawyers have, on several occasions, committed themselves to assisting public authorities to stem IFFs. Apart from giving valuable input into the anti-corruption work of the IBA's Human Rights Institute, many lawyers supported the Pan African Lawyers Union's Yaoundé Declaration in 2014 and the Lima Declaration in 2015. There was also strong support for the baseline study conducted by the African Union High Level Panel on Illicit Financial Flows from Africa between 2012 and 2015.[39] Additionally, at its October 2016 meeting, the council of the Pan African Lawyers Union adopted a code of ethics, which includes several articles related to corruption and IFFs.

Underlying such initiatives is the assumption that lawyers share some consensus on the prime drivers of IFFs. Global Financial Integrity attributes IFFs to three kinds of large-scale practices: 1) international business transactions within global corporations, 2) criminal activities, and 3) corruption. Within these broad categories, the range of factors contributing to IFFs is vast. There is also some overlap between them, with corruption being a common cause and facilitator.

Having recognized the impact of corruption on the work of lawyers, as well as the environment in which they work, the IBA collaborated with the United Nations Office on Drugs and Crime, and the Organization for Economic Cooperation and Development (OECD) to launch their Anti-Corruption Strategy for the Legal Profession in 2010. Furthermore, the uptake of AML measures that impose certain compliance obligations on professional intermediaries (including lawyers) across the world, has made it imperative for lawyers to be more vigilant of the corruption risks, threats and challenges pertinent to their work. As corruption has been increasingly linked to IFFs, so the responsibility of lawyers to familiarize themselves with the dimensions of IFFs, and to be active in minimizing them, has grown.

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Because the drivers of IFFs are located in multiple spheres of social, economic and political activity, they invariably have an impact on – and are influenced by – many different institutions and actors. Reducing and terminating them therefore requires approaches that are strategic, comprehensive and coherent, to ensure that measures adopted are effective and sustainable.[40] As stated in the OECD's policy document on IFFs: 'A coherent approach to illicit financial flows needs to encompass illicit funds, illicit financial techniques, the deficiencies in the legislative, enforcement and policy framework which allow them to take place, and the measures which can be applied to fight them.'[41] Lawyers should be well positioned to lead the processes of defining what financial techniques should be regarded as illicit, and to identify policy, legislative and enforcement gaps that facilitate the persistence and escalation of IFFs.

Beyond the above framework, but connected to it, are mechanisms developed by the OECD, initially directed at the activities of multinational corporations doing business within Europe, but gradually extended to cover all global corporations.

Recommendations

In view of the importance of national assessments of both the risk of exposure and the vulnerability of economies to money laundering, the development of effective responses is critical. The money-laundering risk profile of some jurisdictions may be vague, because of the absence of reliable, up-to-date data. Over the past few years, various methodologies for estimating money-laundering risk have emerged. In order for national risk assessments

to be useful to lawyers, their professional bodies should represent lawyers on the task teams that conduct the assessments. It would also be useful to have the findings circulated. Risk assessments from the various constituent members of regional economic communities can feed initially into regional risk assessments and gradually into continent-wide assessments. This will enable lawyers to profile money-laundering risks at national, regional and global levels. Regional lawyers' organizations, such as the Southern African Development Community Lawyers' Association, should assist their membership by identifying barriers to transparency in the management of public institutions, especially state-owned enterprises and public–private joint ventures.

The anonymity behind which the dishonest can shield illicit activities and the proceeds of crime through legal entities is clearly an important factor behind the persistence of money laundering. The OECD highlighted the implications of anonymity as far back as 2001, noting:

> Any jurisdiction that provides mechanisms enabling individuals to successfully hide their identity behind a corporate vehicle while excessively constraining the capacity of authorities to obtain and share information on beneficial ownership and control for regulatory/supervisory and law enforcement purposes is increasing the vulnerability of its corporate vehicles to misuse.[42]

Lawyers should not perpetuate this negative attribute of legal entities. If they inform themselves about the real identity of the beneficiaries of the legal entities in their particular environments, they will be better able to conduct the required CDD, which is increasingly regarded as a pillar of money-laundering control. Governments should strengthen data documentation and dissemination by public registries. Public authorities should compel resident subsidiaries to disclose the beneficial ownership, identity and residence of enterprises with which they are associated.

The apprehension of losing business on account of being perceived to be meticulous in complying with AML obligations is outweighed by the reputational risks of being found to be complicit in criminality. This risk is underscored by the damage reportedly done to the integrity of major auditing firms that have been implicated, since 2006, in covering up corrupt activities by their corporate clients in South Africa.[43] The worst affected was KPMG, which lost all contracts to audit public institutions following careless work on several assignments.[44]

Lawyers in developing economies have an important role to play in reshaping the basic principles of international taxation. As professionals, African lawyers in particular should participate in rule-making at a global level to lend prominence to African interests and experiences in the global rules that continue to emerge. Although the OECD has taken the lead, particularly on transfer pricing, its initiatives need to be evaluated against African interests.

The negative impact of DTTs on developing economies, specifically resource-endowed economies, is best determined by their revenue authorities. Various initiatives have assisted in raising the profile of trade mis-invoicing and base erosion as global issues, culminating in the establishment of the African Tax Administration Forum in 2008. Lawyers outside the public sector need to complement the initiatives of governments and the African Tax Administration Forum by identifying DTTs that should either be scrapped or revised. The Mauritius–South Africa DTT, for example, was modified to close possible loopholes for tax evasion.

In the particularly problematic sphere of real estate, local-government structures are best placed to improve the regulation of the markets falling within their jurisdiction, and to detect instances of price-manipulation transactions that may be intended to conceal money laundering.

Further reading

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About the author

Charles Goredema is an independent consultant specializing in research on economic crime in Africa and the development of strategies to combat it.

Notes

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2. This followed the FATF's inclusion of lawyers under the category 'designated non-financial businesses and professions' in 2003. The decision appears to have set off a debate that remains unresolved in many jurisdictions.
3. FATF, International standards on combating money laundering and the financing of terrorism & proliferation: The FATF Recommendations, 2012, 20, http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf.
4. AJ Hamman and RA Koen, *Cave pecuniam:* Lawyers as launderers, *Potchefstroom Electronic Law Journal*, 15, 5, 2012, 69–99.
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6. Editor's memo, *Zimbabwe Independent*, 1 September 2006, https://www.theindependent.co.zw/2006/09/01/editors-memo-30.
7. This point was stressed at the 2017 annual general conference of the SADC Lawyers' Association.
8. For example, if the greater proportion of the law firm's business comes from the client.
9. Compliance Assist, Enhanced due diligence, https://www.complianceassist.co.uk/due-diligence-info/enhanced.
10. AJ Hamman and RA Koen, *Cave pecuniam*: Lawyers as launderers, *Potchefstroom Electronic Law Journal*, 15, 5, 2012, 79. The dilemma is also briefly highlighted in Lloyd Kavanagh and Tina Xu, Practical tips on conducting customer due diligence, New Zealand Law Society, 1 December 2017, https://www.lawsociety.org.nz/practice-resources/practice-areas/aml-cft/practical-tips-on-conducting-customer-due-diligence.
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14. See FATF, Money laundering and terrorist financing vulnerabilities of legal professionals, FATF Typologies Report, 2013, http://www.fatf-gafi.org/media/fatf/documents/reports/ML%20and%20TF%20vulnerabilities%20legal%20professionals.pdf.
15. The case was widely reported in the media at the time. See, for example, Angelique Chrisafis, France has finally got tough on corruption by seizing a dictator's Paris mansion, *The Guardian*, 6 August 2012, https://www.theguardian.com/commentisfree/2012/aug/06/france-tough-corruption-dictators-mansion.
16. Their activities are arguably part of a trend towards highly secretive low-tax jurisdictions, whose tax regimes have earned them the French nickname *paradis fiscaux* (tax havens).
17. Madison Marriage and Barney Thompson, 'Offshore magic circle' law firms fear Paradise Papers fallout, *Financial Times*, 10 November 2017, https://www.ft.com/content/8aff482c-c4a3-11e7-b2bb-322b2cb39656.
18. See Intergate Immigration, Setting up an offshore company in Mauritius, https://www.intergate-immigration.com/setting-offshore-company-mauritius.php.
19. Under the previous double-taxation treaty, Mauritian companies were used to hold shares in South African companies that owned fixed property located in South Africa. Where the shares in the Mauritian company were disposed of, South Africa could not levy capital-gains tax on the transaction. A new treaty, concluded in 2015, provides that either state may tax capital gains realized on the disposal of shares deriving more than 50 per cent of their value directly or indirectly from immovable property situated in that state.
20. Appleby considers the transaction to be one of its success stories.
21. See the detailed report by Mike Lewis, *Sweet nothings: The human cost of a British sugar giant avoiding taxes in southern Africa*, Action Aid, 2013, http://www.actionaid.org/sites/files/actionaid/sweet_nothings.pdf.
22. The explanation given by Illovo was that the payments were for 'export services, third party contractors, and expat salaries'.
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24. *S v Price* [2003] 2 SACR 551 (SCA).
25. *S v Pillay* [2004] 1 All SA 61 (SCA).
26. *S v Hattingh* [2015] ZASC 84.
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28. Most regulatory authorities have set the threshold of ownership or control at 25 per cent. See, for example, Beth Moskow-Schnoll's summary of the US Treasury's Financial Crimes Enforcement Network's rule on beneficial ownership: FinCEN's Beneficial Ownership rule: A practical guide to being prepared for implementation, Ballard Spahr, 1 August 2017, https://www.moneylaunderingwatchblog.com/2017/08/fincens-beneficial-ownership-rule-a-practical-guide-to-being-prepared-for-implementation.
29. All individuals entrusted with prominent public roles in a government body or international organization, including politicians and judicial officers, are considered to be PEPs.
30. Regulation 7 of the UK's Money Laundering Regulations 2007 provides an example of this approach, although it also encompasses repeated due diligence. The regulations are accessible at http://www.legislation.gov.uk/uksi/2007/2157/contents/made.
31. Lima Declaration on Tax Justice and Human Rights, Centre for Economic and Social Rights, http://www.cesr.org/sites/default/files/Lima_Declaration_Tax_Justice_Human_Rights.pdf. It appears that only three of the signatory organizations represent practising lawyers, namely Lawyers for Better Business (UK), the IBA's Human Rights Institute and Avocats Sans Frontières (Belgium).
32. The threshold is jurisdiction specific, ranging from R25 000 (approximately US$2 150) in South Africa and US$5 000 in Zimbabwe, to ₦5 million (about US$13 900) in Nigeria.
33. Guidance Note 05A on section 28 of the Financial Intelligence Centre Act, Act 38 of 200, Financial Intelligence Centre, https://www.fic.gov.za/Documents/160331%20GN%2005A%20CTR%202016%20%28web%20submission%29.pdf.

34 Three of the lawyers who have taken up prominent positions in the debate are J Samkange, T Biti and T Mpofu. See RBZ v Lawyers, *Business Weekly*, 25 August 2017, http://ebusinessweekly.co.zw/rbz-v-lawyers-ncentral-bank-pushes-for-lawyers-involvement-in-money-laundering-fight-n-but-lawyers-say-rbz-overstepping-mandate.

35 AJ Hamman and RA Koen, *Cave pecuniam*: Lawyers as launderers, *Potchefstroom Electronic Law Journal*, 15, 5, 2012, 75.

36 See E Vermeulen, Beneficial Ownership and Control: A Comparative Study – Disclosure, Information and Enforcement, OECD Corporate Governance Working Papers 7, 2013.

37 The Financial Transparency Coalition (FTC) has taken the initiative to collate some of the necessary data. See FTC, Letting the Public In: Opportunities & Standards for Open Data, 2 October 2016, https://financialtransparency.org/reports/letting-the-public-in.

38 It is wise to have regard to the framework for ensuring integrity that has been developed by multilateral development financial institutions, including the African Development Bank, the Asian Development Bank and the World Bank.

39 Former South African president Thabo Mbeki led the panel.

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43 The first set of questionable audit statements stemmed from bid-rigging activities in which seven large construction forms were implicated, namely Grinaker–LTA, Group Five, Murray & Roberts, Esofranki, WBHO, Basil Read and Aveng. The construction firms colluded to deceive their clients by engaging in non-competitive bidding and artificial pricing. In 2016, the construction firms were fined a collective R1.5 billion (approximately US$121 586 150 at 2018 rates).

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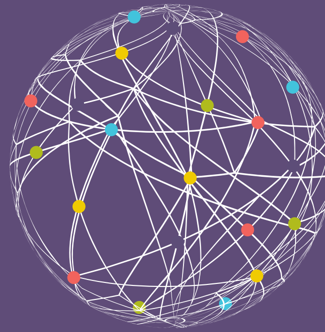

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