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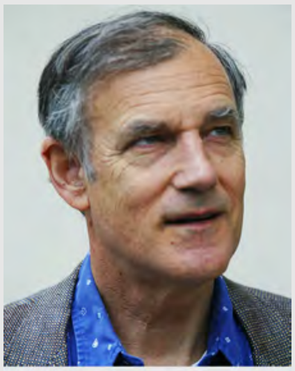

Bruce Zagaris

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In this article, the author discusses an American Bar Association opinion that suggests the United States may begin to impose stricter rules of professional conduct and require lawyers to perform greater due diligence to prevent the facilitation of money laundering, terrorist financing, and other criminal conduct.

On April 29 the American Bar Association's Standing Committee on Ethics and Professional Responsibility issued Formal Opinion 491, titled "Obligations Under Rule 1.2(d) to Avoid Counseling or Assisting in a Crime or Fraud in Non-Litigation Settings."[1] It is the latest in a series of opinions by the committee endorsing the work of the Financial Action Task Force (FATF) and other bodies that seek to have lawyers carry out anti-money-laundering and counterterrorism financial regulatory (AML/CFT) requirements. The opinion presages the likelihood that bar associations will begin to bring more disciplinary proceedings against lawyers.

Rather than changing the model rules, the committee prefers to add new interpretations and extend the application of the model rules when circumstances so require. The ABA Task Force on Gatekeepers and the Profession proposed a new model rule that would impose a basic "client due diligence" requirement on lawyers. They would be obligated to undertake reasonable, proportional, risk-based due diligence on prospective clients, and on new legal matters for existing clients, to determine whether the clients are trying to use the lawyers' services to facilitate money laundering, terrorist financing, or some other criminal conduct, such as circumventing economic sanctions. The rule would subject a lawyer who does not fulfill this basic requirement to potential disciplinary action by the state disciplinary authority.[2]

However, the committee has taken the position that it wants to keep the rules standard and does not want to change them for special groups or special purposes. In August 2010 the ABA's policymaking House of Delegates adopted the Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing, along with a resolution stating that the ABA "acknowledges and supports the United States Government's efforts to combat money laundering and terrorist financing."[3] The guidance states that it is not meant to be a statement of the standard of care that lawyers should follow as they implement a risk-based approach to preventing money laundering and terrorist financing. Instead, it is intended to be a resource that lawyers can consult

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[1] ABA Standing Comm. on Ethics and Prof'l Responsibility, Formal Op. 491 (Apr. 29, 2020). Unless otherwise noted, references to the "rules" or the "model rules," including references to specific rules like "Rule 1.2," refer to the *ABA Model Rules of Professional Conduct*.

[2] Bruce Zagaris, "U.S. Treasury Criticism of EU Anti-Money Laundering Blacklist Shows Crack in International Financial Enforcement," *Tax Notes Int'l*, Mar. 25, 2019, p. 1283.

[3] ABA, "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing," Resolution and Report 116 (2010).

as they develop their own voluntary approaches to these problems.

On May 23, 2013, the committee issued Formal Opinion 463, which discusses the good practices guidance further. The opinion notes that the model rules and the good practices guidance are consistent in their ethical principles.[4] It explains that the good practices guidance provides standards to help lawyers comply with national and international AML norms. In particular, the good practices guidance offers hypothetical fact patterns to help lawyers evaluate situations in which furnishing legal services may contribute to the commission of money laundering and terrorist financing crimes. As Opinion 463 states, "by implementing the risk-based control measures detailed in the Good Practices Guidance where appropriate, lawyers can avoid aiding illegal activities in a manner consistent with the Model Rules."

This article discusses the background and context behind the ABA's issuance of Formal Opinion 491, in particular concerns about adverse publicity and the impact of prior reports such as the 2016 FATF mutual evaluation report (MER),[5] the 2020 U.S. National Strategy for Combating Terrorist and Other Illicit Financing,[6] and other reports showing the vulnerability of lawyers to money laundering and terrorist financing schemes. The article then looks at the content of Opinion 491 and similar opinions, examining their implications and how they relate to other rules such as the OECD's mandatory disclosure rules for addressing common reporting standard (CRS) arrangements and offshore structures, and the EU's sixth directive on administrative cooperation (DAC6, 2018/822/EU). After considering the implication of more disciplinary actions against lawyers, the article discusses the way forward, emphasizing the need for bar associations to effectively monitor these matters and for law firms to engage in AML/CFT due diligence.

The Role of Adverse Publicity

Adverse publicity has placed the gatekeeping obligations of lawyers under a spotlight.

In particular, on January 31, 2016, CBS's *60 Minutes* aired an episode in which an investigator wearing a hidden camera met with personnel from 13 New York law firms, including then-president of the ABA, James Silkenat.[7] The investigator posed as an adviser to a minister from a foreign government and asked the lawyers how to anonymously move large sums of money — a request that should have raised suspicion. In all but one case, the lawyers suggested ways to bring the money into the United States without detection. Many of the lawyers suggested using companies or trusts in foreign secrecy jurisdictions to move the money. The meetings were all preliminary; none of the law firms took the investigator on as a client. Nevertheless, professors of legal ethics commented on the apparent indifference to — and even outright violations of — professional rules of conduct.

Additional adverse publicity involving the role of lawyers in criminal activities has come from the work of the International Consortium of Investigative Journalists (ICIJ). In 2016 the ICIJ published the Panama Papers, an effort that coordinated the work of more than 350 reporters from 80 countries.[8] Since that time, dozens more journalists have joined the effort and continued the investigations. In the weeks after the initial publication, a minister in Spain and Iceland's prime minister resigned. Police in Panama executed searches on the office of Mossack Fonseca and authorities in Switzerland searched the office of the Union of European Football Associations. The European Parliament established the Committee of Inquiry to Investigate Alleged Contraventions and Maladministration in the Application of Union Law in Relation to Money Laundering, Tax Avoidance and Tax Evasion (known as the PANA committee), which prepared and adopted a report

[4] ABA Standing Comm. on Ethics and Prof'l Responsibility, Formal Op. 463 (May 23, 2013) (subtitled "Client Due Diligence, Money Laundering, and Terrorist Financing").

[5] FATF, "Anti-Money Laundering and Counter-Terrorist Financing Measure: United States Mutual Evaluation Report" (Dec. 2016).

[6] U.S. Treasury Department, "National Strategy for Combating Terrorist and Other Illicit Financing" (2020).

[7] Global Witness, "Undercover in New York" (Jan. 31, 2016). *See also* "Anonymous Inc.," *60 Minutes*, Jan. 31, 2016 (includes a transcript).

[8] Will Fitzgibbon, "Panama Papers FAQ: All You Need to Know About the 2016 Investigation," ICIJ (Aug. 21, 2019).

and resolution on the role of lawyers in money laundering and other abuses.[9]

On November 5, 2017, using leaked documents from the global Appleby law firm, the ICIJ published the Paradise Papers. The project exposed the firm's private client work for multinationals (for example, Apple) and individuals, such as the Queen of England and pro soccer player Lionel Messi.[10]

Adverse publicity has contributed to a common understanding in the United States and worldwide of the risks that can arise when lawyers and gatekeepers fail to comply with international standards.[11]

2016 FATF MER and 2020 National Strategy

On December 1, 2016, the FATF released the MER, a report assessing the United States' compliance with the FATF's 40 recommendations. Issued in 2012 and updated in 2019, the recommendations are the global standard for combating money laundering and the financing of terrorism. To provide an example, Recommendation 10 stresses the need for financial institutions to undertake customer due diligence — and the need for the obligation to be made law — which it defines to include:

> (a) Identifying the customer and verifying that customer's identity using reliable, independent source documents, data, or information.
>
> (b) Identifying 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. For legal persons and arrangements this should include financial institutions understanding the ownership and control structure of the customer.
>
> (c) Understanding and, as appropriate, obtaining information on the purpose and intended nature of the business relationship.
>
> (d) Conducting ongoing due diligence on the business relationship and scrutiny of transactions undertaken throughout the course of that relationship to ensure that the transactions being conducted are consistent with the institution's knowledge of the customer, their business and risk profile, including, where necessary, the source of funds.[12]

The United States has played an oversized role in the FATF. For example, during the weeks and months after the terrorist attacks of September 11, 2001, the United States persuaded the FATF to add terrorist financing to its recommendations. In October 2008 the FATF established the Project Team on Proliferation Financing to offer policy alternatives to the Working Group on Terrorist Financing and Money Laundering. In particular, the team evaluated measures that could be used to combat proliferation financing within the established framework of applicable United Nations Security Council resolutions (including Resolution 1540 (2004)), the FATF's Proliferation Financing Typologies Report, and relevant domestic laws.[13]

The U.S. influence makes it particularly notable that the FATF's 2016 MER concluded that the United States had not complied with four of the FATF's recommendations. One area of noncompliance was the lack of beneficial ownership reporting requirements for all domestic companies and an absence of AML/CFT requirements for most "designated non-financial businesses and professionals" (DNFBPs). This group includes lawyers, accountants, trust and

[9] European Parliament, "Report on the Inquiry Into Money Laundering, Tax Avoidance and Tax Evasion," 2017/2013(INI) (Nov. 16, 2017); and European Parliament, "Recommendation Following the Inquiry on Money Laundering, Tax Avoidance and Tax Evasion," P8_TA-PROV (2017)0491 (Dec. 13, 2017). Additional PANA committee documents are available on its website.

[10] *See, e.g.*, Fitzgibbon and Dean Starkman, "The 'Paradise Papers' and the Long Twilight Struggle Against Offshore Secrecy," ICIJ, Dec. 27, 2017.

[11] *See, e.g.*, Laurel S. Terry and José Carlos Llerena Robles, "The Relevance of FATF's Recommendations and Fourth Round of Mutual Evaluations to the Legal Profession," 42 *Fordham Int'l L.J.* 627 (2018); Debra Cassens Weiss, "Group Goes Undercover at 13 Law Firms to Show How U.S. Laws Facilitate Anonymous Investment," *ABA Journal*, Feb. 1, 2016; and Louise Story and Stephanie Saul, "Stream of Foreign Wealth Flows to Elite New York Real Estate," *The New York Times*, Feb. 7, 2015. Notably, ABA Formal Op. 491 cites the last two articles.

[12] FATF, "International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation" (updated June 2019).

[13] FATF, "Combating Proliferation Financing: A Status Report on Policy Development and Consultation" (Feb. 2010).

company service providers (other than trust companies), real estate agents, casinos, and dealers in precious metals and stones. According to the FATF MER, the AML/CFT framework in the United States contains some significant gaps, noting the minimal measures imposed on lawyers and some DNFBPs in high-risk sectors. At present, lawyers and other DNFBPs in the United States are not subject to the AML/CFT legal framework. The MER also states that the DNFBPs' understanding of these risks is uneven.

The FATF has urged the United States to make amending the Bank Secrecy Act and the USA PATRIOT Act to cover these high-risk sectors a high priority. Subjecting lawyers and DNFBPs to these regimes would require them to undertake the know your client (KYC), customer due diligence, and suspicious activity reporting obligations that already apply to financial institutions. It would also subject them to periodic audits, a responsibility that some countries have delegated to self-regulatory bodies, such as bar associations.

The MER indicates that some practices do mitigate the impact of these significant gaps and address vulnerability of the legal profession. In addition to the good practices guidance, "ethical standards, educative efforts and criminal and disciplinary sanctions imposed against complicit lawyers may mitigate the risk to a limited extent, though it does not address the concerns arising out of lack of comprehensive preventive measures." In the absence of comprehensive federal regulatory framework governing attorneys and other DNFBPs, some lawyers have suggested that the ABA should seriously consider developing and adopting a new model rule to ensure lawyers meet the AML/CFT obligations set out in the FATF recommendations.[14] Formal Opinions 463 and 491 answer this call.

Another tool that may help mitigate the impact of gaps on U.S. regulations is the 2020 national strategy, which the U.S. government introduced in February. It identifies and analyzes the threats to and vulnerabilities in the U.S. AML/CFT system. The 2020 national strategy discusses the major illicit financing risks posed by attorneys who do not need to understand the nature or source of their clients' (or potential clients') income. Attorneys often provide an access point to the U.S. economy and regularly offer advice on structuring transactions to avoid tax or other legal implications. The 2020 national strategy report notes that the MER recognized that the failure of the U.S. AML/CFT legal framework to cover attorneys stands in contrast to the important role lawyers play in entity formation and advising on and implementing high-end real estate deals. In this regard, in 2016 the Department of Justice filed a civil forfeiture complaint claiming that lawyer trust accounts at two large law firms were used to launder nearly $600 million that had allegedly been stolen from the Malaysian government and bring the funds into the U.S. financial system.

The MER states that lawyers and company service providers play a role in the formation of nearly 50 percent of U.S. legal persons. Sometimes defendants facing stiff sentences opt to give evidence against their counsel — that is, against their so-called co-conspirators — especially when their counsel participated in structuring transactions that violate foreign or U.S. law. In these cases, lawyers may be forced to produce evidence contradicting their former clients — for example, contemporaneous notes, written communications to the client, and documents evidencing inquiries regarding or confirmation of the purposes and goals of the transactions. The 2016 MER and the 2020 national strategy also reference the role of lawyers in high-value real estate transactions. For example, in transactions on behalf of Teodoro Obiang[15] and 1Malaysia Development Berhad,[16] lawyers were involved in setting up entities to purchase real estate and in making those purchases. The MER explains that lawyers and other DNFBPs (with the exception of trust companies) that participate in high-end real estate transactions are not subject to

[14] *See* Zagaris, *supra* note 2.

[15] *See* U.S. Senate Permanent Subcommittee on Investigations, "Keeping Foreign Corruption Out of the United States: Four Case Histories," Majority and Minority Staff Report (Feb. 4, 2010) (the cases presented at this hearing illustrate how some politically exposed persons use U.S. lawyers, real estate and escrow agents, lobbyists, bankers, and others to circumvent U.S. AML and anti-corruption safeguards).

[16] U.S. Department of Justice, "U.S. Repatriates $300 Million to Malaysia in Proceeds of Funds Misappropriated From 1MDB Investment Fund," Release 20-065 (Apr. 14, 2020).

comprehensive AML/CFT requirements. Often, DNFBPs (other than casinos) do not adequately understand their money-laundering or terrorist-financing vulnerabilities and the need to implement appropriate controls to mitigate these risks. Therefore, they do not systematically undertake basic or enhanced due diligence processes or other preventive measures. The MER further notes that the lack of entity transparency and beneficial ownership controls exacerbate this. In both 2006 and 2016 the FATF determined that the United States failed to comply with entity transparency standards.

Other Reports on Gatekeeper Issues

There is no shortage of reports underscoring the role of lawyers in money laundering. For example, in 2013 the FATF issued a report titled "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals."[17] The report cites examples of criminal prosecutions against lawyers who knowingly engaged in criminal money-laundering activities. The report found that authorities in 16 countries had brought criminal prosecutions for related conduct during the previous five years.

The International Bar Association, American Bar Association, and Council of Bars and Law Societies of Europe were concerned that the FATF report did not adequately discuss the circumstances in which a lawyer might unwittingly — rather than intentionally — help a criminal money launderer. The three bar associations prepared a guide to help lawyers avoid this unintentional involvement in money laundering.[18] The guidance document sets forth various red flags that indicate a money-laundering situation may exist and should lead the lawyer to investigate further.

In October 2017 the United Nations Office on Drugs and Crime and the Stolen Asset Recovery Initiative of the World Bank/UNODC met to discuss the risks associated with a lack of transparency and the failure to provide beneficial ownership information.[19]

On May 31, 2019, after a conference, research, and discussion, the International Bar Association and the OECD secretariat published a report on the role of lawyers and international commercial structures.[20] This effort is, in part, a response to the Panama and Paradise papers scandals, and it focuses on lawyers' ethical duties and the professional obligation to avoid participating in illegal conduct. The report sets out a statement of principles containing eight recommendations that it addresses to national bar associations and law societies:

> with a view to encouraging them to adopt the Principles and engage with their governments to explain the role of the Principles in ensuring the proper administration of justice and in upholding the rule of law.

Formal Opinion 491

Formal Opinion 491 focuses primarily on Model Rule 1.2(d), which states that a lawyer "shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent." A bar association considering discipline may infer knowledge from the circumstances of the case, "including a lawyer's willful blindness to or conscious avoidance of facts." Hence, if the lawyer is aware of circumstances that suggest a high probability that a client is trying to use the lawyer's services for criminal or fraudulent ends, the lawyer has an obligation to make additional inquiries to avoid advising or assisting in improper activity.

The opinion adopts the position that the standard of "actual knowledge" in Model Rule 1.2(d) (also implicated in Rule 1.0(f)) is met by appropriate evidence of willful blindness. The

[17] FATF, "Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals" (June 2013).

[18] International Bar Association, the American Bar Association, and the Council of Bars and Law Societies of Europe, "A Lawyer's Guide to Detecting and Preventing Money Laundering" (Oct. 2014).

[19] U.N. Office on Drugs and Crime and the Stolen Asset Recovery, "International Expert Group Meeting on Concealing Beneficial Ownership: How to Prevent Abuse of Legal Professional Privilege (LPP)" (Oct. 23, 2017). *See also* Zagaris, "International Organizations Review Options to Prevent Abuse of Legal Professional Privilege," 35 *Int'l Enforcement L. Rep.* 6 (Jan. 2018).

[20] International Bar Association and Secretariat of OECD, "Report of the Task Force on the Role of Lawyers and International Commercial Structures" (May 2019). *See also* International Bar Association, "Launch of the Report of the Task Force on the Role of Lawyers and International Commercial Structures" (last visited July 18, 2019).

opinion states that courts will affirm disciplinary sanctions "when a lawyer deliberately or consciously avoids knowledge that a client is or may be using the lawyer's services to further a crime or fraud."[21] Notably, willful blindness is the same standard that is used in U.S. money-laundering prosecutions. The opinion also discusses cases in which some bar associations disciplined attorneys based on a "knew or should have known" standard.[22] Even if information obtained during a preliminary interview or in the course of representation is not adequate to establish "knowledge" in accordance with Model Rule 1.2(d), other professional duties may require the lawyer to make additional inquiries to avoid professional misconduct, help the client avoid committing a crime or fraud, or advance the client's legitimate interests.

If a client or prospective client refuses to provide information necessary to determine the legality of a proposed transaction, the ABA confirms that the lawyer must ordinarily decline the representation or withdraw under Model Rule 1.16.

Other bar associations have also issued opinions regarding similar matters and disciplined members for similar violations.

The ABA opinion includes a reference to the New York City Bar Association's Formal Opinion 2018-4, "Duties When an Attorney Is Asked to Assist in a Suspicious Transaction." The New York opinion presents the following hypothetical:

> A lawyer represents a client in the sale of a business in New York. The client advises the lawyer that the proceeds of the transaction will be used to purchase a different business. The client directs that after the first transaction closes, all payments be sent to a bank in a well-known secrecy jurisdiction. The client then asks the lawyer to proceed with the purchase. In preparing the documents and doing general due diligence, the lawyer realizes that the proposed purchase price is much more than the business is worth. The lawyer also learns inadvertently that the client has two passports, each from a secrecy jurisdiction different than the one in which the bank is located. The lawyer suspects, but does not know, that the transaction will involve a fraud or crime, such as money laundering or tax evasion, on the part of the client.[23]

The opinion explains that the duty of competence under New York Rule 1.1(a) may require the lawyer to conduct due diligence into the client's potentially fraudulent conduct. Depending on the circumstances, a lawyer who fails to investigate potentially fraudulent conduct may also violate New York Rule 1.2(d), which prohibits a lawyer from assisting a client in conduct that the lawyer knows to be criminal or fraudulent.

Perhaps the most challenging aspect of Rule 1.2(d) — whether it is New York's rule or the ABA's — is identifying when a lawyer needs to make more inquiries. In an era of globalization, the number of foreign and international laws that may create criminal liabilities for the U.S. counsel are virtually unlimited. A U.S. attorney who is unfamiliar with the tax, anticorruption, antitrust, or other laws in another country may initially be unaware of some red flags or difficult issues. That attorney may need to do some research on her own and may also want to consult a colleague. In today's world, counsel cannot be afraid to inquire about a proposed transaction or the context. For instance, suppose a potential client from a conflict zone is accused of corruption or human rights violations and wants to consult a U.S. lawyer about estate planning or private wealth planning. Even if the client strenuously professes innocence, the counsel may need to ask more questions and conduct research before deciding whether to undertake the representation.

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[21] *See, e.g.*, *In re Bloom*, 745 P.2d 61 (Cal. 1987) (affirming disbarment when a lawyer helped a client sell and transport explosives to Libya and rejecting the lawyer's claim that he believed in good faith that national security officials had authorized the sale); and *In re Albrecht*, 42 P.3d 887 (Or. 2002) (upholding disbarment when the "suspicious nature" of transactions (and other facts) supported the inference that a lawyer must have known his acts constituted money laundering and that he had assisted in a crime or fraud).

[22] *In re Dobson*, 427 S.E.2d 166 (S.C. 1993) (identifying facts showing that the lawyer "knew or should have known" that he was furthering a client's illegal scheme).

[23] Association of the Bar of the City of New York Comm. on Prof'l Ethics, Formal Op. 2018-4 (July 18, 2018) (subtitled "Duties When an Attorney Is Asked to Assist in a Suspicious Transaction").

If, during the course of representation, a lawyer obtains information indicating that a client is engaging in unlawful conduct or plans to do so, the lawyer has several options. The lawyer should determine the need for any remedial actions based on factors such as his knowledge of the facts and circumstances involved, the seriousness of the client's wrongdoing, and the extent to which the lawyer is involved in the wrongdoing. If the lawyer has actual knowledge of future misconduct, the lawyer must not assist in the misconduct and must also counsel the client against the engaging in the illegal conduct in accordance with Rule 1.4(a)(5). The obligation to provide counsel stems from the general duty of competence in Rule 1.1. Despite the difficulty involved in "persuading a client to take necessary preventive or corrective action," those communications will not only help the client but also reduce the risk the attorney may be assuming by continuing to provide representation.

In the hypothetical presented in the New York City bar opinion, if the lawyer learns that the client may be committing tax fraud or tax evasion, the lawyer may advise the client to pay the correct amount of taxes or take other corrective action. In some cases, corrective action is not possible and the lawyer may have to resign.

Formal Opinion 491 similarly underscores the need for a lawyer to inquire when she has a client who may be trying to use her services in a transaction to commit a crime or fraud. The opinion acknowledges that determining whether a client seeks to use the lawyer's services for prohibited activities can be a delicate, sensitive matter. Generally, lawyers are taught that clients deserve to be believed. Investigating the client's intention can be expensive and time-consuming.

One problem in the United States and in other countries is that once prosecutors indict a person, usually they eventually compel the defendant to cooperate in exchange for sentencing considerations. Almost 95 percent of all criminal cases in the United States — and more than 97 percent of the cases in the federal system — result in a guilty plea.[24] Once identified as a potential participant in a crime, a lawyer who allegedly has failed to adhere to his ethical obligations may be the subject of a criminal investigation and/or a bar association ethics disciplinary investigation.

Even if Rule 1.2(d) does not require a lawyer to make additional inquiries, other rules may. These rules include Rule 1.1 (the duty of competence), Rule 1.3 (the duty of diligence), Rule 1.4 (the duty of communication), Rule 1.13 (the duty to protect the best interests of an organizational client), and Rule 8.4(b) and (c) (the duties of honesty and integrity). In some situations, the duty to withdraw under Rule 1.16(a) may also be triggered.

Making appropriate inquiries in line with the model rules and Formal Opinion 491 not only ensures that the lawyer does not engage in professional misconduct or assist the client in committing a crime or fraud, it also ensures that the lawyer can provide informed advice and assistance to the client.

OECD Disclosures for Offshore Structures

One area that may pose risks for lawyers is inbound investments involving investors from countries participating in the OECD automatic exchange of information scheme known as the CRS. The OECD has developed mandatory disclosure rules (MDRs) that address CRS avoidance arrangements and offshore structures.[25] Under these rules, each participating member should have penal or dissuasive sanctions to address violations. The 2017 U.K. Criminal Finances Act is one example of a law implementing the MDRs. It imposes criminal sanctions extraterritorially on intermediaries that help taxpayers plan or implement structures that violate the act. In addition to heralding the likelihood of disciplinary proceedings for lawyers who fail to make sufficient inquiries when clients may be engaging in criminal activities, Formal Opinion 491 is likely to open the door to prosecutions against U.S. lawyers led by prosecutors in the United States and abroad.

An example of a situation that might pose risks to lawyers is an inbound investment by a

[24] Frederick T. Davis, *American Criminal Justice System: An Introduction* (2019).

[25] OECD, "Model Mandatory Disclosure Rules for CRS Avoidance Arrangements and Opaque Offshore Structures" (2018); and OECD, "International Exchange Framework for Mandatory Disclosure Rules on CRS Avoidance Arrangements and Opaque Offshore Structures" (2019).

Chinese investor looking to evade exchange control rules in China and also hoping to evade any automatic exchange of information with the Chinese tax authority through the CRS. Perhaps, to complicate the hypothetical more, the Chinese individual also has a secondary nationality. There is a Multilateral Competent Authority Agreement (MCAA) that governs the exchange of mandatory disclosure reports. The basic concept is that a jurisdiction that receives information about a CRS avoidance arrangement or opaque offshore structure as a result of the MDRs would exchange that information with the tax residence jurisdictions of all reportable taxpayers if those jurisdictions have also implemented the MDRs and are signatories to the MCAA. This exchange allows the tax authorities in those jurisdictions to use the information to carry out appropriate compliance activities.

The MDRs and the reciprocal automatic exchange system in the MCAA provide tax authorities with information that can be used to carry out their compliance activities in a collaborative manner. For example, in addition to taking action against the reportable taxpayers identified in the MDR reports, authorities might contemplate pursuing further compliance actions involving the intermediaries identified and exchanging information about intermediaries with other jurisdictions if the tax authorities believe that those intermediaries have offered similar services to taxpayers in those jurisdictions.

A U.S. lawyer who does not ask the right questions may violate the requirements of the OECD mandatory disclosure regime.

EU DAC6

Another potential threat to U.S. counsel who advise on international business and tax structures is the EU mandatory disclosure regime known as DAC6. It is poised to take effect in most EU member states soon, with most reporting obligations beginning in August.

The DAC6 regime requires intermediaries — including tax advisers and, in some circumstances, taxpayers — to report cross-border transactions going back to June 25, 2018, to EU tax authorities. Transactions should be reported if they involve at least one EU member state and the transaction contains specific hallmarks that suggest potentially aggressive tax planning. Some hallmarks may apply even if securing a tax advantage is not the main purpose or benefit, or even one of the main benefits, of the transaction. Thus, many commercially motivated transactions involving at least one EU member state are potentially covered by the regime and may need to be reported.

If the intermediaries fail to report the transactions, they could incur significant penalties, which vary considerably among member states and could, in limited cases, include criminal liability.[26] Specifically, the directive establishing the DAC6 regime requires:

> in order to improve the prospects for the effectiveness of this Directive, Member States should lay down penalties against the violation of national rules that implement this Directive. Such penalties should be effective, proportionate and dissuasive.

In view of the DAC6 requirements, U.S. lawyers who do not ask enough questions or refuse to participate in a transaction may need to make reports or risk violating the DAC6.

Disciplinary Actions and Enforcement

A likely outcome of the Formal Opinion 491 and similar rulings (such as New York Formal Opinion 2018-4) is an increase in disciplinary actions against attorneys.

For instance, the New York City bar took action against some of the lawyers involved in the 2016 undercover sting operation featured on *60 Minutes*. In at least once case, the attorney grievance committee initiated a disciplinary proceeding on behalf of the New York bar. The committee alleged that attorney Joshua Koplik was guilty of misconduct in violation of the rules of professional conduct for counseling a prospective client to engage in conduct that he knew was illegal or fraudulent and suggesting to the client that U.S. lawyers can act with impunity.[27] Koplik met with someone whom he

[26] For a graph showing the range of fines, see KPMG, "EU Mandatory Disclosure Regime: DAC6 State of Play" (Nov. 14, 2019).

[27] *In re Koplik*, 2019 NY Slip Op. 00248 (N.Y. App. Div. 2019) (per curiam).

believed to be a potential client acting on behalf of a West African government minister.

The potential client suggested that the minister wanted to purchase a brownstone, a yacht, and an airplane in the United States. Koplik believed that the transaction would involve funds in the tens of millions. The individual suggested that the source of the money was potentially illegal, stating: "Companies are eager to get hold of rare earth or other minerals . . . And so they pay some special money for it. I wouldn't name it bribe; I would say facilitation money."

Koplik told the purported client that he would have to conceal the true source of the (questionably legal) money by creating different corporations to own the properties the minister allegedly wanted to buy. Koplik also assured the individual of the protections that the attorney-client privilege could provide. He even stated, "They don't send the lawyers [in the United States] to jail because we run the country."

The court eventually granted the parties' motion for discipline by consent and censured Koplik. The public censure is one example of the discipline that can result when a member of the bar encounters a potential or existing client who solicits investment advice and assistance investing potentially illegal proceeds of transnational corruption — namely, the client seeks help in corruption-based money laundering.

In September 2018 John Jankoff — another lawyer who was involved in the same investigation and who was told by the undercover investigator that the official's funds were "gray money" or "black money" — was the subject of a similar hearing and received a censure.[28]

One risky area for attorneys is foreign law. Some attorneys in the United States, especially in parts of the country that have attracted flight capital, have tended to avoid asking questions about the source of the clients' funds and compliance with foreign laws. In this regard, in 2008 the New York State Bar said that lawyers must follow not only New York law but also foreign laws.[29] In that opinion, the bar association was responding to an inquiry concerning:

> A client who is a citizen and resident of a foreign country [consulting with an attorney] about a proposed transaction ("Transaction") in which the client would open a bank account in his name at a New York bank, or create a wholly-owned corporation in a zero tax jurisdiction ("Offshore Corporation") and have the Offshore Corporation open a bank account at a bank in New York.

The attorney in the hypothetical learns that the client does not want to report the transaction in the foreign country because reporting would result in tax or other legal liability. The bar said that DR 7-102(a)(7) — that is, the state ethics rule that obligates a lawyer not to counsel or assist in conduct that the lawyer knows to be illegal or fraudulent — includes conduct that is illegal or fraudulent under the laws of jurisdictions other than New York.

As state bar associations in the United States become more proactive about disciplining their members for not assisting clients in conduct that may be criminal or fraudulent, they must also decide whether they will undertake compliance and enforcement. Since attorneys in the United States resist direct regulation by government, self-regulation is the norm, and the relevant self-regulatory bodies are state bars. There are also specialty bar associations, such as the American College of Estate and Trust Counsel. However, the population of U.S. attorneys who engage in the type of non-litigation conduct that may run afoul of the AML/CFT laws is so large and all-encompassing that only the state bar associations are able to regulate the matter — no specialty bar would be broad enough to include all potential offenders.

In contrast, the U.K. Money Laundering Regulations 2017 specifically name the Law Society as the relevant supervisory body. Paragraph 10.2 of the regulations sets out the responsibilities of the supervisory authority, which include monitoring those for whom the

[28] *In re Jankoff*, 81 N.Y.S.3d 733 (App. Div. 2018).

[29] New York State Bar Inquiry No. 14-8 (Oct. 8, 2008).

authority is responsible (that is, those covered by the regulations) and "take necessary measures to ensure those persons comply with the requirements of the Regulations."[30] The rules also require that solicitors' firms that conduct work regulated by the Money Laundering Regulations have a "nominated officer" to receive and make disclosures to the U.K. National Crime Agency. This officer, commonly referred to as the money laundering reporting officer, is responsible for, *inter alia*, implementing AML compliance policies, procedures, and controls; evaluating internal suspicious activity reports; and making reports to the National Crime Agency when necessary.

Notably, the Canadian and Jamaican bar associations have developed procedures to monitor compliance with their AML/CFT requirements, including auditing law firms for compliance with the standards.

The Way Forward

Until now, the United States has tended to respond to concerns about gatekeepers and AML/CFT regulations by emphasizing that — in addition to the state rules of professional conduct — criminal laws apply to lawyers. Officials note that both law enforcement and state bar associations enforce AML/CFT laws and discipline lawyers who violate the laws and ethical rules. Bar associations emphasize that they make ongoing, robust efforts to educate lawyers about their obligations. While the ABA gatekeeper task force has not succeeded in persuading the Committee on Ethics and Professional Responsibility and the Standing Committee on Discipline to revise the model rules, the issuance of formal opinions by the ABA and state bars show that the laws and rules applicable to U.S. attorneys are subject to enforcement.

However, these moves alone are unlikely to persuade the FATF that lawyers and other gatekeepers are properly identifying situations that present money laundering and terrorism financing risks and applying adequate customer due diligence policies. If asked to comment further, the FATF probably would contend that the lack of effective monitoring through audits means that the enforcement is spotty and there remain significant gaps in the United States' efforts to apply these rules to lawyers. The impact of these gaps is exacerbated by deficient entity transparency standards and inadequate regulation of dealings involving high-end real estate. The gaps are likely to lead to improper transactions giving rise to scandalous stories and adverse publicity.

From the perspective of FATF and many countries, especially those with robust international finance sectors, one concern is the lack of a level playing field, which erodes the integrity of the international AML/CFT standards and causes cynicism among policymakers worldwide. The size of the U.S. financial market, the gains that can result from investing in the United States, the investment incentives in many U.S. state jurisdictions, the lack of U.S. reciprocity under Foreign Account Tax Compliance Act intergovernmental agreements, and the failure of the United States to join the CRS are among the factors that give the United States a significant advantage in the fight to attract capital from high-net-worth individuals. The important financial contributions that the United States makes to FATF and the OECD and the tendency of the United States to prioritize incentivizing inward investment over participating in the exchange of information further exacerbate the problem of the lack of a level playing field.

For lawyers, law firms, and other gatekeepers, the best way forward is to consider developing their own AML due diligence policies. With the U.S. Treasury's adoption of customer due diligence regulations, U.S. banks and financial institutions are asking law firms if they have policies. Some are requesting copies of these policies so the financial institution can determine if a particular firm's policy is adequate. While this article focuses on attorneys, most of the considerations apply equally to accounting professionals who engage in tax and financial planning.

AML due diligence policies should cover a wider range of services, including the sale and purchase of real estate; management of client money, securities, or other assets; management of bank, savings, or securities accounts; organization

[30] Legal Sector Affinity Group, "Anti-Money Laundering Guidance for the Legal Sector," Law Society (U.K.) (Mar. 2018); and Law Society, "Anti-Money Laundering" (last accessed May 7, 2020).

of contributions to create, operate, or manage companies; establishment, operation, or management of legal persons or arrangements; purchase and sale of business entities; and tax and business advice.

The AML due diligence policy should be risk-based, taking into consideration the types and amount of financial transactions undertaken by a firm, geographic risks, client risk, service risk, and any dealings with high-risk clients (for example, politically exposed persons) as well as low-risk matters and steps the firm takes to mitigate risk. An AML/CFT due diligence plan should cover client intake and vetting.

A KYC policy should include initial information intake, screening for persons and entities on the U.S. Treasury's specially designated nationals list, client identification information (and verification of such information), online searches to verify client information, proper handling of clients who are not physically present, procedures for existing clients, use of third-party KYC, appropriate examination of any apparent inconsistencies in identification evidence, and the completion of KYC documents before starting work. The firm should preserve copies of the KYC due diligence.

The AML due diligence policy should specify how to determine the beneficial ownership of clients. The policy should consider the circumstances of a specific client and the purpose and intended nature of the business relationship with the client.

The customer due diligence policy should detail how to conduct a risk assessment and include appropriate processes for standard-risk, low-risk, and high-risk clients. It should also discuss the timing of customer due diligence procedures. The customer due diligence policy should provide for ongoing monitoring and detail steps to be taken if a client wants to engage in activities that raise a red flag or present an unacceptable risk. For instance, suppose a Central American or Islamic charity whose charter identifies its purpose as providing for the general welfare of the diaspora in the United States decides to engage in a joint venture with a new currency exchange dealer or cryptocurrency platform to facilitate transactions with the homeland. Depending on the details of this venture, the nature and risks of servicing this client have multiplied significantly; a proper policy would call for significant additional inquiries. A thorough policy should provide for a designated compliance officer, dictate recordkeeping obligations, and include training requirements. It should require keeping logs to identify personnel who receive training, and it should provide forms to guide intake and customer due diligence as well as forms for reporting problems to the compliance officer.

Periodically, the firm must consider whether to update its AML, due diligence, and compliance manual to reflect changes to domestic and international laws. Some firms will want to integrate their AML due diligence policies with other sanctions and integrity policies.

Increasingly, the EU and other international organizations are not going to give U.S. lawyers and gatekeepers a free pass to remain noncompliant while the rest of the world increases AML/CFT due diligence responsibilities. The United States started this game by passing money-laundering legislation in 1986; proposing the creation of FATF; and insisting that FATF, the U.N., and the World Bank not only enact AML rules, but also terrorist financing and nuclear proliferation financing policies. Soon the United States will have to join the dance or suffer the consequences, including the erosion of financial regulatory standards and possible blacklisting.[31] Its vulnerability grows in the "America First" era as the United States reduces its participation in international institutions and loses its political capital. Meanwhile, the international organizations must have the fortitude to hold the superpower to the same standards as the rest of the world if they want international standards to have the necessary legitimacy. ■

[31] For a discussion of a proposed EU AML blacklist that named some U.S. territories and faced criticism from the U.S. Treasury, see Zagaris, *supra* note 2.