

Risk-Based Approach for Legal Professionals

Definition:

The legal sector comprises a broad spectrum of practitioners; however for the purposes of this newsletter, legal professionals refer to barristers, solicitors and other specialist advocates, and notaries.



What is a Risk-Based Approach?

A risk-based approach (RBA) is widely accepted, as the most effective way of tackling money laundering and terrorist financing (ML/TF), as it:

- * reduces the “checklist” mentality inherent in a “rules-based” approach that requires compliance with rules irrespective of the underlying risk;
- * ensures that the highest risk scenarios receive enhanced Customer Due Diligence (CDD) and transaction monitoring; and
- * allows legal professionals to effectively and efficiently deploy their resources and personnel to ensure compliance with Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) Laws and Regulations.

Why a Risk-Based Approach

As Designated Non-Financial Businesses and Professions (DNFBPs), the *Financial Services (Implementation of Industry Standards) Regulations* require Legal Professionals to identify and assess their own risks. It is essential for Legal Professionals to be able to identify the money laundering (and associated legal, regulatory and reputational) risks facing their business and apply appropriate and proportional measures to mitigate those risks. Legal Professionals significantly differ from financial institutions in regards to size. As such, a RBA allows Legal Professionals to adopt a more tailored set of AML/CFT procedures with due regards to their available resources. This approach allows them to effectively and efficiently apply preventive measures that are reasonable and proportionate to the nature and size of their business.



The Financial Action Task Force (FATF) published its revised Guidance for a Risk Based Approach for Legal Professionals in June 2019. This newsletter seeks to summarize the information outlined in the Guidance and provide an overview of the relevant AML/CFT requirements as it relates to Legal Professionals.

Services provided by Legal Professionals

Legal professionals provide a vast range of services to a diverse range of clients. These services may include (but are not restricted to):

1. Advising on the purchase, sale, leasing and financing of real property;
2. Advocacy before courts and tribunals;
3. Representing clients in disputes and mediations;
4. Advice in relation to divorce and custody proceedings;
5. Advice on the structuring of transactions;
6. Advisory services related to insolvency/receiver-managers/bankruptcy;
7. Administration of estates and trusts;
8. Assisting in the formation of entities and trusts;
9. Trust and company services;
10. Acting as intermediaries in the trade of citizenship and residency;
11. Providing escrow services and token custody services;
12. Legitimizing signatures by confirming the identity of the signatory (in the case of notaries); and
13. Overseeing the purchase of shares or other participations (also in the case of notaries).

Guidance for Legal Professionals

All legal professionals should carry out the steps and procedures outlined below.



I. Customer Due Diligence (CDD)

In accordance with FATF Recommendation 10, legal professionals are required to identify and verify beneficial owners when establishing business relations. Legal professionals should collect the relevant Know Your Customer (KYC) documents, such as photo identification documents (IDs) and proof of address (POA) verification documents to establish the true identity of each client. Background checks and enhanced due diligence (EDD) should also be conducted when necessary. FATF's RBA Guidance outlines three (3) types of CDD.

Standard CDD: A standard level of CDD, generally to be applied to all clients to whom specified services are provided.

Simplified CDD: The standard level being reduced after consideration of appropriate risk variables, and in recognized lower risk scenarios.

Enhanced CDD: An increased level of CDD for those clients that are determined by the legal professional to be of higher risk. This may be the result of the client's business activity, ownership structure, or the particular service(s) offered. Enhanced CDD should be conducted for Politically Exposed Persons (PEPs), especially foreign PEPs, and residents and citizens of high risk jurisdictions.

Legal Professionals should appropriately determine which level of CDD to be employed based on the risks posed. The general principle of a RBA is that, where there are higher risks, enhanced measures should be taken to manage and mitigate those risks. Consequently, where the ML/TF risk is assessed as lower, the degree, frequency and/or the intensity of the controls conducted should be relatively lighter. Where risk is assessed at a normal level, the standard AML/CFT controls should apply

II. Risk Identification and Assessment

Legal Professionals should perform a risk assessment of each client at the inception of, and periodically throughout the business relationship. The RBA Guidance divides risks into three categories – country/geographic risk, client risk and service risk – each of which has a number of elements or factors that should be evaluated separately.

Service Risks

Although, Legal Professionals provide a variety of services, the FATF has identified the following services as particularly susceptible to misuse by criminals for money laundering and terrorist financing:

- a) Buying and selling of real estate;
- b) Managing of client money, securities or other assets;
- c) Management of bank, savings or securities accounts;
- d) Organization of contributions for the creation, operation or management of companies; and
- e) Creating, operating or management of legal persons or arrangements and buying and selling of business entities.

As a result, legal professionals that offer these services should be particularly vigilant as to identify any suspicious activities.



Country/Geographic Risks

Geographic risks of ML/TF may arise in a variety of circumstances, including from the domicile of the client, the location of the transaction or the source of the wealth or funds. Legal Professionals are asked to exercise extreme caution when accepting business and carrying out transactions with clients who reside or are citizens of jurisdictions that have been identified as high risk by FATF due to significant deficiencies in their AML/CFT regime.



Client Risks

Determining the potential ML/TF risks posed by a client or category of clients is critical to the development and implementation of an overall risk-based framework. Based on their own criteria, Legal Professionals should seek to determine whether a particular client poses a higher risk. Categories of clients whose activities may indicate a higher risk include:

- PEPs and persons closely associated with or related to PEPs;
- Clients conducting their business relationship or requesting services in unusual or unconventional circumstances;
- Instances where the client's structure, nature of the entity's business or relationship makes it difficult to identify the true beneficial owner or controlling interests or clients attempting to obscure understanding of their business, ownership or the nature of their transactions;
- Clients' companies that operate a considerable part of their business in or have major subsidiaries in countries that may pose higher geographic risk; and
- Clients that are cash (and/or cash equivalent) intensive businesses.

III. Ongoing monitoring of clients and specified activities

Ongoing monitoring of the business relationship should be carried out on a risk related basis to ensure that Legal Professionals are aware of any changes in the client's identity and risk profile. This requires an appropriate level of scrutiny of all activities during the relationship, including enquiry into source of funds where necessary, to assess consistency with expected behaviour based on accumulated CDD information. Monitoring is often best achieved by having contact with the client (either face-to-face or by other means of communication).

IV. Training

An ongoing training program is paramount to an effective risk based AML/CFT regime. Legal Professionals and their staff should be trained commensurate with the complexity, size and nature of their business. It is imperative that staff members are able to detect changes in client activities that may raise suspicion. Targeted training sessions should also be established for the Legal Professionals that provide high risk services or services to high risk clients.

Identifying Red Flags



Client's behaviour or identity	Concealment techniques	The relationship between the client and counterparties
<p>Client is secretive or evasive about:</p> <ul style="list-style-type: none"> ◆ His/her identity or that of the beneficial owner; ◆ The source of funds or money; or ◆ The purpose of the transaction <p>Client is:</p> <ul style="list-style-type: none"> ◆ Known to have convictions, or to be currently under investigation for, a crime or has known connections with criminals; ◆ Related to or a known associate of a person listed as being involved or suspected of involvement with terrorists or terrorist financing operations; ◆ Unusually familiar with CDD procedures and STRs, or asks repeated questions on related procedures. 	<ul style="list-style-type: none"> ◆ Use of intermediaries without good reason; ◆ Avoiding personal contact; ◆ Reluctance to disclose information, and documents that are necessary to enable the execution of the transaction; ◆ Use of false or counterfeited documentation. 	<ul style="list-style-type: none"> ◆ Multiple appearances of the same parties in transactions over a short period of time; ◆ The parties attempt to disguise the real owner or parties to the transaction; ◆ The parties are: <ul style="list-style-type: none"> - native to, resident in, or incorporated in a high-risk country; - not the same as the persons actually directing the operation.

Reference:

- *FATF Guidance for a Risk Based Approach—Legal Professionals, June 2019*
- *A Lawyer's Guide to Detecting and Preventing Money Laundering, a collaborative publication of the International Bar Association, the American Bar Association and the Council of Bars and Law Societies of Europe, October 2014.*

Tipping off and Confidentiality

The FSRC understands that there is a potential conflict between client confidentiality and compliance with AML/CFT obligations by Legal Professionals who owe an ethical obligation to their clients to maintain confidence and to act in their clients' best interests. The FATF Recommendation 23 however requires Legal Professionals to report suspicious transactions. The client should not be notified of any possible internal investigation or Suspicious Transaction Report (STR) filed with the FIU.

In Summary

