Money Laundering

Lawyers as Policemen – the Prevention of Money Laundering Regulations

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I have heard that the first person to be convicted of money laundering in Malta was the drug dealer who, upon being gently interrogated by the Police about the provenance of reasonably large amounts of cash deposited in a safe custody box with a bank, answered "Sir, where else could I have safely concealed all the money I made from selling drugs?". Now that was an easy case – for the prosecution of course. Unfortunately however, money laundering activities are usually much more complex and yes, it has been acknowledged by the most authoritative international voice on money laundering – the Financial Action Task Force – that lawyers too may be "gatekeepers for money laundering".

From 1 December 1994, when money laundering became a criminal offence, up to the entry into force of Legal Notice 199 of 2003 on 12 August 2003, if a lawyer had to be concerned about money laundering it was usually because he was either an adviser to a financial organisation or else required to defend his client – hopefully not as gullible as the one referred to previously - before the criminal courts. The Prevention of Money Laundering Regulations 2003, which substitute the 1994 Regulations, classified lawyers and other independent legal professionals such as legal procurators, as "subject persons" for the purposes of the Regulations. Lawyers were joined in the 2003 list by auditors, external accountants, tax advisors, notaries, nominee companies and licensed nominees, casinos, real estate agents and dealers in precious stones or metals or works of art or similar goods and

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auctioneers when the payment is made in cash in an amount of Lm5,000 or more. All these professions or activities, together with the "traditional" subject persons such as banks, stockbrokers and insurance intermediaries, have significant onerous duties in the law's conception of the fight against money laundering.

We should however be thankful that the catchment area of the regulations does not affect all our work as lawyers. In fact in the case of notaries, lawyers and other legal professionals, the Regulations only apply in relation to assisting in the planning or execution of transactions for their clients concerning the (i) buying and selling of real property or business entities; (ii) managing of client money, securities or other assets, unless the activity is undertaken under a licence issued under the provisions of the Investment Services Act, (iii) opening or management of bank, savings or securities accounts; (iv) organisation of contributions necessary for the creation, operation or management of companies; (v) creation, operation or management of trusts, companies or similar structures; or (vi) by acting on behalf of and for their client in any financial or real estate transaction. Furthermore lawyers who have the status of employees in an undertaking that is not in the business of providing legal advice to third parties are not caught by the Regulations.

If you are a lawyer operating within the Regulations' net there are several things you should be doing. The first is of course to know what money laundering is exactly. The offence of money laundering is linked to an underlying criminal activity, the proceeds of which are being passed into the financial system. Before the amendments introduced by Legal Notice 176 of 2005 and Act VI of 2005, the underlying criminal activity needed to amount to a specific crime,[244] but since those amendments, intended to align

[244] A crime specified in Article 3(1)(a) of the Vienna Convention (namely drug dealing) or else a crime which was listed in the Second Schedule to the Act, namely drugs, illegal dealing in arms and armaments, trafficking in humans, piracy, illegal arrest, wilful homicide and grievous bodily harm, blackmail, crime affecting public trust, theft, fraud, a crime against the Customs Ordinance, the Official Secrets Act, the Arms Ordinance, the Central Bank of Malta Act, the Exchange Control Act or a crime which constitutes a "corrupt practice" in terms of Chapter 326.

Maltese law with the provisions of the European Union's Third Money Laundering Directive, "any criminal offence" is sufficient for the purposes of the definition of underlying criminal activity.

Legal Notice 42 of 2006 which came into force on 21 February 2006 (hereinafter referred to as the "2006 amendments") further extended the 2003 Regulations. It incorporated into Maltese law some of the principles contained in a number of international reference documents such as the revised Recommendations and Special Recommendations of the Financial Action Task Force and the Basle Committee papers on Customer Due Diligence.

The main thrust of the 2006 amendments was a widening of the scope of the legislation. The Regulations have been specifically extended also to cover the "funding of terrorism". Hence the funding of terrorism is covered by the law irrespective of whether there is actual money laundering involved. The title of the Regulations has been amended to reflect this as have been a number of other sections throughout the Regulations. The funding of terrorism has been defined by reference to the Criminal Code specifically the conduct referred to in Sections 328F to 328I both inclusive.

The Regulations impose four distinct duties on lawyers as "subject persons", namely: identification, internal record keeping, reporting and training.

Identification

Identification of the client, or the "applicant for business", is generally always required unless the applicant for business is itself a subject person or is introduced by a subject person who can give assurance that he has identification records, but in the latter cases identification must still be effected if there is any suspicion of money laundering. Identification must be carried out as soon as is reasonably practical after contact is first made with client. It is obligatory to keep a copy of the identification document on file. Furthermore the Regulations require a subject person to be able to

establish the business profile of an applicant for business. The identification process must be repeated if doubts have arisen or changes have occurred during the business relationship. The Regulations also oblige subject persons to examine with special attention any complex or large transactions and any transactions which are particularly likely, by their very nature, to be related to money laundering.

The process of verification of identity was embedded into the Regulations by virtue of the 2006 amendments. This increases the need for investing in specialised software which enables subject persons to easily conduct searches on the profile of prospective investors. Such software, although not cheap to buy, is nevertheless becoming nearly indispensable to conduct a suitable verification and customer due diligence process, especially for lawyers whose business has a substantial international dimension.

If the client is acting on behalf of a third party, both the client and the third party must be identified. If the client is a body corporate, identification must be obtained for all the directors and all shareholders holding more than 25% (10% prior to the 2006 amendments). The need for identification of shareholders and/or beneficial owners is not necessary in the case of a company listed on a recognised stock exchange, a domestic public authority, a state corporation, or any other category of customers where such customers present a low risk of money laundering or the funding of terrorism as may be determined by the FIAU.

If the shareholding is held under a trust, nominee or other fiduciary arrangement, identification of the underlying beneficial owners is also required. In fact nominees or trustees are now required to disclose the underlying beneficiary's identity to a subject person. The old Regulation 7(5), which allowed a nominee to merely assure identification was removed in 2003. Insurance policies with respect to a pension scheme are exempt from the identification requirements provided the policy does not contain a surrender clause and may not be used as collateral for a loan.

In 2006 the concept of acting as a fiduciary has been widened so as to cover also any applicant for business who is acting on behalf of a body corporate, a body of persons, trust or any other form of legal entity or arrangement in which there is a qualifying interest of 25% held by a fiduciary.

The 2006 amendments have further reinforced the duties associated with identification, by integrating it into what is known as "customer due diligence". Special attention must be given to business relationships and transactions with persons, companies and undertakings, including those carrying out relevant financial business or a relevant activity, from a non-reputable jurisdiction. A jurisdiction is classified as being reputable not only if it has legislative measures to combat money laundering but also to combat terrorism funding.

Regulation 5B, added in 2006, imposes a new duty on subject persons which was based on a recommendation of the Basle Committee which was also endorsed by the FATF. Subject persons are now bound to develop and establish effective customer acceptance policies and procedures that are not restrictive in allowing the provision of financial and other services to the public in general but that, as a minimum, include:

(a) a description of the type of customer that is likely to pose higher than average risk;

(b) the identification of risk indicators such as the customer background, country of origin, business activities, linked accounts or activities and public or other high profile positions; and

(c) the requirement for an enhanced customer due diligence for higher risk customers.

This process, known as the "risk-based approach", is particularly onerous and hence the legislator has allowed for the FIAU to determine that certain subject persons may apply simplified measures where the risk of money laundering or terrorism funding

appears low and where adequate check and controls are applied. However such simplified measures may not be utilised in cases of suspicion.

The 2006 amendments also introduced Regulation 5C which puts a special focus on Politically Exposed Persons (PEPs) namely "natural persons who are or have been entrusted with prominent public functions and shall include their immediate family members or persons known to be close associates of such persons, but shall not include middle ranking or more junior officials".

The adoption of a Customer Acceptance Policy must enable subject persons to be able to establish whether an applicant for business is in effect a politically exposed person. When a PEP residing in another country applies for business with a subject person approval of this must be given by the senior management of the organization. Moreover the subject person must conduct 'ongoing monitoring' of the relationship with such a PEP so as to establish the source of wealth and funds that are involved in his transactions.

Record keeping

Records of identity and records of details of transactions must be maintained for a period of five years. The identification requirements of the Regulations only apply to business relationships formed after their coming into force. However if a doubt has arisen or there have been changes in the established business relationship, the identification process must be carried out in accordance with the new Regulations.

All subject persons are to ensure that all customer identification, due diligence records and transaction records and information are made available on a timely basis to the FIAU and to other relevant competent authorities, for the purposes of the prevention of money laundering and the funding of terrorism.

Reporting

Every law firm or sole practitioner must designate a reporting officer who is to exercise judgement as to whether facts reported to him do give rise to a suspicion of money laundering. The reporting officer can be (but in virtue of a clarification introduced in 2006 need not be) an employee and not necessarily a lawyer himself. This so called Money Laundering Reporting Officer (MLRO) is obliged to report to the Financial Intelligence Analysis Unit (FIAU) when he is of the "opinion that the information indicates that any person has or may have been engaged in money laundering". Any information so disclosed can only be used in connection with investigations of money laundering activities. This however does not mean that the information will be used only to investigate the particular report itself, and it will most certainly be retained by the FIAU for other and future money laundering investigations.

This radical change for the legal profession has therefore also shaken the lawyer-client privilege of secrecy. Whilst any reporting made pursuant to the Regulations is covered by a statutory exemption from breach of professional secrecy, reporting is also not required if the information which indicates that a client has or may have been engaged in money laundering is received or obtained by the lawyer in the course of ascertaining the legal position for the client or defending or representing the client in or concerning judicial proceedings, including advice on instituting or avoiding proceedings.

Disclosure to the FIAU in case of suspicion is to be effected by not later than 3 working days from when the suspicion first arose. A time frame has also been established for subject persons to disclose information requested by the FIAU. Upon a demand of the FIAU subject person have to submit such information by not later than 5 working days from when the demand was first made. A request to extend such time is at the discretion of the FIAU.

Training

The fourth obligation involves providing employees from time to time with training in the recognition and handling of transactions carried out by, or on behalf on, any person who is, or appears to be, engaged in money laundering.

Breach of the Regulations

Getting caught unprepared for these obligations is not an easy ride. Failure to comply with the money laundering regulations is a criminal offence punishable on conviction with a fine not exceeding Lm20,000 and\or imprisonment not exceeding 2 years. The same music is faced by committing the offence of "tipping-off" namely disclosing that a reporting has been raised or that an investigation is being carried out to any person except the internal MLRO or the FIAU.

In determining whether a subject person is complying with the Regulations, it is mandatory (as from the 2003 amendments, before which it was merely optional) for a court to consider any guidance given by the Financial Intelligence Analysis Unit (FIAU) with the concurrence of a supervisory authority, and failing such guidance, any other guidance issued by a body which regulates, or is representative of any trade, profession, business or employment carried on by that subject person. Indeed a new regulation gives the FIAU the power to issue procedures for any subject person and such procedures are binding as the law itself.

By virtue of the 2006 amendments, the non-observance of the time frames for the submission of information to the FIAU discussed above now can lead to an administrative penalty of not less than Lm100 and not more than Lm1000 which may be imposed by the FIAU, without recourse to a court hearing and either as a one-time penalty or on a daily basis, however not accumulating to more than Lm5,000.

Conclusion

While complying with the Regulations is no easy task, it is also fair to state that lawyers are reasonably equipped, by virtue of their training and the nature of their profession, to know their customer very well. The Know Your Customer or KYC concept is possibly the most important concept underpinning compliance with prevention of money laundering obligations. If you know your customer well enough you will more easily detect suspicious activity. Once you have the suspicion, and it remains lingering inside your head, there is only one thing left to do – report it. Yes, lawyers have become policemen!

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19th June 2006