TACKLING THE PROFESSIONAL ENABLERS OF ILLICIT FINANCIAL FLOWS – A FOCUS ON LAWYERS

POLICY BRIEF

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• The organised Bar should establish a new standing committee to proactively address the ethical obligations of lawyers through continuing legal education, to create a safe environment for whistleblower disclosures and to take steps to disbar those guilty of wrongdoing.

• Governments should improve the statutory and regulatory framework around beneficial ownership disclosure, client due diligence, suspicious activity reporting, whistleblower protection and establishment of specialised financial crimes divisions in criminal courts.

• Governments and the organised Bar should work together to ensure that those guilty of wrongdoing face appropriate civil and criminal sanctions and penalties.

• Governments should establish specialised divisions within the criminal courts for the investigation, prosecution and adjudication of financial crimes.

1. Background

The Pandora Papers provide a snapshot of elaborate schemes used by the super-rich and kleptocrats to hide financial assets in off-shore havens. However, these kleptocrats did not design the complex schemes. Instead, the schemes were designed by a set of professionals that include lawyers, accountants, bankers, investment and financial advisers, real estate and company professionals, art dealers and those involved in the sale of luxury items, among others. Curtailing the activities of these enablers is crucial to safeguard and strengthen democracy, the rule of law and the administration of justice.

While it is important to tackle all the categories of professional enablers listed above, this policy brief will focus only on lawyers.

2. How do enablers facilitate illicit financial flows

2.1 Complex corporate schemes and tax shelters

Both the AU-ECA High Level Panel on Illicit Financial Flows and the UN FACTI Panel highlighted the use of shell companies to launder the proceeds of ill-gotten gains. Enablers, particularly lawyers, and trust and company service providers, design schemes whereby they establish complex and opaque corporate structures designed to conceal, disguise and obscure the ultimate beneficial owner of financial assets.

These schemes are often designed by large international law firms while the implementation of the elements of the scheme are farmed out to smaller domestic law firms. Multiple small domestic law firms are briefed to deal with different components of the corporate scheme. These small firms are not always aware of the grand plan, or what services other colleagues are providing to the same client. They may suspect that their service contributes to a larger, more complex scheme for tax evasion or abusive avoidance purposes but turn a blind eye to that risk to avoid losing the client.

Much of these activities are strictly speaking legal, especially when dealing with each individual segment. However, when it is all put together in the grand scheme, the question of legality is more complicated.
2.2 Abuse of lawyers escrow and trust accounts

Lawyers’ escrow and trust accounts have been abused to assist clients to hide income, disguise the character and source of funds to evade tax or launder money. In these circumstances banks are required to undertake know your client (KYC) processes with respect to the escrow and trust account held in the name of the lawyer but not with respect to each deposit, withdrawal or payment on behalf of the lawyer’s client.

2.3 Advice on tax evasion and aggressive avoidance schemes

Some lawyers provide advice on how to evade tax using falsified information, documents and submissions. These activities are clearly illegal and might be classified as aiding and abetting. Advice on how to abuse loopholes in the law to avoid tax is strictly speaking legal but goes against the spirit of the law.

3. What can be done to deter lawyers who enable and facilitate illicit financial flows

In most countries, lawyers are required to conduct themselves with integrity in the discharge of their duty to their client, to the court, to other lawyers and to the administration of justice. In most countries, they also have a duty to uphold the reputation of the legal profession. While, in some jurisdictions, they swear to uphold justice in the public interest such that in their representation of a client that they know is guilty, they need not disclose the client’s guilt, but at the same time, they may not suppress evidence or collude with the client in the commission of the crime.

In all countries, the legal profession is organised and mostly self-regulated. An independent legal profession is a cornerstone of the rule of law and hence, the organised bar will normally stand in defence of this principle.

Consequently, the recommendations below will consider steps that ought to be taken by the organised profession and other steps that ought to be taken by the government, under two heads, first improvements to the system of self-regulation and second, improvements to the regulatory environment.

3.1 Improvement to the system of self-regulation

The organised Bar, which is the primary regulator of the legal profession, needs to embrace the notion that lawyers are not only representatives of their clients but are also, in a sense, guardians of the tax system and the larger public interest. Further, that integrity in financial matters is crucial to the reputation of the legal profession as a whole and for sustainable development. They need to acknowledge the role played by some of their members in facilitating and enabling illicit financial flows and commit to ensuring that such conduct is curtailed.

The organised Bar ought to take the following tangible steps:

- Establish a standing committee comprising both lawyers and non-lawyers, that will assist the state to strengthen their capacity and legislative framework and that will focus on reviewing the ethical obligations and procedures of lawyers to address their facilitative role in illicit financial flows as described in section 2 above. This standing committee will also create a safe environment for whistleblower disclosures and protection and for the reporting of suspicious activity;

- Conduct regular continuing legal education and develop guidelines that focus on assisting lawyers to fulfil their reporting obligations under the anti-money laundering and fiscal regime particularly with regard to risk assessment, client due diligence, KYC, beneficial ownership disclosure and suspicious transaction reporting;

- Pro-actively secure the disbarment of those lawyers who fall short of the ethical standards; and

- Actively support the state and others in holding lawyers who fall short of the law to account within the civil and criminal justice framework.

3.2 Improvements to the regulatory environment

The UN FACTI Panel recommends that governments need to enact laws that strengthen accountability, prevent malfeasance and tackle impunity on all sides of every transaction and to particularly ensure that professional enablers of illicit financial flows are held to account, including lawyers.

What follows are recommendations to improve the statutory and enforcement framework around beneficial ownership disclosure, client due diligence, suspicious transaction reporting, protection of whistleblows, the administration of justice and the framework for civil and criminal sanctions and penalties for wrongdoing.

3.2.1 Beneficial ownership disclosure

Transparency on the beneficial ownership and control of all legal persons and legal arrangements is required by the Financial Action Task Force and is crucial to fight against money laundering. While disclosure of beneficial ownership is complex, it is necessary in the fight against illicit financial flows.

Consequently, governments need to:

- Enact legislation and regulatory measures that expand disclosure requirements to include all lawyers and law firms and increase penalties for tax shelter schemes;

- Should introduce corporate transparency legislation to demand details of the true beneficial owner of all legal entities registered within its territory from all lawyers and law firms; and

- Publish beneficial ownership information in a public registry.

While lawyers may argue that attorney-client privilege precludes them from these disclosure requirements and that it will be onerous on small law firms, the broader public interest, state security require such disclosures in relation to financial transactions. Consequently, lawyers involved in these activities cannot be shielded from the disclosure obligations.

3.2.2 Customer due diligence

Linked to beneficial ownership disclosure is customer due diligence (CDD). CDD is a process of checks to help identify a client and make sure they are who they say they are. Lawyers are in a better position to identify potential money laundering if they know their client and understand the rationale for their instructions. Governments need to enact regulations that define when, what and by whom CDD measures need to be taken. For the small law firms mentioned in section 2.1 above, enhanced due diligence should be required when a lawyer does not actually meet the client, as not meeting a client in person poses a higher risk of money-laundering.
3.2.4 Whistle-blower protection

Flowing from the above, a strong framework for whistle-blower protection will help expose non-compliance with legislative obligations, policy documents and ethical obligations and promote financial integrity as a fundamental value. Governments should establish a robust statutory framework to protect individuals who disclose wrongdoings in the workplace, including within law firms.

3.2.5 Civil and criminal sanctions and penalties under law

Governments and the organised Bar should work together to ensure that those guilty of wrongdoing face appropriate civil and criminal sanctions and penalties.

A specialised financial crimes division in the criminal courts

One way to do this is through the establishment of specialised financial crimes divisions in criminal courts. Financial crimes require specialised skills to investigate, prosecute and adjudicate successfully. In addition, it requires individuals with high levels of integrity and fierce independence. Consequently governments need to secure and allocate adequate resources for the recruitment, training and empowerment of specialised investigators, prosecutors and judges to deal with financial crimes. This division should ensure that enablers of financial crime, including lawyers, face equivalent criminal penalties to the perpetrators of the financial crime and thus ensure that there are no lawless zones for both perpetrators and enablers as per the recommendations of the UN FACTI panel.

Sources

We work to see a united, just and prosperous Africa, built on the rule of law and good governance.