



The Law Society

Response to second consultation on FATF standards

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supporting
solicitors

Contents

| | |
|---|-----------|
| 1. Introduction | 3 |
| 1.1. Preparation of this response | 3 |
| 1.2. Terminology | 3 |
| 1.3. General comments | 3 |
| 2. Beneficial ownership..... | 4 |
| 2.1. Recommendation 5 | 4 |
| 2.1.1. Identifying and verifying the client | 5 |
| 2.1.2. Corporate beneficial owners..... | 5 |
| 2.1.3. Legal arrangement beneficial owners..... | 6 |
| 2.2. Recommendation 33 | 7 |
| 2.2.1. Adoption of a companies' register | 7 |
| 2.2.2. Holding of all ultimate beneficial ownership information | 8 |
| 2.2.3. Bearer shares | 8 |
| 2.2.4. Nominee shareholders | 9 |
| 2.2.5. Extensions and exemptions | 10 |
| 2.2.6. Alternative ways to increase effectiveness | 10 |
| 2.3. Recommendation 34 | 11 |
| 2.3.1. Assessing the risk of the misuse of trusts..... | 11 |
| 2.3.2. Trustees' legal obligations | 13 |
| 2.3.3. Access to information..... | 14 |
| 2.3.4. Trustee disclosure..... | 15 |
| 2.3.5. Sharing of information by competent authorities..... | 15 |
| 2.3.6. Registration in source of law jurisdictions..... | 16 |
| 2.3.7. Alternative ways to enhance effectiveness | 17 |
| 3. Data protection and privacy | 17 |
| 4. Financial sanctions | 18 |
| 5. FIUs and international cooperation | 18 |
| 6. Other issues..... | 19 |
| 6.1. Assessment of implementation..... | 19 |
| 6.2. Risk based approach in supervision | 19 |
| 6.3. Politically exposed persons | 19 |

1. Introduction

This response has been prepared by the Law Society of England and Wales (the Law Society), which represents over 140,000 solicitors in England and Wales. The Law Society negotiates on behalf of the profession and lobbies regulators, governments and others. The Law Society is the anti-money laundering supervisor for solicitors in England and Wales and also supports them in compliance through the provision of advice, awareness raising and education.

The Law Society welcomes the opportunity to respond to FATF's review of the standards in preparation for the 4th round of mutual evaluations.

1.1. Preparation of this response

This response has been informed by numerous consultations and our work on anti-money laundering with the legal profession in England and Wales over the past decade.

This response has specifically been prepared with assistance from the members of the Law Society's Money Laundering Taskforce, Company Law Committee and Wills and Equity Committee.

We have also had the benefit of seeing the responses of the International Bar Association, the American College of Trust and Estate Counsel, and the Society of Trust and Estate Practitioners, with which we broadly concur.

1.2. Terminology

Where we have referred to regulated entities in this response, we are referring to both financial institutions and designated non-financial businesses which are covered by the standards. Where we are referring solely to law firms in England and Wales and to our members, we have made this clear.

1.3. General comments

While the Law Society welcomes the opportunity to comment on these proposals, it is still difficult to fully understand the ramifications of the proposals without seeing the actual drafting. As we advised in our response to the first consultation, the potential unintended consequences of amendments only truly become apparent when one seeks to apply the actual drafting to real life circumstances. We therefore request the opportunity if at all possible before February 2012 to review the actual drafting and provide feedback to FATF on the practical consequences of the changes.

2. Beneficial ownership

The main proposals relating to corporate vehicles and legal arrangements focus on the beneficial ownership aspect of due diligence. However it is important to view these requirements in the wider anti-money laundering context.

Identification and verification of beneficial ownership is but one of the four arms of effective client due diligence required under Recommendation 5, the others being:

- identification and verification of the client;
- understanding the nature and purpose of the business relationship; and
- conducting ongoing scrutiny of the transactions including where necessary the source of funds.

As we stated in our January response, the Law Society accepts that sophisticated criminals will at times seek to hide behind business structures and agents to help facilitate money laundering. For this reason we appreciate that a greater understanding of the client's ownership and control structure can be of use for regulated entities to better understand the motivation behind transactions and spot anomalous activities or relationships which may be indicative of money laundering.

However, it is also true that the percentage of individuals who use companies, trusts and agents for a legitimate purpose¹, significantly outweigh the percentage who use them for criminal means. It is this very point which is at the heart of FATF's adoption of the risk-based approach and must be borne in mind when assessing the proportionality of the proposals.

Further, from FATF's 2010 typology research on the misuse of trust and company service providers² it is apparent that the warning signs of money laundering often come not from who the owners are; but rather from the nature of their business, the specific transactions they are undertaking and the size and source of funds they are utilising. This observation is supported by the experience of our members.

In these circumstances, the continued insistence on seeking out an ultimate beneficial owner irrespective of risk would seem to be not only disproportionate but also counter productive.

Such a requirement wastes resources which could be better deployed on identifying and managing real areas of risk; while seriously impinging the fundamental human right of privacy for millions of law abiding individuals who are involved with companies and legal arrangements.

Such a requirement incurs significant costs for individuals who are conducting legitimate business and seeking to comply with the law; while it does nothing to prevent criminals from providing false details on beneficial ownership either to regulated entities or on business registers.

2.1. Recommendation 5

It is proposed that Recommendation 5 refer to specific types of documents that a regulated entity would normally need to obtain to demonstrate that they had adequate identity information on the client or the beneficial owner.

¹ The European Business Register alone holds information on over 20 million companies

² http://www.fatf-gafi.org/document/0/0,3746,en_32250379_32237202_46706112_1_1_1_1,00.html

While Interpretive Note 4 to Recommendation 5 already provides some guidance on this issue, the Law Society believes that the further specification of documents, either in the Interpretive Note or the Recommendation itself, will significantly undermine the risk-based approach.

2.1.1. Identifying and verifying the client

Considering in turn the specific documents suggested as verification documents for a corporate client; we have a number of concerns relating to the lack of clarity around some of the proposals and how they will undermine the application of the risk-based approach:

- Proof of existence of incorporation.

It is not clear what is envisaged by this requirement. Will a print out from a company register be sufficient? Will a certificate of incorporation be required? Is there an expectation that all countries will now issue certificates of good standing? Will regulated entities need to be able to show photographs of a physical premises and obtain copies of detailed accounts?

- Powers that regulate and bind the entity such as the memorandum and articles of association.

These documents are not obtained as a matter of course for anti-money laundering compliance, as often the identity information will also be included on the face of the register.

When considering the cost/benefit implications of the proposals, it should be noted that company registries generally levy extra charges to obtain these documents. When clients are foreign corporations, such documents are often difficult to obtain and will generally be in the language of the country of incorporation, incurring costs for translation so that obtaining the information is meaningful.

- Names of persons holding senior management positions.

This proposal constitutes a departure from the current obligations, which may include reviewing a list of directors or obtaining details of a number of directors, which is usually available from existing registers. It is really not clear what FATF means by this concept of senior management. There is a risk that attention will be focussed deeper into the organisation and onto people who are actually not in a position to bind the company with their decisions. There is a further challenge as to where the information will be obtained from, other than the company itself, which means it will not be from an independent source.

2.1.2. Corporate beneficial owners

The proposals for verification of beneficial owners also appear to add further obligations to the current requirements without justification.

The proposals appear to suggest that an exhaustive process must be undertaken for a natural person with the requisite ownership. If such a person does not exist, then the regulated entity will have to search for any

person who may possibly exercise any other unspecified control. If they do not exist, then the regulated entity will have to spend time identifying this undefined group of senior management officials.

In practice this will mean that the most beneficial ownership checks will be undertaken on companies where there is no one with sufficient power to subvert the legitimate running of the company for nefarious means. This approach seems very wasteful of precious and finite due diligence resources for no demonstrable benefit.

Further, the amendments do not assist regulated entities in assessing how they can prove the negative requirement of showing that: there is no person with control other than through ownership interests. For the FATF Recommendations to be effective it must be possible to clearly explain how a regulated entity could actually be compliant.

It remains our preference that regulated entities are able to continue to consider the matter on a risk sensitive basis, rather than introducing additional requirements, particularly given the associated costs.

Finally, the exemption for public companies appears to have been restricted further than at present. Interpretive Note 4 (c) to Recommendation 5 permits simplified due diligence for a public company which is subject to regulatory disclosure requirements. The new proposals refer to companies listed on recognised stock exchanges and subject to proper disclosure requirements. It is not clear which stock exchanges FATF deems to be recognised nor which disclosure requirements FATF considers to be proper. The Law Society is not aware of any evidence of extensive abuse of public companies for money laundering purposes and certainly not to a degree which would warrant the proposed changes. We are concerned that such changes are not proportionate.

2.1.3. Legal arrangement beneficial owners

The proposals regarding legal arrangements are a new addition to the standards. The Law Society would support an amendment to Interpretive Note 4 which made reference to normally conducting due diligence on the trustees and the protector.

We also accept that there may be a justification to require identification of the settlor, although they in fact do not have ownership rights. We would point out though that this requirement is more relevant at the formation of the legal arrangement, rather than during the existence of the trust, especially as some legal arrangements can be in existence 100 years or more after the settlor's death.

As expanded at point 3 below, we do not agree that the beneficiaries of a legal arrangement should be considered to be beneficial owners as they do not have ownership of or control over the property in the legal arrangement.

2.2. Recommendation 33

Recommendation 33 currently provides:

Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

2.2.1. Adoption of a companies' register

Having considered all of the proposed changes, the Law Society would support either the addition of an Interpretive Note or an amendment to the Recommendation which required that:

Certain basic information on legal persons should be freely available from Register of Companies, including at a minimum:

- the company name,
- a statement of incorporation,
- information on the legal form and status,
- the address of the registered office,
- basic regulating powers,
- a list of directors, and
- a list of shareholders³.

This is currently required in the UK and is a very useful source of information for the regulated sector and law enforcement when they are seeking to verify information on beneficial ownership or trace ownership chains in criminal investigations.

We understand that it is when ownership chains move into jurisdictions without such registers that searching for the ultimate beneficial owners becomes burdensome for regulated entities and the endeavours of law enforcement can be frustrated.

This simple requirement to register all companies could make a significant difference in the fight against money laundering.

For the individual company, the requirement to provide the information once to the register, and update the register if there was a change, would limit the amount of times they have to provide this information to their bank, accountant, lawyer or any other regulated entity.

The list of shareholders should be restricted to a list of the direct shareholders of the company, rather than the ultimate beneficial owners. Further, as we discuss below, careful consideration should be given to what identifying

³ Or a list of members where the company is incorporated by way of guarantee rather than by shareholding

information is required about the directors and the shareholders, taking into account legitimate expectations of privacy and protection of individual safety.

Requiring the company registries to verify the information provided, or at least undertake verification processes by way of random and/or risk-based sampling⁴, would enhance the effectiveness and reliability of the registers, for both regulated entities and law enforcement.

2.2.2. Holding of all ultimate beneficial ownership information

The Law Society does not support either of the proposals for one individual or entity to hold and keep up to date all of the information about ultimate beneficial ownership for each entity.

An individual company will and should know who its direct shareholders are, as that is to whom they are accountable. Where they are owned by a number of other entities, particularly if it is via minority shareholdings, who are in turn owned by other entities, they will often not be aware of the identity of these ultimate beneficial owners. While they can ask for information through the ownership chain as to who the ultimate beneficial owner is; unless they make that request everyday (or even more frequently), if the ultimate beneficial owner changes, the information they hold will be out of date and completely worthless.

These accuracy limitations will equally apply if the ultimate beneficial owner information is required to be held by regulated entities, company registers or competent authorities.

The Law Society appreciates that being able to access ultimate beneficial ownership information is important for those few companies who are misused by criminals. However this approach will simply incur significant costs for businesses who, particularly in the current economic climate, are in no position to afford it; while providing no assurance to law enforcement that the information is accurate. Further, criminals will simply hold or provide false information, so it will not actually assist in stopping money laundering, which should be the actual aim of any requirements.

2.2.3. Bearer shares

Bearer shares are not a common feature of the UK corporate landscape, so any changes will have a limited impact on our members.

However, we understand that bearer shares are admissible and the most common security used by German corporations. We understand that a prohibition on bearer shares would mean that around 6,800 non-listed stock corporations and some hundred listed companies would need to change their articles. Unless grandfathering rules are put in place, a prohibition of bearer shares would require significant resources and incur significant costs for these corporations.

In terms of the proposals, we can see benefits in immobilising the shares by requiring them to be held with a regulated financial institution or professional

⁴ As stated above, the European Business Register holds information on 20 million companies, while the UK's Companies House register advised in its 2010/11 annual report that there were 2.5 million active companies on the register. Any verification measures to be undertaken by the company registries would need to be cost effective.

intermediary, particularly as most bearer shares are already held by these organisations or individuals.

The other proposals are likely to incur significant costs and fail to take into account the legitimate privacy concerns of the share holders which are outlined below in relation to nominee shareholders.

2.2.4. Nominee shareholders

There are quite a number of examples of where nominee shareholders are utilised for legitimate reasons, including:

- Where companies are involved in controversial but legal activities, such as vivisection research, and the shareholders have concerns about harassment and physical harm should their identities be revealed.
- In countries where there are higher levels of corruption and the rule of law is not particularly strong, wealthy individuals are often targeted in kidnapping and extortion cases.⁵
- By companies who are seeking to invest in competitors, which they see as a potential acquisition target, while remaining anonymous and reducing potential market distortion.
- By investors who have a broad investment policy and would prefer not to reveal a particular investment which may seem contradictory, avoiding unnecessary market speculation⁶.
- Where stocks and shares are held in a discretionary managed portfolio by an investment manager (who is regulated eg by the FSA) so that the stock can be dealt with on a timely basis and bargains completed effectively. This approach is common in the UK.
- Where a large number of employees have small shareholdings in the company, for ease of administration these are generally held by a nominee shareholder who acts on behalf of all of the employees.

One of the proposals is that the details of the nominators should be on a public register, irrespective of whether they hold a controlling share and irrespective of the money laundering risks associated with the company generally. The Law Society believes that this is a completely disproportionate infringement on the fundamental right to privacy of these individuals.

The Law Society notes that most nominee shareholders are actually regulated financial intermediaries and so are already regulated for money laundering compliance. If there is significant evidence of misuse of nominee shareholdings, then encouraging countries who do not regulate nominee shareholders to do so, to have their nominee status noted in the share register and for the nominee to keep details of their nominators, may be a more proportionate and effective approach to mitigate this misuse.

⁵ These risks are highlighted in the recent FATF typology report on Organised Maritime Piracy and related Kidnapping for Ransom. Although the recent Australian case of the extortion attempt on the Pulver family shows that these risks can still be real even in quite stable and democratic countries.

⁶ There are rules against this practice in some jurisdictions if the companies are public companies, but it is otherwise a legitimate practice.

2.2.5. Extensions and exemptions

The Law Society agrees that the registration process we support should be applied to foundations, anstalts and limited liability partnerships, to promote a level playing field, as these are also legal entities. We think the existing provisions in the Recommendations and the Interpretive Notes regarding simplified due diligence are sufficiently flexible to enable an appropriate risk-based approach to apply. Further examples may only result in a tick-box approach being applied upon implementation, which the Law Society believes would be neither effective nor proportionate.

2.2.6. Alternative ways to increase effectiveness

Corporate vehicles are a very common business structure around the world. In most instances the purpose behind their use is completely legitimate

The real money laundering risk associated with corporate vehicles occurs where the company is set up with the purpose of disguising the proceeds of crime from other activities undertaken by its owners. This is why the company formation stage is so important, as is the regulation of those who are permitted to form a company.

In the UK, trust and company service providers who provide these services by way of business are regulated for money laundering purposes. Lawyers and accountants are supervised by their professional bodies, while others without affiliation to a professional body are supervised by HM Revenue and Customs.

FATF should encourage member countries to regulate company formation agents. This will mean the company formation agents are required to:

- conduct due diligence on the beneficial owners at the point of formation,
- understand the reason for the specific incorporation of the company and the business it will conduct, and
- consider whether there are any warning signs that the new company will be utilised for money laundering.

In addition, by requiring company formation agents to make suspicious transaction reports where there are unexplained warning signs of money laundering, law enforcement will be alerted to individuals who are in possession of the proceeds of crime before they are able to set up the company and dissipate the funds. Supervision of company formation agents will mean that they face greater scrutiny and any corrupt individuals are likely to be identified and removed from business more quickly than conventional criminal law processes would usually achieve.

2.3. Recommendation 34

Recommendation 34 provides that:

Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on express trusts, including information on the settlor, trustee and beneficiaries, that can be obtained or accessed in a timely fashion by competent authorities. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.

2.3.1. Assessing the risk of the misuse of trusts

Trusts were created in England in the 11th century as a way to protect the interests of vulnerable individuals who were not permitted by law to hold property.

In essence a trust is a relationship, which places full legal ownership of the property in a trustee or group of trustees, which they must hold for another individual or group of individuals. The trustee is not permitted to enjoy the use of the property for themselves, but must instead deal with the property in a way which is in the best interests of the beneficiaries, which may include allowing them to enjoy either the property (for example to live in a house owned by the trust) or the income from the property.

A trust is not an arrangement where the trustee is bound to follow the instructions of the beneficiaries⁷, it is not a legal person in its own right, and the settlor has no rights relating to the property other than those expressly set out in the trust instrument.

In a personal context, trusts are generally used to:

- pass on assets to children or grandchildren
- provide for a specific need such as paying education fees
- manage the money of and pay for the living expenses of an individual who is unable to effectively manage their own affairs whether that is as a result of physical or mental disability or frailty due to age
- ensure that children do not receive an inheritance before a certain age
- make donations to charitable causes.

In the vast majority of these cases, trusts involve information about the settlor and the beneficiaries which is extremely sensitive and personal, such that a legitimate expectation of privacy would arise.

In a business context, trusts are generally used to:

- run local sporting clubs and other social or community groups
- provide charitable, research and educational services
- manage employee pension schemes
- facilitate venture capital funding for small and medium sized enterprises
- issue sovereign debt

⁷ Except where all the beneficiaries are absolutely entitled and of full age and capacity

However, as the above examples demonstrate, trusts are actually common features of our everyday lives and used by people across the economic spectrum. This is in contrast to the often cited perception of trusts, namely that trusts are only used by the extremely wealthy or by determined criminals to put their assets out of reach of law enforcement and the tax authorities.

The Law Society accepts that trusts may on occasion be used by criminals as a means of distancing the apparent ownership of criminal property from themselves. However, having reviewed the research published by FATF on the misuse of trusts for money laundering purposes, we remain to be convinced that the problem is so wide spread as to warrant the measures proposed or to justify the attention paid to the beneficiaries.

In the 2010 typology review conducted by FATF into money laundering using trust and company service providers⁸, only four cases were provided where an actual trust was utilised⁹.

While two of the examples were undated, one occurred in 2002, before trust and company service providers were included in the relevant country's anti-money laundering regime and the other took place in 2004. As such the examples do not allow one to assess the extent to which the existing measures are effective.

Further, in three of the cases, the trust and company service provider was clearly complicit in the criminal conduct. In one of those cases the trust and company service provider lied about the beneficial ownership of the trust to the competent authorities.

Finally, in one case the criminal was the trustee and in the other two cases the criminals were the settlor. As such the identity of the beneficiary was irrelevant to the money laundering methodology or to the warning signs which helped identify those particular trusts as suspicious.

The 2010 typology report recommended that FATF undertake further investigation into the way trusts were misused in the laundering of the proceeds of corruption. FATF released this further report in July 2011.¹⁰ Despite repeated references to the abuse of trusts for laundering of the proceeds of corruption in the commentary of the report, only one example is given where a trust is explicitly referred to as part of the laundering methodology. This case occurred in the late 1990's and the trust was set up by a US bank, before the current regulatory regime was in place.

Five case examples out of the millions of trusts which are in existence around the world does not give one much scope from which to draw robust conclusions. However due to their inclusion in these typologies one must draw the inference that these are the key cases which law enforcement considered illustrated the main areas of money laundering concern with trusts.

The Law Society simply does not see how the proposals contained in the consultation will effectively help to prevent the manner in which trusts are currently being abused by money launderers as described in FATF's own

⁸ http://www.fatf-gafi.org/document/0/0,3746,en_32250379_32237202_46706112_1_1_1_1,00.html

⁹ We have discounted the examples relating to lawyers' client accounts which is an agency relationship rather than an express trust.

¹⁰ http://www.fatf-gafi.org/document/63/0,3746,en_32250379_32237202_48472703_1_1_1_1,00.html

research. Instead the proposals will disproportionately infringe legitimate expectations of privacy for law abiding individuals, and place extensive burdens on legitimate arrangements which can easily be circumvented by determined criminals who will simply lie about beneficial ownership details.

2.3.2. Trustees' legal obligations

The first proposal is that trustees should be given a legal obligation to obtain and hold beneficial ownership information about trusts.

This proposal demonstrates a fundamental misunderstanding about trusts, as such an obligation already exists. Under common law, there are a number of legal obligations with which a trustee must comply.

Upon becoming a trustee, the trustee must:

- establish the assets which comprise the trust;
- review all documents relating to the trust so that they are familiar with the terms of the trusts including the identity of all current trustees and beneficiaries, and
- avoid conflicts of interests between their fiduciary duties and their own self interest. It is widely recognised that to do this, they again need to establish who all the beneficiaries are.

When managing a trust, a trustee must:

- comply with the terms of the trust unless generally authorised by all of the beneficiaries (the only exemptions are when the trustee is authorised to make changes by the trust instrument, the courts or by statute);
- exercise reasonable skill and care;
- act fairly and impartially between beneficiaries;
- fulfil a duty of 'real and genuine consideration', which requires that they consider the implications of any action or inaction they undertake on the beneficiaries;
- act in the beneficiaries' best interests;
- distribute assets to the right people; and
- keep records and accounts.

It is widely recognised that in order to undertake all of these duties it is essential that the trustee establishes and keeps under review who the beneficiaries are.

This does not however mean that they need to verify identity in the same way it is usually undertaken for anti-money laundering compliance, namely the collection of copies of passports and utility bills.

The Law Society believes that the reiteration of a requirement to obtain and hold information on beneficial owners for trustees in the anti-money laundering standards is superfluous and is likely to simply add extra bureaucratic burdens to processes which have already been working effectively for hundreds of years.

2.3.3. Access to information

The second proposal is that competent authorities in all countries should be able to access information on the identity of the trustee, the beneficial ownership of the trust and the trust assets from one or more sources including financial institutions and DNFBs; registries of assets or trusts; or other competent authorities, of any trust with a nexus to their country. A nexus to the country is defined as where the trust is managed, the trust assets are located or where trustees live.

Recommendation 34 already requires that such information should be able to be accessed by competent authorities.

Regulated entities are already required to obtain the relevant information when conducting due diligence on client trusts and are required to conduct ongoing monitoring at appropriate and risk-sensitive intervals throughout the retainer. There are legal processes in each jurisdiction already in existence which allow competent authorities to obtain such information as is held by the regulated entity at any given time. It is not clear what more this proposal is attempting to achieve.

The Law Society is of the view that a trusts register would:

- infringe disproportionately on the fundamental human right to privacy of the millions of individuals who utilise trusts legitimately;
- create significant administrative costs for both government and legitimate businesses and individuals;
- be difficult and costly to keep up to date; and
- be easily circumvented by criminals who would simply not register or would register false information.

The costs and challenges for ensuring accuracy have been noted in the FATF review of South Africa, which is the only jurisdiction to institute a trusts register. Further, South Africa only received a rating of partially compliant for Recommendation 34 in that review. The existence of such a register, where the accuracy of information is questionable is likely to lull regulated entities into a false sense of security which can only impinge on the effectiveness of the AML regime.

In light of our comments at 2.3.1 above, we simply do not see that the creation of such costly and rights infringing registers are warranted by the scale of reported trust misuse evidenced in the FATF reports or that they are likely to disrupt and prevent the methodologies outlined in those reports.

With respect to the exchange of information between competent authorities generally, please see our comments at point 2.3.5 below.

The application of the final point in the proposal, namely 'of any trust with a nexus to their country' is unclear, on both a linguistic and a practical level. It is not clear whether that is meant to apply to all possible sources or only to the competent authorities.

If it is meant to apply to all possible sources there are fundamental practical challenges with the proposals. Regulated entities will only have the relevant information for those trusts who are their clients, not for every trust that has a nexus with the country. The costs which would be incurred through trust registers, as outlined above, would be even more disproportionate if a trust is required to be registered in every country where there is a nexus.

Competent authorities will have information on a trust if the trust is required to pay tax in that country. The legal basis for the requirement to pay tax may not correlate with the definition of nexus envisaged in these proposals, creating both confusion and increased administrative burdens.

The Law Society does not believe that these proposals will result in Recommendation 34 becoming any more effective than it currently is and that they will instead create unwarranted burdens on governments, as well as businesses and individuals who are using trusts for lawful purposes.

2.3.4. Trustee disclosure

The third proposal is that trustees should be required to disclose their status to:

- relevant authorities, and
- financial institutions and DNFBs when entering a business relationship.

It is not clear when trustees would be required to disclose their status to relevant authorities and which authorities would be considered relevant. As such the Law Society cannot comment on this proposal other than to reiterate the concerns raised in other parts of this response to similar proposals.

The Law Society is not aware of there being a significant issue with trustees failing to mention to regulated entities that they are engaging their services as a trustee rather than for their own purposes. In the UK this information simply has to be provided by the trustee in order to fulfil their role properly. Further it is a part of the basic due diligence requirements for regulated entities to understand the nature of their client's business and the purpose of specific transaction or retainer. Fairly simple questioning should actually reveal that the client is acting in their capacity as a trustee. As such it is not clear what mischief or deficiency this proposal is seeing to address or that it is justified.

2.3.5. Sharing of information by competent authorities

The fourth proposals is that competent authorities should have powers to obtain information regarding trusts and that they should share it as necessary.

In many countries the competent authorities already collect information each year on trusts for the purposes of taxation. The Law Society agrees that it makes sense for competent authorities to look at ways that they can share relevant information where there is a legitimate law enforcement need for the information. We believe that the proper application of data protection principles would help ensure that only relevant information is shared, to the extent actually required, in a manner which is appropriately secure given the personal and sensitive nature of the information. This would effectively enable law enforcement to continue to detect and bring to justice those engaging in money laundering, while still protecting the privacy of millions of individuals who are using trusts for legitimate purposes.

2.3.6. Registration in source of law jurisdictions

Finally, the consultation raises the question of whether additional measures should be taken by jurisdictions which provide the source law for trusts or other such arrangements. One suggestion of possible additional measures is registration in the jurisdiction of the source law. It is not clear whether this registration would be of the trusts, the trustees or the trust and company service providers.

It is simply not clear how FATF envisages that one country would exercise this level of control over individuals and legal arrangements which exist in other jurisdictions without significantly impinging on the sovereignty of those jurisdictions.

The effect of these proposals on Switzerland is perhaps a pertinent example of the challenges faced. Swiss domestic law does not provide for the creation of a trust, yet they have a thriving trust industry. Switzerland has ratified the Hague Convention on the Law Applicable to Trusts and their Recognition, meaning that the trusts created in Switzerland are governed by the law chosen by the settlor. In practice the law selected is often the law of England and Wales, Jersey, Guernsey, the Cayman Islands or the BVI, among others.

With respect to these proposals, it is not clear how the governments in any of those jurisdictions would be able to:

- require registration of the trust, trustee or trust and company service provider in their country,
- monitor for non-compliance or
- take enforcement action against such non-compliance.

This is especially the case if the trust has no other connection with the jurisdiction and the relevant government has no control over the actual trust and company service providers. A requirement for Swiss trust and company service providers to register with, for example the UK's default trust and company service provider supervisor - HM Revenue and Customs, is likely to be a very undesirable prospect for the Swiss authorities, let alone the individuals providing the services.

The Law Society is not aware of this registration approach being applied in any other context, let alone being applied successfully. The proposal is quite unlike that of listing on a foreign stock exchange, where the company voluntarily consents to comply with the listing requirements and can be delisted if they fail to comply. Accordingly the Law Society does not envisage that such a shifting of jurisdictional responsibility would be practically achievable or effective in limiting the misuse of trusts and other legal arrangements by money launderers.

2.3.7. Alternative ways to enhance effectiveness

As evidenced in the FATF typologies reports referred to above, the real problem with trusts is the rare occasions (taking into account how many trusts exist) when they are set up with the purpose of hiding criminal money.

Therefore, in the Law Society's view, it is critical to ensure that individuals who are setting up trusts are effectively regulated for anti-money laundering compliance in the country in which they are conducting business. This would mean that they are required to undertake due diligence on the relevant people and entities involved with the trust, that they understand the purpose for setting up the trust and that they understand the source of the trust property.

By requiring trust formation agents to make suspicious transaction reports about unexplained warning signs of money laundering, law enforcement will be alerted to individuals who are in possession of the proceeds of crime before they are able to set up the trust and dissipate the funds. Supervision of trust formation agents will mean they face greater scrutiny and corrupt individuals are likely to be identified and removed from business more quickly than conventional criminal law processes usually achieve.

The registration and monitoring approach applies in the Cayman Islands, one of the few jurisdictions to be rated as compliant on Recommendation 34 in their FATF review. The UK has also followed the registration approach, with trust and company service providers not supervised by relevant professional bodies now being subject to monitoring by HM Revenue and Customs, which addresses the only deficiency noted in the UK's compliance on this Recommendation. The Law Society strongly suggests that FATF pursues this approach in enhancing the effectiveness of Recommendation 34.

3. Data protection and privacy

The Law Society is concerned at the inference in the consultation paper that data protection and privacy laws should be amended to allow anti-money laundering and counter terrorist financing (AML/CTF) laws to operate unfettered.

As discussed elsewhere in this consultation, anti-money laundering compliance often involves the accumulation of sensitive personal data. The sensitivity of the data may relate not only to clients and beneficial owners, but also to those in regulated entities who are making suspicious transaction reports. The need to have safeguards around the handling of this information is, we would suggest, self-evident.

In our view fully integrating the AML/CTF regime within the privacy and data protection framework will provide clearer gateways and processes for the collection and sharing of information. This can only strengthen the legitimacy of AML/CFT activity, provide greater confidence to those applying the regime, ensure a proper balance in its application and discourage the view that privacy and data protection are obstacles rather than enablers of effective AML/CFT.

Therefore it is the Law Society's view that FATF should have regard to the Article 29 Data Protection Working Party Opinion 14/2011¹¹ on data protection issues related to the prevention of money laundering and terrorist financing. This calls, above all, for a clear legal basis for AML/CFT data processing, reflecting the status of privacy and data protection as human rights recognised by law.

¹¹ http://ec.europa.eu/justice/policies/privacy/docs/wpdocs/2011/wp186_en.pdf

4. Financial sanctions

The Law Society recognises the importance of targeted financial sanctions as a diplomatic and practical tool to limit the ability of individuals, entities and governments to sponsor terrorism. However in light of recent court judgements reflecting upon the appropriate balance between the need to protect the public from terrorism and the need to provide due process and consideration for individual's human rights, the Law Society makes two observations on the current proposals.

Firstly, as these requirements are directed at ordinary members of the public, rather than just regulated entities, it would be prudent to require that competent authorities take reasonable steps to bring the lists of designated individuals to the public's attention. Ensuring that the lists are publicised, easily locatable and easily searchable will enhance compliance and promote the rule of law.

The second observation is a corollary to the first, in that there should be a defence available to an individual if they deal with assets, economic resources or provide relevant resources to a designated person when they did not have any reason to believe that the individual was so designated.

From an implementation perspective, FATF should take care to restrict the scope of the Recommendations regarding sanctions to terrorist financing. Many governments will also make use of sanctioning powers for a range of reasons which they see as nationally legitimate ends, such as preventing serious abuses of human rights by governments in foreign countries or activities which could destabilise the national economy. While the Law Society is not challenging the right of national governments to utilise sanctioning powers for these purposes, they should do so within their own authority rather than by seeking to extend the remit of the FATF Recommendations.

5. FIUs and international cooperation

The Law Society generally supports efforts by FATF to enhance the role of and cooperation between FIUs.

With respect to confidentiality, we commend to FATF the approach taken in the UK by the Serious Organised Crime Agency. The creation of a confidentiality breach helpline, where complaints are investigated independently and reports made directly to the relevant government minister has improved the confidence of regulated entities in making reports.

With respect to the exchange of information, the Law Society appreciates the importance of effective gateways for sharing of intelligence. However we are aware that in certain circumstances FIUs will choose not to pass on information to other FIUs where there is a real concern that human rights abuses will result. We would support FIUs retaining discretion as to when they will share information in circumstances such as these.

6. Other issues

6.1. Assessment of implementation

As we stated in our response to the first FATF consultation, the current mutual evaluations are quite dense and lacking in up to date statistics. It would be useful for our members to more easily assess the anti-money laundering risks of different jurisdictions if FATF were to provide a quick reference table of all jurisdictions who have been mutually evaluated and their compliance ratings.

6.2. Risk based approach in supervision

The Law Society supports supervisors applying a risk-based approach to their supervision roles. The small number of regulated entities being convicted in relation to money laundering offences justifies supervisors generally starting from the position that most of their supervised population are trying to conduct themselves in compliance with the law. Therefore they should focus their monitoring activities on the higher risk regulated entities.

The Law Society would also commend the UK's approach to supervision to FATF. The UK has allocated supervisory responsibility, especially for the designated non financial business sectors, to the relevant professional bodies. This has resulted in more tailored support and education being provided to regulated entities to assist them with compliance and a higher level of actual monitoring of firms that would have been possible for a single governmental supervisory authority.

6.3. Politically exposed persons

The Law Society has reviewed our representations on the issue of politically exposed persons (PEPs) in light of the recent FATF typology on money laundering the proceeds of corruption issued in June 2011.¹² We stand by our views that the enhanced due diligence should only be required for PEPs on a risk-based approach.

The case examples provided in the typology were quite dated, with some occurring prior to PEPs being covered by the FATF standards and others occurring even before the FATF standards were in existence.

In all of the cases provided, standard due diligence would have made it clear that the regulated entity was acting for a politically exposed person who was accessing more significant funding than they were legally entitled to access.

The clear issue highlighted in each case was not a lack of due diligence. Rather it was either individuals who did not care about the legal consequences and continued to help launder the funds, or regulated entities who decided to take a risk-based approach to whether they would keep the client and / or the account.

FATF needs to send a clear message that where, as a regulated entity, you have a client who is a PEP who is clearly stripping assets from their countries, you

¹² http://www.fatf-gafi.org/document/63/0,3746,en_32250379_32237202_48472703_1_1_1_1,00.html

need to make a report and cease acting¹³ and/or close the account. Supervisors and law enforcement need to be clear that they will take enforcement action where this does not occur.

¹³ Unless of course you are an independent legal professional providing litigation or legal advice services, as even PEPs accused of corruption have the right to legal advice and representation.