

ANTI-MONEY LAUNDERING AND COUNTER-TERRORIST FINANCING - UPDATES FOR LEGAL PRACTITIONERS

Understanding AML risks in the legal sector

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Why Legal Professionals are Targeted by Money Launderers?

1 LEGITIMACY

- Money launderers aim to legitimize their illicit gains through the use of legal services
- Lawyers provide a veneer of legitimacy that helps obscure the true origins of funds
- By associating with lawyers, criminals can create a façade of lawful activity

2 USE OF CLIENT MONEY ACCOUNT

- Money launderers often exploit legal practices and client accounts to their advantage by transferring funds in and out of these accounts making the transaction look legitimate - funds are shown as originating from the regulated law firm
- Lawyers have access to "clean" bank accounts, as banks often view pooled or omnibus client money accounts as requiring less scrutiny in terms of monitoring, and see only the name of the law firm, not the client

3 USE OF COMPLEX STRUCTURES

- Money laundering often involves use of complex financial transactions and corporate structures that are then used to transfer illicit funds and hide both their source and the ultimate beneficial owner
- Lawyers possess the expertise to create these structures, such as trusts and complex corporate structures

4 CONFIDENTIAL CLOAK

- Money launderers mistakenly believe that solicitor-client privilege offers them shield against scrutiny. This misconception may lead them to involve legal professionals in their schemes, assuming that their activities will remain confidential and undetected

Key Money Laundering Risks in the Legal Sector



Key Areas of Legal Practice exposed to Money Laundering and Terrorist Financing – Service Risk

1 BUYING AND SELLING OF REAL ESTATE, COMPANY, BUSINESS, SECURITIES, OR ASSETS

- Property is an attractive asset for criminals because of the large amounts of money that can be laundered through a single transaction, and the fact that property will tend to appreciate, can be used to generate rental income or can be lived in
- Conveyancing attracts high risk clients: PEPs, overseas companies linked to the proceeds of crime, including high profile fraud and international corruption

2 TRUST/COMPANY FORMATION AND MANGEMENT SERVICES

- Trusts or corporate structures can facilitate anonymity, help disguise the source or destination of money or assets and can be used to hide the true beneficial owner
- Shell companies can pose higher risk if set up for no apparent economic reason to disguise beneficial ownership

3 TAX ADVICE

- When offering certain types of advice and services, there is a higher risk that legal professionals may come into contact with the proceeds of crime most notably, when offering advice to a client who is attempting to evade or avoid tax

4 MANAGING CLIENT MONEY, BANK ACCOUNTS, SECURITIES OR OTHER ASSETS, ESCROW SERVICES

- The risks include the possibility of dealing with illicit funds through client accounts, concealing the true ownership of assets, and executing complex layers of transactions to obscure the trail of illegal money

5 LITIGATION

- While litigation falls outside the money laundering regulations, there is still a risk of money laundering offenses if the litigation is not genuine (known as sham litigation)
- Common Methods of Sham Litigation:
 - Criminals agree to sue each other, using damage payments to launder funds
 - Criminals create sham companies to bring cases against themselves
 - Criminals engage a law firm for a dispute, send upfront payment, then request a refund minus a small fee, resulting in laundered money
 - Criminals initiate a debt recovery matter, and the debtor settles by sending money to the law firm, which is then forwarded to the criminal after deducting fees

Client Risk - Who are the risky clients?

Politically exposed persons (“PEPs”), their family members and close associates

- Higher risk of corruption and bribery due to the position of power and influence
- Access to public funds
- Access to vast networks and resources which can be exploited to facilitate financial transactions

Clients in higher-risk sectors

- Certain sectors have been identified as presenting an elevated risk of corruption, illegitimate source of funding or could be subject to international sanctions. Examples include:
 - Construction work
 - High value good businesses (dealers/traders in precious metals, gems, jewelry, or art & antiques)
 - Entertainment – Casinos, Karaoke, Night clubs, Pubs, Gambling operators
 - Crypto-asset wallet providers and exchanges
 - Unregulated charities (particularly those operating in higher risk jurisdictions)

Clients with complex ownership structures without economic purpose

- Issue with identification of true beneficial owner
- Difficult to trace the origins of fund(s)

Clients with cash-intensive businesses

- For example: Restaurants, Bars, Car dealers, Massage parlor, Money change, Taxi drivers
- Misused by money launders to legitimise the illicit proceeds
- Unexplained large cash balance – can the client prove with evidence where did the money come from?

Clients with Sanctions exposure or ties to terrorist organisations/individuals

- Clients with exposure/connection to individuals, entities, or organizations listed by governments or international body due to their involvement in terrorist-related activities or non-compliance with laws and regulations such as those listed on the United Nations Sanctions Lists

Geographic (Country) Risk – Higher-Risk Jurisdictions

□ What is Geographic Risk?

- Geographic risk refers to countries or geographic areas where:
 - (a) legal services are delivered
 - (b) clients reside
 - (c) beneficial owner(s) or counterparties reside
 - (d) the origins and destination of the funds



□ What are the Higher-Risk Jurisdictions?

- Jurisdictions/Countries that face significant threats of money laundering often due to their proximity to conflict areas and weak AML/CTF regulations
- Jurisdictions/Countries exposed to a high level of corruption, lack transparency in their financial systems, and do not implement AML regulations, making the country more vulnerable to money laundering risks

How to Identify Higher-Risk Jurisdictions?

FATF High-Risk Jurisdictions Subject to a Call for Action (Blacklist)

- List of countries deemed inadequate in AML/CFT according to FATF's international standards
- Countries on the **FATF's Black List** can be subject to economic sanctions by FATF member nations
- These countries are: **Iran, North Korea and Myanmar** (as of October 2024)
- FATF recommends to avoid undertake business activities with those countries

Basel AML Index

- The **Basel AML Index** measures the risk of money laundering and terrorist financing in jurisdictions across various jurisdictions worldwide
- An independent source that can help to understand a country's quality of AML/CTF framework, exposure to bribery and corruption and financial/public transparency

FATF Jurisdictions Under Increased Monitoring (Grey List)

- List of countries identified by FATF as having strategic deficiencies in their AML/CTF regimes
- Those countries are subject to increased monitoring by the FATF
- As of October 2024, there are **21 countries** listed on the **FATF's Grey List**
- Legal practices must apply enhanced due diligence when dealing with clients from countries listed on the FATF's Grey List

Corruption Perception Index

- An annual ranking published by **Transparency International** that measures the perceived levels of public sector corruption in countries around the world

Key AML Risks for Legal Professionals - Transaction Risk

- ❑ Transaction risk refers to the potential risks associated with the nature and complexity of a transaction
- ❑ Lawyers must always understand the three key elements: (a) purpose; (b) parties involved; and (c) source of funds for the transaction

Transactions involving cash

- Cash transactions often lack records that electronic transactions have, making it harder to track and verify the legitimacy of the funds
- Cash can be easily transported across borders, bypassing financial institutions and regulatory oversight

Cross-Border Transactions

- Could involve High-risk jurisdictions
- Sanctions evasion - increased exposure to designated parties listed on the Sanctions Lists
- Increased exposure to Terrorist Financing involving the cross-border movement of illicit funds to support terrorist activities, making it challenging to identify and intercept these covert flows

Unusually Large or High Value Transactions

- Clients may seek large or high value transactions to launder as much money as possible in one go, making it harder to trace the origin and destination of the funds.
- Clients may seek to make a number of linked transactions (breaking down large transaction) into smaller (known as “structuring”) to avoid detection

Transactions without apparent economic reasons

- Transactions that do not align with the information gathered as part of the client due diligence or deviate from their normal transaction patterns without a valid explanation
- Transactions or services that fall outside the firm's usual offerings that client is asking for - this may be deemed suspicious if no clear rationale is provided

Key AML Risks for Legal Professionals - Delivery Channel Risk



- Delivery channel risk refers to the mode in which legal services are delivered to clients
- The AML risks increase when lawyers cannot meet a client face-to-face to verify a client's identity before accepting instructions

Non-face-to-face interaction with a client (such as video calls, emails, virtual meetings)

- Difficult to verify client's identity
- Difficult to verify the authenticity of the client information
- Increase potential for fraud
- Harder to detect suspicious client behaviors without face-to-face interaction

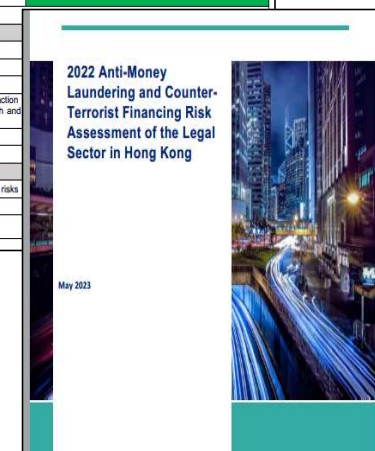
Instructions taken from agents or intermediaries

- Less direct oversight and control over client due diligence and transactions handled by intermediaries, increasing the risk of non-compliance with AML regulations
- Transactions involving intermediaries often increases complexity and ambiguity, which can be exploited to conceal illicit activities

AML/CTF Risk Assessment of the Legal Sector 2023

- ❑ Assesses inherent risks specific to the legal profession in Hong Kong
- ❑ Helps to understand which areas of legal practice and which other ML/TF risks can make a firm vulnerable to ML/TF threats
- ❑ Should be factored in the firm's-wide risk assessment and when assessing ML/TF risks applicable to a client

Key ML/TF Risks	Inherent Risk Rating
Geographical Risk Factors	
Clients/matters with links to higher risk jurisdictions	Yellow
Client Risk Factors	
Politically Exposed Persons (PEPs)	Red
Familiar Clients	Yellow
Situations where underlying client identity is obscured	Yellow
Cash intensive/risky sectors or businesses	Not assessed as part of the AML Review, firms should make an independent assessment of the risk.
Products and Services Risk Factors	
Conveyancing	Red
Trust & Company Service Provision	Yellow
Tax advice	Green
Sham Litigations	Green
Delivery Channels Risk Factors	
Non-Face-to Face Delivery Channels	
Transaction Risk Factors	
(i) Size/value/complexity of the transaction	
(ii) Methods of payment: use of cash and cheques	
Third-Party Payments	
Emerging/Other Risks	
Pandemic and Post Pandemic-related risks	
Internal Fraud	
Cryptocurrencies	



Available for legal professionals in the **Member's Zone** under the tab **“Support for Members / Law Firms”**, **“AML/CTF Sectoral Risk Assessment”**
<https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AMLCTF-Sectoral-Risk-Assessment>

Examples of Suspicious Indicators

Unusual Payment Practices

- Cash Transactions: Use of cash for large property purchases, especially when clients appear unable to afford such payments.
- Third-Party Payments: Payments made via third-party cheques or transfers with discrepancies among the account holder, signatory, and investor.
- Large Sums in Client Accounts: Holding significant amounts of cash in client accounts with no clear purpose or instructions.

Inconsistent Client Behavior

- Lack of Clear Purpose: Clients with no discernible reason for using the firm's services, particularly when similar services are available in their home country.
- Secretive Clients: Clients who prefer non-face-to-face interactions or are evasive about their identity and intentions.
- Suspect Personalities: Individuals known or suspected to be involved in criminal activities or connected to known criminals.

High-Risk Jurisdictions and Transactions

- Clients from FATF grey and black list jurisdictions: Involvement of clients or parties from these higher risk countries raises red flags.
- Foreign Assets: Transactions involving assets in foreign jurisdictions that may be lawful elsewhere but illegal in Hong Kong.

Unexplained Source of Funds

- Unknown Funding Sources: Receipt of funds from unknown sources, especially large cash payments that pose significant money laundering risks.
- Unrelated Party Funding: Funds provided by individuals with no apparent relationship to the property buyer or transaction.

U-Turn and Structuring Transactions

- "U-Turn" Transactions: Funds or assets transferred between parties and then returned to the original party without legitimate reasons can indicate money laundering schemes.
- Structuring or Smurfing: Multiple smaller transactions conducted instead of a single larger transaction to evade detection by authorities.

Misuse of Solicitor's Client Accounts

- Banking Purposes: Use of solicitor's client accounts solely for banking transactions can facilitate money laundering activities.
- Identity Verification Failures: Opening client accounts without verifying the identity of the client or the source of funding increases susceptibility to illicit activities.

Use of Nominee Structures

- Nominee Companies: Use of nominee companies to hold property titles without reasonable explanations may indicate suspicious activity.
- Trust Arrangements: Establishment of trusts or power of attorney arrangements without clear justification raises concerns about the legitimacy of the assets.

Common Types of STRs Raised by Legal Professionals in Hong Kong



- Property purchase without mortgage
- Large amount of cash deposits and withdrawals
- Report fraud cases on behalf of the client or the client's counter-party
- Change of trusteeship which did not make sense
- Clients incorporating a number of companies (suspected to be shell) in a short period of time

How To Detect AML Red Flags



Ask yourself those question:

- **WHO** is the client?
- **WHAT** is the nature/purpose of the transaction?
- **WHERE** does the money come from and where is it going?
- **WHY** is my firm engaged?

Does it make sense? Is there proper documentation in place?

Exploitation of Legal Services – Hong Kong case



Case Study (3):

Dealing with clients know to the firm/friends – be cautious!

- Mr Wu, partner at the HK law firm was sentenced to **six years in prison** for facilitating transactions that were proceeds of crime. He was acquitted at the later stage by the Court of Appeal.
- Mr Jack Chen (director and joint-chairman of HK listed company Natural Dairy (NZ) Holdings Limited (“ND”)) was an established client and a friend of Mr Wu. Mr Wu assisted ND to acquire an interest in dairy farms in New Zealand through companies controlled by May Wang (“Wang”).
- Wang received part payment of the purchase price from ND (NZ\$25 million), and then remitted NZ\$13,7 (HKD73.7) million into Goldmate Securities (USA) Limited (“Goldmate”), a company controlled by Chen.
- Chen remitted HKD68.95 million of the HKD73.7 million to the client account of the law firm where Mr Wu was a partner. **Chen told Mr Wu that the money come from investors** who Chen represented. The investors were said to be about to buy Chen’s wife’s interest of in Wang’s companies.
- This amount was described by the law firm in its records as “Costs and Distributions on Account”.
- The next day, Wu signed a cheque for HKD68.95 million drawn on the client account and made out in favour of Chen’s wife.
- Subsequently Chen was alleged to have accepted an advantage from Wang for procuring the Company to acquire Wang’s companies in New Zealand.
- **Wu did not ascertain any information about the investors on whose behalf Chen told him the deposit had been made or sought evidence of source of funds.**

<https://vlex.hk/vid/hksar-v-wu-wing-862483443>




Insights:

- ❖ The prosecution argued that Mr Wu **failed to conduct adequate due diligence on the funds he handled**, which included HK\$68.95 million transferred to his client account from Chen. These funds were believed to be connected to fraudulent activities, including potential bribery related to the acquisition deal
- ❖ During the retrial, Mr Wu's defense successfully contended that he was merely following Chen's instructions and **had no reasonable grounds to suspect the funds were illicit**. Additionally, the defense presented evidence showing that Mr Wu had conducted some level of due diligence regarding the transactions, which contributed to the argument that he was not willfully blind to the potential for money laundering
- ❖ **Long-standing client relationships do not guarantee AML compliance**
Complacency or over-reliance on existing relationships can prevent lawyers from spotting red flags and conducting necessary due diligence
- ❖ **Client Due Diligence is important!** Conducting thorough checks on clients, their source of funds, and the purpose of transactions can help lawyers identify anomalies and avoid inadvertent involvement in money laundering schemes

Effective Client Due Diligence


What should I do to spot risky clients or transactions?




- Identify and verify a client's identity – information confirming a client's identity




- Obtain information on the nature and intended purpose of the transaction




- Obtain information on the business relationship between the client and other interested parties to the transaction



- Verify and understand the Source of Funds for the transaction and the Source of Wealth for High-risk clients



- Screen client's name against the Sanctions, PEP and Terrorist Lists at appointment and on an ongoing basis (for companies that should include directors, beneficial owners/controlling person and person giving instructions)



- Apply risk-based approach to determine the level of information required (Enhanced CDD / Simplified CDD)

Law Society of Hong Kong – AML support for Lawyers



AML Toolkit

CLIENT DUE DILIGENCE FORM (CDD FORM) LEGAL PERSONS 2022

Alternative Processes to Verify a Client's Identity
Guideline for Legal Practitioners

Anti-Money Laundering
What you need to know as a Client?

2022 Anti-Money Laundering and Counter-Terrorist Financing Risk Assessment of the Legal Sector in Hong Kong

Conveyancing and Related Transactions for Law Firms

May 2023

Experience sharing session
– Lawyer's Perspective

Michael Lintern-Smith
Chairman, Anti-Money Laundering Committee
Past-President, the Law Society of Hong Kong

22 June 2021

THE LAW SOCIETY OF HONG KONG 115th ANNIVERSARY

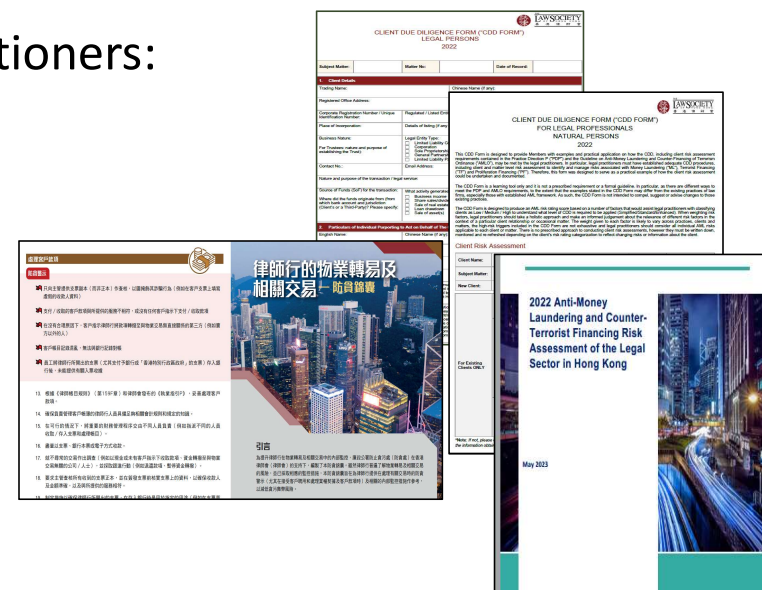
AML WORKSHOP

Patricia Egoz, AML Executive
December 2022

AML Toolkit - Supporting Materials for Legal Practitioners

AML Toolkit – Supporting materials for legal practitioners:

- Guide on Alternative Processes to Verify a Client’s Identity
- AML Policies and Procedures Template
- Sample Client Due Diligence Forms
- AML Leaflet for Clients
- AML FAQ
- Best Practice Leaflet for Conveyancing Transactions
- AML/CTF Risk Assessment of the Legal Sector 2023



AML guidance materials can be found on the LSHK webpage: <https://www.hklawsoc.org.hk/en/Support-Members/Professional-Support/AML/AML-Resources> under the “Tools and Templates” tab



Questions?



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