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**COMMISSION STAFF WORKING DOCUMENT**

**The application to the legal profession of Directive 91/308/EEC on the prevention of the use of the financial system for the purpose of money laundering**

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## 1. INTRODUCTION

1. The confidence in and the stability of the financial system as a whole could be seriously jeopardised by the efforts of criminals and their associates to disguise the origin of criminal proceeds. In the fight against this phenomenon, and as a complement to the traditional criminal law approach, the European Community considered it appropriate to adopt a preventative policy via the financial system. This preventative policy was initiated in 1991 with the adoption of Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering<sup>1</sup>. The aim of the rules was to encourage the financial sector to identify their customers, to report suspicions of money laundering to the authorities and to establish appropriate internal procedures to guard against money laundering. This directive had, however, a limited scope of application in so far as it concentrated solely on the laundering of proceeds from specific criminal activities (e.g. drugs trafficking).
2. The legal profession and the anti-money laundering rules. In 2001, Directive 2001/97/EC<sup>2</sup> (hereinafter the "Second Directive") amended the preventative regime established by the 1991 directive. The goal was to adapt to the new money laundering methods and techniques that had appeared in the preceding years. Experience at international level showed the increased use of legal persons to disguise the true ownership and control of illegal proceeds and an increase use of professionals to provide advice and assistance in laundering criminal funds. As a result, this modification substantially enlarged the material and personal scope of the rules: not only was the fight against money laundering no longer limited to the proceeds of drugs trafficking, but also professionals other than financial institutions become subject to the anti-money laundering rules in the European Community for the first time. In the case of legal professionals, the objective of the new rules was to avoid those professionals becoming an instrument of the money launderers that abuse or misuse their legal services<sup>3</sup>.

Hereinafter, for the purposes of this document, all references to the "Directive" shall be understood to Directive 91/308/EEC as amended by Directive 2001/97/EC<sup>4</sup>. Although this Directive has been formally repealed by a new directive<sup>5</sup>, this new Directive (so-called "Third Directive") builds on the previous one and does not

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<sup>1</sup> OJ L 166, 28.6.1991, p.77.

<sup>2</sup> Directive 2001/97/EC of 4 December 2001, amending the first anti-money laundering Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purpose of money laundering, OJ L 344/76 of 28.12.2001. Text available at: [http://europa.eu.int/smartapi/cgi/sga\\_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32001L0097&model=guichett](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=en&numdoc=32001L0097&model=guichett)

<sup>3</sup> It should be noted in this context that criminal legislation prohibits and sanctions money laundering. Legal professionals are, as any other person, liable for any infringement (e.g. participating or assisting in the commission of money laundering activities) to the criminal code.

<sup>4</sup> For a consolidated version of the first directive (as amended by the second Directive), see: <http://europa.eu.int/eur-lex/lex/LexUriServ/site/en/consleg/1991/L/01991L0308-20011228-en.pdf>

<sup>5</sup> Directive 2005/60/EC of the European Parliament and of the Council of 26 October 2005 on the prevention of the use of the financial system for the purpose of money laundering and terrorist financing, OJ L 309, 25.11.2005.

substantially change the nature of the obligations of the legal profession in relation to the prevention of money laundering.

3. The examination on the treatment of the legal profession by the Directive. Given the novelty of the anti-money laundering obligations for the legal profession as well as the special circumstances surrounding this profession, in particular the relationship of trust between lawyer and client, the Second Directive required the Commission to carry out a "particular examination" of aspects relating to "the specific treatment of lawyers and other independent legal professionals" pursuant to that directive. This document aims at replying to the call contained in the Second Directive, which the Commission committed to respect during the adoption of the Third Directive<sup>6</sup>.
4. The examination process. The Commission services undertook this examination in the autumn of 2005, once a critical mass of Member States having transposed the new obligations brought by the Second Directive had been reached (see section 2, below). A wide information-gathering exercise involving the major stakeholders was launched. Both public authorities and the legal profession received standard questionnaires on the application of the Directive<sup>7</sup>. Additionally, individual lawyers and notaries were invited to give their views on the anti-money laundering directive by responding to an on-line questionnaire in several languages<sup>8</sup>. In addition to the questionnaires, meetings were held with some European and international associations on this issue. The Commission services also used other available information in the preparation of this document, including in particular reports on the mutual evaluations on the implementation by some Member States of the so-called 40 Recommendations of the FATF<sup>9</sup> conducted either by the International Monetary Fund, the FATF itself or Moneyval<sup>10</sup>.

The response to the information-gathering exercise has been somewhat disappointing. While 17 national organisations representing notaries replied to the questionnaire (out of 19 possible replies, as notaries as such do not exist in all countries), the response from lawyers professional organisations was significantly lower: only national organisations from 7 Member States provided a reply to the questionnaire, and some other national organisations limited their reply to statements on the role that lawyers should have in the fight against money laundering. The response from individual practitioners was not high either: only around 50 replies (out of thousands of practitioners), more than half of them from the United Kingdom and Spain. This low response rate may be partially explained by the recent application of most national laws implementing the Directive (see section 2, below). In addition to the difficulties in receiving quantitative replies to the questionnaires, obtaining qualitative and reliable information on some of the aspects covered by the

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<sup>6</sup> A parallel examination has been conducted concerning the application of this Directive in relation to the identification of clients in non-face to face transactions and possible implications for electronic commerce. The results of this other examination are presented in a different working document.

<sup>7</sup> The following organisations were contacted: Conference of Notaries of the European Union (CNUE), the European Federation of Bar Associations (FBE), the Council of Bar Associations and Law Societies of Europe (CCBE), the International Bar Association (IBA), Association of European Lawyers (AEA); Union of European Lawyers (UAE) and Society of Trust and Estate Practitioners (STEP). Where relevant, the organisations were invited to disseminate the questionnaires to their national affiliates.

<sup>8</sup> IP/05/1528 of 5 December 2005

<sup>9</sup> Financial Action Task Force. See [www.fatf-gafi.org](http://www.fatf-gafi.org)

<sup>10</sup> See [www.coe.int/moneyval](http://www.coe.int/moneyval)

examination was also difficult and, in some cases, was not possible. This will be reflected in the relevant parts of the report.

5. This document presents the results of this examination regarding:

- (section 2) the transposition of the Directive and the scope of the national implementing legislation;
- (section 3) the impact of the Directive on the behaviour of the legal professionals: i.e. when entering into a professional relationship with the client, when identifying suspicious transactions and reporting them; and in relation to their internal organisation to cope with the obligations of the Directive;
- (section 4) the impact of the legislation on the competitive environment of legal professionals;
- (section 5) the effectiveness of the reporting system and the view of the stakeholders as regards the role of the legal professionals in the fight against money laundering.

Finally, some conclusions will be provided in section 6.

## **2. THE IMPLEMENTING LEGISLATION: TRANSPOSITION AND SCOPE**

6. This section briefly presents the process leading to the transposition into national law, from the formal perspective, of the obligations set out in the Directive in relation to the legal profession (subsection 2.1). It also examines the transposition of the personal scope of application of the Directive, and the extent to which Member States have extended it (subsection 2.2.).

### **2.1. The transposition process**

7. The Second Directive required Member States to align their national legislation to its requirements by 15 June 2003 at the latest. However, the transposition of the Second Directive did not take place within the foreseen deadline. In some cases, the delay affected only the legal profession.

Only four (Denmark, Germany, Finland and the Netherlands) out of the then 15 Member States enacted national transposition measures within the given time limit, while Ireland and Spain did so shortly afterwards. Following the opening of infringement proceedings, Austria, Belgium and the United Kingdom notified the Commission of their implementation by the end of 2003. At the beginning of 2004, the Commission sent formal requests to Italy, Portugal, Greece, Sweden, Luxembourg and France to implement the directive<sup>11</sup>. Concerning the 10 Member States that joined the Community in May 2004, most either had legislation in place by that time (Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovak Republic, Slovenia) or put it in place shortly afterwards (Czech Republic in

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<sup>11</sup> IP/04/180 of 9 February 2004.

September 2004). By mid-2005, the main legislation was (formally)<sup>12</sup> in place in almost all Member States, although as regards the legal profession the practical application of the national rules pursuant to the Directive could not take place in some of them (notably Italy), as some decrees developing the law were missing. Italy finally completed its legislation as regards the legal profession in early 2006. In October 2005, the Commission announced that it would take France and Greece to court for non-communication of the national implementation measures<sup>13</sup>. These proceedings were eventually withdrawn once these Member States communicated the adoption of the relevant national legislation. Greece adopted legislation in December 2005. France did it so in June 2006.

8. This has resulted in few Member States having a sufficiently long experience with the application of anti-money laundering rules to the legal profession. Indeed, in the vast majority of Member States, prior to the adoption of this Directive, legal professionals were not subject before to any anti-money laundering obligations<sup>14</sup>.

## **2.2. The scope of the implementing legislation: lawyers, notaries and others**

9. National implementing legislation follows the Directive closely as far as the personal scope is concerned. The focus of the Directive's preventative system in relation to the independent legal professionals is "activity based": independent legal professionals do not fall within the scope of the Directive in all circumstances, but only when (in the exercise of their professional activities) they carry out certain financial, real estate and corporate related activities<sup>15</sup>. For any other activity, lawyers do not fall within the scope of the Directive, unless Member States extend the Directive requirements: this has rarely been done<sup>16</sup>.

However, the drafting technique adopted in the directive, to ensure consistency with the existing legislation, was subjective: e.g. identifying professional categories. This has been followed in national legislation. In a large number of Member States only

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<sup>12</sup> This paragraph intends to provide an overview of the timing of adoption of national measures. It does not judge on the quality of the national transposition measures.

<sup>13</sup> IP/05/1288 of 17 October 2005.

<sup>14</sup> Prior to the adoption of the Directive, legislation of this kind was only applied to all kinds of legal professionals in few Member States, such as in the United Kingdom. However, in some other Member States (Belgium, France or Spain, for instance) notaries were already subject to some anti-money laundering rules involving reporting obligations. Indeed, in most countries, notaries used to at least identify and verify the identity of their clients.

<sup>15</sup> Cf. Article 2a(5) of the Directive: "[...] when they participate, whether (a) by assisting in the planning or execution of transactions for their client concerning the: (i) buying and selling of real property or business entities; (ii) managing of client money, securities or other assets; (iii) opening or management of bank, savings or securities accounts; (iv) organization of contributions necessary for the creation, operation or management of companies; (v) creation, operation or management of trusts, companies or similar structures; (b) or by acting on behalf of and for their client in any financial or real estate transaction."

<sup>16</sup> For instance, in Denmark, independent legal professionals are also subject to the rules when they provide other kind of business assistance; in Poland (only for notaries) when a transaction exceeds a certain amount; in Belgium (only for notaries) for all kind of business, or in the United Kingdom when they provide tax advice. It should be noted that national legislation in some countries may also go beyond the requirements of the Directive in terms of material scope insofar as it covers the financing of terrorism in addition to money laundering, thus anticipating already the implementation of the Third Directive.

lawyers<sup>17</sup> and notaries<sup>18</sup> are within the categories of independent legal professionals subject to the national legislation pursuant to the Directive. Normally lawyers or notaries are subject to the law as individual practitioners, independently of whether they practice alone or within a law firm or similar grouping of professionals. However, in a few countries, law firms are explicitly mentioned as an entity subject to the law.

In some Member States, in addition to lawyers and notaries, other categories of legal professionals are also covered<sup>19</sup>. These regulated professions are often country specific and are not necessarily found in other Member States. This report will therefore focus on lawyers and notaries only.

10. There are competitors to independent legal professionals in the provision of legal or quasi-legal services who remain outside the scope of the Directive. Interventions in real estate or financial transactions may be practiced by other regulated or unregulated professionals, financial institutions or by any duly empowered person in the normal exercise of his civil rights, without the need to be qualified as a lawyer or notary. Even the planning or execution of transactions concerning the creation, operation or management of trusts, companies or similar structures is not a reserved activity for lawyers or notaries. From this perspective, the subjective approach in the Directive may create loopholes in the anti-money laundering preventative system in cases where these services are provided by persons not subject to the Directive. This may also create distortions of competition<sup>20</sup>.
11. Whilst the way in which independent legal professionals are covered by the different national legislation is similar, the extent of their obligations varies in practice from country to country. This different treatment derives from other provisions, such as the definition of criminal activity giving rise to proceeds (e.g. some Member States, such as the United Kingdom, follow an all-crime approach with no *de minimis* rules); the different rules regarding reporting obligations (see below on the role of self-regulatory bodies and the tipping off problem); or the sanctions regime (where some

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<sup>17</sup> To be understood as the professionals referred to in Article 1(2) of Directive 1998/5/EC of the European Parliament and of the Council of 16 February 1998 to facilitate practice of the profession of lawyer on a permanent basis in a Member States other than that in which the qualification was obtained, OJ L77, 14.3.1998, p. 36. It should be noted that in Ireland, barristers are not subject to the national legislation pursuant to the anti-money laundering Directive, only solicitors are. In the United Kingdom, both barristers and solicitors are subject.

<sup>18</sup> The so-called 'Latin' notary profession (sometimes referred to as 'civil law notaries') are independent professionals who advise private parties and draft contracts on their instructions, as well as partake in the issuing of public documents, and fulfil quasi judicial duties. They are appointed by the state, entrusted with public functions and hold a public office. They are not however civil servants and remain independent from the state and economically self-reliant. This profession exists in 19 of the 25 Member States: all except, Cyprus, Denmark, Finland, Ireland, Sweden and United Kingdom.

<sup>19</sup> For instance: judicial distrainers (CZ), persons providing consultancy services (EE), *procuradores* (ES), *huissiers de justice* (BE, FR), *avoués* (FR), *commissaires-priseurs* (FR), *administrateurs judiciaires* (FR), *mandataires liquidateurs* (FR), *sociétés de vente volontaires de meubles aux enchères publiques* (FR), providers of legal services (NL); labour law advisors (IT), *solicitadores* (PT), executors (SK).

<sup>20</sup> The need to cover the whole range of activities consisting in giving advice and assisting in the conduction of corporate businesses, identified as exposed to misuse for money laundering purposes, led the European Community, in line with the FATF Recommendations, to include in the scope of the Third anti-money laundering Directive as well the provision of trust and company services by natural or legal persons. Such activities, although not included among those whose exercise is reserved to legal professionals, are typically carried out also by lawyers, notaries and accountants.

Member States may be stricter, see below). The differences in the implementation of the Directive have related implications for competition in the (mostly cross-border) supply of legal services (see section 4).

### **3. IMPACT OF THE LEGISLATION ON THE BEHAVIOUR OF INDEPENDENT LEGAL PROFESSIONALS**

12. For independent legal professionals (in particular lawyers), the enactment of the Directive has resulted in significant changes in the organisation of their professional activities. The main impact appears to be in relation to 3 issues: (1) the way they enter into a professional relationship with a client; (2) the need to be able to identify suspicious transactions and report about them; and (3) the need to adapt their internal organization to be able to cope with the Directive's obligations<sup>21</sup>. This will be examined in the following three subsections.

#### **3.1. Entering into a professional relationship with a client: the main difficulties**

13. According to the Directive, entering into a professional relationship with a client requires, in particular, upfront identification of this client by means of supporting evidence (which implies a certain verification of his/her/its identity). This subsection examines the main impact of this obligation, as implemented at national level, on the practitioners.

14. Upfront identification of a client<sup>22</sup> is a well established practice for notaries under national law. Notaries, in addition, normally participate in "face-to-face" transactions only, which facilitates the identification process. From this perspective, notaries have not had to substantially alter their behaviour as a result of the application of the Directive. This is not, however, necessarily the case for lawyers. In their case, the compulsory obligation to identify clients, as defined by the Directive and the national legislation, is a relatively new legal obligation. However, the deontological rules in some countries already encouraged lawyers to identify their clients, in particular to avoid conflicts of interest. In any case, this obligation does not appear to present any particular ethical problem for lawyers<sup>23</sup>

15. According to the legal profession, the implementation of the obligation on lawyers to identify the client is not without some practical difficulties (which are not always

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<sup>21</sup> See Article 3(1), (2), (7) and (8) in relation to the identification of clients when entering into a professional relation; Article 6(1) and (2) in relation to the report (in certain circumstances) of any fact that might be an indication of money laundering to the relevant authorities; and Articles 11 and 4 in relation to the establishment of adequate procedures of internal control and communication in order to forestall and prevent operations related to money laundering, and other adequate supporting measures, such as training or record keeping .

<sup>22</sup> However, notaries point out that, in their case, they cannot really refuse clients as they are not in a totally normal contractual relationship as a result of their public official duties.

<sup>23</sup> This was recognised by the Council of the Bars and Law Societies of the European Community as early as in 1997, well before the presentation of the proposal for the second anti-money laundering directive. The CCBE recommended that the deontological codes of the different Bars and Law Societies require the obligation to identify the clients. Voir the « Déclaration de principe du CCBE sur le secret professionnel des avocats et la législation sur le blanchiment d'argent », adopted at the 14/15 November 1997 CCBE Plenary Meeting.

lawyer-specific)<sup>24</sup>. Some of the difficulties apply both at a purely national level and at the cross-border level:

- (i) Choosing the right time for the identification of new clients present difficulties if it turns out only after the first meeting with the new client that the latter seeks to participate in transactions covered by the Directive, in which case lawyers would have to revert to such clients to obtain the necessary documentation. In practice lawyers tend to solve this problem by conducting due diligence in all cases, irrespective of whether the legal service falls under the Directive or not. In this context, it is underlined that prospective clients do not necessarily respond favourably to being asked for identification details (in some countries there is some cultural resistance), are slow to send the required information or provide incorrect documents (e.g. uncertified copies of requested documents), which delays the process and therefore the initiation of the provision of the legal service. As a possible solution, some elements of the legal profession claim that, given their advisory role and the on-going relationship they develop with their clients (contrary to the transaction-based approach prevailing in the financial sector), there is possibly a case for lighter rules on customer due diligence at the initial stages of the relationship. The need for the identification of current clients (who may have had a close and continuous relationship with the professional) has also been put into question.
- (ii) A particular practical difficulty appears when the client is introduced to the law practitioner by other professionals (e.g. tax advisers) to provide legal services to their clients in circumstances where such client will become a client of the lawyer. The second Directive did not provide a reply to this problem. In such circumstances it may be difficult to obtain identification materials directly from such clients. This difficulty also applies to the relationships between barristers and solicitors in the United Kingdom. Even where the "introducer" is also subject to the obligations of the directive, it is not always possible to obtain written confirmation from this professional confirming that he has taken all reasonable steps to identify the client and that he holds the relevant identification papers on file (i.e. where the other designated body has been acting for the client prior to the introduction of the anti-money laundering regime). This difficulty also applies in the case of cross-border referrals, even within the same law firm. In this context, part of the legal profession hopes that these difficulties could be overcome through the transposition by Member States of Article 14 (and subsequent) of the Third Anti-Money Laundering Directive.

**Box n° 1 – Example of difficulties relating to cross-border referrals within the same law firm**

Law firm A in country B has had its national central bank as a client for many years. In the absence of grandfathering rights or a list of low risk bodies exempted from identification requirements, Law firm A's office in country C was compelled by its own local regulations to take all the necessary steps to verify the identity of the national central bank of country B. Given the usual long-standing relationships lawyers have with their clients, such a requirement leads to acute embarrassment for members of the legal profession.

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<sup>24</sup> Around half of the (few) respondents to the on-line consultation declared having faced difficulties in the application of this obligation.

- (iii) Verifying the identity of beneficial owners (although strictly speaking not required by the Second Directive) and obtaining information on the origin of the funds are underlined (also by notaries) as not always easy tasks, whether at national or at cross border level (see also the following paragraph). Obtaining information on beneficial owners (in particular trusts) is not always easy, unless the client cooperates, and publicly available information exists. Doing so in a timely manner is difficult in all cases.
- (iv) The impact of identity fraud/theft has been raised in some countries (especially the United Kingdom) as an increasing problem for the identification of the client, leading in some cases to legal practitioners purchasing electronic identity verification systems (although their reliability may be uncertain) in order to fulfil their obligations. Identity fraud/theft, however, is not induced by the Directive rules. On the contrary, the Directive provides an indirect useful tool to fight against this phenomenon.

16. Other practical difficulties are of an almost purely cross-border nature.

- (i) Difficulties (also for notaries) in respect of documentary evidence<sup>25</sup>. The principal issue that practitioners have encountered in dealing with non-resident clients (whether within the EU or from a third Country) is that of determining what constitutes the “relevant documentation” to be provided as a result of the differing national transposition of the Directive. In some cases, the Member State of the practitioner may require certain specific documents to prove the identity of the client, irrespective of whether those documents exist or are routinely available in the client's country of origin. Furthermore, in the case where the client has already been identified in his own country by another practitioner or branch of the law firm, if the type of documents to be produced differs from those of the country of origin of the client, this will imply additional delays for the law firm in the dealings with that client (e.g. if the identification is not complete, many law firms do not allow practitioners to undertake any work or open a file). International law firms claim that the existence of different requirements makes it difficult to have a single pan-European client-acceptance policy and that at the end of the day, the more demanding legislation sets the standard.
- (ii) The difficulties in obtaining documentation also arise in the case where the client is a corporate vehicle from a different country: where there is no trade register, then a lawyer's statement is needed, which implies costs and timing problems<sup>26</sup>. The evidence of existence of the company may merely be a reference to a Chamber of Commerce register, and if a trade register exists, it may not certify the information it provides. In these cases, such documents might not be enough to meet the minimum legal requirements of the Member State of the practitioner. It has been highlighted to the Commission that particular problems arise in the dealings with clients from so-called tax havens. It has been underlined that this problem is likely to become even more important in the light of the new

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<sup>25</sup> According to the few replies to the on-line consultation, around two thirds of the difficulties in this area are related to cross-border issues.

<sup>26</sup> For instance, there is no trade register in the US. Requesting legal opinion from US counsel is very costly and cannot be done on an overnight basis

requirements of the Third Anti-Money Directive in relation to the identification of the beneficial owners. The translation problem has also been underlined.

- (iii) Practitioners also underline that cross-border problems are generated by the different speed in the transposition of the Directive by Member States (i.e. rules being applicable in some countries, but not in others) and also by the lack of level playing field (more severe requirements in some countries than in others). The implementation of the rules in some countries is perceived as being more bureaucratic than in others. The legal profession calls for Member States to take into account cross-border situations when transposing the obligations under the directive into national law, to implement in a timely manner, and for the Commission to monitor this process.

17. Although the identification of the client is straightforward in the vast majority of cases, practical difficulties of this kind, when they arise, are considered by the legal profession as a waste of energy and goodwill, and may lead to a focus on formalistic procedures (also because of fear of sanctions) or a refusal of service, rather than to taking important steps to forestall criminal access to the financial system.

### **3.2. Identifying suspicious transactions and reporting about them**

18. The obligation to identify transactions suspected of being related to money laundering and reporting them to the authorities constitutes the major innovation resulting from the application of the Directive as regards the legal profession. In the first place, this obligation affects the relationship between the lawyer and the client. The changes to this relationship will be briefly described in subsection 3.2.1. Secondly, the reporting obligation has created in some cases a new role in the reporting process for the self-regulatory bodies, to which lawyers and notaries belong. This new role and the consequences that it entails, notably the duty to cooperate with the public authorities in the reporting process, are examined in subsection 3.2.2. The difficulties in the application of the reporting obligation will be examined in section 5 (effectiveness of the reporting process).

#### *3.2.1. The reporting obligation and the relationship with the client*

19. The reporting obligation is the most controversial element of the Directive, in particular from the lawyers' perspective, as it has an important impact in the relationship between the legal professional and his/her client. Lawyers (and also notaries) are no longer "safe harbours" for clients as the information they transmit to the legal professional in the context of their professional relationship may be disclosed to the public authorities in certain circumstances. This is a radical change to the principle of confidentiality that the legal profession has traditionally observed. This breach of confidentiality has a certain impact on the relationship of trust between legal professionals and their clients. Indeed, many legal professionals feel obliged to inform their clients in their first meeting or prospective clients in their privacy statements about this reporting obligation.
20. The reporting obligation is, however, not an absolute one. All Member States have opted for the flexibility provided in the Directive to exempt lawyers from the

reporting obligation in the situations subject to legal privilege in relation to litigation (as defined in the Directive)<sup>27</sup>. In this way, the core of the legal profession is still safeguarded from intrusion from the authorities<sup>28</sup>. The legal privilege exemption is also extended to notaries in most cases, at least partially (i.e. for some parts of their activity), but not in all Member States, as the activity related to litigation may not be conducted by notaries in those cases.

The legal privilege is normally regulated by law or regulation (and in some cases it is directly guaranteed in the national constitutions), as it is considered part of the fundamental freedoms that citizens enjoy<sup>29</sup>. In some countries, specific legislation on professional secrecy has been developed. The legal privilege exception for the purposes of the anti-money laundering legislation is normally regulated either directly by that legislation (e.g. providing that its obligations do not apply in that particular case) or through other means (e.g. a provision in the criminal code indicating that non-respect of professional secrecy would qualify as a criminal offence), or both. In some cases this legislation is supplemented by ethical standards prepared by the professionals. In common law countries, case law appears to be very important in defining the boundaries of the legal privilege<sup>30</sup>, and indeed, one country (Ireland) seems to rely exclusively on case law and ethical standards.

21. In spite of the legal privilege exemption that waives the obligation to report in certain specific circumstances, lawyers (more than notaries) believe that this obligation is disproportionate. Since the process leading to the adoption of Directive 2001/97/EC began, they have repeatedly expressed the view that the reporting obligation runs contrary to the essence of the profession and presents ethical problems. Indeed, they consider that the reporting obligation is in conflict with the fundamental rights of the EU citizens to consult a lawyer in full confidentiality, without the lawyer reporting on them to government authorities<sup>31</sup>. They consider that this has a negative impact on the citizen's access to justice. As a result, they are of the view that the reporting obligation should be removed (see also section 5.5).

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<sup>27</sup> E.g. with regard to information they receive from or obtain on one of their clients, in the course of ascertaining the legal position for their client or performing their task of defending or representing that client in, or concerning judicial proceedings, including advice on institution or avoiding proceedings (most of the Member States seem to directly transpose the language of the Directive).

The legal privilege exemption normally extends to the communication between client and legal professional in the circumstances foreseen in the Directive, but cannot cover the communications done for the purposes of committing a prescribed offence or if keeping the secrecy would result in making the independent legal professional an accessory/accomplice of the client under criminal law. It does not apply either if the legal professional knows that the client is deliberately using the legal advice for the purposes of money laundering.

<sup>28</sup> It is noted that for many lawyers, litigation is not part of their main activity.

<sup>29</sup> In some countries the client can free the independent legal professional in part or completely from his confidentiality obligation. In other countries, however, keeping the professional secrecy is a public order obligation.

<sup>30</sup> Indeed, in the United Kingdom a recent case (*Bowman v Fels*, 2005 EWCA Civ 226) clarified the application of the legal privilege in relation to the money laundering offences in the law, which was ambiguous on this issue.

<sup>31</sup> For instance, in February 2005, the European Bar Presidents, on the occasion of the 33<sup>rd</sup> Conference of Presidents of the Bars and Law Societies signed an open letter to the European Commission, the European Parliament and the Council of Ministers. The Council of Bars and Law Societies of Europe (CCBE) has also publicly expressed this view several times.

In this context, the Belgian and the Polish Bar Associations have both instituted legal challenges on constitutional grounds before their respective national jurisdictions. The Belgian Constitutional Court recently filed a request for a preliminary ruling with the European Court of Justice (case C-305/05) on the compatibility of directive 2001/97/EC with Article 6 of the Convention for the Protection of Human Rights and Fundamental Freedoms, and, as a consequence, Article 6(2) of the Treaty on European Union. The European Court of Justice has not yet adopted a decision in this case.

Moreover, a Petition was presented before the European Parliament in 2003 in connection with the Directive 2001/97/EC<sup>32</sup>. This petition was declared admissible on 12 January 2004, but no formal position on it has been taken by the Parliament<sup>33</sup>.

3.2.2. *The channels for reporting: the role of the self-regulatory bodies and of the authorities*

22. The reporting obligation has also resulted in important changes for the role of some professional associations (so-called self-regulatory bodies). The self-regulatory bodies, whose membership is compulsory for the independent practitioners have, in some Member States, been given a role to play in the reporting system by national law<sup>34</sup>. These bodies, instead of the financial intelligence units (FIU), have been appointed as the first authority to be informed by practitioners of facts that might be an indication of money laundering. This appointment has been either for both notaries and lawyers (as in the Czech Republic, Germany, Hungary, Poland<sup>35</sup>), only for lawyers (Belgium, Denmark, France, Lithuania, Luxembourg, Portugal<sup>36</sup>) or only for notaries (Spain<sup>37</sup>).

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<sup>32</sup> Petition 693/2003 by Paul-Albert Iweins (French), on behalf of the Paris Bar, the National Bar Council and the Conference of Chairmen of the Bar, bearing 2 signatures, on new Community legislation on the prevention of the use of the financial system for the purpose of money laundering. The petitioner objects to this Directive, arguing that it contradicts the case law recently established by the Court of Justice and the European Convention for the Protection of Human Rights. Were it put into practice, the directive would undermine the relationship between a lawyer and his client, effectively requiring the lawyer to become an informer and to act on behalf of the State.

<sup>33</sup> The Commission provided a written contribution to the Petitions Committee on 19 May 2004. In its meeting of 17 January 2005, the Petitions Committee left the petition open, waiting for the achievement of the co-decision procedure leading to the adoption of the 3rd Directive. Since then, this Committee has not taken a position on the petition. Nevertheless, in its report on the proposal for a 3rd Directive (draftsperson, Ms. Sbarbati) adopted on 27 January 2005, this Committee, further to the presentation of draft amendments to the text, requested the withdrawal of the proposal for a 3rd Directive and the preparation of the examination on the application of the 2nd Directive.

<sup>34</sup> This is a faculty provided for in Article 6(3) of the Directive, but not an obligation.

<sup>35</sup> Czech Republic: the Czech Bar Association ([www.cak.cz](http://www.cak.cz)); the Civil Law Notaries Chamber. Germany: for lawyers, the regional councils of bars, for notaries, the regional chambers of notaries. In addition, there is a Federal Council of Bars and a Federal Chamber of Notaries. Hungary: the regional bar associations and the regional chambers of notaries. Poland: there is a self-regulatory body for lawyers and another one for notaries. Both are divided into regional bodies.

<sup>36</sup> Belgium: the president ("bâtonnier de l'ordre") of the regional bar to which the lawyer belongs. Denmark: Danish Bar and Law Society. France: for lawyers, the president ("bâtonnier de l'ordre") of the regional bar to which the lawyer belongs, for "avoués", the president of the regional chamber ("compagnie") to which the "avoué" belongs, for the lawyers admitted at the "Conseil d'État" and the "Cour de Cassation", the president of the bar grouping this kind of lawyers. In addition, there is a national bar council and a national chamber of "avoués". Lithuania: Lithuanian Bar Association.

Nevertheless, in the majority of Member States independent legal professionals should report directly to the public authorities (Austria, Cyprus<sup>38</sup>, Estonia, Greece, Ireland, Italy, Latvia, Malta, the Netherlands, the Slovak Republic, Slovenia, Sweden and the United Kingdom).

**Box n°2 – The self-regulatory body of the Spanish notaries**

The case of notaries in Spain presents many particularities. Since December 2005, an *ad hoc* body within the self-regulatory body has been created by legislation. The so-called "Centralised Body for the Prevention of Money Laundering for Notaries" (OCP<sup>39</sup>) is composed of two units: (i) the analysis and reporting unit and (ii) the procedures and training unit. The task of the first unit is to analyse transactions captured from a unified database (in which the details of all transactions involving Spanish notaries are recorded) or sent directly by the notaries and to determine those which are to be sent to the FIU or the competent authority. The second unit is charged with the duty to elaborate the procedures to fulfil the range of obligations by a notary and assist him/her in understanding the regime, provide them with examples of suspicious transactions, risk factors and adequate training. The OCP's methodology is based on: (i) its technological capability to obtain information from the integrated database (unified index or *Índice Único Informatizado*) on risk transactions and to raise red flags whenever these risk transactions take place in front of one or more Notaries<sup>40</sup>; (ii) the involvement of the notaries in reporting immediately to the OCP those transactions featuring several risk parameters before or immediately after the intervention, so that it can be analysed on a urgent basis and eventually delivered to the FIU or the competent Authority; and (iii) the capability of the OCP to interact with the notary in order to get additional information on the analysed transactions, with a view to substantially enriching the reports sent on. It is compulsory for the Notary to join the OCP and to grant access to all the information included in the unified index.

23. As mandated by the Directive, Member States have established "appropriate forms of co-operation" between the designated self-regulatory bodies (those with powers in the reporting process) and the relevant authorities responsible for combating money laundering.
24. This relates in the first place to the forwarding of the reports. Subject to the filtering activity (see below), the self regulatory body should forward the information to the authorities, and in a few cases it has been made explicit that this transfer of information should take place within a given deadline after receipt of the suspicious transaction report (e.g. in Lithuania, the Bar Association must forward the information to the FIU within 3 working hours after receipt of the report).

In this context, an issue of particular concern for the legal profession is the possibility of the self-regulatory bodies to act as a filter in the reporting system: i.e. to transfer to the authorities the information it deems necessary after conducting an assessment of the information it receives from the legal practitioner, but not necessarily all the information disclosed in the first place by the practitioner. The rationale behind the filtering activity is to block the reports in case the practitioner would infringe the legal privilege principle by providing information concerning proceedings. In roughly half of the Member States that give the self-regulatory

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Luxembourg: the president ("bâtonnier de l'ordre") of the regional bar to which the lawyer belongs. Portugal: "Ordem dos advogados" (and "Ordem dos solicitadores" for "solicitadores").

<sup>37</sup> Spain: "Consejo General del notariado". In Spain, lawyers should report directly to the authorities.

<sup>38</sup> In Cyprus, the Council of the Cyprus Bar was appointed as supervisory body for lawyers, but the reports are done directly to the FIU.

<sup>39</sup> "Organo centralizado de prevención del blanqueo"

<sup>40</sup> It improves the traditional situation where an individual Notary had only partial information on a legal or physical person.

bodies a role to play in the reporting process, those bodies are not allowed to act as a filter and should forward the relevant reports to the relevant authorities. However, the filtering practice is formally accepted in a few Member States (the Czech Republic, Denmark, France, Portugal or Spain). It is noted that, in some countries (for example, in Germany and the Czech Republic), the self-regulatory body, regardless of any filtering role, may send to the authorities comments on the suspicious transaction reports they are transmitting. In any case, the filtering role is considered as a hypothetical situation by many stakeholders and has rarely been fulfilled in practice.

**Box n°3 – Self-regulatory bodies acting as filter in the reporting system: examples.**

National legislation provides in some cases for wider powers for the self-regulatory body. For example, in France, the law foresees that the self-regulatory body concerned may not forward the reports received from the lawyers to the FIU if the body considers that there is no suspicion of money laundering. In such a case, the body in question should inform the lawyers at the origin of the report of the reasons why the report has not been forwarded to the FIU and should also inform the president of the national bar council (or the president of the national chamber of "avoués") of the situation (but without transmitting information allowing for the identification of the persons involved). Then, the president of the national bar council, the president of the bar for the lawyers at the "Conseil d'État" and the "Cour de cassation", or the president of the national chamber of "avoués" should inform the Minister of Justice on a periodical basis of the reports received that resulted in information not transmitted to the FIU. The FIU should be informed by the Minister of Justice.

The case of the notaries in Spain is different. While the self-regulatory body can act as a filter in the reporting system, it can also act as ex-officio reporter because of its access to all details on all transactions carried out by the Spanish notaries, regardless of whether the notary concerned qualifies a transaction as suspicious.

25. In addition to this filtering role, a sensitive question relates to the power to request the legal professional to make further information available. This power generally rests with the authorities, but not with the self-regulatory body, except in a few cases (e.g. Czech Republic, France, Lithuania and Spain – for notaries only). In Hungary, the authorities' requests are transmitted to the practitioners through the self-regulatory bodies as a courtesy.
26. Finally, other forms of co-operation established often relate to working groups or liaison committees between the authorities and the professions (and, in some cases, the financial sector)<sup>41</sup>.

**Box n°4 – Cooperation between the self regulatory bodies and the authorities: examples.**

In France, the law provides for an anti-money laundering liaison committee, chaired by the Ministry of Justice and the FIU, to structure discussions with the financial sector and the professionals subject to the law. In Germany, a discussion working group chaired by the FIU with representatives of the self-regulatory bodies of the lawyers, notaries and other regulated professions has been created.

### 3.3. Adaptation of the internal organisation to cope with the obligations

27. Legal professionals also need to establish internal procedures and adopt supporting measures in order to adapt to the Directive obligations. This subsection will examine

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<sup>41</sup> This kind of working groups have also been created in countries that gave no formal role to the self-regulatory bodies in the reporting system, as in the Netherlands or Latvia.

how this obligation has been implemented in relation to the procedures of internal control and communication, internal training and record keeping. A particular focus will be put on the difficulties faced by the legal profession. It must be underlined in this context that establishing internal procedures and adopting supporting measures, as such, does not appear to present ethical problems, but may create an administrative burden or increase the costs for the legal profession (see also section 4).

28. In the vast majority of Member States, independent legal professionals generally have an obligation to adopt their own procedures of internal control and communication in order to deal with the risks related to money laundering<sup>42</sup>. This obligation is implemented differently, depending on the type of professional involved and the working environment<sup>43</sup>.

Due to the fact that the work of legal professionals is not based on division of labour as is the case for credit and financial institutions, these procedures tend to focus on the duty of the professional itself to be familiar with the obligations to prevent money laundering and in particular to be familiar with the typologies of money laundering and the facts that might be an indication for money laundering. This is in particular the case for notaries (that generally extend the written procedures, where they exist, to their clerks and support staff) and, to a lesser extent, for individual lawyers. Indeed, the latter are less likely to apply this kind of procedures in practice, as in most cases they would work alone (and bear the responsibility to report individually) and their support staff would be very limited. Indeed, in some countries (e.g. France), the obligations to apply this kind of procedures internally only apply to firms.

As far as law firms are concerned, division of labour is more common in larger firms and therefore specific procedures of internal control and communication are easier to implement, in particular by law firms having international activities. Ease of implementation does not necessarily mean lack of or low costs as, depending of the solutions chosen (e.g. use of commercial automated systems for verifying identities), the cost can be high. Some countries (e.g. Germany, Hungary) impose the obligation to apply this kind of procedures for law firms/partnerships above 10 professionals. Smaller firms (similarly to individual lawyers) have a tendency to adapt or develop their existing procedures aiming at avoiding conflict of interest with their clients (e.g. clients and opponents checks) to cover money laundering issues too. These kinds of internal procedures are generally limited to the persons directly dealing with the transactions referred to in Article 2a(5) of the Directive, which almost always mean the independent legal professional only, but not the support staff. Only in a few Member States (Denmark, Ireland, the Netherlands, Spain, United Kingdom) are employees made aware, as a matter of general practice, of the policies and procedures in place in their law firm to prevent money laundering.

**Box n°5 – Examples of internal control and communication procedures. Compliance officers/ Money Laundering reporting officers.**

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<sup>42</sup> In the Czech Republic the law excludes legal professionals from this obligation, although it obliges them to provide training to their staff.

<sup>43</sup> In some cases, practitioners and law firms may follow the guidelines issued by their respective self-regulatory body but this does not appear to be the general rule.

**Procedures of internal control** in law firms could for instance involve obtaining access to commercial automated systems for verification of identities, the establishment of computerised client management systems (e.g. a new client file cannot be opened until such time as verification of identity has been carried out), centralised client vetting by compliance department, the use of standard questionnaires for gathering information from the client on the origin of funds or the definition of thresholds for acceptance of cash from clients. They can as well consist in setting out internal reporting procedures or in conducting internal audits. In this context, **compliance officers** (also referred to as money laundering reporting officers – MLRO) with responsibility for receiving money laundering reports internally and liaising with the authorities in cases where a report must be made seem to be appointed in a limited number of countries and mostly in large law firms. In Ireland, the Law Society strongly recommends appointing a MLRO to whom all solicitors and employees should report suspicious transactions. In the United Kingdom appointing a MLRO is a statutory obligation for law firms. The MLRO is personally liable and can face up to 5 years imprisonment if he fails to report knowledge or suspicion of money laundering to the FIU. In Germany, appointing a compliance officer is compulsory for law firms/partnerships above 10 professionals and in Slovenia for law firms above 4 professionals. Cypriot lawyers are obliged to appoint a MLRO to whom reports are made internally and who should report to the FIU.

**Procedures of internal control for notaries:** In Luxembourg, the notaries' self-regulatory body has set up a database containing updated lists of identified money launderers and terrorist financiers. Notaries are connected through a secured line and conduct searches in the database when identifying clients.

**Procedures of communication** could consist of internal memos dealing with indicators for the determination of whether a transaction is suspicious, indicating the type of documents which can be accepted for the identification of the client, indicating where to find more information etc.

29. Small law firms do not generally conduct internal training for their members on this issue. The situation is similar for notaries and individual lawyers for their staff. Members (and other employees) rather generally benefit from training provided by self-regulatory bodies or the authorities (see section 5.2, below). This approach, in addition to facilitating the reduction of costs, helps in ensuring a similar level of quality of the content of the training actions. Practitioners and supporting staff are generally only provided training internally in really large firms or where compliance officers exist, although this practice seems to vary from country to country. Internal training seems to be more frequent in Denmark, Ireland, the Netherlands and the United Kingdom.

**Box n°6 – Internal training: example**

In the United Kingdom, the provision of training is an obligation under the Money Laundering Regulations in respect of a number of areas, including how to recognise and deal with transactions which may be related to money laundering. The Law Society's Money Laundering Guidance provides firms with information that should guide the implementation of their own money laundering training policies. The legal requirements for law firms are that "relevant employees" must receive training and legal professionals are clearly covered by this definition. Members of a firm's accounts department, who handle funds, generally receive money laundering training as well. The Law Society's guidance provides that different levels of training are required for different staff. The guidance also advises that the majority of staff who deal with transactions which are at risk of money laundering need to have some understanding of the provisions. Training may be conducted by using a combination of several tools, including guidance notes, staff manuals, face-to-face learning, electronic learning resources, video presentations and written tests. Providing training for staff is a protection for the firm in the United Kingdom because under the Proceeds of Crime Act an employee has a defence to a charge of failure to disclose knowledge or suspicion of money laundering, if the employer did not provide adequate training.

30. Further to record keeping, which is mandatory, no other supporting measures are adopted by legal professionals, not least because of the cost of compliance with

existing obligations, which also includes the need to respect data protection legislation. In some cases, in particular in relation to larger law firms or notaries, record keeping may imply upgrading computer systems to deal with the new requirements (e.g. scanning systems etc.). In other cases, record keeping has appeared as a new burden (increasing cost) to an existing practice (verification of identity): for example, notaries in Spain used to note down in the official papers the type and number of the document used for identification purposes without keeping a copy of the document used, which they must do now.

31. In general, it is not an easy task for the legal profession to get organised in order to fully comply with the anti-money laundering regime, which is perceived as not being part of the core, normal activity of the functions they perform. The common perception of the stakeholders is that large firms are in a better position than small firms or individual practitioners to establish the best way to fulfil their obligations under the directive. As a result, it is tougher for small firms or individual practitioners to define (and update) the right procedures. Indeed, it takes time to get adapted to the new rules and also to fit some obligations to the legal profession in an efficient way. It is also considered costly. Establishing procedures for the identification of clients (and related record keeping) and training schemes (where this is compulsory) are considered to be the most resource-intensive. In large firms, many resources are also used in taking decisions on whether to make reports to the authorities and giving guidance to staff. Moreover, any change to the rules implies the adaptation of the procedures which causes further administrative burden and cost. Overall, only in some Member States did stakeholders (usually public administrations and notaries) perceive that the directive was easily applied. In the majority of cases, the role of self-regulatory bodies has been important in facilitating the application of the Directive (see section 5.2, below).

#### **4. IMPACT OF THE LEGISLATION ON THE COMPETITIVE ENVIRONMENT OF THE INDEPENDENT LEGAL PROFESSIONALS<sup>44</sup>**

32. The application of the Directive may also have a direct or indirect impact on the competitive position of lawyers vis-à-vis other professionals providing legal or quasi-legal services. This section provides a brief attempt to examine (i) the cost of the requirements of the Directive; (ii) whether there has been any impact on the demand for the services of lawyers and notaries; (iii) whether the impact of the Directive has been circumvented by money launderers by using other means to obtain legal advice; and finally, (iv) whether lawyers or notaries benefit from competitive advantages compared to tax advisors, external accountants and auditors.
33. (i) Complying with the anti-money laundering legislation implies a certain cost for independent legal professionals, which is not easy to estimate. First, an important cost factor relates to the performance of the customer due diligence procedures, although this depends very much on the profile of the customer (e.g. higher costs if non-face-to-face non-resident customer, high costs in relation to the identification of beneficial owners etc). This cost, however, will normally be passed on to the

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<sup>44</sup> Generally on the competitive situation of the legal profession, see the Commission's communication of 5 September 2005 on "Professional Services – Scope for more reform", document COM(2005)405; IP/05/1089.

customer, thus increasing the cost of the service. The cost of reporting is also underlined by the profession. Secondly, independent legal professionals also have some general non-customer related costs (also referred to as 'hidden costs' by the profession), either at the initial stages of the application of the legislation (e.g. setting up of procedures of internal control and communication, designing training schemes, investing in equipment etc.), or on an ongoing basis (e.g. the actual provision of training, the cost of administrative burden, compliance & reporting officers, the need for additional staff etc)<sup>45</sup>. These costs are difficult to evaluate because of the significant differences between independent legal professionals in terms of working structures (e.g. from totally independent professionals to large law firms with dozens of lawyers) or in terms of activity (e.g. specialised lawyers or notaries) and also because the accounting data is not adapted to calculate these costs. Indeed, most stakeholders do not have reliable information on this issue. In any case, they are of the view that the cost issue constitutes a barrier for smaller law firms or individual practitioners.

34. (ii) The entry into force of the national legislation pursuant to the Directive does not seem to have had any significant or measurable impact on the demand for services of independent legal professionals, or such an impact has not been measured. However, for a few stakeholders, the application of the directive would have resulted in an increase of demand because of customers requesting advice on anti-money laundering legislation, although this would relate only to a small proportion of practitioners.

On the contrary, practitioners claim that the Directive had some impact on "lawyer to lawyer" competition. As a result of more stringent national rules (sometimes perceived as "gold plating"), the attractiveness of law firms established in those countries (notably the United Kingdom) diminishes for sophisticated international clients. In addition, some practitioners are of the view that others are lazy in applying the rules, in order to "satisfy" clients and therefore obtain competitive advantages. Part of the legal profession has also signalled that the competitiveness of the EU legal services industry vis-à-vis third country practitioners suffers from the application of the EU directive, in particular compared to the regulations in Switzerland, Canada and the US. The legal profession warns about the risk of possible regulatory arbitrage, which should be avoided.

35. (iii) No circumvention of the rules of the Directive has been identified. Indeed, the application of the directive has not resulted in any significant impact on the demand for the services of individuals or entities which are not subject to the Directive, but are nevertheless able to provide legal or quasi legal services in competition with independent legal professionals<sup>46</sup>. In particular, it has not been proved that customers

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<sup>45</sup> Some stakeholders underline the costs in relation to setting up electronic databases with customer information or to acceding databases (e.g. a secure line to accede a database containing names of terrorist financiers held by the self-regulatory body). Some stakeholders claim that the cost of training is not important at this stage as some public authorities provide free of charge training schemes.

<sup>46</sup> In a few Member States, professionals that are not subject to the Directive provide legal or quasi-legal services in competition with independent legal professionals, such as: "legalisatoren" in certain areas of Austria that have the power of authenticating sales of real property and act in competition with lawyers in certain rural districts or divorce consultancy services operated by non-lawyers in Ireland. Additionally, there are trade unions, associations, not-for-profit organisations etc. that provide legal advice and help with the preparation of transactions for their members (although they do not represent

avail of the services of these individuals or entities with a view to circumvent the rules of the directive.

36. (iv) Legal professions do not seem to benefit from competitive advantages compared to other regulated professions. It had been claimed that the Directive creates competitive advantages for lawyers compared to other professionals (in particular tax advisors) resulting from the scope of application of its rules: in certain circumstances for lawyers, in all cases for tax advisors and other regulated professionals<sup>47</sup>. Indeed, regulated professions other than lawyers or notaries are also subject to high deontological standards, including strict rules on confidentiality and professional secrecy<sup>48</sup>. This view is, however, supported by very few stakeholders. The legal profession in particular considers that its specific professional duties and ethical obligations place it in a different situation to other professionals<sup>49</sup>. Furthermore, according to stakeholders, in practice, there are no such competitive advantages: in the case of the provision of tax advice, there seems to be little demand for sole tax advice without acting on behalf of or for the client in relation to a financial transaction (which would be subject to the Directive rules).

## 5. EFFECTIVENESS OF THE REPORTING SYSTEM

37. This section evaluates the extent to which the reporting system is effective in preventing the use and misuse of the financial system for the purposes of money

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them). In some cases persons with law studies but not registered with a Bar association are mentioned as possible providers of services.

<sup>47</sup> In a recent opinion, the European Economic and Social Committee considered that it is unclear why the applicability of the directive to notaries and other independent legal professions is restricted to certain activities, while other liberal professions, with equivalent high standards of ethical and competence standards enforced on their membership, have all their services included. While the Committee has some understanding for excluding from the scope of the directive the activities reserved by law to legal professionals, the Committee believes that legal professionals should be included within the scope of the directive wherever the activities in which they are engaged are not reserved to legal professionals, and the services would be included within the scope of the Directive if carried out by any other appropriately regulated professional firm. In particular, the Committee recommends that the obligations of the directive should also apply to lawyers when they provide tax advice. See the opinion of 25 April 2005 of the EESC on the proposal for a third anti-money laundering directive, points 3.1.9 and 3.7.1.2. [*N.B. Although this opinion relates to the third directive, the arguments remain valid as regards the first and second directives*].

<sup>48</sup> See for instance, recitals 9 and seq. and Articles 21 and seq. of Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts, amending Council directives 78/660/EEC and 83/349/EEC and repealing Council Directive 84/253/EEC, OJ L 157, 9 June 2006, p. 87. This text requires that statutory auditors adhere to the highest ethical standards, including standards on integrity and objectivity, and respect the privacy of their clients, among others. There are also requirements in relation to confidentiality and professional secrecy.

<sup>49</sup> In the *Wouters* case (C-309/99), the Court of Justice recognised that a rule in the deontological code of Dutch lawyers, which prohibited partnership between lawyers and accountants in the Netherlands, could reasonably be considered necessary for the proper practice of the profession as organised by the Member State concerned, despite the effects restrictive of competition that were inherent in it, and did not infringe the EC Competition rules. The Court arrived at this conclusion having considered several factors, including the specific national set-up and whether the rule was proportionate in these circumstances. In that ruling, the Court of Justice considered that accountants were not subject to deontological obligations comparable to those of lawyers (cf. §103), but this assessment was in relation to the traditional activities of lawyers before the courts.

laundering. For this, it examines: (1) the reporting trends; (2) the ease of application of the reporting obligation; (3) the facilitation of professionals' compliance through actions undertaken by the authorities and by the self-regulatory bodies; (4) the monitoring activities as a tool to increase effectiveness; and (5) the view of the legal profession on their own role in the fight against money laundering.

## 5.1. Reporting trends

38. This subsection will briefly examine whether lawyers and notaries report suspicious transactions; the reasons for the low or high number of reports, including the influence of subjective factors in the reporting system; and the extent to which these reports are useful for law enforcement purposes.
39. The number of reports made by independent legal professionals on suspicious transactions is particularly low in the vast majority of EU countries, notably compared to the reports made by financial institutions. During the period 2003-2005, in the case of notaries, only in Belgium, Estonia, France, Hungary, the Netherlands and Poland do the total number of reports amount to at least 10 per year; and only in the case of Belgium, France and Poland has the number of reports been above 100 per year in at least one of the three years considered. In the case of lawyers, figures are even lower (with the exception of the United Kingdom): only in Germany, Hungary and the Netherlands have the authorities received more than 10 reports from lawyers in at least one of the three years examined. The reporting trends in the United Kingdom are totally different and the number of reports from lawyers is significantly higher: above 3000 in 2003, above 9000 in 2004 and above 10000 in 2005.
40. Several concurring reasons seem to explain the low numbers of reports from independent legal professionals in the majority of countries<sup>50</sup>. First of all, there is a general perception that the application by the professionals of the legal privilege exception in relation to litigation, in particular when interpreted extensively, contributes to the explanation for the low numbers. Secondly, there are practical difficulties in applying the rules, as reported by stakeholders (see section 5.2). In addition, legal professionals mention the confusion created by the lack of logic and complexity of the rules (the insufficient knowledge of market and market practice by the legislation is also underlined) as another factor contributing to the diminution of the effectiveness of the system. The regime is "one size fits all" in its approach and possibly too wide to be effective. Legal professionals claim that it should be more risk based/bespoke according to the situation. Lastly, stakeholders also underline that the effectiveness of the reporting system may suffer from the fact that the legal profession is forced to pay excessive attention to the customer due diligence process and the related problems, distracting it from the evaluation of potentially suspicious transactions. Indeed, the perception of part of the profession is that compliance with the Directive means the mere respect of formalities, which is of little help in the prevention of money laundering. In this context, the profession also underlines that practitioners have a natural tendency to refuse the provision of legal services to doubtful clients as a result of the application of the high ethical standards of the

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<sup>50</sup> It could be conceivable to argue in this context that there are few reports because there is no money laundering happening. The other concurring factors do not appear, however, to confirm this statement.

profession and also in order to avoid being implicated in any possible primary offence or to avoid reputational problems for the law firm.

In the United Kingdom there are specific reasons, on which stakeholders agree, for the different (high) figures: firstly, the high penalties foreseen by the legislation in case of non reporting (up to five years imprisonment) which leads to "defensive" reporting; secondly a committed enforcement policy from the authorities which, further to the prosecution of lawyers for absence of reporting, included a largely publicised "dawn raid" on a solicitors' office for alleged non respect of the anti-money laundering regulation; thirdly, the very broad definition of criminal activity as predicate offence ('all-crimes' approach), which also includes self-laundering (as a result, many reports have been submitted in relation to possible tax fraud/evasion or in the context of divorce procedures), and no *de minimis* rule (with the result that practitioners spent too much time considering very low value matters); and finally certain ambiguity in the interpretation of national law with respect to the need to report in the context of litigation, the result being a high prevalence of precautionary reporting<sup>51</sup>.

41. Subjective factors may also have an influence on the number of reports made and ultimately on the effectiveness of the reporting obligations. Firstly, many public authorities (and some professional associations, notably representing notaries) are of the opinion that the negative perception of the independent legal professionals on the proportionality of the Directive obligations in relation to the legal profession has probably some effect on the effectiveness of the reporting system. This is perceived to be the case because, although legal professionals (no doubt) comply with their legal obligations<sup>52</sup>, they prefer to avoid situations which would require them to make reports and therefore break the relationship of trust with the client which the legal profession considers of paramount importance (civil liability versus their clients for damage or loss caused by unjustified reports may also play a role here). This view is not shared by the legal profession (in particular lawyers) or by a number of public authorities. For them, there is no such effect and both lawyers and notaries respect the law. In any event, no particular evidence supporting either position or measuring the impact can be presented.

Secondly, the confidence of the regulated sector in the reporting system seems to diminish as a result of what is perceived by practitioners as unjustified disclosure of the identity of the legal professionals making reports about money laundering suspicions. Not only may such identity may be disclosed in subsequent related judicial proceedings in some Member States<sup>53</sup>, but also legal professionals warn

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<sup>51</sup> Given the wide definition of proceeds of crime, barristers and solicitors became worried that they could not act for or against clients in civil proceedings, whose assets might in part include the products of tax evasion, since by doing so the barrister or solicitor might become involved in "an arrangement...to facilitate...the acquisition or retention of the proceeds of crime". However, a decision from the English Court of Appeal in 2005, in the case *Bowman vs Fels*, has clarified that there was no need to report in the context of the conduct of ordinary litigation: e.g. acting for a client in legal proceedings could not amount to an "arrangement" for the purposes of the Proceeds of Crime Act.

<sup>52</sup> A few public authorities go beyond in their judgement and consider that the negative perception of the legal profession appreciably affects the reporting system: i.e. the legal professionals would be indifferent to the obligations. Public statements by lawyers are mentioned as evidence of this attitude.

<sup>53</sup> In some countries, such as Belgium, France, Hungary, Malta and Portugal, the identity of the reporting person is never disclosed.

about prosecuting authorities leaking indiscriminately the reports, with the risk of reprisals against those signing the reports. Such disclosure is perceived as having a potential impact on the effectiveness of the reporting system<sup>54</sup>.

42. Concerning the usefulness of the reports produced by the legal profession for law enforcement purposes, the current statistical reporting framework in the vast majority of Member States does not collect data linking the specific reports to cases brought before court and to, eventually, convictions for money laundering offences<sup>55</sup>. A further problem in this area relates to the fact that in some cases, law enforcement authorities have a tendency to prosecute primarily the predicate offence, but not necessarily the money laundering offence that derives from it. Therefore, it is not possible to make an informed assessment on this issue.

In any event, it should be underlined that the effectiveness of the anti-money laundering system goes beyond mere quantitative data for its measuring. Indeed, the overall purpose of the Directive rules is to prevent the misuse of the financial system for the purposes of money laundering and ultimately to preserve the stability, integrity, soundness and reputation of the Community's financial markets. For this purpose the Directive appoints a number of gatekeepers and sets in place a certain reporting mechanism among other measures. While the deterrent effect of the measures is an important component of effectiveness, it cannot be subsumed into figures. A low level of reports may reflect either an effective preventative system or poor application of the measures. In such a context, it is particularly important to ensure that the latter does not occur. The effectiveness of processes are of particular relevance here (see also section 5.5 on this debate).

## **5.2. Ease of application of the reporting obligation**

43. This subsection will examine the difficulties identified by the legal professionals in the practical application of the reporting obligation.
44. The general perception from stakeholders is that the reporting obligation has not been easily applied in practice by the legal professionals. This perception results in particular from informal anonymous complaints received by the self-regulatory bodies and questions for advice made to these bodies by legal professionals. There are, however, few records of formal complaints by legal professionals to either public authorities or self-regulatory bodies on practical difficulties in complying with the reporting obligations, except in the United Kingdom.
45. The main difficulties experienced by independent legal professionals relate to:

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<sup>54</sup> The legal profession underlines that there are other consequences: risk of serious commercial and physical harm to the legal professional and risk of damaging the public's confidence in the legal system as a result of the breakdown in the relationship with the client when the latter discovers that their confidential relationship has been breached.

<sup>55</sup> The Commission is aware of this problem, which affects generally the statistical reporting in the justice area. It adopted on 8 August 2006 a Communication "Developing a comprehensive and coherent EU strategy to measure crime and criminal justice: an EU Action Plan 2006-2010" (document COM(2006)437). This action plan should allow to have better knowledge about crime levels, crime trends and criminal justice.

- (i) The recognition of suspicious transactions. Firstly, practitioners experience difficulties in recognising situations in which money laundering could take place. A second factor is that independent legal professionals do not generally get enough information from their clients regarding the transaction concerned. Clients do not necessarily disclose their true state of affairs or their financial situation, business interest etc. for a single transaction. This may be partially explained by their fear of being the subject of a report to the authorities. This problem increases in the case of notaries as most of the transactions performed at the notary premises are one-off or occasional ones. It is quite unusual to deal with the same client in front of the same notary. Thirdly, they consider it difficult to judge the origin of the client's funds when they come through the banking system, even if they come from tax havens. The combination of these factors enables money launderers to stay out of the suspicion "net". The legal professionals indicate in this context their own interest in recognising accurately suspicious transactions, so as to avoid being implicated in the commission of a primary criminal offence.
- (ii) The delimitation of the legal privilege in this context. This problem is mainly about striking a balance between the practical application of the "suspicion test" and the requirements for the professionals to respect a duty of confidentiality vis-à-vis their clients<sup>56</sup>. It has been underlined by the legal profession that in some countries, despite the provisions of Article 9 of the Directive waiving liability in case of reporting in good faith, the client can sue the lawyer for breach of secrecy in case of unnecessary reporting. This is perceived as a complex issue as it is not easy to reconcile all these various and often conflicting obligations. In the absence of a clear delimitation in the national law (or in supplementary guidelines) or of a clear interpretation by the courts, independent legal professionals anticipate that they will continue to be confronted with practical difficulties: you do not always get black and white solutions from particularly difficult questions. Lawyers underline the cost of reporting, in terms of hours spent and they also point to the need in some complex cases to get additional external legal advice from specialised lawyers in relation to the delimitation of the legal privilege, which adds to the cost.
- (iii) The post-report period (the prohibition of tipping off and the request for consent). Difficulties also arise once the report has been made, where the tipping off provisions become applicable<sup>57</sup>. If a report has been made, the related transactions are frozen until appropriate consent by the authorities to carry it out is given. Lawyers (in particular in the United Kingdom, where most of the reports are made) report being forced into situations of trying to carry on their normal duties and relationship with clients without committing a tipping off offence.

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<sup>56</sup> Lawyers, in particular, consider that the directive has not been easily applied because it has undermined the fundamental professional duties of the lawyers and the rights of their clients: i.e. the entire basis of the lawyer-client relationship. See also sections 3.2 and 5.5.

<sup>57</sup> In the vast majority of countries tipping off the client is not allowed (in some countries the law foresees the possibility to make a disclosure in connection with legal proceedings, but for the purposes of this report, the legal privilege situation is treated in section 3.2). However, in a few countries (such as Austria, the Czech Republic, Denmark, France, Luxembourg, Slovenia and Sweden) lawyers (but not always notaries) are allowed to disclose to their client (or to other third person) that information indicating money laundering has been transmitted to the relevant authorities or that a money laundering investigation is being carried out. It is claimed in these countries that the special confidence relation between lawyer and client justifies this conduct.

They also consider this to be an impossible moral situation. This has an adverse impact in the relationship of the lawyer with the client, which is unfortunate in cases where a suspicion of money laundering is found to be ill-founded. Hence, legal professionals consider that if consent is not handled expeditiously (and this is not always done), it is not only the suspected party who may be prejudiced but also innocent parties involved in the transaction. Lawyers also indicate that in case of cross-border transactions, consent has to be requested to two different authorities which may provide a different reply. This latter situation is reported to have taken place at least in one case.

46. These difficulties have an adverse impact on the rate of reporting, as described in the preceding section. They also contribute to increasing the negative perception by the legal professionals on the proportionality and usefulness of the Directive obligations (see section 5.5 on this issue).

### **5.3. Facilitation of compliance by the authorities and by the self regulatory bodies**

47. In the light of the difficulties described in the precedent subsection, facilitating the work of the legal professionals in complying with the rules should be a key element for improving the effectiveness of the preventative system. This section will briefly present the view of the practitioners on the pro-active role of public authorities and the self-regulatory bodies in facilitating their compliance with the obligations by means other than enforcement activities. It will in particular look at the main activities, e.g. provision of training, provision of information on typologies, provision of feedback on cases reported, preparation of general guidelines and provision of advice on specific cases.

48. The general view of practitioners is that public authorities have done little to facilitate their compliance with the Directive obligations and should do much more: public authorities should not insist on formal procedures, but rather assist with measures that lead to the intended goals. They criticise in particular that there is insufficient information from the public authorities regarding the rules and the practical aspects: legal professionals need to know what to do, but are not always told. Checklists of applicable procedures, more training and clear and reliable information should be provided to avoid legal uncertainty.

49. While it is true that many public authorities have undertaken activities aiming at facilitating the application of the Directive, the scope of these activities appears limited. They have provided or organised training activities (in many cases in cooperation with the self-regulatory bodies), but normally of limited scope (sometimes general presentations only) and often for the benefit of the self-regulatory bodies or selected groups of professionals only. Some authorities have also issued guidelines (or contributed to those issued by the self-regulatory bodies) but they do not seem to be particularly highly regarded.

50. Few authorities have provided enough or sufficiently systematic information to the self-regulatory bodies, or directly to the independent legal professionals, on typologies susceptible to imply higher money laundering risks which are of specific relevance to the legal profession. Some authorities raised the risk of information leakage to money launderers, which would allow them to change their pattern of activity, as a reason to be cautious in disclosing this information. Obtaining this kind

of information from the authorities is, however, considered by the legal profession as an important element in improving the reporting system: lawyers and notaries need to know the common themes.

**Box n° 7 – Information on typologies by public authorities: example**

In Germany, it is a legally standardised task of the FIU to co-operate with the persons subject to the Money Laundering Act, and in particular with the regulated professions. This is reflected further to incident-related discussion groups and workshops with the regulated professions in, for example, a FIU newsletter providing information on typologies and developments. The publication of the FIU newsletter has resulted in intensified and improved communication between the FIU and the regulated profession. In addition, the FIU, supported by the professional associations of the regulated professions, an external consultancy and some Land Criminal Police Offices, developed an online information platform. The aim is to inform and sensitise the regulated professionals concerning money laundering, including the development and the current state of money laundering control in Germany, the stages of money laundering, examples as well as comprehensive information about prevention mechanisms and suspicious transaction reports. In addition, the online offer encompasses links to other websites dealing with the topic of money laundering and also provides answers to important questions that other persons subject to the law might have.

51. In many Member States, feedback to the reporting legal professionals, in relation to specific investigations opened as a result of reports they made, is generally not provided at all by the appropriate authorities, either to the legal professional concerned, or to the self-regulatory bodies<sup>58</sup>. Public authorities rarely undertake other specific activities in this field, apart from monitoring activities (see section 5.4).

**Box n° 8 – Feedback on specific cases: examples**

In Latvia, a representative from the Latvian Council of notaries is a member of the advisory board of the Control Service, a specialised body which, in accordance with the law, exercises control over unusual and suspicious transactions, and acquires, receives, registers, processes, complies, stores, analyses and provides information to pre-trial investigative institutions and the court. In this way, the Council of Notaries is informed on a regular basis about on-going events. This information is further delivered to notaries. In Germany, the public prosecutor should provide feedback to the reporting parties and they have a right to ask for it. Currently, forms are being developed for practical use in order to standardise this feedback. In France, the law foresees that the FIU should inform the reporting lawyer if his report is communicated to the law enforcement authorities, but as the implementing decree was adopted only recently, this procedure has not yet been tested. In Slovenia, upon completion of investigation on a case for which reasons existed for suspicion of money laundering, the FIU notifies the informant in writing. In Denmark, this kind of feedback to the self-regulatory body only happens exceptionally. In Spain there is a limited feedback system established by the FIU.

52. The role of the self-regulatory bodies is perceived more positively. Although not explicitly required by the Directive, self-regulatory bodies have generally undertaken initiatives in assisting (or cooperating) with legal professionals in order to facilitate their compliance with the reporting obligations (and other preventative measures). Thus, training activities have generally been provided, organised or facilitated by several self-regulatory bodies. The percentage of the legal professional population reached is unknown, but given the large number of practitioners it is presumably not high. Some of these bodies have prepared (or are in the process of preparing) specific guidelines related to the anti-money laundering legislation, either on their own or, in

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<sup>58</sup> The self-regulatory bodies with powers in the reporting system do not provide this kind of feedback either, as they lack information.

a few cases, in cooperation with public authorities such as FIUs<sup>59</sup>. Guidelines are generally very much appreciated by the legal profession as they try to facilitate the interpretation of the law, although practitioners also claim that guidance notes are not always practical.

**Box n° 9 – Guidelines to facilitate the understanding of the obligations: examples.**

The Law Society of Ireland prepared guidelines intended to provide a guide to solicitors as to best practice, rather than to provide a mere legal interpretation of the legislation. These guidelines reflect best practice in financial institutions and in third countries: inter alia, they provide recommendations in relation to the customer due diligence procedure depending on the client and situation, and on how to organise internal reporting procedures in law firms. They contain common indicators of potentially suspicious transactions and some forms (e.g. on the verification of the identity of the client for internal reporting etc) are provided too.

The Swedish Bar Association has compiled a guidance/instruction for law firms on how advocates and associate lawyers should apply the anti-money laundering rules, and this guidance is published on the internet. These guidelines refer to the Swedish financial supervisory authority (Finansinspektionen) guidelines. Finansinspektionen issued Regulations/Guidelines in June 2005. This publication contains elements (regulations) that are directly binding and enforceable, and other elements (general guidelines) that are indirectly enforceable and subject to sanctions where the institution is also failing to conduct its business in a sound manner.

In the United Kingdom, the Law Society of England and Wales has published Money Laundering Guidance Notes for solicitors. The Guidance was published in pilot form in January 2004. It covers (inter alia) the necessary level for knowledge of suspicion, or reasonable grounds for suspicion, of money laundering which is the key test in the British legislation. It also covers potential compliance methods with the rules, which are purposely intended to be risk-based and focus resources effectively whilst ensuring that there are no wasted compliance costs. This Guidance is available electronically on the Law Society's web-site ([www.moneylaundering.lawsociety.org.uk](http://www.moneylaundering.lawsociety.org.uk)). Additional guidance notes and information on recent developments in this area are also placed on the Law Society's website.

53. Many self-regulatory bodies provide advice to practitioners on concrete cases, upon request, usually on an anonymous basis, before deciding to formalise a report. By adopting this careful approach, practitioners (in particular lawyers) try to mitigate conflicting obligations (e.g. the respect of the confidentiality in the relationship with the client and the reporting obligation). This activity does not appear to be systematic, except for some cases (see the following box). In any case, such advice is more often provided by those self-regulatory bodies with formal powers in the reporting system. In some cases, there is a correlation between the request for advice and the fact that the law or reporting system is of recent application (e.g. notaries in Spain with regard to their new reporting system).

**Box n° 10 – Advice to practitioners by the self regulatory bodies**

There are help lines at the disposal of lawyers (for example within the Danish Bar and Law Society and the professional ethics department of the Law Society of England and Wales) where specific questions can be answered: in 2004, the number of specific enquiries from solicitors in England and Wales exceeded 8000. Indeed, the England and Wales Law Society has developed a team of specialists to provide confidential advice and guidance to solicitors (and their staff) on this issue.

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<sup>59</sup> Establishing guidelines (prepared either by the public authorities or by the professional associations) in order to facilitate their understanding of the obligations and also in order to facilitate their relations with clients is considered important by stakeholders. Experience in the financial sector also supports this perception.

Interestingly, the Irish Law Society has the opposite view. Indeed, the Society cannot give legal advice in relation to an individual solicitor's obligations under the legislation. The 'test' of whether a suspicion exists is a subjective one and can only be met by the solicitor himself. Consequently, the Society's role is confined to providing general guidance as to best practice. When dealing with such queries, the Society's advice is to consult the Society's Guidance Notes and then consider whether, in the specific circumstances, an obligation arises to report the matter to the relevant authorities. If, following this exercise, the practitioner still has some doubts as to the appropriate course of action, the Society's advice would be to seek independent legal advice on the matter.

Besides the provision of training, guidelines, informal advice and the database run by the notaries self regulatory body in Luxembourg (see box 5), no other particular measures or best practices can be highlighted, except divulgative articles in the periodical publications of those bodies.

#### **5.4. Monitoring of compliance as a tool to increase effectiveness**

54. This subsection will briefly examine the extent to which (regular) monitoring of the legal professionals' compliance with the obligations by the public authorities can be used as a tool for increasing the effectiveness of the reporting system and the views of the stakeholders on this issue.

55. The existence (or not) of monitoring activities by public authorities does not seem to have had any significant effect yet in the reporting system of the majority of Member States. Monitoring of compliance by independent legal professionals with the anti-money laundering legislation, although not required by the Directive, is already performed in some countries, or at least foreseen to start soon. In most cases, it is performed by the relevant self-regulatory body in connection with its usual monitoring activities related to law practitioners. In a few cases (Estonia, Lithuania, Malta, Poland, Slovakia, Slovenia and Spain), the FIU has been specifically granted monitoring powers in respect of the legal profession. Only in one country (the Netherlands), a specific independent public body (the Financial Supervision Office) has been entrusted with monitoring tasks. Monitoring, in particular for lawyers, appears to be more often incident-related or occasional, although there are examples of more regular activities (see the following box). Notaries, on the contrary, are subject to strict periodic and systematic supervision in some countries (such as Estonia, Germany, France and Hungary).

##### **Box n° 11 – Monitoring of compliance**

In Ireland, the Law Society conducts investigations of the books of account of solicitors' practices on a regular basis to monitor compliance with Solicitors' Accounts Regulations, i.e. to ensure financial propriety of practices and proper treatment of clients' monies. By their nature, these investigations require Investigating Accountants to inspect client files whereupon they may be put on notice, or have grounds to suspect, that an offence has been committed under anti-money laundering legislation. The Law Society's Investigating Accountants are required to make a separate report to the Society's Money Laundering Reporting Committee (MLRC) in circumstances where it appears that a solicitor is either a) failing to comply with his obligations under the legislation, or b) actively engaged in money laundering activities. The MLRC is responsible for deciding whether a report should subsequently be made to the authorities.

In the United Kingdom, the England and Wales Law Society's Practice Standards Unit ("PSU") monitors solicitors' firms for compliance with the Money Laundering Regulations and the best practice contained in the Law Society's money Laundering Guidance. The PSU makes approximately 1,200 visits a year. PSU visits usually take two days per firm by one PSU staff member. PSU has 49 staff, 70% of whom are solicitors themselves, and some of whom are ex-investment business monitors

with good experience of monitoring law firms. Money laundering compliance checks by PSU staff are at a high level. Money laundering is one of 20 or more areas reviewed at such a high level.

The policy of the Law Society in this context is to adopt a positive approach and provide support and assistance to enable firms to maintain compliance with the Money Laundering Regulations. Thus, it concentrates its efforts not only on monitoring but on providing solicitors with the training, guidance and information. Fostering a positive rather than overly-punitive compliance environment should encourage solicitors to take on board the new requirements in a more meaningful and ultimately more effective manner. In any event, in case of breach of the anti-money laundering rules (treated as a material breach of the professional conduct rules), the Law Society is empowered to, inter alia, place conditions on a solicitor's Practising Certificate, adopt disciplinary measures, approve reports requiring a firm to improve an aspect of compliance etc.

56. Concerning the possibility to impose sanctions for lack of compliance<sup>60</sup>, the self-regulatory bodies can normally impose disciplinary sanctions or bring a case before a public prosecutor or a court. Public authorities can normally impose administrative sanctions (e.g. fines), but not disciplinary ones (with the exception of the Dutch supervisory body– and some FIUs are entitled to generally withdraw licences for undertaking economic activities in case of repeated infringements to the rules). In the United Kingdom, a few legal professionals have already been prosecuted and charged with a criminal offence for failure to report suspicious transactions, although normally they are prosecuted for the primary offences only.
57. Public authorities generally see value in reinforcing the monitoring/supervisory system (which, incidentally, should be done under the third Anti-Money Laundering Directive). Such enhanced monitoring would allow the monitoring bodies to detect best practices and spread them among the different practitioners. Monitoring is also seen as a strong tool for raising awareness among professionals, which may lead to enhanced cooperation of the professionals with the authorities and to an increase of reports. For instance, in the Netherlands, the Financial Supervision Office conducted pilot studies at some selected law firms that resulted in closer cooperation of this body with the professional associations. This view on the reinforcement of the monitoring /supervisory system is not, however, shared by the professional associations, who rather prefer to have discretion as to the undertaking of any monitoring activity. Some practitioners are of the view that more monitoring will assist them in better understanding the obligations, thus contributing to a greater effectiveness of the system.
- 5.5. The role of independent legal professionals in the fight against money laundering**
58. As seen in the precedent subsections, the effectiveness of the reporting system also depends on the subjective perception of stakeholders on the usefulness and proportionality of the obligations and on their own role in the system. In this context, this subsection presents the view of the stakeholders in relation to two important questions:

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<sup>60</sup> To the extent that there is no sufficient comparable statistical data available concerning the number and level of sanctions imposed, no reliable information on trends can be provided in this document. However, it can be noted that disciplinary sanctions and administrative sanctions have been applied and that cases have been brought before criminal courts in some Member States.

- Is the application of the Directive to the legal profession having a real impact in the fight against money laundering?
- Which should be the role of the independent legal professionals in the fight against money laundering?

The views of the stakeholders are divided on both issues.

59. Concerning the impact of the Directive in the fight against money laundering, some Member States and some professional organisations representing notaries are of the view that the Directive has already had a positive impact in terms of prevention: they estimate that, more often than before, suspicious mandates have been declined as a result of the deterrent effect of the rules. This preventative role as "gatekeeper" to the financial system is praised as helping to close gaps in the system.
60. On the contrary, some Member States and professional associations representing lawyers are of the view that the application of the Directive to the legal professions has not had any impact in the fight against money laundering and, more importantly, will not have any impact because of the particularities of the lawyers' work<sup>61</sup> and/or the type of (quasi-prosecutorial) obligations foreseen in the directive, which run against the principles of the profession. They also point to the absence of reliable prior information about the scale of the problem<sup>62</sup>, making it difficult to ascertain whether there has now been a reduction in money launderers' use of professionals.

They also underline the absence of records or statistics in relation to any criminal prosecution for a money laundering offence out of reports made by lawyers in respect of their clients<sup>63</sup> and they question the justification of the wide scope of the legal profession's reporting obligations given the law enforcement outputs directly related to these reports.

61. Some other stakeholders are slightly more optimistic as to the usefulness of the legal profession's involvement for law enforcement purposes. However, they predict a lower impact than expected by the legislator because the Directive obligations, initially developed for financial institutions, were extended to the legal professions without taking more into account the specificities and differences of these professions compared to those institutions. Other stakeholders point to the need to increase the trust of all persons involved in the system to have a higher impact.

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<sup>61</sup> Specifically as regards barristers, English barristers are of the view that the applicability of the directive to barristers is unlikely to have much of an impact in the fight against ML since the majority of barristers' work in independent practice is contentious legal work in the courts or in arbitration, and in this context, there is little evidence that money laundering is taking place. 'Sham litigation' being conducted by clients as part of a money laundering exercise is extremely unusual. Moreover, they claim that it is extremely rare for a barrister to find himself involved in any money laundering scheme in the course of this court work: there is no evidence of people laundering their money through court judgments or through the award of arbitration tribunals. It is noted that Irish barristers are directly not subject to the anti-money laundering rules.

<sup>62</sup> Lawyers indicate in particular that there is no evidence of research, studies or statistics about the incidence of money laundering involving the legal profession further to the FATF typologies reports (only references given by the authorities of the increased use of professionals for money laundering).

<sup>63</sup> Interestingly, some Member States and notaries' professional associations report on cases discovered out of notaries' reports.

Nevertheless, many stakeholders consider that it is too early to provide an informed assessment on the impact of the Directive.

62. The views of the stakeholders are also divided as regards which the most effective role for the legal profession in the fight against money laundering could be. For several public authorities, the most effective role for the legal profession should be to apply the existing rules, although they concede that legal professionals need better information on what they can and cannot do. While some arguments have been raised to apply the rules to the legal profession without intermediaries (e.g. the self-regulatory bodies) and without the legal privilege applying, others consider that it is not possible to require from legal professionals more than the actual rules, without infringing the legal privilege/lawyer-client confidentiality principle and hence putting the work of the legal profession into question.
63. Some of the professional associations representing notaries recommend strengthening the role of notaries, as real introducers. For them, an increase of notarial authentication of transactions would have a higher deterrent effect for possible money launderers.
64. Finally, the professional associations representing lawyers see a totally different role for their profession in the fight against money laundering (see the following box). They believe that the risks should be better targeted by the law and that the legislative reply should be proportionate to the identified risks. In this context, they believe that the main risks relate to complex corporate and real estate transactions of a cross-border nature, activities in which only a minority of legal professionals are involved. They are of the opinion that this fight should be conducted primarily by financial institutions, as they are better placed and better suited to carrying out this function. They also noted that some major countries, such as United States, have chosen not to impose reporting obligations upon the legal profession.

**Box n°12 – The role of lawyers in the fight against money laundering – The view of the lawyers**

Firstly, lawyers claim they should be exempted from the obligation to report suspicions of money laundering. They are of the opinion that this obligation, originally conceived for financial institutions, is not the most suitable means to prevent and combat money laundering in the case of lawyers (and possibly other liberal professions) because they are badly placed for intelligence gathering as regards financial transactions, nor it is an appropriate measure in their case (because of the contradiction with the fundamental rights of the citizens and the role of the legal profession). They also point that this obligation is useless: under criminal law, a lawyer who assists his client in the laundering of proceeds of crime incurs a penalty for aiding and abetting anyway and would hence definitely not denounce the suspicion on money-laundering. Indeed, if any reporting to the authorities is to be made, this should only take place in relation to clear cases of (pre-existing) infringements of criminal law (e.g. there is a high level of certainty in respect of the illicit nature of the funds or property), not on the basis of a mere suspicion test that irreparably damages the fundamental principle of confidentiality between a lawyer and his client.

Secondly, lawyers consider that their traditional professional rules of conduct, guaranteed by their ethical codes and the corresponding disciplinary sanctions in case of breach, is already a good tool in the fight against money laundering. A lawyer can best contribute to the prevention of money laundering when a client can freely consult his lawyer on money laundering issues without the fear of being denounced. In this way, the legal advisor has the possibility to prevent his client from taking such an action. If clients do not trust that their affairs will remain confidential, they will be less likely to reveal to their legal advisor all the facts of their situation or even reluctant to contact him/her (fearing potential notification on suspicion by their legal advisor). The effect is that criminality is

more likely to remain undetected and clients will not receive the appropriate advice to safeguard their rights or advice about how to remedy their position lawfully.

Thirdly, developing an awareness of the risks posed by money launderers and putting in place preventative measures is an acceptable policy for the legal profession, not least in order to avoid putting the profession into disrepute, whether by being involved in money laundering or any other kind of related criminality. Hence, a lesser emphasis on criminal penalties and a greater emphasis on awareness raising, educating the profession about the risks involved (e.g. by providing guidelines and/or information on money laundering typologies/indices) and the development of a genuine risk-based approach adapted to the needs of the professional (for which less invasive measures already contained in the directive, such as identification of the client, record keeping or training are useful) would result in a more effective role for the profession. Ultimately, this would be sufficient in order to ensure that no money laundering attempt is unwittingly supported by lawyers<sup>64</sup>.

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In this context, the role of public authorities should be limited, not intrusive, with a preference for self-regulation. If compliance with rules and standards should be monitored, this should be done only by the bodies competent for the supervision of the profession (namely the Bar Associations and Law Societies in most of the EU).

## 6. CONCLUSIONS

65. This survey shows that the application of the Directive to the legal profession has not yet produced the expected impact as regards its application to the legal profession. The slow transposition of the provisions of the Directive into national law by Member States has resulted in the period of application of its rules being too short to assess in the majority of Member States. The different pace of implementation is a further impediment to comparisons among Member States. In addition, once the obligations have been transposed into national law, their practical application by practitioners has been particularly difficult, notably as regards the delimitation of coexisting opposing obligations for lawyers, such as: the reporting obligation and the duty of confidentiality vis-à-vis their clients. The immediate consequence is that it is difficult at this stage to make a measured judgment on the effectiveness of the rules. With the exception of one country, few objective results can be presented at this stage in terms of reporting of suspicious transactions. Furthermore, the deterrent effect of the anti-money laundering defences is, while important, difficult to measure.

Therefore, improving the effectiveness of the rules appears to be a necessity at the present stage. The survey has shown that efforts should concentrate in three main areas:

- Improving the quality of the national legislation implementing the anti-money laundering rules adopted at European level;
  - Increasing outreach and awareness efforts;
  - Exploring whether there are additional tools that can be used in facilitating compliance.
66. In this context, the enactment of the Third Directive, which incorporates the provisions of the Second Directive as regards the legal profession, provides a window of opportunity for Member States to tackle some of the problems and difficulties in the practical application of the anti-money laundering defences by the legal profession. This new Directive opens a new transposition period in which Member States will be adapting their legal instruments. Targeting the real risks while transposing the new Directive and therefore improving the quality of its implementation appear as key elements to render the rules more effective. Better implementation could notably consist in Member States taking advantage of the new opportunities that the Third Directive offers to facilitate the adjustment of the performance of the customer due diligence procedures to the real risk involved. In particular, the survey has shown the value of Member States paying due consideration to allowing legal professionals to rely on customer due diligence procedures already performed by trusted third parties, as this would largely facilitate the relationships with their clients. Under the new Directive, this is a faculty that Member States enjoy, not an obligation, despite the Commission original proposal in this regard<sup>65</sup>. With regard to the relationships with the client, consideration should

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<sup>65</sup> COM(2004)448final, of 30 June 2004.

also be given to the fact that, in cross border situations, documentary evidence might be different according to the national situation. One should avoid in this context that national implementing legislation adopts a bureaucratic box-ticking approach in relation to customer due diligence procedures. Practitioners should enjoy the flexibility offered by the new Directive to adapt their conduct and their internal procedures to the perceived risk. Indeed, the large majority of clients are not money launderers.

67. In this survey, the survey has also shown a particular need for increasing outreach and awareness efforts, in particular as regards lawyers, both by the national authorities and the self-regulatory bodies. It appears from the survey that it would be useful to raise awareness among the legal profession, not just on the anti-money laundering obligations arising from the directive, but also on the question of the possible commission by legal professionals of a primary offence in case they are unwittingly involved in money laundering schemes. Facilitation of compliance with the anti-money laundering rules, in particular for small law firms and individual practitioners, will be essential for reinforcing the effectiveness of the rules. For instance, the profession is eager to receive better guidance on the scope of the rules, particularly as regards the delimitation between the legal privilege and the reporting obligation, which is not easy to make. Indeed, in the majority of countries, the short period of application of the rules has not allowed for sufficient experience in this regard. Further to the clarifications that the Court of Justice may provide on this delimitation at European level, it appears appropriate that this type of guidance is adopted at national level, either by the authorities, the self-regulatory bodies or preferable through joint cooperation, as this would allow to better cater for the different national traditions regarding the legal privilege. Further to the need for provision of guidance, this survey has also showed the added value that self-regulatory bodies may provide in this field. The Commission services note with particular interest the role adopted by some of these bodies in providing specific services to their affiliates, such as operating common databases, with a view to rendering the application of the obligations easier. Equally, the Commission services anticipate in this regard that authorities, including supervisory bodies and European institutions, have an important role to play in providing guidance to the professionals and enforcing supervisory policies as regards the practical implementation of the approach based on the risk, which allows for tailored responses rather than one-size-fits-all solutions. Work in this regard has already started at the FATF level as well as at the European level.
68. Finally, it should be noted that the Commission services are exploring whether additional tools can be used in reply to some of the problems identified in this survey, in particular those which have a clear cross-border character. This relates for instance to obtaining corporate identity documents (statutes etc.) in cross border situations: e.g. the Commission is funding a research programme, the so-called Brite project<sup>66</sup>, in relation to cross-border access to business registries. It is also noticeable

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<sup>66</sup> [www.briteproject.net](http://www.briteproject.net). This project aims at facilitating cross-border access to information contained in business registries, including the provision of certified copies of this information. This project is considering extending its scope to better address the needs of the legal professionals (and generally of the persons and entities subject to the rules of the Directive) in relation to the anti-money laundering obligations.

in this regard that the Commission has also launched a cost-benefit study<sup>67</sup> in relation to the upfront disclosure of large holdings in unlisted companies. Such disclosure could facilitate obtaining information of who the beneficial owner is. The identification of the beneficial owner remains a difficult issue, as shown by a recent report from the FATF<sup>68</sup>.

69. The aim of this survey was to describe how the directive has been applied in practice to the legal profession and to outline the main practical difficulties arising from this application. This survey will also provide a basis for a future examination to be conducted before 15 December 2009 on the application of the new Directive 2005/60/EC to this sector<sup>69</sup>.

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<sup>67</sup> Call for tender JLS/2005/D2/01. This study was preceded by a shorter scoping study.

<sup>68</sup> Report from the Working Group on Typologies, October 2006: "Misuse of corporate vehicles including trust company services provider activity?"

<sup>69</sup> See Article 42 of Directive 2005/60/EC.