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When Money is the Reason: Preliminary Evidence of Legal Business Compliance with Anti-Money Laundering (AML) Obligations

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ABSTRACT

Since 2004, legal practitioners in Malaysia are regarded as reporting institutions under the Anti-Money Laundering (AML) regime, with several statutory obligations imposed upon them involving record-keeping, customer due diligence, reporting suspicious transactions and implementing the compliance programme within their legal firms. However, official reports indicate that since then, the lawyers' compliance with such duties is rather dismal. It is within this context that this paper seeks to examine their rationale not conforming to their statutory obligations. This paper adopts a qualitative approach. Primary data is obtained from seven case studies of legal firms in the country, which is triangulated with t data from the Central Bank and the Bar Council. Preliminary findings suggest that apart from legal professional privilege and assurance of client confidentiality, business rationality, and the cost-benefit analysis significantly contribute to the unwillingness of lawyers to comply with their AML obligations.

Keywords: Compliance, cost-benefit analysis, money laundering, obligations, privilege, rationality

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INTRODUCTION

The inclusion of businesses under the Anti-Money Laundering regime can be traced to 1990 when the financial institutions were first included as gatekeepers under the AML regime. Soon after the Financial Action Task Force (FATF) in 2003 extended its gatekeeping mandate to other businesses such as the legal profession, accountants, money services business, casinos, and precious metal dealers and stones. The inclusion of firms under the AML regime comes with several mandatory obligations, which require their compliance. However, concerns have been raised by the authorities about the level of compliance of such gatekeepers, in particular, the legal business, as being rather dismal. The primary objective of this paper is to examine the justifications for the lack of compliance by Malaysian businesses, particularly the legal practitioners, in complying with their obligations under the AML regime. The first part of the paper examines the legislative setting of the anti-money laundering law. The second part discusses the legal obligations under the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act (AMLTFPUAA) 2001. The third section reviews the literature on the lack of compliance by lawyers in adhering to their AML obligations. The fourth part explains the methodology adopted in this research. The fifth section, which is the crux of this paper, highlights preliminary findings of the research focusing on the factors hindering the legal business and legal practitioners' compliance with the AML law such as the legal professional privilege and the assurance of client confidentiality, business rationality, and the cost-benefit analysis. The following section examines the relationship between the findings and the literature on such compliance. The final section concludes the paper.

Legislative Setting of the Anti-money Laundering Law in Malaysia

The development of anti-money laundering law in Malaysia is influenced by the international and regional instruments on money laundering, namely the Vienna Convention, the Palermo Convention and the Asia Pacific Group on Money Laundering (Castle, 1999). The anti-money laundering law in Malaysia has been in existence since 2001. Before 2001, such crime was governed by the Drugs Dangerous (Forfeiture of Property) Act 1988, section 18 of the Prevention of Corruption Act, 1997, Section 411 to Section 414 of the Penal Code (Hamin, Othman & Kamaruddin, 2014).

In May 2001, the anti-money laundering law was passed in the Malaysian parliament, which adopted the FATF 40 Recommendations and subsequently came into force in January 2002, known as Anti-Money Laundering Act 2001 (AMLA) (Singh, 2002). Hamin, Omar and Kamaruddin. (2015) found that in 2004, Malaysia amended its anti-money laundering law so as to keep pace with the FATF 2003 Recommendations. With this amendment, the designated non-financial businesses and professions (DNFBPs) including the legal profession were made as one of the gatekeepers or reporting institutions under the AML regime and the beginning of the criminalisation of terrorism funding. Also, such amendment led to a name change from AMLA to the Anti-Money Laundering Anti-Terrorism

Financing Act 2001 (AMLATFA 2001). Dhillon, Ahmad, Rahman, and Miin, (2013) assert that the AMLATFA is very much a big leap in the history of Malaysian legislation a as its coverage is wider compared with other previous statutes.

In 2014, the Malaysian government had overhauled the AMLATFA to be in accord with the FATF 2012 40+9 Recommendations. The recent amendment led to a name change, now known as the Anti-Money Laundering, Anti-Terrorism Financing and Proceeds of Unlawful Activities Act (AMLATFPUAA) 2001 (or the 2001 Act). Other changes involve the creation of new offences for money laundering such as smurfing and cross-border cash transfers; clarification on the duty to report by the reporting institutions under Section 14. A new Section 14A was created to prohibit the disclosure of reports and related information that have been provided to the competent authority (Hamin et. al., 2014).

Statutory Obligation of Legal Professionals

The term gatekeeper means an independent watchdog or someone who screens flaws or defects or who verifies compliance with standards or procedures (Coffee, 2006). In the context of money laundering, the term gatekeeper is known as someone who screens out any wrongdoings of their clients or persons associated with their business concerning AML/CFT wrongdoings (Sullivan, 2011). As one of the gatekeepers under the AML regime, legal practitioners are required by law to comply with their legal obligations stated in Sections 13 to Section 19 of the AMLTFPUAA 2001. Such duties of the gatekeepers are in pari materia or similar to the FATF Recommendations. For instance, Section 16 of the 2001 Act provides that legal professionals must establish customer due diligence when dealing with their clients. Such duties include taking and maintaining a proper customer identity as well as restriction on dealing or maintaining anonymous accounts when establishing any business relationship with the clients.

In addition to building a client profile, Section 13 and Section 17 of the 2001 Act also required legal practitioners to exercise their record keeping and record retention measures obtained from due diligence process. The records should be kept for six years from the date the relationship was established. Section 13 (3) stated the types of information that should be held by reporting institutions. For example, the identity and address of the person in whose name the transaction is conducted, the identity and address of the beneficiary or the person on whose behalf the transaction is conducted and the identity of the accounts affected by the transaction. Other information includes the type of operation involved, such as deposit, withdrawal, exchange of currency, cheque cashing, purchase of cashier's cheques or money orders or other payment or transfer by or through, or to such reporting institution and finally, the date, time, and amount of the transaction.

Section 14 of the 2001 Act provides for the duty to report on any suspicious transactions to the Central Bank of Malaysia or the Bank Negara. Such reporting obligation under the law arises when any transaction of which the identity of the person involved, the transaction itself or any other circumstances concerning that transaction gives any officer or employee of the reporting institution any reason to suspect that the transaction involves the proceeds of an unlawful activity or instrumentalities of an offence (Section 14 (1) (b) of the 2001 Act). The reporting institutions are required to create a proper system of notification for the submission of the Suspicious Transaction Reports (STRs), which would provide the guidelines for the identification of the red flags within the reporting institution (Hamin, Omar, Rosli & Kamaruddin, 2015; Omar, Johari, Azam, & Hakim, 2015).

Finally, Section 19 of the 2001 Act deals with the obligation of the reporting institutions to implement a proper internal control process within their businesses for AML/CFT monitoring purposes (Hamin et.al, 2015). Yasin (2015) remarks that the duties under Section 19 are known as the four-fold functions. These obligations include the creation of specific policies and procedures for anti-money laundering measures, training and awareness programme for the employees, the appointment of an independent audit and the appointment of the compliance officer within the legal firms or reporting institutions.

LITERATURE REVIEW ON THE LAWYERS' AML COMPLIANCE

The extensive literature on money laundering suggests that such crime is a financially-related crime involving the essential act of conversion and concealment of the illegal source of funds into legitimate ones. For instance, the Financial Action Task Force (FATF), an inter-governmental body that oversees the policies to counter money laundering and terrorist financing, defines money laundering as the processing of a vast number of criminal acts to generate profit for individual or group that carries out the act with the intention to disguise their illegal origin, in order to legitimize the ill-gotten gains of crime (FATF, 2002). Similarly, Houpton (2009) has defined money laundering as a process in which criminals attempt to hide the origins and ownership of the proceeds of their illegal activities. Also, Shehu (2004) defines money laundering as an effort to disguise the true origin, source, ownership and sources of wealth derived from crimes and legitimize the income.

Studies show that there was a shift of platform in the commission of such crime from the financial institutions to the professionals including the legal practitioners. This is due to the strict implementation of anti-money laundering regulation within the financial industry (FATF Typology Report 2002). Choo (2014) asserts that the shifting of the platform to launder money by criminals are due to the services provided by the professionals and businesses that the criminals can utilise to perform series of transactions. Such services include transferring the money through offshore companies and purchasing goods for resale, before channelling the proceeds into the legitimate financial system. Legal and financial professionals have become unwitting accomplices in this complex money laundering schemes, particularly those involving significant financial fraud and organised crime (Global Money Laundering and Terrorist Financing Threat Assessment, FATF 2010: Benson, 2014).

It has been argued that the imposition of AML statutory obligations upon the legal practitioners are impacting on client privilege and thus, affecting the legal profession. For instance, the FATF indicates that the ethics of the legal profession and the traditions of client secrecy are hindering the duties imposed upon the legal practitioners (FATF Typology Report 2003-2004). Similarly, Gregory (2003) notes the implication of the legal profession as gatekeepers under the AML regime has led to a debate on the attorney-client legal privilege. Shepherd (2013) on the other hand, speculates that the imposition of duties on lawyers would dissuade the clients with potential legal issues from seeking advice from lawyers and thus making the former more likely to break the law.

Yasin (2004) opines this obligation will impact on Malaysian lawyers while Hamin et al. (2015) argue that the AML duties on the lawyers would, to a certain extent, be inconsistent with their legal professional privilege and thus impacting on their legal profession. Additionally, the APG report 2007, the APG Report 2015 and the Bank Negara Compliance Report 2011 state that the low level of compliance by the legal practitioners in Malaysia can be partially attributed to the client-attorney privilege.

Literature has also examined the financial implication or the cost benefit analysis of the AML compliance. For instance, Koh (2013) speculates that the economic impact is the primary concern of the legal professionals in fulfilling their obligations. He argues that lawyers are concerned about breaching their professional ethics as they consider their roles as legal advisors to their their clients rather than policing them (Koh, 2013). Satar (2013) highlights that money laundering has led to legal firms losing 10 percent of their revenue in addition to incurring extra costs (25%) to install a proper system to reduce such crime.

According to Antonius (2013), there are numerous budgetary and administrative constraints facing businesses in putting an appropriate AML system in place. External challenges include geographical boundaries, market penetrations, sophisticated crime typologies, and increased regulatory expectations. It is, therefore, imperative that businesses carry out the cost-benefit analysis on a periodic basis so as to ensure that the proper system is in place to monitor the AML activities (Antonius, 2013). In the context of the financial services industry, Gruppetta (2015) asserts that the efforts to tackle money laundering and comply with the financial sanctions are costly and time-consuming. The same limitations could apply to the legal firms operating in Malaysia, which are mostly small and mediums-sized firms.

There are very few studies focusing on the topic of business rationality in the context AML compliance by the legal profession. For example, the International Monetary Fund Report (2006) highlighted the reluctance of non-financial businesses and profession (DNFBPs) such as the legal profession and the money services business to expend their resources in ensuring compliance with their AML obligations as it would defeat the purpose of establishing their business. The APG Report on Malaysia in 2007 and 2015 have consistently reported on the low level of compliance by the legal profession. Lack of conformity was also due to limited resources within the legal firms. As a result of such lack of compliance, the internal control measure has not been satisfactorily achieved (APG Report 2007; APG Report 2015).

METHODS

This study adopted is a qualitative research aimed at providing a deeper understanding of the AML regime in Malaysia and the compliance of the legal profession with it (Silverman, 2005). Preliminary findings of this research are based on the analysis of primary and secondary data: The first stage of the data collection stage was literature review in which all of the relevant studies on money laundering and the compliance of legal professional to the anti-money laundering regime were evaluated. The primary source was the Anti-Money Laundering Anti-Terrorism Financing Proceeds of Unlawful Activities Act 2001 (AMLATFPUAA 2001), and the secondary sources were textbooks, academic journal articles, government reports, newspaper articles, and online sources.

The second phase of data collection involved fieldwork, and adopting a case study research design. Such design involved six units of analysis representing two large, two medium sized and two small sized legal firms within the Klang Valley. The instrument for the case study was face-to-face semi-structured interviews, using purposive sampling technique, with 20 respondents who are lawyers, office managers and the compliance officers Primary data obtained from the interviews was triangulated with the those obtained from two representatives of the Malaysian Bar Council and the Central Bank of Malaysia respectively, as well data from fieldwork. The interviews were digitally recorded and transcribed and later analysed using Atlas ti qualitative software and content analysis approach.

RESULTS

Preliminary Findings

This research is currently at data analysis stage and for the purpose of this paper, some preliminary findings are highlighted.

Legal professional privilege. Results revealed that regardless of the size of the legal firm, the existence of legal privilege and assurance of confidentiality among the Malaysian lawyers under the Section 126(1) of the Evidence Act 1950 had, to some extent, impeded their compliance with the AML regime. Despite the fact that professional secrecy has been overridden by Section 20 of the 2001 Act, the majority of the respondents were unaware or ignorant of such provision and its implications. Indeed, they believed that their responsibilities were to uphold their clients' secrets. As a result of such adherence to these duties, they have never reported or were reluctant to report to the Financial Intelligence Unit (FIU) at Bank Negara of any suspicious transactions involving their clients.

Cost benefit analysis. The imposition of the legal duties on lawyers to prevent money laundering occurring within their legal firms had financial implications for the respondents. . Except for large legal firms, the majority of the respondents believed that the economic effect of the AML statutory obligation, in particular, the requirement of Section 19 concerning the internal control measures, were burdensome on them. They opined that such demands were rather costly and challenging for them and suggested appointing a compliance officer as well as an independent auditor to check the internal control measures, specific AML training for their employees and finally specific AML policies and procedures in place within their firms. Apart from the financial burden to fulfil the Section 19 requirement, findings also revealed that many respondents were unaware of their specific obligations under this particular section and as such, have failed to carry out such duties.

Business rationality. In the context of business rationality, more than half of the respondents felt that adherence to the AML statutory obligations would defeat their purpose as profit making entities. The respondents also expressed the view that their primary purpose was to solve their clients' problems rather than make them more complicated. When asked about their suspicions of money laundering activities involving their clients, the majority of the respondents stated that rather them taking any action against such clients under the anti-money laundering law, they would politely refuse to act further on behalf of such clients. They believed that such measure would prevent unnecessary confrontations or disputes with such clients, which would be more prudent and less financially risky than reporting the matter to the relevant authorities.

DISCUSSION

This study highlighted some of the rationale that prevent compliance of legal professionals to AML obligation. It is apparent that professional privilege and the duties of confidentiality have remained the main concerns of the Malaysian lawyers. Given that such legal professional ethics guided the respondents' actions, their adherence to their legal duties as the gatekeeper for anti-money laundering activities has taken a back seat. Such findings confirmed those of Gregory (2003) who noted on the possible conflict between the attorney-client privilege and the AML statutory obligations of the legal professionals. Also, within the Malaysian context, the findings confirmed Hamin et al. (2015), Yasin (2004) and Koh (2013) who suggested that the AML statutory obligations imposed upon the legal practitioners were contrary to the legal professional's privilege under Section 126 (1) of the Evidence Act 1950. Such findings were also in line with the official reports from the FATF 2002, the APG Report 2007 and the APG Report 2015, which have reported on the same issues.

The above findings also showed that the financial implication was significant, in particular, the requirement to implement the four-fold of mitigation measures of the internal control process under section 19 for small and medium scale legal businesses. Such findings verified Koh (2013) who contended on the financial implication of putting a proper AML system in place within the legal firms. Also, the results confirmed those of Satar (2013), Antonius (2013) and Gruppetta (2015) who were similarly concerned about the rising cost of implementing the proper AML measures.

Findings revealed that the existence of business rationality consideration further contributed to the low level of compliance by the legal practitioners to their AML obligations. Such reluctance to comply with their AML duties confirmed the recent views of Hamin et al. (2016) and Koh (2013) who indicated that the primary motivation of the legal business was on profit making rather than assisting the State in policing money laundering activities.

CONCLUSION

The inclusion of lawyers as one of the gatekeepers of the AML regime is controversial. The State one the one hand is attempting to address the vulnerability of lawyers as a conduit to money laundering while at the same time place some responsibility on the legal profession to monitor money laundering activities of their clients. On the other hand, despite such legal obligation, lawyers tend to remain loyal to their clients as part of their privileged relationship requiring them to be professional and practise confidentiality. Findings of this study suggest that the low level of compliance by lawyers were due to both their privileged relationship with their client, the cost-benefit analysis of conformity and business rationality of the legal actors. These preliminary findings confirm official reports and literature findings on the extent of compliance by lawyers and their firms to their AML obligations. As there was no evidence to show that the authorities would come down hard on the lawyers for their lack of compliance to the AML law, the status quo will prevail.

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