



## **Anti-Money Laundering and Terrorist Financing Working Group**

# **Risk Assessment Case Studies for the Legal Profession**

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## OVERVIEW

The practice of law exposes members of the legal profession<sup>1</sup> to unique risks and vulnerabilities in relation to money laundering. Criminals may target legal advisors to lend legitimacy to their illicit operations or make use of trust accounts to launder proceeds of criminal activity. Legal advisors are also necessary to complete real estate transactions and set up trusts, both common vehicles for cleaning dirty money.

As a legal advisor you have important legal and ethical duties in relation to money laundering and other crimes. Under the rules of professional conduct, legal advisors must not knowingly assist in or encourage any fraud, crime or other illegal conduct. Additionally, you must withdraw if a client persists in instructing you to act contrary to law or professional ethics. As a legal advisor it is important for you to be aware of a recent amendment to the Criminal Code that added a recklessness standard to the offence of money laundering. This amendment makes it an offence to deal with property or proceeds of property “knowing or believing or being reckless as to whether” they are the proceeds of crime<sup>2</sup>.

Understanding these duties and knowing how to recognize the risks and vulnerabilities are essential to protecting you and your practice, the legal profession, and the public.

This document is designed to help you become familiar with and learn how to spot red flags, as well as to guide practical responses when faced with situations of possible money laundering. It is recommended that you review the document periodically, as a preventative measure, to enhance your ability to spot and avoid problems.

The following case studies<sup>3</sup>, which describe the scenario, identify red flags, and include commentary on how you can respond, are divided thematically according to common methods that criminals use in targeting legal advisors<sup>4</sup>:

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<sup>1</sup> Members of the legal profession in Canada include lawyers, Quebec notaries, and Ontario paralegals. For simplicity the term legal advisor is used throughout the document to refer to all members of the profession.

<sup>2</sup> Section 462.31, effective June 21, 2019.

<sup>3</sup> The case studies are adapted from the Financial Action Task Force’s (FATF) Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals (2013), the International Bar Association, the American Bar Association and the Council of Bars and Law Societies of Europe’s A Lawyer’s Guide to Detecting and Preventing Money Laundering (2014), case law and other open source materials.

<sup>4</sup> See, for example, FATF Money Laundering and Terrorist Financing Vulnerabilities of Legal Professionals (2013).

1. Misuse of trust accounts
2. Purchase and sales of real estate property and other transactions
3. Creation and management of trusts and companies
4. Managing client affairs and making introductions
5. Disputes and litigation

A quick reference guide of red flags is included as an Appendix.

Several of the case studies include reference to individuals who come from, or transactions that involve, “countries that pose a geographic risk.” These are countries that have been identified by competent authorities as posing a high risk for money laundering based on, among other things, prevalence of corruption and financial crime, and weakness of anti-money laundering laws and measures<sup>5</sup>.

Some case studies refer to “politically exposed persons” (PEPs). These are individuals who are or have been entrusted with prominent public functions within domestic or foreign governments, or international organizations, as well as their family and business associates<sup>6</sup>. Due to the opportunity that PEPs have to influence decisions and control resources, they are vulnerable to corruption.

Heightened scrutiny and enhanced risk assessment measures are required when a case involves a PEP and/or a country that poses a geographic risk.

If you have questions about a case or circumstance in which you are involved that may relate to money laundering, you may wish to consult your law society or independent legal counsel.

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<sup>5</sup> Government of Canada-imposed Economic Sanctions ([https://www.international.gc.ca/world-monde/international\\_relations-relations\\_internationales/sanctions/current-actuelles.aspx?lang=eng](https://www.international.gc.ca/world-monde/international_relations-relations_internationales/sanctions/current-actuelles.aspx?lang=eng)), FATF (<http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/>), FINTRAC (<https://www.fintrac-canafe.gc.ca/new-neuf/1-eng#tab2>), United Nations Security Council (<https://www.un.org/securitycouncil/sanctions/information>).

<sup>6</sup> Defined under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (PCMLTFA), S.C. 2000, c. 17, section 9.3, PEPs include the head of state or government, member of executive council of a government, member of a legislature, deputy minister (or equivalent), ambassador, senior military officer, president of a state-owned corporation, head of a government agency, judge, and president of a political party represented in a legislature, as well as the personal . Domestic PEPs include officials at the federal and provincial/territorial level as well as a mayor of a municipality. The head of international organizations are also considered PEPs. See the PCMLTFA for a full list of PEPs and visit FINTRAC’s website for more information on PEPs: <https://www.fintrac-canafe.gc.ca/publications/general/faq-pep-eng>.

# 1. MISUSE OF TRUST ACCOUNTS

## SCENARIO:

### **Aborted transaction and transfer of funds without substantial legal work done**

A law firm was approached by a new client seeking legal services on some asset purchases. The firm assigned the matter to a junior lawyer, who was keen to grow their client list and help bring new work into the firm. The new client also seemed eager to retain the lawyer and the firm. At the client's request, the lawyer gave the client the law firm's trust account details before the client identification and verification checks on the client were completed or the engagement letter was signed. The client quickly deposited funds in the law firm's trust account.

Following the deposit of funds, the client did not immediately respond to communications or requests to attend at the firm's office and she did not give any further instructions. When the client responded to the lawyer a few days later by email, the client explained that she no longer intended to purchase the assets and asked for the deposited funds to be returned; however, she requested they be sent to a third party, rather than to the original account.

#### **RED FLAGS**



- Urgency on the part of the client to deposit funds.
- Transaction is aborted shortly after funds deposited.
- Client initially appears keen but becomes difficult to reach following the deposit of funds.
- Client requests the deposited funds be returned before any substantive legal work has commenced.
- Client requests that deposited funds be sent to a new account or a third party, rather than returned to the same account.
- Client avoids personal contact without good reason.

## **What can you do?**

Client funds should not be deposited into your trust account until you have completed your due diligence and risk assessment of the client, including the required client identification and verification steps, established the details of the transaction (including its purpose), and satisfied yourself that there is no reasonable risk that acting for the client or on the transaction will involve assisting in or encouraging any fraud or other illegal conduct including money laundering.

To avoid the risk of a client depositing funds into your trust account before you have taken these due diligence steps, you should not provide the client with the details of your trust account. Any unused client trust funds should be returned to the client or the original payor (if received from someone on behalf of the client).

Where a client directs that funds deposited into your trust account be paid out to a third party, you should, at a minimum seek an explanation for the directions. If you have concerns about the bona fides of the proposed payment, you should return the funds to the original source. You should also consult your regulator's rules regarding the acceptance and return of cash or other money.

## 2. PURCHASE AND SALE OF REAL ESTATE PROPERTY AND OTHER TRANSACTIONS

### SCENARIO:

#### Investing potential proceeds of crime

A client retained a legal advisor for the purchase of a residential property. The client did not come into the office and communicated by telephone and email only. At the outset of the engagement, the client indicated that he wished to pay the total purchase price for deposit into the law firm's trust account before the final agreement was reached.

The legal advisor's due diligence suggested that the sum provided was a large amount relative to the client's employment income. After the client's funds were deposited the client became slower to respond with instructions and seemed less interested in the details of the transaction as it progressed. At one point, the legal advisor told the client about an easement discovered on title that would allow his neighbour to drive through the back part of the property. The client did not seem concerned about this or ask many questions. The purchase of the property went ahead for a sum smaller than that deposited.

### RED FLAGS



- Client's unusual request to deposit funds early in the transaction, especially before the purchase price had been finalized.
- Sum deposited appears large relative to the client's income.
- Client becomes evasive and less interested in the transaction despite depositing a large sum of money.
- Transaction results in surplus funds from the initial large deposit.

### What can you do?

You should be wary of clients who are prepared to deposit large sums into a trust account at the very outset of an engagement (and certainly prior to the agreement being finalized). Advise the client on a more common or appropriate time to deposit funds (i.e. just prior to closing). If the funds the client has deposited are large relative to their socio-economic profile, you should consider conducting enhanced verification of the source of funds.

This may include asking for additional information and documents demonstrating how the client acquired and maintained the funds (e.g. banking and investment records, receipts, contracts). Be wary of accepting client funds in excess of those required for the transaction and associated expenses (e.g. fees and disbursements).

## SCENARIO:

### Unexplained source of wealth used to purchase property<sup>7</sup>

A couple with some wealth recently immigrated to Canada from a country that poses a geographic risk. They retained a legal advisor to assist with the purchase of a large residential property and to set up a company. The home was paid for without any financing. The couple separated soon after moving to Canada. Despite separating, they continued to buy and develop residential properties together, usually without financing through their joint company.

At one point, the ex-husband transferred his interest in the company to a real estate agent they had been using for the purchases, only to transfer the interest back a short time later. The couple did not have any employment or business interests in Canada beyond real estate investing. The ex-husband was an extensive gambler and required income from the properties to pay for these activities.



#### RED FLAGS

- Clients coming from a high risk country.
- Unexplained source of wealth for the purchase of properties.
- Purchase of several residential properties without financing over a short period of time.
- Potential marriage of convenience (separating soon after entering Canada).
- Unusual transfer of the client's interest in the company only to be returned for no apparent reason.
- Client heavily involved in gambling activities.

## What can you do?

In addition to verifying the source of funds, when a client is from a high-risk country and has wealth of a mysterious origin, you should conduct further inquiries including requesting additional supporting documentation. Additional red flags – extensive gambling, possible marriage of convenience, large purchases without financing – also indicate the need for caution. Unless you are satisfied to a reasonable standard that the money is not the proceeds of crime, you must not act or continue to act for the clients.

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<sup>7</sup> Based on *Wang v. Kesarwani*, 2017 ONSC 6821 (CanLII).

## SCENARIO:

### Back-to-back sales from client with low income relative to amounts paid

An individual in his 20s who worked as a labourer approached a legal advisor to purchase multiple real estate properties. The client appeared to have negotiated good prices for the properties. The legal advisor believed the client was getting a very good deal even in the current slow market. The client claimed to be funding the purchases from previous real estate sales. Shortly after the purchases, the client instructed another lawyer to re-sell the same properties at a higher price. The purchasers were also in their early 20s with low-paying jobs. The client had in fact taken out mortgages on these properties using false documents, generating proceeds of crime. The multiple re-sales helped to launder those funds.

### RED FLAGS



- Funds at the client's disposal appear large relative to the client's income.
- Client and other parties appear to be young for high value transactions given their income.
- Properties are paid for without financing.
- Client engaged in back to back property transactions, out of sync with normal market dynamics.
- Reason for the transactions is unclear.
- Purported value of the properties rapidly increases with each subsequent transaction despite the short period of time in between transactions.
- Client changes legal advisor in a short time period for no apparent reason.

### What can you do?

If a client with a low to modest income and no other apparent source of wealth proposes to buy property with no financing, additional information is required. In this case, you need to conduct enhanced due diligence on the source of funds including obtaining supporting documentation for the "previous real estate sales" that reportedly generated the initial funding.

Before acting you must be satisfied that the explanation provides a reasonable basis for concluding that the transactions are legitimate. A subsequent legal advisor hired in a back to back sale should also inquire about the reasons for the client retaining new legal representation.

## SCENARIO:

### Criminal uses elderly parents to launder proceeds of crime

An elderly couple and their adult son met with a legal advisor about the purchase of a home. The son explained he was there to support his parents. The parents acknowledged this and presented valid identification. The son did most of the talking for his parents during the meeting. The parents' income consisted of a modest pension. They lived in a trailer home, which they planned to keep for their son's use. About half of the purchase price for the new home came from a bank account in the parents' name, which the son helped to set up. The balance was financed through a private mortgage in the parents' names.

The legal advisor assisted the couple in purchasing the property speaking mainly with the son and, as instructed, registered title in the parents' names. The mortgage, which was over \$300,000, was paid off immediately. The son returned to the legal advisor's office soon after and inquired about new wills for his parents. The son turned out to be a career criminal using his parents to launder proceeds of crime from drug trafficking, fraud, and auto theft.



#### RED FLAGS

- Third party, rather than the clients, appears to be directing decision making.
- Disproportionate amount of private funding or availability of cash, which is inconsistent with the known legitimate income of the clients.
- There is uncertainty about who the real beneficiary or owner is.
- Mortgage repaid significantly prior to the maturity date with no logical explanation.

## What can you do?

Although it is not uncommon for family members to assist in legal matters, you should carefully consider who you are really acting for and whether there may be capacity issues. Additional steps may be necessary to confirm who is giving the instructions and to ascertain who are the true beneficiaries of the transactions. Enhanced verification of the source of funds is also warranted when the client's income is modest, they have no other apparent source of wealth (such as selling property) and they are financing only a portion of the purchase price.



### 3. CREATION AND MANAGEMENT OF TRUSTS AND COMPANIES

#### SCENARIO:

#### Creation of a private trust

A woman contacted a mid-sized law firm seeking legal advice on creating a trust. She found the law firm through an internet search. The woman was from a country that poses a geographic risk. She provided a valid visa as proof of identification. She asked the lawyer to prepare a trust to handle an inheritance she received back in her home country. The trust was to be funded via wire transfer of the inheritance into the law firm's trust account in Canada. She asked for a legal opinion on tax issues and filing requirements in relation to the trust.

The client wanted to be the trustee with her adult children, one of whom lives in Canada named as the beneficiaries. She did not have a Canadian residence or bank account. The client also wanted an introduction to a chartered accountant and a banker in Canada. The type of trust requested by the client was a normal structure familiar to most legal counsel with experience with trusts. The goal of the client appeared to be asset management for the benefit of her children. While the tax consequences may have been complex, the plan itself was relatively typical.

#### RED FLAGS



- Client is not known to the legal advisor and the source of the connection (i.e., internet search) does not add any comfort.
- Client comes from a country that poses a geographic risk.
- The funds are to be wired from outside of the country into the law firm's trust account.
- Client does not have a bank account in the jurisdiction.
- Client requires introduction to multiple professionals (i.e. certified accountant and banker) indicating lack of connection with the jurisdiction.

#### What can you do?

Despite the fact that the plan for the trust is not unusual, several factors give cause for concern and suggest a potential money laundering risk, including the client's geographic location, limited connection to the jurisdiction, and rationale for selecting the legal advisor. There is also no compelling reason for the funds to flow through the legal advisor's trust account. In such cases, you should advise the client to open a Canadian bank account and not accept the funds directly into your trust account.

Additional inquiries should be made into the source of funds, including a request for supporting documentation. If after further inquiries, you are not satisfied on an objective basis that the transactions are legitimate, you must not act.

**SCENARIO:****Management of an existing trust that may contain criminal property**

A client went into the trust lawyer's office to terminate a trust established by his deceased mother. The client was the sole beneficiary of the trust. When asked about the source of the funds in the trust, the client was ambiguous and appeared evasive. When pressed, the client informed the legal advisor that he believed his mother may have embezzled the funds over many years from her long-time employer. The client asked the legal advisor for advice regarding the disposition of the assets in the trust and any legal obligations to the former employer.

**RED FLAGS**

- Client is not well known to the lawyer.
- The funds in the trust may be from illegal activity.

**What can you do?**

If you suspect assets may have been obtained through illegal activity, you have legal and ethical duties to make further inquiries. Facilitating the distribution of the trust assets to the client without making such inquiries and without being satisfied that the funds in the trust account were not obtained illegally would likely result in the breach of the applicable legal and ethical duties. There are no legal or ethical issues with preparing an opinion on the rights of the defrauded employer and the impact of those rights on the trust assets and client's entitlement to them.

## SCENARIO:

### Trust managed to facilitate a fraud<sup>8</sup>

A client retained a legal advisor to set up a trust. After the trust was established and the retainer had ended, the client created a false genealogy for the trust claiming it was a long-standing trust associated with a European monarchy. He then solicited investments for phony loans. The client hired a new legal advisor to manage the trust and publicized the advisor's credentials to legitimize the trust. The client provided the second legal advisor with false documentation about the trust.

The client then instructed the legal advisor to provide guarantees on behalf of the trust, maintain an escrow account into which "investments" could be deposited, and distribute the deposited monies to the client and his third party associates when requested.

### RED FLAGS



- Client retained different legal advisors for setting up the trust, and later managing it, to hide the origins of the trust.
- Payments to the trust appear to be advance fees in a potentially fraudulent scheme.
- Client relied on the reputation of the second legal advisor to bolster the trust.
- Client instructed the legal advisor to give guarantees, receive advance fees, and distribute funds out of the trust to the client and third parties.

### What can you do?

The legal and ethical obligation on legal professionals to not act for a client if there is reasonable likelihood it will aid or result in the commission of a crime is a very serious one. In this case, there are strong indications that the trust was being used fraudulently. Additional due diligence should be undertaken in such cases, including obtaining and carefully inspecting documents related to the creation and existence of the trust and scrutinizing the transactions that fund the trust.

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<sup>8</sup> Based on *United States v. Anderskow*, 88 F.3d 245 (3d Cir. 1996).

## 4. MANAGING CLIENT AFFAIRS AND MAKING INTRODUCTIONS

### SCENARIO:

### Legal advisor fails to respond to money laundering warning signs

A client who owned several residential rental properties contacted a legal advisor for assistance with the purchase of another rental property. He had not yet decided on a property to purchase. He told the legal advisor that he wanted to choose a legal advisor he liked working with and whom he could trust before making his decision on a property. The two had several common interests and got along very well. They met often and became friends, but the client did not provide any immediate work.

One day, the client told the legal advisor that he had found a suitable property but could not proceed due to temporary cash flow difficulties caused by the need to make repairs to one of his rental units. He asked for a short-term loan, which the legal advisor agreed to, lending the money from his personal account. The legal advisor did not advise the client to get independent legal advice. The transaction went ahead and, shortly after closing, the client settled the loan. The client subsequently purchased two more properties, one funded by another loan from the legal advisor; the other funded by payments from a third party account. The client explained that the third party owed him a debt for unpaid rent.

The legal advisor took the client at his word and did not ask for additional information or supporting documents about this debt. Around this time, the legal advisor saw a news report indicating the client was being investigated for involvement with organized crime. The real estate deals closed without issue and the second loan was repaid quickly.



### RED FLAGS

- Client is seeking to establish a relationship without specific work identified.
- Source of funds for the transactions are unusual.
- Lack of information on the source of funds for loan repayments.
- Payments from third parties.
- Client has suspected criminal associations.

### What can you do?

You should exercise a high degree of caution when a client seeks to establish a relationship without asking you to undertake any specific legal work. Criminals may seek to “groom” you as part of their illegal scheme. The rules of professional conduct prohibit the lending of money to a client unless you explain the conflicting interest and require the client to obtain independent legal advice. Short-term loans of large sums raise red flags and, in circumstances such as these, particularly if discovering suspected links to organized crime, you should not act for the client.

**SCENARIO:****Lawyer's judgment clouded by relationship with longstanding client**

A sole practitioner, with 18 years of estates law practise, was asked by a longstanding client for help in selling his cottage. The legal advisor very rarely did real estate work, but wanted to keep this client's employment law business. She relied on her longstanding relationship with the client and did not take steps to verify the client's identity or otherwise try to learn anything more about the client. The client told her that he wished to sell the property quickly and was willing to list it at almost two-thirds its potential value.

The legal advisor found this odd, but accepted the client's explanation that he was experiencing financial difficulties and could no longer keep up with mortgage payments on his home. The legal advisor had heard a rumour that the police had investigated the client at some point for involvement in drug dealing, but she was not aware of any details. The client was subsequently convicted of drug trafficking. It emerged that he sold the cottage in a hurry as he feared it might be confiscated as part of the criminal proceedings.

**RED FLAGS**

- Client asked the lawyer to perform work outside her usual scope of practice.
- The instructions to sell the house below value were unusual and could result in a loss to the client.
- Client may be involved in the illegal drug trade.

**What can you do?**

You should make inquiries if you have information or hear “rumours” indicating the transaction may pose a risk for illegal activity, even with long-standing clients. You should also monitor your clients on an ongoing basis to ensure the information and instructions given are consistent with the purpose of the retainer and that you are not involved in or encouraging dishonesty, fraud, or illegal conduct. In this case, the client's possible criminal activity and his instructions to proceed with an expedited sale of property below market value were indicators that the lawyer might be facilitating criminal activity. In such circumstances, it would not be reasonable to proceed with the transaction.

## SCENARIO:

### Failure to complete due diligence due to source of referral

A junior partner in a law firm visited an important corporate client to make a pitch on a potential major new file. During a break in the meetings, the CEO for the client introduced the legal advisor to his nephew. The nephew needed help on some commercial matters and the director told the legal advisor that he would be “very grateful” if he would act for his nephew. The legal advisor wanted to please the corporate client and the work sounded straightforward. Urged to say “yes” or “no” right away, the lawyer agreed to act for the new client. Relying on the referral by a respected client and proof that the nephew had accounts with at least two major banks, the legal advisor decided to forgo the full due diligence checks.

Over the next two years, the lawyer acted for the nephew in straightforward commercial matters and significant funds remained in the law firm’s trust account following the transactions. One day, the police contacted the legal advisor and advised that they were investigating the nephew for suspected involvement in a fraud ring. Shortly afterward, the nephew called to ask the lawyer to transfer a large sum of money held in the client trust account to an overseas bank.



#### RED FLAGS

- Client puts pressure on the lawyer to represent unknown relative of client (in this case leveraging the lawyer’s desire to please another important client).
- Significant funds were being held for the client in the firm’s trust account following completion of transactions.
- Client is being investigated for fraudulent activities.

### What can you do?

Always complete your client identification and verification checks, regardless of who the source of the referral. Only funds directly related to legal services are permitted to be held in a lawyer’s trust account. You must disburse funds held in trust for the client as soon as practicable following completion of the related legal services.

## SCENARIO:

### International client and creation of shell corporations

A woman contacted a law firm and met with a legal advisor looking to set up some companies under the *Canada Business Corporations Act*. She presented valid identification and said she is a dual citizen of Canada and a country that poses a geographic risk. She was not employed in Canada, but acted as a director of several corporations in other jurisdictions. She described these other corporations in general terms, stating that most were in the importing and exporting business. The woman gave a similar description for the Canadian companies she wanted to set up. She told the legal advisor that the Canadian companies would initially be funded by the corporations outside the country.

The woman provided documentation and the law firm conducted a search of the corporations, which were verified but appeared to be mainly holding companies. The law firm and the woman entered into engagement retainer agreement. After the legal advisor began setting up the Canadian companies, as instructed, she came across news articles indicating that, even though they had different family names, the client appeared to be the daughter of a former well-known head of state, accused of corruption.

### RED FLAGS



- Client is a citizen of a country that poses a geographic risk.
- Client is a director of several corporations in multiple jurisdictions.
- Client can only provide general descriptions of the companies of which she is a director.
- Reason for setting up the new corporations is vague.
- Source of funds is uncertain.
- Funding for the new Canadian corporations is coming exclusively from outside the country.
- Client appears to be a politically exposed person, or have links to one.
- Client's role as director could be an attempt to disguise the real owner or parties to the transaction.

### What can you do?

In a situation like this you should make further inquiries about the source of funds and business plan for the companies to be set up in Canada and the client's actual role in these and other corporations. You should also take steps to determine whether the client is a PEP. There are a number of online lists of PEPs. Before acting in such a case, you must be satisfied on reasonable grounds that the matters for which you are being retained are legitimate.

## SCENARIO:

### International politically exposed person investing in Canada

An individual approached a senior lawyer in a law firm to act for him in the purchase of a local sports franchise. The lawyer and the firm were pleased because the firm's sports law work had been declining lately. The potential client was a wealthy individual who made his fortune in the mining industry in a country that poses a geographic risk due to a high level of corruption. The law firm completed its client identification and verification checks and found out that the client was heavily involved in politics in his home country, serving as a member of the national legislature and, at one time, minister of natural resources. These positions made the client a foreign PEP as defined under Canadian anti-money laundering legislation.

The senior lawyer raised the issue of source of funds with the client who responded that the acquisition would be funded out of the proceeds of the sale of one of his former mining businesses. The law firm accepted the engagement. During the course of advising on the proposed investment, a junior lawyer brought to the attention of the senior lawyer a news article reporting that the client had been accused of bribery in obtaining the mining concessions on which his fortune was built. Further, during his time in politics, the client was implicated in an expenses scandal, although a parliamentary investigation found him not guilty of these accusations.

The senior lawyer raised this issue (accusation of bribery) with the client and the client explained that the charges were politically motivated and were made up by an opponent to discredit him. The law firm accepted the client's explanation. A couple of years later, a foreign court convicted the client of bribery and corruption in connection with the mining rights and the parliamentary investigation, which had been conducted by a close associate, and ordered the client's assets frozen.



#### RED FLAGS

- Client obtained his wealth from a country that poses a geographic risk.
- Mining and natural resource extraction in a country with high corruption may pose a higher risk for money laundering.
- Client is a politically exposed person.
- Client is the subject of allegations of corruption.

### What can you do?

You should engage in more thorough risk assessment and due diligence when the client is a PEP or is from a high risk country or region. In this case, the client is both. You should undertake independent research instead of relying on the client's explanation. Before acting or continuing to act for a client in these circumstances, you must be satisfied on an objective basis that you are not facilitating a criminal offence.



## SCENARIO:

### Multiple high-risk factors relating to an international transaction

An individual attended at the office of a mid-sized law firm without a scheduled appointment seeking legal advice on setting up a business. He told the legal advisor he was an international businessman from a country in Europe and was in the process of moving to Canada. He said that he had secured \$700K in funding for the Canadian business from a company located in a country that poses a geographic risk. When asked for identification, he told the legal advisor he misplaced his passport in the move and had applied to replace it. He produced a photocopy of some temporary travel papers and promised to bring in his new passport as soon as it was issued. He also produced the investment agreement with the company from the high-risk jurisdiction.

The agreement was very basic and did not appear to have been drafted by a lawyer/legal professional. The individual said the funds would be wired by the company from a bank account in a country known for banking secrecy. The legal advisor performed an Internet search on the individual, his other businesses, and the investing company. The search showed that the individual had a very common name in his jurisdiction making it difficult to verify information on him. A Facebook page was found for one of his international companies, but the site had only the company's name, a low resolution logo and a street address with no phone number or email. The legal advisor did not find any information on the investing company.

### RED FLAGS



- Client shows up at the law office without an appointment or prior phone or email contact despite the relatively large investment at stake.
- Client and investing company are both located in high-risk countries.
- Client's connection to the jurisdiction is unclear beyond desire to start a business there.
- Client is not able to present valid identification.
- There is little to no information available on the potential client, his business or investing company.
- The purported investment agreement documentation is uncharacteristically simple for the nature of the transaction.
- Funding is arriving from a jurisdiction known for banking secrecy.

### What can you do?

You must satisfy the requirements under your regulator's client identification and verification rules. Given the lack of information on the client, his business and the investing company, you should conduct a risk assessment on the client and the other parties to the transaction to find out who they are and determine the source of funds. You should decline to act where there are multiple high-risk factors, as in this case.

**SCENARIO:****Failure to consider who controls the client**

A corporation retained a law firm in relation to the sale of assets. The corporation “passed” the law firm’s client identification and verification checks and provided documentation on the client’s ownership of the assets. In email communications with the legal advisor, the client copied several other individuals and asked that these individuals be included in future emails from the law firm.

When complications arose on the asset sale, a previously unidentified individual started to attend meetings and appeared to be leading the discussions and decisions for the client. It emerged that this individual had an outstanding warrant for fraud and was making decisions for the client despite holding no formal role with the corporation.

**RED FLAGS**

- Client is requesting that individuals with no apparent relation to the client be included in communications or meetings.
- Client decisions and instructions appear to be coming from a third party.
- Actual directing party has been charged with fraud.
- There appears to be an attempt to disguise the real owner or parties to the transaction.

**What can you do?**

You may only take instructions from third parties in very limited circumstances, and only after verifying their identity and obtaining the clear consent of the client. The absence of a logical explanation for the role of the third party is a red flag. The fact that the person who is apparently directing the transaction faces criminal charges for fraud significantly increases the risk of illegal activity. In this scenario, the red flags are sufficient to suggest that the lawyer ought not to continue acting.

## SCENARIO: Questionable source of funds

A legal advisor represented a company trying to create an initial public offering (IPO) for an opaque tech start-up. Due to concerns over the company's financial viability and a potentially messy ownership dispute, the company struggled to make the IPO a success. At the last minute, a previously unknown wealthy investor came along and made a substantial bid.

The money offered by the wealthy investor was actually the company's money. Representatives of the company were paying money to the purported investor to promote the investment.



### RED FLAGS

- Purpose of the client company is ambiguous.
- Unexplained financing arrangements.
- Appearance of sudden willing investor when previous interest was lacking.

## What can you do?

When questionable circumstances arise, such as the unexpected and last minute appearance of a wealthy investor, you should take additional steps, including requesting additional information on the source of funds, inquiring about the reasons for the investor's sudden appearance in the transaction, and/or establishing whether a relationship exists between the investor and the company. Also, when acting on an IPO, the legal advisor must have clear and detailed information on the nature of the corporation and its plans.

## SCENARIO: Instructions from an overseas client

A woman who was a UK national, phoned a Canadian legal advisor specializing in estates law seeking representation in relation to the purchase of some high-value properties. The woman told the legal advisor that he came highly recommended by a close friend of hers who was a long-time client and whose opinion she valued highly. The potential client said that she understood that her matter was not in the legal advisor's primary area of practice, but what mattered most to her was that she be able to deal with someone she could trust. The woman did not intend to travel to visit the properties prior to purchasing them.

She asked that the purchases be completed as soon as possible and offered to pay the legal advisor an extra fee if the purchases were completed by a certain date. She assured the legal advisor that financing would not delay the purchase since no loans were required.



### RED FLAGS

- Legal advisor being asked to advise on an area of law outside his expertise.
- Client is not planning to visit the properties, despite the high value of the transaction.
- No financing is required for the transactions despite their high value.
- Client promises to pay extra fees for speedily completing transaction.
- Client provides no explanation for an expedited transaction.

## What can you do?

You must always verify a client's identity and obtain information about the source of funds when a financial transaction is involved, even for referrals from trusted sources. You should undertake additional inquiries when there are high risk indicators, such as the client not visiting the properties, paying for high value properties without financing, asking you to take on a matter outside your areas of expertise or requesting you to expedite the transaction without a logical explanation. It is good practice to check any referral source. You can ask the client who referred them, and request consent to contact the referral source. If the client says "no", that is an additional red flag. If the client says "yes", you may discover that the source doesn't know the client well or at all, which may also be a red flag.

## SCENARIO:

### Performing due diligence on other parties to a transaction

A Canadian company was a longstanding and major client of a large law firm. The company planned to acquire a construction entity based in a country that poses a geographic risk. The client wanted the entity for its many lucrative government contracts. Very late into the negotiations, it was revealed that the construction entity had made a large number of payments to companies described in the records only as “consulting services”. Establishing the identity of the consultants or the exact nature of the services they provided was difficult. The legal advisors recommended that the client obtain more information about the consultant contracts and the fees paid under those contracts.

On a more detailed analysis, it became apparent that many of the consultants were linked to government officials responsible for awarding public contracts, licenses and permits. No details as to the precise services performed for the construction company were provided. The law firm became concerned that the fees might constitute bribes paid by the construction entity to secure contracts. The legal advisor informed the client that the construction entity it planned to purchase may have obtained its contracts through illegal acts and that the resulting revenue could constitute the proceeds of crime. Since the client was very interested in acquiring the entity, it asked the law firm to proceed with the transaction.



#### RED FLAGS

- Involvement of a higher-risk jurisdiction.
- Difficulty in obtaining satisfactory information related to services being provided to the target construction company and related to the payments it made.
- Certain assets of the entity being purchased (i.e., construction contracts) appear to have been illegally obtained.

### What can you do?

As a legal advisor you have an obligation to satisfy yourself that the transaction with which you are assisting is legal. In this scenario, you would have to inform the client that you could not complete the transaction unless additional information and supporting documentation was obtained to demonstrate the contracts were not illegally acquired. It is important to undertake appropriate risk assessment and due diligence, and to seek additional information when concerns arise. This may occur at any stage of the transaction. In the circumstances of this scenario, seeking further clarification was part of the legal advisor’s duty of care to the client.

## SCENARIO:

### Third party involvement in an expedited transaction

Legal advisor A is good friends with legal advisor B, whom she has known for years as their practices are similar. B called A and advised that a former client needed assistance with papering a loan that the client was going to make to Company X. B told A that she did not know much about the matter and could not act because she had a trial coming up. A didn't know (and didn't ask) any details about B's relationship with the client, including whether B had complied with the client identification and verification rules. A met with the client, who attended with two other individuals: the person to whom the client had made the loan at issue; and, a third party, introduced only by his first name. No information was provided about the third party's relationship to the lender or the borrower.

The third party did most of the talking during the meeting, explaining that the client lent \$500,000.00 to the borrower a few months ago at an interest rate of 30%. The third party said the proposal was to place a mortgage on the borrower's property for the loan. The third party told A that the borrower was leaving the country shortly on a business trip so they would need to get everything set up and signed immediately. Before anyone asked what A would charge for the retainer, the third party said they could pay her fees with cash or run out to get a bank draft.

### RED FLAGS



- No certainty that the client(s)/beneficial owners have been properly identified/verified.
- Involvement of a third party, whose relationship to the client and other parties is not known.
- Both client and other party meet with the lawyer together despite obvious conflict of interest issues.
- Third party appears to be in control of client and other party, and gives instructions.
- Desire to complete the transaction very quickly (i.e. same day).
- Third party offers to pay lawyer's fees in cash or bank draft right away without knowledge of the lawyer's rate.

### What can you do?

You should always ensure you know who the client is. Clarify the relationship of any third parties who may appear to be controlling or wanting to give instructions on behalf of the named client. You need the client's clear consent before accepting instructions from a third party and have an obligation to identify and verify the identity of the third party in such circumstances. You should also always assess and communicate any potential conflicts of interest if multiple parties are looking to retain you. It is important to be cautious when faced with a client seeking a transaction within a very short timeline and expressing a willingness to pay your fees immediately in cash without first learning your rate or an estimate of the final bill. You should also avoid entering into a joint retainer with the borrower and lender in private loan agreements.

## 5. DISPUTES AND LITIGATION

### SCENARIO:

### Claim for debt recovery with little substantive legal work required

A foreign company retained a legal advisor at a small firm to commence a debt recovery claim against a company located in the firm's jurisdiction. The legal advisor's main area of practice was employment law. At the time, he was busy with several large files. However, the matter appeared straightforward and he decided to take it on. A search verified the identity of the debtor company as a registered corporation, but it was not clear whether it had any assets in the jurisdiction. The legal advisor told the client, but the client did not seem concerned and instructed the legal advisor to proceed with the claim.

After one initial phone call with the legal advisor, the client only communicated via email. The legal advisor asked the client to send him documents to support the debt claim. The client sent a scanned copy of an invoice marked "unpaid" by email. The defendant company did not contest the claim and a default judgment was entered. The legal advisor served the default judgment on the defendant company and a demand letter explaining how to make payment. The defendant company responded by immediately transferring the sum into the law firm's trust account.



### RED FLAGS

- Legal services sought by client are beyond the expertise of the legal advisor.
- Foreign company without an obvious connection to the place of litigation.
- Defendant company with no apparent assets in the jurisdiction.
- Limited documentation on the nature of the debt underlying the claim.
- Defendant does not contest default judgment.
- Defendant pays the amount with little debt recovery work required by the legal advisor.

### What can you do?

It may be difficult to establish whether one is dealing with fictitious claims, but you must keep an eye out where matters seem to be proceeding too smoothly. You should also be cautious when being asked to take on matters outside your usual area(s) of practise. In this scenario, the legal advisor should have been alerted by the client's lack of concern about the defendant appearing to have no assets in the jurisdiction and the ease with which the litigation was settled. You should always obtain an explanation when asked to provide unused or excess trust funds to a third party since this can increase the risk of money laundering. To avoid this, you should return trust funds to the client or the original payor (if received from someone on behalf of the client).



## SCENARIO:

### Demand letter and settlement with little substantive legal work

A legal advisor was approached by a new potential client who asked for help regarding a dispute with the owner of ABC Ltd. The client said that the owner of ABC Ltd. convinced her to invest in his company by regaling her with its impressive sales numbers and promising the imminent global launch of ABC's product. The client bought shares in ABC Ltd. for \$100,000 with the expectation that the shares would be worth at least \$600,000 within 12 months. The client said that she now realizes that the owner of ABC Ltd. duped her and that the shares she bought are worthless. Although the legal advisor was busy with several tight deadlines on other files, he agreed to prepare a demand letter. He did not ask her for any documents since he thought the client had told him what he needed and he was only making a demand at this stage.

He sent the demand letter to a Hotmail email address that the client provided for the owner of ABC Ltd. The owner replied within days and agreed to buy-back the client's shares for \$500,000. The client was delighted and asked for the payment to be made by ABC Ltd. into the legal advisor's trust account, and then paid out equally to two separate numbered companies that she controlled. A few days later, the legal advisor received the settlement funds into his trust account by wire transfer from a country known for banking secrecy. The client thanked the legal advisor by giving him a \$5,000 bonus on top of his fees.

### RED FLAGS



- Client's loss relates to misleading and potentially fraudulent activity.
- Free online email (i.e., Hotmail) is used to communicate with corporate party.
- Settlement funds are paid very quickly and without explanation following the demand letter, particularly large sums.
- Settlement funds are received from an account located out of the country without explanation.
- Client requests, without explanation, that settlement funds on a personal debt be sent to two corporate accounts with no apparent connection to the dispute.
- Client pays a bonus in addition to fees.

### What can you do?

When acting for clients on a claim or demand for recovery of a debt or actionable loss, you should request and review documents supporting the debt or loss. In this scenario, the fact that the client claimed to have lost the money in potentially fraudulent circumstances ought to have reinforced the need for investigation into the nature of the debt. The other red flags, including the quick payment of settlement funds following a simple demand letter and the payment coming from out of the country, suggest this situation is high-risk for money laundering. If a client makes specific unusual requests about how to transfer the funds (e.g., to unrelated corporate accounts) you should make inquiries as to the reason for these instructions.



## APPENDIX

# RED FLAGS QUICK REFERENCE GUIDE

This appendix provides a list of red flags that indicate potential risks of money laundering and other illegal activity, including fraud. They are arranged by the nature of the risk.<sup>9</sup> This list is not exhaustive and is intended as a quick reference guide to identify common red flags. Other circumstances may arise suggesting a particular client or transaction poses a money laundering risk.

### Identity of the client

- Reluctant to provide or refuses to provide information relating to their identity and/or the identity of a beneficial owner or controlling interest.
- Provides false information or counterfeited documentation in relation to their identity and/or the identity of a beneficial owner or controlling interest.
- Known to have convictions or to be currently under investigation for acquisitive crime, or has known connections with criminals.
- Age or capacity of the client is unusual for the transaction, especially if they are under legal age and there is no logical explanation for their involvement.
- Business entity that has no internet presence at all, cannot be found in corporate registries, and/or is only using an email address from a free web-based email provider (e.g., Hotmail, Gmail, Yahoo, etc.), especially if the client is otherwise secretive or avoids direct contact.
- Business is in cash-intensive industries that are not usually cash-rich but generate substantial amounts of cash (e.g., money-service businesses and casinos).
- Structure of the client organization makes it difficult to identify its beneficial owner or controlling interests (e.g., the unexplained use of legal persons or legal instruments).
- Domestic or international politically exposed person (PEP); i.e. holds or has previously held a public position (political or high-level professional appointment) or has professional or family ties to such an individual and is engaged in unusual private business given the frequency or characteristics involved.
- Originally from, a resident of, or owner of a company incorporated in a high-risk country as identified by credible sources (e.g., Government of Canada, FINTRAC, FATF, UN) as:
  - o Generally lacking appropriate AML laws, regulations and other measures;
  - o Being in a location from which funds or support are provided to terrorist organisations; or
  - o Having significant levels of corruption or other criminal activity.
- Related to or is a known associate of a person listed as being involved or suspected of involvement with terrorist or terrorist financing related activities.

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<sup>9</sup> This list is based on resources from the Financial Action Task Force, the International Bar Association, the American Bar Association and the Council of Bars and Law Societies of Europe.

## APPENDIX

# RED FLAGS QUICK REFERENCE GUIDE

### Behaviour of the client

- Overly secretive or evasive about:
  - o Their identity
  - o Their address or contact information
  - o Identity of the true client
  - o Identity of the beneficial owner
  - o Where the money is coming from (i.e., source of funds)
  - o Why they are doing the transaction this way
  - o The overall reason for, or purpose of the transaction i
- Chooses a legal advisor who is:
  - o At a distance from the client or the transaction without legitimate or economic reason.
  - o Without experience in a particular specialty or without experience in providing services in complicated or especially large transactions.
- Has changed legal advisor a number of times in a short time or engaged multiple legal advisors without legitimate reason.
- Uses an agent or intermediary without good reason.
- Uses financial intermediaries that are neither subject to adequate anti-money laundering laws nor adequately supervised by authorities.
- Is evasive or actively avoiding personal contact without good reason.
- Is prepared to pay substantially higher fees than usual or bonus for services that would not warrant such a premium or without good reason.
- Demonstrates an excessive desire to expedite the transaction and/or offers an incentive to complete the transaction by a certain date (e.g., higher fee or bonus), without a good reason.
- Changes settlement or execution instructions multiple times or in a short period of time without good reason.
- Is reluctant to provide or refuses to provide information, data and documents usually required in order to enable the transaction's execution.
- Provides false or counterfeited documentation.
- Demonstrates unusual familiarity with the ordinary standards provided for by the law in satisfactory customer identification, data entries and suspicious transaction reporting or asks repeated questions on related procedures.

## APPENDIX

# RED FLAGS QUICK REFERENCE GUIDE

### Source of Funds/ Source of Wealth

- Transaction involves a disproportionate amount of private funding, bearer cheques, bank drafts or an attempt to use cash, especially if it is inconsistent with the socio-economic profile of the individual or the company's economic profile.
- Source of funds is unusual, e.g.:
  - o Third party funding for the transaction with no apparent connection or legitimate explanation.
  - o Funds received from or sent to a foreign country when there is no apparent connection between the country and the client.
  - o Funds received from or sent to high-risk countries.
- Client is using multiple bank accounts and/or foreign accounts without good reason.
- Client funds provided for a transaction appear to be large relative to the client's income without logical explanation.
- Personal private expenditure is funded by a company, business, or government.
- Collateral being provided for the transaction is currently located in a higher-risk country
- Unusually short repayment period has been set without logical explanation.
- Mortgages are repeatedly repaid well before the initially agreed maturity date, with no logical explanation.
- High value transaction does not require financing.
- Asset is purchased without financing and then rapidly used as collateral for a loan.
- Request to change the payment procedures previously agreed upon without logical explanation, especially when payment instruments are suggested that are not appropriate for the common practice used for the ordered transaction.
- Financing provided by a lender other than a bank or credit institution with no logical explanation or economic justification.
- Significant increase in capital for a recently incorporated company or successive contributions over a short period of time to the same company, with no logical explanation.
- Increase in capital from a foreign country, which either has no relationship to the company or is high risk.
- Business receives an injection of capital or assets suddenly and/or notably high in comparison to the business, size or market value of the company, with no logical explanation.
- Excessively high or low price attached to the securities transferred.
- No legitimate explanation for large financial transactions, especially if requested by recently created companies, where these transactions are not justified by the corporate purpose, the activity of the client or the possible group of companies.

## APPENDIX

# RED FLAGS QUICK REFERENCE GUIDE

### Nature of the retainer or transaction

- Transaction is unusual, e.g.:
  - o Type, size, frequency, manner of execution of transaction is unusual for or inconsistent with the size (entity), age, or activity of the client.
  - o Remarkable and highly significant differences between the declared price and the approximate or actual values in accordance with any reference that could give an approximate idea of this value or in the judgement of a legal advisor.
  - o Non-profit organization requests services for purposes or transactions not compatible or typical with those declared for that body.
- Requested service was refused by another legal advisor or professional or the relationship with another legal advisor or professional was terminated.
- Transaction does not correspond to client's normal professional or business activities.
- Client lacks suitable knowledge of the nature, object or the purpose of professional services requested.
- Client wishes to establish or take over a legal person or entity with a dubious description of the aim, or a description that is not related to client's normal professional or commercial activities or his other activities.
- Client frequently changes legal structures and/or managers without legitimate reason.
- Unexplained changes in instructions, especially at the last minute.
- Client asks for short cuts or unexplained speed in completing the transaction.
- Client requires introduction to financial institutions to help secure banking facilities in the context of the transaction.
- Client instructs the creation of complicated ownership structures when there is no legitimate business or economic reason.
- Involvement of entities in multiple countries where there is no apparent link to the client or transaction, with no legitimate or economic reason.
- Incorporation and/or purchase of stock or securities of several companies, enterprises or legal entities within a short time with elements in common (one or several partners or shareholders, director, registered company office, corporate purpose etc.) with no logical explanation.
- Absence of documentation to support client's story, previous transactions, or company activities.
- Several common elements in a number of transactions in a short period of time without logical explanation.
- Back-to-back property transactions, with rapidly increasing value or purchase price.
- Abandoned transactions with no concern for the fee level or after receipt of funds.
- Retainer exclusively relates to keeping documents or other goods, holding large deposits of money or otherwise using the legal advisor's trust account without the provision of legal services.
- Lack of sensible commercial/financial/tax or legal reason for the transaction.
- Increased complexity in the transaction or the structures used for the transaction that result in higher taxes and fees than apparently necessary.
- Power of attorney is sought for the administration or disposal of assets under conditions that are unusual, where there is no logical explanation.
- Investment in immovable property, without any links to the place where the property is located and/or without any financial advantage from the investment.
- Litigation is settled too easily or quickly, with little to no involvement by the legal advisor retained.
- Includes requests for payments to third parties without substantiating reason and/or corresponding transaction.

## **APPENDIX**

# **RED FLAGS QUICK REFERENCE GUIDE**

### **Parties**

- Originally from, resident or incorporated in a country posing a high risk to money laundering.
- No apparent business reason connecting the parties to the transaction.
- Ties between the parties of a family, employment, corporate or any other nature generate doubts as to the real nature/reason of the connection.
- Multiple appearances of the same parties in transactions over a short period of time.
- Age or capacity of the executing parties is unusual for the transaction, especially if they are under legal age and there is no logical explanation for their involvement.
- Attempts to disguise the real owner or parties to the transaction.
- Business entities cannot be found and/or have no presence on the internet and/or in corporate registries.
- Person directing the operation is not one of the formal parties to the transaction or the representative.
- Natural person acting as the director or representative does not appear to be a suitable representative.