Financial
Intelligence Centre

Assessment of the inherent money laundering and terrorist financing risks

LEGAL PRACTITIONERS

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1. INTRODUCTION

Money laundering can be described as the process whereby criminals attempt to conceal the proceeds of their criminal activities from the actual crime thereby giving the funds derived from criminal activities an appearance of legitimacy.

Terrorist financing is the process by which individual terrorist and terrorist organisations obtain funds to commit acts of terrorism.

The legal profession is one of the non-financial sectors identified by the international anti-money laundering community as potentially highly vulnerable for money laundering and terrorist financing (ML and TF).

The Financial Intelligence Centre (FIC) conducted a risk assessment of the inherent ML and TF risks of legal practitioners in South Africa. The risk assessment included a survey that was sent to attorneys registered under Item 1 of Schedule 1 to the Financial Intelligence Centre Act, 2001 (Act 38 of 2001) (FIC Act), to ascertain their views on the sector's vulnerability to money laundering and terrorist financing.

This risk assessment report provides feedback on the legal practitioners' sector risk assessment, including responses received from legal practitioners and contains open-source information on the inherent national and international money laundering and terrorist financing risks of legal practitioners. In addition, the FIC's regulatory knowledge of the sector and the analysis of the financial intelligence reports submitted by legal practitioners to the FIC are also considered.

The survey offers valuable insights to legal practitioners, the Legal Practice Council (LPC) and the FIC. While it is understood the ML and TF environment may change over time, the ML and TF risks drawn from this survey and incorporated into this sector risk assessment report are nonetheless important for the sector and the FIC.

2. SCOPE, LIMITATIONS AND METHODOLOGY OF THE RISK ASSESSMENT

This sector risk assessment report addresses principally the inherent ML risk factors facing legal practitioners, and particularly attorneys and trust account advocates, pertaining to products, services, clients, transactions, delivery channels and geographical areas, and the potential mitigation of these risks by complying with the FIC Act. Terrorist financing risks were addressed to a limited extent, because of limited information available on terrorist financing in the sector. The reference to legal practitioners in this document refers to attorneys and trust account advocates, being advocates who operate a trust account.

Although it is recognised that these risks could be mitigated by introducing processes and procedures in accordance with the requirements of the FIC Act, details of such mitigation factors were not included in this report. The report focuses on inherent risks.

3. OVERVIEW OF THE SECTOR

3.1. Nature and regulation of the sector

3.1.1. Schedule 1, Item 1 of the FIC Act defines an attorney as “A practitioner who practices as defined in section 1 of the Attorneys Act, 1979 (Act 53 of 1979)”. The Attorneys Act was repealed and replaced by the Legal Practice Act, 2014 (Act 28 of 2014) (LP Act) which introduced and defined the term “legal practitioners”.

To address the legislative changes introduced by the LP Act, the FIC issued public compliance communication (PCC) 47 which confirms that the definition as set out in Schedule 1 of the FIC Act, includes the historical attorneys, notaries, and conveyancers.

3.1.2. Item 8 of Schedule 2 of the FIC Act lists “A law society as contemplated in section 56 of the Attorneys Act, 1979 (Act 53 of 1979)” as the supervisory body for legal practitioners. The provisions of the LP Act automatically substitute any reference to the previous law societies in any other legislation with the LPC.

3.1.3. In November 2019, the FIC, in terms of a Memorandum of Understanding, agreed to assume the LPC's supervisory duties to conduct inspections on legal practitioners in terms of the FIC Act.

4. INTERNATIONAL MONEY LAUNDERING RISKS ASSOCIATED WITH LEGAL PRACTITIONERS

The legal profession is internationally recognised as potentially vulnerable to being abused by criminals to launder their proceeds of crimes. The services provided by the legal profession such as advising on and creating legal entities, including shell companies and trusts, property conveyancing services and the provision of client accounts, make them potentially vulnerable to money laundering abuse. Additionally, internationally recognised high-risk services include managing of client affairs, establishing and managing charities and certain types of litigation.

The use of legal practitioners to recover fictitious debts has also been identified as a method to possibly move funds from one entity or person to another, thereby giving criminal proceeds an appearance of legitimacy.

5. REPORTING BY LEGAL PRACTITIONERS UNDER THE FIC ACT

5.1. The volume of reports received from legal practitioners

During the five years from April 2016 to March 2021, legal practitioners filed a total of 11 966 cash threshold reports (CTRs[1]) at an average of 2 393 per year. During the same period, the sector filed a total of 1 160 suspicious and unusual transaction reports (STRs[2]) at an average of 232 per year.

The number of regulatory reports filed by legal practitioners with the FIC in each financial year from 2016 to 2021 is depicted below.

[1] Reports on cash transactions exceeding R24 999.99
[2] Reports on transactions that are regarded as unusual and suspicious, as explained in section 29(1) of the FIC Act

Table 1: Regulatory reports filed by legal practitioners

Reports filed	2016/17	2017/18	2018/19	2019/20	2020/21	Average number of reports
CTRs	2 229	2 396	2 504	2 549	2 288	2 393
STRs	133	123	430	205	269	232

With an annual average of 2 393 CTRs and 232 STRs received from legal practitioners over the period 2016/17 to 2020/21, the volume of reporting can be regarded as very low considering that at 31 March 2021 there were 16 059 legal practitioners, including branches, registered with the FIC. The low number of reports could possibly be the result of a limited understanding of the risks in the sector, as described hereunder.

5.2. Types of reports filed

Legal practitioners registered with the FIC file regulatory reports in terms of section 28, section 28A and section 29 of the FIC Act. The vast majority of regulatory reports submitted to the FIC by legal practitioners are CTRs, filed in terms of section 28 of the FIC Act. This leads to the assumption that cash is still being used and appears prevalent in the legal practitioners' sector. The use of cash (sent and received by a legal practitioner) in the legal services environment makes legal practitioners, and specifically attorneys and trust account advocates even more vulnerable to money laundering abuse.

6. RISKS BASED ON THE SECTOR SURVEY AND RESEARCH

The risk factors used in this report align with those used in the FIC's Guidance Note 7, issued by the FIC and is available on www.fic.gov.za, and also includes a short reference to terrorist financing risk.

The risk factors below were taken into consideration when the inputs on the survey were analysed. Legal practitioners need to consider these factors when conducting their daily business.

6.1. Products and services risks

6.1.1. Certain products and services are regarded as posing a higher risk for money laundering purposes.

6.1.2. The products and services legal practitioners provide that are internationally recognised as more likely to be abused by criminals in the money laundering process include:

- Conveyancing: Legal practitioners who are conveyancers may knowingly or unwittingly assist criminals by falsifying documents, drafting documents with overstated or understated value of the properties, facilitating the transfer of properties to third parties and establishing complex loans and financial arrangements.
- Business in a customer account: legal practitioners may be requested to assist with an investment that never takes place or where the funds eventually end up in a third-party account.
- Formation and management of legal entities: legal practitioners may be requested to create and assist in managing fictitious entities, complex, legal structures or shell companies that are aimed at and result in the true ownership of assets being hidden through different layers or legal structures.

6.1.3. The method of payment for services provided by legal practitioners could, in some instances, also be a channel for money laundering, with the use of cash pointing to a higher likelihood of funds derived from criminal activities.

6.1.4. Legal practitioners that perform the role of a trustee or a director of a company are also required to obtain the necessary information about the nature of the transactions of the trust or company, the natural persons or legal persons that are parties to such transaction with the trust or company, whether the transaction makes economic or commercial sense, as well as the origin of the funds received by the trust or company, in order to make an informed decision about the ML/TF risks associated with such a transaction.

6.2. Client risks

6.2.1. Listed as accountable institutions under the FIC Act, legal practitioners are required to assess, identify, understand and then risk-rate the inherent money laundering and terrorist financing risks associated with their clients. Some clients, such as foreign prominent public officials (FPPOs), domestic prominent influential persons (DPIPs), complex legal structures or foreigners potentially pose a higher risk for money laundering, depending on the identified circumstances. The establishment of complex structures, involving legal persons (companies) and legal arrangements such as trusts and partnerships – including where such structures are named as beneficiaries for a trust – could possibly be aimed at concealing the ultimate beneficial owners of such legal persons and arrangements.

6.2.2. When dealing with their clients, legal practitioners should be aware of, inter alia, the following possible scenarios pertaining to the nature and behaviour of the clients that could point to possible money laundering:

- Clients trying to conceal their identities
- Transactions inconsistent with their stated income or occupation
- Clients use an unusual source of funds to transact
- Transactions do not have a legitimate or economic reason
- Clients cease their business relationships upon a request for customer due diligence (CDD) information.

6.3. Transaction risks

6.3.1. International research and literature indicate that criminals can potentially use legal service providers to enter into transactions on their behalf, thereby creating an impression of legitimacy to transactions involving the proceeds of crime. Monitoring the nature and purpose of these transactions, their monetary worth and the means of payments involved, will contribute to understanding and monitoring the ML risks associated with such transactions.

6.3.2. Examples of transactions that are potentially high risk for money laundering include the use of cash or crypto currencies in transactions, the reversing of transactions with a request to repay funds already paid and transactions that do not make economic sense. Legal practitioners should be aware of the potential money laundering risks associated with such transactions and take the necessary steps to mitigate such risks.

6.3.3. In addition to considering whether a transaction makes economic and business sense and whether the prices of obtained or disposed assets market related, a legal practitioner must also consider the use of cash in the buying, selling and renting of properties or other assets by their clients, where applicable.

In South Africa, cash is still used extensively, and there are indications that cash transactions occur in the legal practitioners' environment as is evident by the number of cash threshold reports filed with the FIC (see paragraph 5.1 above). In addition to the receipt of cash in their trust accounts, legal practitioners should also be aware of instances where cash is paid into their accounts or the accounts of their clients.

6.4. Risks relating to delivery channels

6.4.1. Legal practitioners must be aware of the delivery channels they use to attract and deal with clients. Delivery channels that may obscure or conceal the true identity of the client, or that result in clients not being on-boarded face-to-face, may increase the risk of the legal practitioner being abused by criminals to launder the proceeds of crime. Where an intermediary is used to on-board clients, a legal practitioner must do

proper due diligence on the intermediary and its business and must be familiar with the risk-mitigation processes and procedures the intermediary may have in place.

6.4.2. Various forms of technology are used to advertise services and to conduct business. Legal practitioners who advertise their services on social media platforms or who are considering conducting business with clients via social media platforms must be aware of the potential higher risks associated with the less stringent verification requirements of social media. Where social media platforms are used to share information on products or services or to on-board clients, a legal practitioner must ensure that such clients are properly identified and verified and that all the relevant information pertaining to the risks posed by such clients is obtained.

6.4.3. Where third party service providers are used to assist with the identification and verification of clients or to introduce clients to the practice, a legal service provider must ensure that the third party is properly identified and verified and that its services are above board. The payment of funds through a third party could be done to disguise the source of funds or certain assets. When such a situation occurs a legal practitioner must, in order to mitigate the risks, always ensure that it understands the source of the funds and the reason for constructing the transaction in this manner.

6.4.4. A South African example of potential money laundering risks associated with delivery channels is where a legal practitioner is introduced to a client through an estate agent, to provide a property transfer service. In such an instance the legal practitioner can mitigate the risks associated with the use of an “intermediary” by verifying that the estate agent is registered with the Property Practitioners Regulatory Authority and that it complies with relevant legislation. Verification of the good standing of an estate agent introducing a client will mitigate the potential risk of a property transaction not being on an arm’s length basis but to facilitate the transfer of funds or to hide the origin of funds.

6.5. Geographic risk

6.5.1. Some foreign jurisdictions pose a higher risk for money laundering. It is important that legal practitioners be aware of the risks posed by clients from these jurisdictions and that they have the necessary risk mitigation processes in place. This risk is exacerbated by the fact that transactions can take place electronically across regions and national jurisdictions, and that such transactions often require the services of legal practitioners.

6.5.2. The geographic location and services provided by the legal practitioners are also important factors for determining ultimate money laundering risks. International and domestic experience has indicated that criminals are attracted to high-value assets, particularly high-end immovable property in exclusive or seaboard areas in South Africa, and therefore legal practitioners need to be vigilant when conducting business in areas where such assets are acquired.

- As mentioned in open-source information, legal practitioners must be aware of the potential higher risks posed by clients from the following types of countries:That are subject to a travel ban
- Which the Financial Action Task Force[3] regards as having high ML risk
- That are regarded as high secrecy jurisdictions
- Which are regarded as “tax havens”
- Where they are known to have high levels of organised crime, corruption or from which terrorist organisations are known to operate.

6.6. Terrorist financing risk

6.6.1. Where legal practitioners provide services to non-profit and non-governmental organisations, they should ensure that the funds used are in accordance with the stated objectives of these organisations.

[3] The Financial Action Task Force is the international standard setting body for combating money laundering and the financing of terrorism and proliferation. South Africa is a member of the Financial Action Task Force and has to comply with its standards.

6.6.2. Legal practitioners should also be aware of the appropriate compliance obligations referred to in sections 26A and 28A of the FIC Act which relate to the screening of clients to ensure that clients are not included in United Nations sanctions lists.

6.6.3. Legal practitioners must know how to access the referenced targeted financial sanctions list and determine whether they are conducting business with individuals and institutions on such lists.

7. INDICATORS OF MONEY LAUNDERING AND TERRORIST FINANCING ACTIVITY FOR THE SECTOR

The following could be regarded as ML/TF vulnerabilities and risks associated with legal practitioners:

- The use of cash for payment of services or payment into trust accounts
- Anonymity of clients and transactions that are complex in nature for which legal advice is provided by legal practitioners
- New payment technologies, for example crypto currencies
- Lack of ML and TF awareness of the legal practitioners
- Trusts, shell companies and other legal arrangements with a potential to conceal the true identity of the ultimate beneficial owners of the clients
- International payments received from clients
- High-risk customers and jurisdictions, such as clients linked to institutions or jurisdictions on the sanctions lists
- FPPOs, DPIPs, and high net worth individuals, which are internationally regarded as high-risk clients
- Organised crime can use legal practitioners to conceal proceeds of crime, obscure ultimate ownership through complex layers and legal entity structures, avoid paying tax, work around financial regulatory controls, create a veneer of legitimacy to criminal activity, create distance between criminal entities and their illicit income or wealth, avoid detection and confiscation of assets, and hinder law enforcement investigations
- Clients who offer to or do pay extraordinary fees for services that would not warrant such fees

- Payments from non-associated or unknown third parties and payments for fees in cash where this practice is not typical
- Where legal practitioners, including those acting as financial intermediaries, physically handle the receipt and transmission of funds through accounts they control, they may be requested to transfer real estate between parties in an unusually short period, thereby hindering the know-your-client process and potentially contribute to concealing the beneficial ownership of the client or other parties to the transactions(s) from competent authorities
- Funds are received from or sent to a foreign country when there is no apparent connection between the country and the client
- The client is using multiple bank accounts or foreign accounts without good reason
- Possible involvement of FPPOs and DPIPs in instances where the entity, structure or relationships of the client make it difficult to identify its beneficial owner or controlling interests (e.g. the unexplained use of legal persons or legal arrangements)
- Instances where clients, for no apparent reasons change the way in which transactions are concluded or change their instructions to the legal practitioners on short notice or in a manner that does not make economic sense.

8. CONCLUSIONS

8.1. Based on the international experience, the risk factors described above and the range of services they offer, it is evident that legal practitioners are potentially at high risk of being exposed to the inherent risk of ML. They should therefore take all the necessary precautionary steps to reduce the risk of them being exposed to abuse by criminals who want to launder the proceeds of crime through the sector.

8.2. The use of cash is evident and appears prevalent in the sector which increases the ML and TF risk profile of legal practitioners. The number of regulatory reports received from legal practitioners is very low, which is of concern, as it points to a possible lack of compliance awareness among legal practitioner firms and their staff. Although this report focuses mainly on the inherent ML and TF risks in the legal practitioners sector, it is acknowledged that poor systems and controls and compliance failures would have a large impact on the residual risks for the sector.

8.3. Overall, the inherent risk of money laundering for the legal practitioners sector in South Africa, based on national and international experience, is classified as high and the inherent terrorist financing risk is regarded as low.

Risk analysis and rating for legal practitioners

Money laundering risk factor	Likelihood	Consequence	Overall risk rating	Priority
Compliance: Lack of mitigating circumstances through compliance – e.g. CDD, training, record-keeping	3	4	18	2
Products and services/delivery channels – use of cash, online platforms, transaction size	4	4	21	1
Risk/threats associated with clients – politically exposed persons, source of funds, complex structures	4	4	21	2
Risk/threat associated with geographical area – sales to clients outside geographic area, sales to clients in restricted area	3	3	13	3

Overall money laundering risks facing legal practitioners – Rating heat map

Likelihood scale (probability)						
	5 Almost certain likelihood/ probability	11	16	20	23	25
	4 Highly probable likelihood	7	12	17	21 Products/ services/ client risk	24
	3 Possible likelihood	4	8	13 Geographic risk	18 Compliance risk	22
	2 Unlikely probability	3	5	9	14	19
	1 Improbable likelihood	1	2	6	10	15
		1 Low impact	2 Minor impact	3 Moderate impact	4 Major impact Significant	5 Severe impact
		Consequence scale (impact)				