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May 24, 2016

The Honorable Michael G. Fitzpatrick
Chairman
Task Force to Investigate Terrorism Financing
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

The Honorable Stephen F. Lynch
Ranking Member
Task Force to Investigate Terrorism Financing
Committee on Financial Services
U.S. House of Representatives
Washington, D.C. 20515

Re: Today's Hearing on "Stopping Terror Finance: A Coordinated Government Effort" and Concerns Over H.R. 4450, the "Incorporation Transparency and Law Enforcement Assistance Act," and Other Similar Legislation

Dear Chairman Fitzpatrick and Ranking Member Lynch:

On behalf of the American Bar Association (ABA), which has almost 400,000 members, I write to express our serious concerns regarding H.R. 4450, the "Incorporation Transparency and Law Enforcement Assistance Act" (ITLEAA), and other similar legislation that would require businesses, their lawyers, and the states to gather and maintain extensive beneficial ownership information on the corporations and limited liability companies (LLCs) they help create and make that information available to federal law enforcement authorities. We ask that this letter be included in the record of today's Task Force hearing on "Stopping Terror Finance: A Coordinated Government Effort."

The ABA has for years worked diligently with the legal community, federal and international law enforcement authorities, and states to advance reforms to combat money laundering and terrorist financing. Indeed, the ABA supports reasonable and necessary domestic and international efforts to combat these illicit activities, and we commend the various sponsors of legislation for their efforts in this regard. However, the ABA opposes the ITLEAA, as we believe the legislation is unjustified and would be counterproductive. H.R. 4450 and the similar Senate bill, S. 2489, are updated versions of legislation with the same name that was originally introduced by then Senator Carl Levin in the 110th Congress and then reintroduced in each of the three succeeding Congresses.¹ We oppose the proposed regulatory approach set forth in the ITLEAA for several important reasons.

First, the ABA opposes H.R. 4450 because it would subject many lawyers and law firms to the anti-money laundering (AML) and suspicious activity reporting (SAR) requirements of the Bank Secrecy Act and therefore undermine the attorney-client privilege, the confidential lawyer-client relationship, and state court regulation of the legal profession. Under the legislation, lawyers and

¹ On December 16, 2011, the ABA sent a letter to the Senate Homeland Security and Governmental Affairs Committee that expressed the ABA's detailed concerns regarding S. 1483, Senator Levin's version of the ITLEAA as introduced in the 112th Congress, and those same concerns also apply to H.R. 4450. The ABA's letter is available at http://www.americanbar.org/content/dam/aba/uncategorized/2011/gao/2011dec16_incorptransparency_1.authcheckdam.pdf.

law firms that help clients to form corporations or LLCs would be considered “formation agents” (and hence a new category of “financial institution”) under the Bank Secrecy Act and thus would be subject to the strict AML and SAR requirements of the Act. These SAR requirements could compel lawyers to report certain privileged or confidential client information to governmental authorities, such as information regarding various types of client transactions or any suspicion that a client may be engaging in money laundering or other illicit activity.

While such reporting may be appropriate for banks or other financial institutions, requiring lawyers to report such client information to the government is plainly inconsistent with their ethical duties and obligations established by the state supreme courts that possess the authority to license, regulate, and discipline lawyers.² These mandates would also undermine the attorney-client privilege and the confidential lawyer-client relationship by discouraging the full and candid communications between clients and their lawyers that are essential to the lawyer being able to provide the client with effective representation.

Although H.R. 4450 would exempt lawyers from the AML and SAR requirements of the Bank Secrecy Act when they use “paid formation agents” to form corporations or LLCs for their clients, lawyers would still be subject to the bill’s other costly and burdensome beneficial ownership reporting requirements. The limited attorney exemption in the bill is also flawed because it requires lawyers to outsource important practice of law activities—i.e., company formation services—to non-lawyers who are often not legally authorized to perform these legal services, and it would impose excessive new costs on clients.³

Second, the ABA opposes the legislation because it would impose burdensome, costly, and unworkable new regulatory burdens on legitimate businesses and states by requiring all states to obtain beneficial ownership information on corporations and LLCs from those creating these entities, keep that information current, and make it available to law enforcement authorities. Many lawyers and law firms that help clients to form these entities would be deemed to be “formation agents” under the bill and hence would also be subject to these reporting requirements.

The bill’s definition of “beneficial owner” is vague and overly broad. It includes every “natural person” who directly or indirectly “exercises substantial control over” or “has a substantial interest in or receives substantial economic benefits from the assets of a corporation or limited liability company,” subject to several exceptions. This definition could include not just the actual stockholders of the company, but also a multitude of other people associated with the business,

²Imposing SAR requirements on lawyers directly undermines ABA Model Rule of Professional Conduct 1.6 dealing with “Confidentiality of Information” and with the many binding state rules of professional conduct that closely track the ABA Model Rule. The ABA Model Rule states that “a lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent...” or unless one or more of the narrow exceptions listed in the Rule is present. See ABA Model Rule 1.6, and the related commentary, available at http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_6_confidentiality_of_information.html. See also Charts Comparing Individual Professional Conduct Rules as Adopted or Proposed by States to ABA Model Rules, available at http://www.americanbar.org/groups/professional_responsibility/policy.html.

³ For a more detailed explanation of how the ITLEAA would undermine the attorney-client privilege and the confidential lawyer-client relationship as well as the inadequacy of the bill’s attorney exemption, please see the ABA’s December 16, 2011 comment letter, *supra*, footnote 1, at pages 3-5.

including officers and directors, lenders, creditors, contactors, and lien holders. Once the beneficial owners are identified, their names, addresses, and driver's license or passport numbers would have to be disclosed to the state where the entity is formed or incorporated or to the Treasury Department, and the information would have to be made available to law enforcement authorities.

H.R. 4450 would compel state agencies to collect this extensive beneficial ownership information on millions of legitimate businesses throughout the country. On a practical level, this would require state regulators to adopt significant and expensive hardware and software changes, including the creation of a parallel record keeping system consisting of public and non-public information. This regulatory burden, coupled with a vague and unworkable definition of "beneficial owner," would be costly; impose onerous burdens on state authorities, legitimate businesses, and the businesses' lawyers; sow confusion into the formation process; and not be effective in fighting money laundering and terrorist financing.

Third, the burdensome and intrusive new reporting requirements in H.R. 4450 are unnecessary because in recent years, the Federal Government, financial institutions, and the legal profession have developed other tools and taken other steps that are far more effective in fighting money laundering and terrorist financing than the bill's mandates.

For example, the Internal Revenue Service (IRS) and financial institutions already collect entity-related information needed to fight money laundering and terrorist financing, and that information is available to law enforcement authorities. Since January 1, 2010, the IRS has required every business that obtains an Employer Identification Number to submit IRS Form SS-4, which includes the name of a "responsible party" within the business—i.e., an individual who has the ability to "control, manage, or direct the entity and the disposition of its funds and assets." In addition, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued its new Customer Due Diligence Rule earlier this month that requires banks and other financial institutions to collect certain specific beneficial ownership information regarding entities that establish new bank accounts.⁴ Therefore, because federal law enforcement authorities are already able to access information regarding a business entity's responsible parties or beneficial owners from the IRS and financial institutions, it is simply unnecessary to create a costly and duplicative new regulatory apparatus that would unfairly burden the states and millions of businesses across the country.

In addition to these federal law enforcement tools, the legal profession and the states have also taken aggressive steps to help fight money laundering and terrorist financing in ways that minimize the impact on the confidential lawyer-client relationship, the U.S. economy, and state regulators. For example, the ABA developed and is actively promoting the "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing" (Voluntary Guidance).⁵ The Voluntary Guidance, which is based on the principle that the risks posed by certain types of clients and matters are far greater than those posed by others, encourages lawyers to combat money laundering and terrorist financing by taking prudent, proportional, risk-based steps tailored

⁴ See FinCEN's Final Rule on Customer Due Diligence Requirements for Financial Institutions, 81 Fed. Reg. 29398 (May 11, 2016), available at <https://www.gpo.gov/fdsys/pkg/FR-2016-05-11/pdf/2016-10567.pdf>.

⁵ The ABA Voluntary Guidance and related "Frequently Asked Questions"; ABA Formal Ethics Opinion 463 and the Conference of Chief Justices' Resolution supporting the Voluntary Guidance; and the ABA/IBA/CCBE Lawyer's Guide are all available at http://www.americanbar.org/groups/criminal_justice/gatekeeper.html.

to the individual situation rather than the burdensome and costly rules-based approach of the legislation. Unlike H.R. 4450, the Voluntary Guidance also helps lawyers to effectively combat these illicit activities while still complying with their existing court-imposed ethical duties and other legal obligations.

Since adopting the Voluntary Guidance in August 2010, the ABA has worked diligently to educate lawyers, judges, state and local bars, and the public regarding the problem of money laundering and the benefits of following the Voluntary Guidance. Towards that end, the President of the ABA sent the Guidance to all state and local bars and urged their members to follow it. In addition, the ABA issued ABA Formal Ethics Opinion 463 in May 2013, which expressed support for the Voluntary Guidance and encouraged lawyers to follow its provisions. The Conference of Chief Justices, which is comprised of the Chief Justices of the 50 state supreme courts (and the D.C. and U.S. territorial court systems) that license all lawyers in the U.S., formally endorsed the Voluntary Guidance in 2014. In October 2014, the ABA, the International Bar Association (IBA), and the Council of Bars and Law Societies of Europe (CCBE) jointly published the “Lawyer’s Guide to Detecting and Preventing Money Laundering” (Lawyer’s Guide), which provides practical tips to help lawyers around the world to avoid inadvertently participating in money laundering activities and to comply with their legal obligations to fight money laundering in countries where they apply.

The ABA also has been working closely with the states’ secretaries of state, the Treasury Department, and other entities on alternative solutions to the problem of money laundering and terrorist financing that would not require new federal legislation or regulations. For example, substantive law groups within the ABA have developed proposals that would require business entities to collect, maintain, and disclose more information regarding their incorporators, officers, directors, and shareholders in order to provide additional useful tools to law enforcement officials, but within the existing state company formation system. These proposals would aid law enforcement without creating unnecessary new federal mandates that would preempt or interfere with the confidential lawyer-client relationship or traditional state business formation practices.⁶

For all these reasons, the ABA urges you to oppose H.R. 4450 and all other similar measures. The ABA cannot support this legislation, but we will continue our efforts to disseminate the Voluntary Guidance, the Lawyers’ Guide, and other important educational materials to lawyers, courts, and the entire legal profession, both in the U.S. and abroad. In addition, the ABA will continue to support efforts by federal and international law enforcement agencies and the states to fight money laundering and terrorist financing in ways that minimize the impact on the lawyer-client relationship, state regulation of the business formation process and legal profession, and the U.S. economy.

⁶ For more information on efforts to revise and update the Model Business Corporation Act, Uniform Partnership Act, Uniform Limited Partnership Act, Uniform Limited Liability Company Act, and Uniform Limited Cooperative Association Act, see ABA Resolution 300 adopted in August 2008 and the related Report at pages 13-15, available at <http://www.americanbar.org/content/dam/aba/migrated/poladv/priorities/gatekeeper/ABAResolution300.pdf>. In addition, information regarding the Uniform Law Enforcement Access to Entity Information Act is available at <http://www.uniformlaws.org/Act.aspx?title=Law%20Enforcement%20Access%20to%20Entity%20Information%20Act>.

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Thank you for considering our views on these important issues. If you have any questions regarding the ABA's position on the legislation or any other matter, please contact ABA Governmental Affairs Director Thomas Susman at (202) 662-1765 or Associate Governmental Affairs Director Larson Frisby at (202) 662-1098.

Sincerely,

A handwritten signature in black ink, appearing to read "Paulette Brown", with a long, sweeping horizontal line extending to the right.

Paulette Brown
President, American Bar Association

cc: Members of the House Financial Services Committee