

**AMERICAN BAR ASSOCIATION****ADOPTED BY THE HOUSE OF DELEGATES****AUGUST 11-12, 2008****RECOMMENDATION**

RESOLVED, That the American Bar Association supports all reasonable and necessary efforts of the United States government and the international community to combat money laundering and terrorist financing activity in the international financial system;

FURTHER RESOLVED, That the American Bar Association urges that the regulation of those involved in the formation of business entities within the states and territories of the United States should remain a matter of state and territorial law and state sovereign prerogative, with a minimum of federal governmental regulation;

FURTHER RESOLVED, That the American Bar Association urges Congress to refrain from enacting legislation that would regulate lawyers in the formation of business entities and to defer to the states as they consider amendments to the Model Business Corporation Act, Uniform Partnership Act, Uniform Limited Partnership Act, Uniform Limited Liability Company Act, and Uniform Limited Cooperative Association Act (collectively, the "Entity Paradigm Laws") proposed by the American Bar Association, the National Conference of Commissioners on Uniform State Laws, and others;

FURTHER RESOLVED, That the American Bar Association urges that the manner in which lawyers conduct client due diligence for purposes of rendering legal services and the manner in which record or beneficial ownership of business entities is documented, verified, and made available to law enforcement authorities, not conflict with the ethical requirements and regulations imposed by state authorities on the legal profession, be risk-based, and take into account:

(1) the actual risk of money laundering and terrorist financing in the formation of business entities; and

(2) the burdens that such requirements or regulations might impose on state and territorial authorities, those involved in the formation of such entities, and the bona fide investment community; and

FURTHER RESOLVED, That the American Bar Association urges state and local bar associations, and other appropriate constituencies within the legal profession, with the assistance of the ABA Task Force on Gatekeeper Regulation & the Profession, to develop appropriate guidance on adopting voluntary risk-based approaches to client due diligence that will inform legal professionals of the risks of money laundering and terrorist financing, and assist them in taking appropriate steps for compliance with anti-money laundering and anti-terrorist financing legal requirements.

## REPORT

### I. Executive Summary

The American Bar Association's Task Force on Gatekeeper Regulation and the Profession ("Task Force") was formed over five years ago to address certain issues arising from increased interest among U.S. government and foreign regulatory officials in combating money laundering and terrorist financing and enlisting the assistance of certain professionals, including lawyers, in this effort ("Gatekeeper Initiative"). Two recent developments affecting the Gatekeeper Initiative require that the American Bar Association adopt policy to address concerns with these developments.

Federal legislation was proposed in May 2008 to require those who form unincorporated business entities, trusts, partnerships, and other organizational structures to document, verify, and make available to law enforcement authorities the record and beneficial ownership of these business entities. This legislation would impose significant and difficult burdens on company formation agents (including lawyers in some circumstances), state authorities, and others to comply with this legislation. States, and not the federal government, should retain the authority to regulate those who form these business entities. Amendments to certain uniform and model laws relating to the formation of these business entities are currently under review to address concerns raised by law enforcement officials and policy makers. These amendments would render the proposed federal legislation unnecessary, and they represent a more efficient way to address regulatory concerns without unduly burdening state authorities, those involved in the formation of business entities, and bona fide businesses themselves.

The second development relates to recent efforts by the Financial Action Task Force ("FATF") to adopt a risk-based approach to client due diligence in the delivery of legal services. FATF is collaborating with certain designated non-financial businesses and professions, including lawyers, to develop voluntary risk-based guidance for legal professionals. FATF expects to adopt this guidance at its October 2008 plenary meeting. Assuming this guidance is adopted, U.S. lawyers should work to develop voluntary risk-based guidance for client due diligence. The proposed recommendation will allow the American Bar Association to develop this voluntary guidance for one or more of its constituent sections and to engage with the federal government and other interested parties in this process. Absent this voluntary guidance, it is possible that federal regulators and lawmakers may impose a rules-based approach on the legal profession, thereby triggering significant issues with regard to the attorney-client privilege, the duty of client confidentiality, the attorney-client relationship, and the delivery of legal services more generally.

### II. Background on the Gatekeeper Initiative

The Gatekeeper Initiative originates from the Moscow Communiqué issued at the 1999 meeting of the G-8 Finance Ministers. It calls upon countries to consider various means to address

money laundering through the efforts of professional gatekeepers of the international financial system, including lawyers, accountants, company formation agents, and others.

In recent years, the fight against money laundering has gained importance in the priorities of many countries. Moved by the FATF, the leading global organization in the fight against money laundering, governments from countries that comprise the principal financial centers have worked collaboratively to identify money laundering typologies, develop recommendations on best practices to combat money laundering, criminalize money laundering around the world, and encourage cooperation among national law enforcement and regulation agencies. Following the Moscow Communiqué, FATF created a working group that has identified several professions as "gatekeepers" with respect to money laundering. On May 31, 2002, FATF published a consultation paper entitled "Review of the FATF 40 Recommendations" in which the FATF identified several areas where possible changes could be made to the FATF anti-money laundering framework. The broad topics covered concern customer due diligence and suspicious transaction reporting ("STR"), beneficial ownership and control of corporate vehicles, and the application of anti-money laundering obligations to non-financial businesses and professions, including the legal profession.

In the United States, the Money Laundering and Financial Crime Strategy Act of 1998 obligates the U.S. Departments of Justice and Treasury to issue an annual "National Money Laundering Strategy Report," outlining a plan of action to enhance U.S. anti-money laundering efforts. The report for 2000 tasked the Justice Department with reviewing the professional responsibilities of lawyers and making recommendations "ranging from enhanced professional education, standards, or rules, or legislation, as may be needed." A similar theme was set forth in the report for 2001. An inter-agency working group was established, including the Department of Justice, the Department of Treasury, the Securities and Exchange Commission, and Treasury's Financial Crimes and Enforcement Network ("FinCEN"). This inter-agency group is charged with developing a U.S. position on the Gatekeeper Initiative.

### **III. Gatekeeper Task Force**

#### **A. Background**

The Task Force was created in February 2002 by ABA President Robert E. Hirshon to address the Gatekeeper Initiative. The mission of the Task Force is to respond to initiatives by the U.S. Department of Justice, U.S. Department of the Treasury, the Congress, the Financial Action Task Force ("FATF"), and others that will impact on the attorney-client relationship in the context of anti-money laundering enforcement. The Task Force reviews and evaluates ABA policies and rules regarding the ability of attorneys to disclose client activity and information, and works to develop positions on the Gatekeeper issue. The Task Force also develops educational programs for legal professionals and law students, and organizes resource materials to allow lawyers to comply with their anti-money laundering responsibilities. At the time the Task Force was established, the principal focus of the Task Force with regard to U.S. anti-money laundering policy was whether the U.S. government would impose a mandatory STR requirement on lawyers – i.e., filing with U.S. government regulators or law enforcement personnel reports on suspicious activity by clients, and being prohibited from informing clients that such a report had been filed (the so-called "no tipping off" rule). This would have made lawyers subject to

reporting obligations that are similar to what banks and other financial institutions have with regard to reporting suspicious financing transactions to FinCEN.

## **B. Efforts**

In response to concerns with the imposition of the STR requirement on the U.S. legal profession, in February 2002, the ABA Criminal Justice Section proposed a recommendation before the ABA House of Delegates that stated “That the American Bar Association urges the United States government to seek to protect and uphold the attorney/client relationship, including the attorney/client privilege, in dealing with international money laundering.”

In addition, in February 2003, the Task Force, together with the Section of Real Property, Probate and Trust Law (now the Section of Real Property, Trust and Estate Law), the Criminal Justice Section, the Section of Litigation, and the Section of International Law, submitted a Recommendation and Report to the House of Delegates with regard to the Gatekeeper Initiative. The Recommendation supported the enactment of reasonable and balanced initiatives to detect and prevent money laundering and terrorist financing. At the same time, the Recommendation opposed any law or regulation that would compel lawyers to disclose confidential information to government officials or otherwise compromise the attorney-client relationship of independence of the bar. The Recommendation also noted that the Model Rules of Professional Responsibility would continue to be reviewed as they relate to the obligations of lawyers to maintain client confidences, and urged bar associations and law schools to undertake educational efforts with regard to money laundering risks and concerns.

The Report accompanying this recommendation explained the appropriate role of lawyers in U.S. government efforts to combat money laundering; analyzed the legal and ethical problems arising from any mandatory reporting obligation to the U.S. government to reveal client information that involves a “suspicion” of possible money laundering or other criminal activity; and discussed existing legal and ethical requirements that minimize the risk that lawyers will be involved in money laundering activities.

Since that time the Task Force has been involved in encouraging lawyer educational programs with regard to anti-money laundering risks and compliance more generally; with continuing a dialogue with the U.S. government and the FATF concerning the imposition of STR and other anti-money laundering requirements on the legal profession; and liaising with other U.S. and non-U.S. bar associations and legal professional organizations concerning government policy and the work of the FATF regarding the role of the legal profession in preventing money laundering and terrorist financing.

## **IV. Lack of Beneficial Ownership Information for Law Enforcement – Background**

One issue that has recently arisen with regard to the legal profession concerns the possible abuse of trusts and other forms of business organization by persons involved in illegal activity. Specifically, there has been an increasing concern with undisclosed owners or beneficiaries of such corporate entities who might be establishing such entities in order to pursue illegal objectives, such as tax evasion or money laundering. While the focus on identifying “beneficial

ownership” information for all companies formed within the United States is rooted in the FATF’s efforts over the last nine years, a more recent focus has arisen as a result of legislation proposed by Senator Levin in his capacity as Chairman of the Permanent Subcommittee on Investigations for the Homeland Security Committee and FATF Recommendation 33.

### A. The Financial Action Task Force

The FATF is an inter-governmental body whose self-described purpose is the development and promotion of policies, both at national and international levels, to combat money laundering and terrorist financing. The FATF describes itself as “a policy-making body which works to generate the necessary political will to bring about national legislative and regulatory reforms in these areas.”<sup>1</sup> To this end, the FATF monitors members’ progress in implementing necessary measures, reviews money laundering and terrorist financing techniques and counter-measures, and promotes the adoption and implementation of appropriate measures globally. In performing these activities, the FATF collaborates with other international bodies involved in combating money laundering and terrorist financing.

Prior to September 11, 2001, the FATF was primarily focused on anti-money laundering and issued the Forty Recommendations (the “Recommendations”)<sup>2</sup> to provide a set of counter-measures against money laundering. The Recommendations cover a wide range of topics, such as an effective criminal justice system and law enforcement procedures to combat money laundering, the type of structure and mechanisms for effective regulation of a country’s financial system, and international co-operation. These Recommendations have been endorsed or adopted by many international bodies and are designed to allow countries a certain flexibility in implementing these principles according to their particular circumstances and constitutional frameworks. Though not a binding international convention, many countries (including the United States) have made a political commitment to combat money laundering by implementing the Recommendations.<sup>3</sup>

#### 1. Recommendation 33

FATF Recommendation 33 provides the impetus for much of the current activity to amend entity formation and beneficial ownership laws. Recommendation 33 addresses the exploitation of

---

<sup>1</sup> See Financial Action Task Force on Money Laundering, *The Forty Recommendations* (Oct. 22, 2004), available at <http://www.oecd.org/dataoecd/7/40/34849567.PDF>.

<sup>2</sup> Initially developed in 1990, the Recommendations were revised for the first time in 1996 to take into account changes in money laundering trends and to anticipate potential future threats. More recently, the FATF has completed a thorough review and update of the Forty Recommendations (2003). The FATF has also elaborated various Interpretative Notes that are designed to clarify the application of specific Recommendations and to provide additional guidance. See Forty Recommendations available at: [http://www.fatf-gafi.org/document/28/0,3343,en\\_32250379\\_32236930\\_33658140\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html).

<sup>3</sup> After September 11, FATF revised its focus to also include counter-terrorist financing provisions. These take the form of the additional Nine Special Recommendations. See Nine Special Recommendations on Terrorist Financing available at [http://www.fatf-gafi.org/document/9/0,3343,en\\_32250379\\_32236920\\_34032073\\_1\\_1\\_1\\_1,00.html](http://www.fatf-gafi.org/document/9/0,3343,en_32250379_32236920_34032073_1_1_1_1,00.html).

legal persons by money launderers and identifies as the solution to such abuse a need for complete and accessible information about beneficial ownership.<sup>4</sup> The Recommendation reads:

Countries should take measures to prevent the unlawful use of legal persons by money launderers. Countries should ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities. In particular, countries that have legal persons that are able to issue bearer shares should take appropriate measures to ensure that they are not misused for money laundering and be able to demonstrate the adequacy of those measures. Countries could consider measures to facilitate access to beneficial ownership and control information to financial institutions undertaking the requirements set out in Recommendation 5.<sup>5</sup>

FATF defines “beneficial owner” as “the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted,” as well as “those persons who exercise ultimate effective control over a legal person or arrangement.”<sup>6</sup>

## **2. FATF Report: Methodology for Assessing Compliance with the Forty Recommendations and the FATF 9 Special Recommendations**

To aid countries in their attempts to comply with the Recommendations, FATF issued a report outlining how it assesses compliance with each Recommendation.<sup>7</sup> Regarding Recommendation 33, FATF identified three “examples of mechanisms” that countries could use to ensure they had adequate transparency concerning beneficial ownership and control of legal persons.<sup>8</sup> The report advised that “these mechanisms are, to a large degree, complementary and countries may find it highly desirable and beneficial to use a combination of them.”<sup>9</sup> The identified mechanisms are:

1. A system of central registration (or up front disclosure system) where a national registry records the required ownership and control details for all companies and other legal persons registered in that country. The relevant information could be either publicly available or only available to competent authorities. Changes in ownership and control information would need to be kept up to date.
2. Requiring company service providers to obtain, verify and retain records of the beneficial ownership and control of legal persons.

---

<sup>4</sup> See *id.* at 9.

<sup>5</sup> FATF, *Recommendations*, at 9.

<sup>6</sup> FATF, *Key Topics, 40 Recommendations Glossary*, available at [http://www.oecd.org/glossary/0,3414,en\\_32250379\\_32236889\\_35433764\\_1\\_1\\_1\\_1,00.html#34276864](http://www.oecd.org/glossary/0,3414,en_32250379_32236889_35433764_1_1_1_1,00.html#34276864).

<sup>7</sup> See FATF, *Methodology for Assessing Compliance with the FATF 40 Recommendations and the FATF 9 Special Recommendations* (February 2008), available at <http://www.oecd.org/dataoecd/16/54/40339628.pdf>.

<sup>8</sup> *Id.*

<sup>9</sup> *Id.*

3. Relying on the investigative and other powers of law enforcement, regulatory, supervisory, or other competent authorities in a jurisdiction to obtain or have access to the information.<sup>10</sup>

Furthermore, FATF explained that “whatever mechanism is used it is essential that: (a) competent authorities are able to obtain or have access in a timely fashion to the beneficial ownership and control information, (b) the information is adequate, accurate and timely, and (c) competent authorities are able to share such information with other competent authorities domestically or internationally.”<sup>11</sup> Therefore, it would seem that a country could use any one of the three example mechanisms, or a combination thereof – so long as these three results are attained.

### 3. FATF Mutual Evaluation Report: United Kingdom

FATF teams perform mutual evaluations of each country’s compliance with the Recommendations, and produce reports providing additional guidance on FATF’s expectations for each respective country.

FATF evaluated the United Kingdom (“UK”) in 2007 and rated its programs regarding beneficial ownership and transparency in corporate formation as “partially compliant.”<sup>12</sup> FATF’s explanation of the UK’s program noted the UK’s requirement that all limited companies and limited liability partnerships must provide to a national registry a full list of their shareholders or partners, contact information, and information about the company’s registered office.<sup>13</sup> Furthermore, the report stated that the UK had, in 2002, considered a system requiring up-front disclosure of beneficial ownership and determined that a cost-benefit analysis counseled against its implementation.<sup>14</sup> FATF stated that “the UK system for access to beneficial ownership and control information of legal persons basically relies upon investigatory powers available to law enforcement.”<sup>15</sup>

The evaluation team did have a number of concerns, including “concerns regarding the possibility to use nominee shareholders who would appear on public record at the company registry instead of the real beneficial owner”, as well as similar concerns that legal persons acting as company directors or shareholders would mean that investigators would need to pursue a chain of entities before reaching the ultimate beneficial owner.<sup>16</sup> There were also concerns regarding the accuracy of information and the use of share warrants to a “bearer”.<sup>17</sup> FATF recommended that the UK bring company formation agents into an anti-money laundering

---

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> See FATF, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: The United Kingdom of Great Britain and Northern Ireland* at 292 (June 29 2007), available at <http://www.oecd.org/dataoecd/55/29/39064399.pdf>.

<sup>13</sup> *Id.* at 231.

<sup>14</sup> *Id.* at 234.

<sup>15</sup> *Id.* at 236.

<sup>16</sup> *Id.* at 231.

<sup>17</sup> *Id.* at 236.

compliance regime.<sup>18</sup> However, FATF recognized that improvements were soon to be made to the UK system, and recognized as among these improvements a new UK legal requirement that at least one director be a natural person and the reporting of a usual residential address and a service address for directors.<sup>19</sup>

#### 4. FATF Mutual Evaluation Report: United States

In 2006, FATF conducted an evaluation of the United States' compliance with the FATF Recommendations, and found the U.S. "non-compliant" with Recommendation 33,<sup>20</sup> giving the United States until July 2008 to make progress toward compliance.<sup>21</sup> In its "Summary of Factors Underlying Ratings," the Mutual Evaluation Report of the U.S. identified two factors contributing to the "non-compliant" rating:

- While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.
- There are no measures taken by those jurisdictions which permit the issue of bearer shares to ensure that bearer shares are not misused for money laundering.<sup>22</sup>

Additionally, the FATF criticized the United States for its lack of available information for private companies registered within its borders.<sup>23</sup> In its recommendations, the FATF stated that "the proposal [from FinCEN] to bring company formation agents within the [Bank Secrecy Act] framework, and to require them to implement [anti-money laundering programs] and [Customer Identification Procedures] should be taken forward in the very near future."<sup>24</sup>

#### 5. FATF Guidance for Non-Financial Businesses

FATF also issued guidance on its recommendation to apply anti-money laundering regulations to non-financial businesses and professions ("DNFBPs"), such as lawyers. On May 30, 2002, FATF issued a "Consultation Paper" outlining various options for strengthening national anti-money laundering measures and sought comments on those options.<sup>25</sup> As noted in the introduction, the

<sup>18</sup> *Id.*

<sup>19</sup> *Id.* This acknowledgment is a significant point as to why the amendments to the Entity Paradigm Laws discussed below adequately address the FATF Recommendation 33 while obviating the need for federal legislation.

<sup>20</sup> See Financial Action Task Force, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism* (June 23, 2006), available at <http://www.oecd.org/dataoecd/44/9/37101772.pdf>.

<sup>21</sup> *Introducing the Incorporation Transparency and Law Enforcement Assistance Act*, 110<sup>th</sup> Cong. (May 1, 2008) (statement of Sen. Carl Levin, S. Comm. on Homeland Sec. and Gov't Affairs).

<sup>22</sup> *Id.*

<sup>23</sup> The Financial Action Task Force, *Mutual Evaluation Report: United States* (June 23, 2006). Published at <http://www.fatf-gafi.org/dataoecd/44/9/37101772.pdf>.

<sup>24</sup> *Mutual Evaluation Report* at 308.

<sup>25</sup> See Financial Action Task Force on Money Laundering, *Review of the FATF Forty Recommendations: Consultation Paper*, May 30, 2002.

Consultation Paper proposed that certain anti-money laundering measures be extended to lawyers including (1) increased regulation and supervision of the profession, (2) increased due diligence requirements on clients, (3) new internal compliance training and record-keeping requirements for lawyers and law firms, and (4) new STR requirements mandating that lawyers report to a government enforcement agency or a self-regulatory organization (“SRO”) information that triggers a “suspicion” of money laundering relating to a client activity. Furthermore, the Consultation Paper indicated that lawyers would be prohibited from informing their clients when an STR has been filed with the government. The Consultation Paper proposed that the STR requirement be enforced through criminal, administrative or other sanctions.<sup>26</sup>

While the Consultation Paper recommended the imposition of such regulations, it also established the framework for a certain amount of flexibility by providing a number of “options” for countries to choose from when developing their individual anti-money laundering system. The Consultation Paper also acknowledged the special role played by the legal profession and recognized that lawyers would be under no obligation to report in instances where attorney-client privilege would be implicated. As noted above, the ABA passed a resolution in February 2003 opposing any mandatory STR obligation that would compromise the confidentiality of client information or adversely affect the attorney-client relationship in the U.S. justice system.

#### **B. The Senate Committee on Homeland Security and Governmental Affairs**

The United States Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations (“PSI”) held a series of hearings beginning in 2001 that investigated the role of domestically and internationally formed private companies and the role those entities play in U.S. tax evasion, money laundering, and terrorist financing. In each of these hearings, the presumption was that lack of information about underlying beneficial ownership impeded law enforcement investigations. Specifically,

- In 2001, the PSI examined “the historic and ongoing lack of cooperation by some offshore tax havens with international tax enforcement efforts and their resistance to divulging information needed to detect, stop and prosecute U.S. tax evasion.”
- In December 2002, the PSI conducted an “in-depth examination of an abusive tax shelter used by Enron.”
- In November 2003, the PSI held hearings looking into “how accounting firms, banks, investment advisors, and lawyers have become engines pushing the design, sale and implementation of abusive tax shelters to corporations and individuals across the country.”
- In August 2006, the PSI held hearings covering “case histories on the use of offshore trusts and corporations to circumvent U.S. tax, securities and anti-money laundering laws.”

---

<sup>26</sup> Id., at p. 103.

- In November 2006, the PSI held a hearing to examine “the issue of states routinely incorporating hundreds of thousands of new, non-publicly traded companies in the United States each year without obtaining the identity of the corporate owners, thereby impeding law enforcement investigations into persons misusing U.S. shell corporations for money laundering, tax evasion, terrorist financing, or other crimes.” The hearing featured the April 2006 GAO report prepared at the Subcommittee’s request, “Company Formations: Minimal Ownership Information Is Collected and Available.” Published at <http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Home>.
- In July 2008, the PSI held a hearing on Tax Haven Banks and U.S. Compliance to examine “how financial institutions located in offshore tax havens . . . may be engaged in banking practices that could facilitate, and in some instances have resulted in, tax evasion and other misconduct by U.S. clients. The hearing will also examine how U.S. domestic and international tax enforcement efforts could be strengthened.”

As a result of these findings, on February 17, 2007, Senators Levin, Coleman and Obama proposed S. 681 (Stop Tax Haven Abuse Act) that *inter alia*, proposed to subject persons involved in the formation of companies to anti-money laundering program requirements of the Bank Secrecy Act.<sup>27</sup> Section 203 of S. 681 would have amended the definition of “financial institution” to include a new category, namely “corporate formation agents”, in the Bank Secrecy Act to include “persons involved in forming new corporations, limited liability companies, partnerships, trusts, or other legal entities.” This new category was broad enough to include, among others, lawyers and any other person even tangentially involved in the process (including secretaries of state).

In response, various industry groups involved in entity formation including the ABA’s Business Law Section, the ABA Committee on Corporate Laws, the National Conference of Commissioners on Uniform State Law (“NCCUSL”), the National Association of Secretaries of State, the National Conference of State Legislatures, the International Association of Commercial Administrators, and Association of Registered Agents began to work together with representatives from the Department of Justice’s Asset Forfeiture and Money Laundering Section in the Criminal Division, the Department of the Treasury’s Office of Terrorist Financing, the Office of Foreign Assets Control (“OFAC”) and FinCEN to discuss entity formation laws, to understand the type of information sought by law enforcement in their respective investigations, and to offer to work together to resolve law enforcement’s information gathering issues through a means other than federal legislation. These industry groups worked with Treasury to draft amended entity laws that would require privately held entities to maintain ownership information and make it readily accessible to law enforcement.

Although most of the parties involved believed that progress was being made to address the issues identified by the FATF, the GAO Reports, and the PSI, and thus new legislation would not

---

<sup>27</sup> See section 203 of S. 681, To Restrict the Use of Offshore Tax Havens and Abusive Tax Shelters to Inappropriately Avoid Federal Taxation, and for Other Purposes. Published at <http://www.levin.senate.gov/newsroom/supporting/2007/PSI.OffshoreTaxBill.021707.pdf>.

be pursued, on May 1 2008, Senator Levin together with Senators Obama and Coleman, introduced S. 2956, largely an updated version of S. 681.

## **C. Current Efforts on the Hill: S. 2956**

S. 2956 would require privately held entities to provide more extensive beneficial ownership information to state governments and law enforcement authorities. S. 2956 would require each applicant seeking to form a corporation or limited liability company (“LLC”) to provide the state of formation with a list of its beneficial owners (including their names and current addresses). This list would have to be updated either annually or each time a change is made, and the states would be required to maintain this information for five years after the entity is terminated. This beneficial ownership information would be provided to law enforcement or a congressional committee upon service of a subpoena to the state. For foreign beneficial owners of an entity, additional information would have to be provided. This additional information would include a written certification by a formation agent that the agent has verified the name, address, and identity of each beneficial owner and a certification that the formation agent has obtained a copy of the beneficial owner’s passport. The formation agent would be required to retain this information for a specified period of time and produce it upon request. Penalties to be imposed under the bill for the provision of false beneficial ownership information would include civil penalties of up to \$10,000, imprisonment for up to three years, or both.

Section 4 of S. 2956 (much like section 203 of S. 681) would create a new category of “financial institution” under the Bank Secrecy Act – i.e., corporate formation agents defined to include “any person involved in forming a corporation, limited liability company, partnership, trust, or other legal entity.” The legislation would require the Department of the Treasury to require corporate formation agents, defined broadly enough to include lawyers, to establish anti-money laundering programs to ensure that they are not forming corporations or LLCs for money launderers. To satisfy these programs, lawyers and their law firms involved in the formation of these types of business entities would be required to establish internal policies, procedures, and controls, designate a compliance officer, conduct ongoing employee training programs, and permit independent audit functions to test programs. Moreover, at some point in the future, STR and due diligence requirements could potentially be imposed under such a program.

For purposes of the legislation, “beneficial owner” is defined as “an individual who has a level of control over, or entitlement to, the funds or assets of a corporation or limited liability company that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the corporation or limited liability company.” A “formation agent” is defined as “a person, who, for compensation, acts on behalf of another person to assist in the formation of a corporation or limited liability company under the laws of a state.” The Bank Secrecy Act would be amended to impose anti-money laundering obligations on “any person involved in forming a corporation, limited liability company, partnership, trust, or other legal entity.”

## **V. Drawbacks to Proposed Federal Legislation**

### **A. Anti-Money Laundering Program Requirements for Entity Formation Agents (including lawyers)**

To the extent that S. 681 and S. 2956 require those involved in the entity formation process to be incorporated under the Bank Secrecy Act Regulations, lawyers (and others) will be required to maintain anti-money laundering programs, which could in the future include the filing of STRs.<sup>1</sup> This latter requirement does not acknowledge the sanctity of the attorney-client privilege nor does it pose a reasonable solution to PSI's identified problem, whereby U.S. privately held entities can be abused by money launderers, tax abusers and terrorist financiers. While all parties involved recognize the threat that money laundering, terrorist financing and tax evasion pose to the U.S. national security, it does not appear that S. 681 or S. 2956 resolves the problem effectively. In practice, S. 681 and S. 2956 impose an undue burden on U.S. businesses and persons involved in entity formation (including lawyers). Moreover, the combination of Entity Paradigm Laws (as identified in Section VI of this Report) and risk based guidance for legal professionals effectively addresses the problem of beneficial ownership without the undue burdens of S. 2956 and S. 681.

#### **B. S. 681 May Draw the United States into WTO Case for discriminatory practices**

S. 681 arguably violates the principle in Article II of the General Agreement on Trade in Services (GATS) that prohibits countries from discriminating among foreign trading partners on the basis of nationality and requires that rules and regulations be based on objective, nondiscriminatory criteria.<sup>2</sup> Enactment of S. 681 could result in additional litigation against the United States before the WTO.

The cumulative adverse impact of burdensome tax enforcement on foreign investment, more U.S. losses in the WTO as a result of U.S. discriminatory regulation, and a downturn in foreign investments – with little likelihood of actually addressing money laundering and terrorist financing abuse of the U.S. financial sector – are strong arguments in favor of opposing federal legislation as drafted and supporting the alternatives – including Risk-Based Guidance for Legal Professionals discussed in Section VI.

### **VI. Alternative to Federal Legislation**

The ABA and NCCUSL, working together with private industry, with the secretaries of state and with Treasury's Office of Terrorist Financing, have been developing an alternative solution to the beneficial ownership issue identified by both the FATF and those sponsoring S. 681 and S. 2956. The ABA Committee on Corporate Laws has been preparing amendments to the Model Business Corporation Act and NCCUSL has been preparing amendments to the Uniform Partnership Act, Uniform Limited Partnership Act, Uniform Limited Liability Company Act, and Uniform Limited Cooperative Association Act (collectively, the "Entity Paradigm Laws").

---

<sup>1</sup> The Treasury Department could take the position that it has the discretion to impose STR requirements on legal professionals without further legislative action or guidance.

<sup>2</sup> WTO Economic Research and Analysis Division, Special Studies 6, Market Access: Unfinished Business Post-Uruguay Round Inventory and Issues 99.

The most recent version of the ABA amendments to the Model Business Corporation Act would require public disclosure of the directors and officers of a corporation throughout its existence. The provision that allowed “persons” to act as incorporators would be amended to require incorporators to be “individuals”. The amendments further impose duties on the incorporator – an incorporator would now have the duties and liabilities of (1) a director until either a director has been named in an annual report, and (2) a records contact until a records contact has been named. The ABA amendments impose an additional requirement on closely-held companies, to identify themselves as such and to provide the secretary of state with the name and a business or residential street address of its records contact. Annual reports to the secretary of state must now be promptly amended whenever information becomes incorrect or incomplete.

The general record-keeping requirements of a corporation would be updated under the ABA amendments. These amendments would make the following enhancements to record-keeping procedures so as to address the concerns of U.S. law enforcement and regulatory officials. First, a closely-held company would be required to maintain a current record showing the name and last known address of each shareholder. The record must indicate for each shareholder that is a person incorporated or formed by a public filing, whether within or outside the United States, the jurisdiction under whose laws the person is incorporated or formed. The individuals responsible for preparing and maintaining the record would also need to be named. To ensure that this information is accessible to law enforcement when necessary, a closely-held company would need, at all times, to have an individual whose principal residence is in the United States who has access to the record and can produce it within the United States promptly upon request by an authorized agent of a governmental body. This individual must also be able to produce a copy of a passport, driver’s license or other government-issued, photo identification document for each director at the time who is an individual and whose principal residence is outside the United States.

The proposed amendments also impose requirements on those becoming shareholders. A person incorporated or formed under the laws of a foreign jurisdiction would need to provide the company with a current certification stating the name and business or residential street address in the United States of an individual whose principal residence is in the United States and who has access to the company’s records, to be produced promptly upon request by an authorized agent of a governmental body. These records must include the name and last known address of each record owner of the shareholder, indicate for each record owner of the shareholder that is not an individual the jurisdiction under whose laws the record owner is incorporated or formed.

It is anticipated that NCCUSL will prepare amendments to the other Entity Paradigm Laws similar to the ABA amendments described above. Business trusts will also be covered by the amendments.

The proposed ABA amendments received general – albeit informal – approval from various officials at the Department of the Treasury. It also appears that these proposals would satisfy the FATF’s three mechanisms for compliance with Recommendation 33. The FATF’s Mutual Evaluation Report for the UK indicated that the UK’s intent to implement a similar reporting requirement for a director and natural person would be a move toward complying with

Recommendation 33. As a result, it appears that the ABA and NCCUSL efforts can meet Recommendation 33 requirements without the need for congressional intervention.

## **VII. Solution: Risk Based Guidance to Legal Professionals through Best Practices Guidance rather than a Rules-Based Solution**

The proposed ABA resolution would also make clear the Task Force's ability to participate in future discussions with the U.S. Government, the FATF or other governmental bodies relating to client due diligence initiatives for the legal profession, including suggestions for a set of voluntary best practices guidelines on client due diligence for the legal profession. A risk-based guidance on client due diligence for legal professionals, combined with the Entity Paradigm Laws and other policies proposed by industry groups, will obviate the need for new federal legislation such as S. 681 and S. 2956.

FATF has been active in developing risk-based guidance for financial institutions and DNFBPs, including legal professionals. In June 2007, the FATF adopted Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing: High Level Principles and Procedures, which includes guidance for public authorities and guidance for financial institutions ("Financial Institution Guidance"). This effort was the culmination of extensive consultation between private and public sector members of an Electronic Advisory Group ("EAG") established by the FATF.

In addition to financial institutions, the FATF Recommendations also cover a number of DNFBPs. At its June 2007 meeting, the FATF's Working Group on Evaluation and Implementation ("WGEI") endorsed a proposal to convene a meeting of the representatives from the DNFBPs to assess the possibility of developing guidance on the risk-based approach for their sectors, using the same structure and style as the Financial Institution Guidance.

Three months later, in September 2007, FATF convened a meeting in London attended by members of organizations that represent lawyers, notaries, trust and company service providers ("TCSPs"), accountants, casinos, real estate agents and dealers in precious metals and dealers in precious stones. Task Force representatives attended this meeting. This private sector group expressed an interest in contributing to FATF guidance on implementing a risk-based approach for their sectors. The guidance for the DNFBPs would follow the principles of the risk-based approach already established by FATF, and would highlight risk factors specific to the DNFBPs, as well as suggest mitigation strategies that fit with the particular activities and businesses of the DNFBPs. The FATF established another EAG to facilitate the work. The U.S. government was supportive of the FATF effort and outreach to the private sector.

The private sector group met again in December 2007 in Bern, Switzerland and was joined by a number of specialist public sector members, including representatives from the Task Force and the American College of Trust and Estate Counsel. Separate working groups comprising public and private sectors members were established, and private sector chairs were appointed. The EAG met in Paris in April 2008 and in London in June 2008 to advance discussions on developing guidance for legal professionals. During the course of the discussions with the FATF, Task Force members made clear to the participants the ABA resolution from 2003 opposing the imposition of any STR requirement on the U.S. legal profession, and indicated that

the STR provisions of the FATF Forty Recommendations should not be part of the risk-based client due diligence guidance for the legal profession. Members of the FATF Secretariat appear to have acceded to this position at this time, noting that the requirement on lawyers to file STRs regarding client activities is a matter of specific legal requirements in different jurisdictions, and therefore was not a matter for a risk-based approach to client due diligence. The Task Force will continue to espouse the policy of the ABA opposing mandatory reporting requirements with regard to “suspicious” client activities.

The draft guidance is scheduled to be presented to the WGEI in Ottawa, Canada in September 2008. After further international consultation with both public and private sectors, the FATF anticipates to adopt this guidance at its October 2008 plenary in Rio de Janeiro. Guidance for each of the other DNFBP sectors is being published separately.

A key component contained in the current draft of the guidance for legal professionals is recognition of the need for the legal profession (and not a third party or governmental entity) to develop guidance for its members that is specifically tailored to address any risks that might arise. To that end, and assuming the draft guidance is adopted at FATF’s October 2008 plenary, the Task Force understands through discussions with representatives of the Treasury Department that it would be helpful for the ABA to exhibit leadership in the development of non-governmentally imposed risk-based guidance for U.S. lawyers. Because Task Force representatives have been directly and intimately involved in the development of FATF guidance paper for legal professionals since its inception, the Task Force is uniquely qualified to assist in the development of voluntary risk-based guidance. The Task Force’s efforts in this area, coupled with on-going dialogue with Treasury Department representatives in the development of such guidance, would obviate the need for Congress to enact legislation designed to impose a rules-based system on U.S. lawyers.

GENERAL INFORMATION FORM

To Be Appended to Reports with Recommendations  
(Please refer to instructions for completing this form.)

Submitting Entity: Task Force on Gatekeeper Regulation and the Profession  
Section of Real Property, Trust and Estate Law

Submitted By: Edward J. Krauland

1. Summary of Recommendation(s).

The Recommendation addresses certain proposed legislation and international policy initiatives intended to impose obligations on company formation agents, including lawyers, to undertake extensive due diligence and determine “beneficial owners” when assisting in the formation of non-publicly traded business entities and trusts. It urges that federal legislation is not needed; that the appropriate way to address these issues is through existing state laws and regulatory bodies; that any requirement to determine beneficial ownership and conduct client due diligence be reasonable, risk-based, cost-effective, and not interfere with lawyer ethical obligations; and that the legal profession undertake voluntary initiatives to provide guidance to members as to the risk of money laundering and terrorist financing and complying with existing laws.

2. Approval by Submitting Entity.

The ABA Task Force on Gatekeeper Regulation and the Profession prepared this Recommendation and Report and approved it on July 25<sup>th</sup>, as has the Council of the ABA Section of Real Property, Trust and Estate Law. Other Sections considering the Recommendation and Report are the Sections of Business Law, Criminal Justice, International Law, and Taxation. Action by the Councils of these Sections is expected by or on August 8, 2008.

3. Has this or a similar recommendation been submitted to the ABA House of Delegates or Board of Governors previously?

No. However, the ABA Gatekeeper Task Force did submit a Recommendation at the Midyear Meeting of the ABA in February 2003. That Recommendation opposed the imposition of mandatory “suspicious transaction reporting” requirements on lawyers, in connection with initiatives by the U.S. government and the Financial Action Task Force to impose new anti-money laundering compliance requirements on the legal profession. The Recommendation was approved (Resolution 104).

4. What existing Association policies are relevant to this recommendation and how would they be affected by its adoption?

No other Association policies, other than that identified in response to question 3, are known to be relevant to this Recommendation. This Recommendation would be consistent with the policy described in response to question 3.

5. What urgency exists which requires action at this meeting of the House?

Legislation (S.2956) has been introduced in the Senate (and hearings have been held), which seeks to impose onerous and unworkable requirements on company formation agents, including lawyers. We understand that a mark-up of this legislation is expected later this year. Therefore, it is urgent that the ABA take a position on the legislation as soon as possible. Even if the legislation does not move this year, we have been informed it will be re-introduced early next year. The ABA Office of Government Affairs has requested the Task Force to move forward with a Recommendation at this annual meeting in order to be in a position to advocate on behalf of the legal profession with regard to S.2956 and any related bills. Furthermore, the Financial Action Task Force is expected to release a paper in October 2008, providing its views on how the legal profession should conduct client due diligence in order to comply with anti-money laundering and anti-terrorist financing legal requirements. The ABA Task Force wants to be in a position to work with the U.S. government to address the views set forth in the FATF paper, and to prevent any effort to impose new regulatory requirements in this area on the legal profession.

6. Status of Legislation. (If applicable.)

S.2956 has been introduced in the U.S. Senate. It has been referred to the Senate Committee on Homeland Security and Governmental Affairs.

7. Cost to the Association. (Both direct and indirect costs.)

None expected at this time. There may be certain travel requirements that will arise in the future, but \$5,000 has already been budgeted to cover any such costs.

8. Disclosure of Interest. (If applicable.)

None.

9. Referrals. (List entities to which the recommendation has been referred, the date of referral and the response of each entity if known.)

See response to question 2. Also, the Recommendation has been referred to the Task Force on Attorney-Client Privilege and the Section of Litigation. Efforts are also underway to refer the Recommendation to the Standing Committee on Ethics and

Professional Responsibility, Standing Committee on Governmental Affairs, General Practice, Solo and Small Firm Division, Law Practice Management Section, Tort Trial & Insurance Practice, and Young Lawyers Division.

10. Contact Person. (Prior to the meeting. Please include name, address, telephone number and email address.)

Edward Krauland,  
Steptoe & Johnson LLP,  
1330 Connecticut Avenue, NW,  
Washington, D.C. 20036;  
202-429-8083;  
ekrauland@steptoe.com

11. Contact Person. (Who will present the report to the House. Please include email address and cell phone number.)

Neal R. Sonnett,  
Neal R. Sonnett PA,  
Suite 2600,  
2 S Biscayne Blvd,  
Miami, FL 33131;  
[nrs@sonnett.com](mailto:nrs@sonnett.com);  
305-358-2000;  
(cell) 305-333-5444 ;

Stephen A. Saltzburg,  
George Washington University School of Law,  
2000 H Street, NW,  
Washington, D.C., 20052;  
[ssaltz@law.gwu.edu](mailto:ssaltz@law.gwu.edu);  
202-994-7089;  
(cell) 202-489-7464.

Edward Krauland, Chair  
ABA Task Force on Gatekeeper Regulation and the Profession  
August 2008

## EXECUTIVE SUMMARY

### 1. Summary of the Recommendation:

The Recommendation addresses certain proposed legislation and international policy initiatives intended to impose obligations on company formation agents, including lawyers, to undertake extensive due diligence on clients, and to determine “beneficial owners” when assisting in the formation of non-publicly traded business entities and trusts. This is being driven by concerns over money laundering, tax evasion, terrorist financing, and abuse of corporate vehicles for improper purposes. The Recommendation urges that federal legislation is not needed to address the concerns of U.S. regulators; that the appropriate way to address these issues is through existing state laws and regulatory bodies; that any requirement to determine beneficial ownership and conduct client due diligence be reasonable, risk-based, cost-effective, and not interfere with lawyer ethical obligations; and that the legal profession undertake voluntary initiatives to provide client due diligence guidance to members, so as to help address the risk of money laundering and terrorist financing and assist members in complying with existing laws.

### 2. Summary of the Issue that the Resolution Addresses:

See answer to item 1. The Recommendation addresses the appropriate way for the U.S. government to approach the oversight of company formation agents, including lawyers, in areas such as identifying “beneficial owners” when forming business entities and trusts, conducting client due diligence when initiating client relationships, and avoiding money laundering and terrorist financing risks in the performance of legal services.

### 3. Please Explain How the Proposed Policy Position will Address the Issue

The Recommendation will provide the ABA Office of Government Affairs with necessary ABA policy to more effectively oppose S. 2956 and work with Congress to pass legislation less burdensome on lawyers, and which secures the attorney-client privilege. The Recommendation urges that new federal legislation is not needed, nor is it the most effective way to address U.S. and international concerns with regard to the impact of non-transparent beneficial ownership in business entities on money laundering and terrorist financing activities. Rather, existing state laws and state regulatory regimes, as appropriately modified through ongoing work of the ABA and other organizations (such as the ABA Committee on Corporate Laws, the ABA Section of Business Law, the National Conference of Commissioners on Uniform State Laws, the National Conference of State Legislatures, the National Association of Secretaries of State), are the appropriate way to increase transparency and information available to regulators. Moreover, client due diligence should be the subject of voluntary guidance developed by the profession, to help educate and assist lawyers to identify and address money laundering and terrorist financing risks when delivering legal services.

4. Summary of Minority Views

There are no known minority views.