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VIA E-MAIL (fatf.consultation@fatf-gafi.org)

Mr. John Carlson
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Re: Comments to Consultation Paper—The Review of the Standards—Preparation for the 4th Round of Mutual Evaluations—Second Public Consultation

Dear John:

The American Bar Association ("ABA"), which has almost 400,000 members, is pleased to offer these comments to the Financial Action Task Force ("FATF") on the issues raised in the Second Public Consultation. As Chair of the ABA Task Force on Gatekeeper Regulation and the Profession, I have been authorized to express the ABA’s views on this important topic. We would like to preface these comments, however, with a general observation.

In my letter to you dated June 17, 2011, and my e-mail message to you on September 2, 2011, the ABA urged the FATF to continue to reach out and engage in an active dialogue with all stakeholders, including the ABA and other legal sector representatives. To date, that has not occurred. I understand that the FATF may convene a public consultation meeting in early November to discuss the Consultation Paper and that the FATF plans to adopt the revised Standards at its February 2012 plenary meeting. In light of this compressed timetable, it is difficult to envision that the private sector will have ample opportunity to engage in a robust, meaningful manner with the FATF on various complicated issues that affect financial institutions, the business community generally, governments, and designated non-financial businesses and professions ("DNFBPs") (including lawyers).

The ABA believes that to improve compliance with the Standards, the FATF needs to have a substantive dialogue with all stakeholders to identify the shortcomings in the current Standards. Meaningful engagement with the legal sector is particularly important not only because of its "gatekeeper" role, but also because of its role in advising both financial institutions as well as other DNFBPs.
The ABA is concerned that the FATF may issue revisions to the Standards as a *fait accompli*. The Consultation Paper explains that the FATF intends to “consider its proposed revisions to the Standards, and the contributions to the consultation process, in the months after September, and will provide substantive feedback on its response to both rounds of consultation when the revised Standards are adopted in February 2012.” Based on this language, it seems that the FATF plans to provide “substantive feedback” only after the FATF has already made its key decisions (i.e., “when the revised Standards are adopted”), and not before that time when there would still be an opportunity to adjust the Standards in a manner that accommodates the reasonable and meritorious views of the interested stakeholders.

The ABA urges the FATF—sooner rather than later—to engage with the legal profession on the substantive issues raised in the Consultation Paper, especially those issues that permeate Recommendations 33 and 34. Absent this engagement, there is a likelihood that the revised Standards will fail to achieve the desired goals. That outcome misses an opportunity to enhance compliance, and indeed would run the risk of undermining the credibility of the Standards. Impractical and excessively burdensome Standards may in fact inadvertently subvert the process.

The ABA recommends that the FATF have public deliberations on the Consultation Paper with a written record of the decisions, so that a legislative history exists of the choices and reasons for its choices. The provision of enhanced transparency in its decision-making will strengthen the rationale and overall legitimacy of the Consultation process. The fact that the FATF is a body with a relatively small membership makes transparency even more vital to the integrity of the process.

In general some of the requirements, while well intentioned, do not seem to take account of the cost-benefit of the proposed task and some of the mandatory requirements (e.g., see the discussion in Recommendation 5). Many of the requirements in the Consultation Paper assume that a lawyer will undertake a large and extensive relationship with a client. Most legitimate clients, especially start-up and/or small ones are not intending and perhaps cannot afford to pay for the amount of due diligence the Consultation Paper is proposing for a modest assignment with a professional with which it has no or little experience and hence does not know the extent of the potential relationship. Requiring 4-5 hours of due diligence for a two-hour consultation is not practically feasible.

The comments below are arranged in the order in which they appear in the Consultation Paper, and the numbering reflects the paragraph, page, and other references in the Consultation Paper.

### 1.1 Recommendation 5 (paragraph 8, page 5)

The suggested methodologies for verifying beneficial ownership under Recommendation 5 raise a number of feasibility, complexity, and cost issues. For example, the proposed revisions to Recommendation 5 would require lawyers to undertake additional client intake steps, including a directive that lawyers identify “and verify” the customer’s persons who hold senior management
positions. There is no explanation of what “verify” would mean in this context, and lawyers will likely be unable to do so in any meaningful way. Certainly for international clients, the data privacy, logistics, and in many instances nature of the work will present major obstacles. For instance, a lawyer would be hard pressed to verify the identity of senior officers generally at the customer due diligence stage, and specifically if the request for legal service might be small or limited, or of a nature where verification of senior officers will make little sense. Complying with the rule would not be cost-effective in many one-off arrangements. Hence, the requirement lacks practicality in many relationships in the real world.

Unlike the beneficial ownership sub point in paragraph 11 referenced below, there is no carve out for identification and verification of senior officers for publicly-traded companies. At a minimum, given the significant costs and burdens that Recommendation 5 would impose on lawyers and other DNFBPs, there should be a parallel scope of requirement between the customer verification and beneficial ownership verification provisions. Our comments on paragraph 11 below will elaborate on this point in more detail. As we have expressed previously, lawyers will have difficulty identifying and verifying beneficial owners, other than the senior managing official. Law firms and lawyers are not well-equipped to obtain or otherwise demand beneficial ownership information.

Paragraph 8 lists the information “that would normally be needed in order to satisfactorily perform” the functions of identifying and verifying the identity of customers that are legal persons or legal arrangements and understanding the nature of their business and their ownership structure. The first bullet point states that customer identification and verification entails the need to obtain and review, among other things, the entity’s articles of association. Imposing a non-risk based, mandatory obligation of this nature on financial institutions and DNFBPs will likely yield little useful information while, at the same time, forcing these stakeholders to undertake a compulsory review of an entity’s formation documentation irrespective of the risk profile of the entity and the requested work.

If the goal of such a mandatory review is to gain a better understanding of the customer during the customer due diligence phase, it is difficult to understand how this type of forced review will advance compliance goals and the detection of money laundering and terrorist financing. It is unlikely that a review of an entity’s articles of association or other formation documents will lead to a greater understanding of the customer and the types of transactions in which it will be involved. Indeed, this type of approach appears mechanical and serves to dissuade a more piercing review of matters of greater relevance under a true risk-based approach.

On a related point, the Consultation Paper does not provide direction on what is to be done with the collected articles of association. For example, must financial institutions and DNFBPs review the articles to assist in the verification of the customer’s identity? That type of requirement would be contrary to the typical—and traditional—purpose of obtaining and reviewing an entity’s articles so as to determine whether the entity possesses the power to undertake certain actions. Mandating that financial institutions and DNFBPs review the articles
for customer verification purposes, again without regard to the risk profile of the customer, would represent an ill-advised and radical change to the customer due diligence process and would invariably impose significant review costs on the affected stakeholders. The disproportionate impact of such an approach is obvious.

The first bullet point in Paragraph 8 obligates financial institutions and DNFBPs to obtain, among other things, “proof of existence” of the customer. It is unclear whether FATF intends for the financial institutions and DNFBPs to obtain the certification of incorporation or formation for the entity in question or whether FATF wants them to obtain evidence of good standing for the entity in question. A good standing certificate in most jurisdictions simply states whether the entity exists and is in “good standing” (i.e., whether it has paid all applicable taxes and fees). In some jurisdictions, such as the United Kingdom, it is not possible to obtain a U.S.-style good standing certificate.

The second bullet in Paragraph 8 refers to the “controlling ownership interest in a legal person,” but does not define what is meant by that phrase. Nor does the Consultation Paper shed light on what is meant by “natural persons exercising control through other means.” These ambiguities foster non-compliance or lack of compliance with the Standards, thereby underscoring the need to impart clarity in the use of these phrases.

1.2 Recommendation 33—Legal Persons

In General (paragraph 10, pages 5-6)

The proposed revisions to Recommendation 33 raise a number of nuanced, complex beneficial ownership issues that affect the legal profession and other DNFBPs. We understand that the member states of FATF have grappled with these issues. Engagement with the legal profession is critical. Recommendations 33 and 34 are areas where the FATF and the legal profession need to collaborate to work toward a balanced and workable approach that accommodates the concerns of the relevant stakeholders.

At the outset, it bears repeating that in 2008 the ABA House of Delegates, the principal policy making body of the organization, adopted a resolution (Resolution 300) dealing with beneficial ownership issues. This policy provides, in pertinent part, as follows:

[The ABA] 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 and 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[.]

The ABA continues to adhere to the view that the verification of beneficial ownership information and its availability to law enforcement authorities be risk-based and not conflict with applicable ethical requirements that govern the legal profession. Notably missing from the narrative accompanying proposed changes to Recommendation 33 is any notion that the risk-based approach has any bearing on these beneficial ownership issues. That certainly cannot be the case.

Set forth below are comments on the proposed changes to Recommendation 33.

**Beneficial Ownership Information (paragraph 10, page 6, 1st bullet).**

To the extent Recommendation 33 suggests that lawyers (i.e., professional intermediaries) should hold beneficial ownership information and be compelled to disclose it to law enforcement authorities, the FATF must consider a lawyer’s obligation under professional ethical rules to protect the attorney-client privilege, the client-lawyer relationship that is fundamental to the functioning of democracies, and confidential client information. Court orders can obviously require or permit the disclosure of this information under current U.S. federal and state law in certain exceptional situations not present here, but this issue raises important ethical and professionalism considerations that are uniquely applicable to lawyers and the legal profession. The same concerns similarly apply to Recommendation 34 in the context of trusts.

In addition to these legal ethics and privilege issues, granting access to information to competent authorities faces a host of privacy and constitutional issues under U.S. law. With respect to privacy issues, the ability to obtain information from third parties, such as professional intermediaries (including lawyers) or government authorities raises numerous privacy related issues well beyond the scope of this letter. Competent authorities may, through the use of subpoena power and the appropriate constitutional protections afforded to that process, obtain access to information. However, special care needs to be taken to ensure that Recommendation 33 does not suggest that private information can be accessible merely because it constitutes the type of information that Recommendation 33 attempts to make available. Accordingly, the process of making information accessible should be circumscribed to provide careful consideration of constitutional and other legal safeguards to unwarranted governmental intrusion.

The Consultation Paper identifies two options (options (a) and (b)) regarding access to beneficial ownership information. A third possible option, not discussed in this portion of the Consultation
Paper, is reliance on the risk-based approach. It is unclear why the FATF does not offer the risk-based approach as a viable third alternative.

Options (a) and (b) suffer from fundamental shortcomings. United States law has never given an entity either the right or power to compel disclosure of its beneficial owners. Instead, United States entity law has always been based on the concept of record owners. An entity should always know the direct owners of interests in the entity. But legitimate business enterprises may not know the identity of their beneficial owners and often do not need to know that information.

Even if it were possible in all cases for an entity to identify its initial beneficial owners, that information would quickly become stale unless there were a way to update the beneficial ownership information initially filed with the corporate registry. At this point the focus of Recommendation 33 on beneficial owners becomes even more problematic. United States law does not provide an entity with either the right or power to inquire about changes in its beneficial owners, as opposed to the entity’s record owners.

The system by which ownership is transferred can be informal and is often private. The occasions on which an entity learns informally about a change in its beneficial owners are most likely to be associated with a meeting of its owners at which a vote is to be taken. But those meetings typically occur annually and some entities may go for years without holding a meeting. Even when a meeting is held, a person other than a beneficial owner may be the person who attends and exercises the voting power of the beneficial owner. Absent some new power to compel disclosure of the indirect owners of the entity, the entity will be unable to identify its beneficial owners.

The focus of Recommendation 33 on beneficial owners creates particularly troublesome issues in the international context. Assume, for example, that a New York corporation has a majority shareholder that is a Canadian corporation, and that Canadian corporation in turn has a majority shareholder that is an English corporation. If United States law required the New York corporation to file beneficial ownership information with a corporate registry, the New York corporation would need to look through both the Canadian corporation and the English corporation to identify an individual (who might even be a citizen of a fourth country) who controls the English corporation and who thus is able to control the Canadian corporation and through it the New York corporation. The obvious question raised by this example is how the United States can force the Canadian corporation – let alone the English corporation – to provide information to the New York corporation.

Problems such as those discussed above could be avoided if every country required disclosure of the record owners of entities formed under its laws. If systems for disclosure of record owners were in place around the world, it would be possible to use the information in corporate registries to trace the ownership of any entity back to the individual human beings at the start of the ownership chain. At the same time, such a system would avoid the problems inherent in the
current focus of Recommendation 33 on beneficial owners. We would like to understand from the FATF why this approach would not be workable.

**Bearer Shares (paragraph 10, page 6, 3rd bullet)**

The FATF is considering whether to prohibit bearer shares, converting them to registered shares or share warrants, immobilizing them by requiring that they be held with a regulated financial institution or financial intermediary, or requiring shareholders with a controlling interest to notify the company, and the company to record their identity.

A prohibition on the issuance of bearer shares may be appropriate, but with an important caveat. The Delaware General Corporation Law, which is the most widely-used corporation law in the United States, as well as a number of other state corporation laws, prohibit the issuance of bearer shares. See, e.g., 8 Del. Code § 158. Those prohibitions have not proven to be a problem for legitimate businesses.

If the FATF decides to impose a prohibition on the issuance of bearer shares, we believe further study and definition is needed before prohibiting the issuance of bearer share warrants. A variety of derivative securities are used to conduct legitimate hedging activities that could be seen as “bearer share warrants” under an expansive definition of that term. FATF should be careful to prohibit only those types of securities whose function is limited to circumventing the prohibition on bearer shares.

**Nominee Shareholders (paragraph 10, page 6, 4th bullet)**

United States corporate law principles do not define the precise nature of nominee shareholders. There is no central clearinghouse for registering nominee shareholders. There is no regulatory mechanism, nor has one ever been viewed as required, to license a nominee. Perhaps the closest analogy to such a register is the well-recognized mechanism by which public company shares are often held by a broker in “street name.” This complicated and cumbersome mechanism, however, relates only to record share ownership of companies that generally would be considered as exempt from the requirements of Recommendation 33 as listed on a recognized stock exchange. Thus, to set up a register for nominee shareholders would entail the creation of both an accepted definition of what is and what is not a nominee shareholder and a gathering of information that has never been centrally maintained in the past. If, as suggested earlier, there is a mechanism in place focused on record ownership, competent authorities could track ownership back to ultimate owners directly through such a mechanism.

From a practical viewpoint, the use of nominee shareholders advances at least three important objectives: the nominator’s personal privacy, the personal safety of nominators in high risk jurisdictions, and the need for anonymity in certain business transactions. A nominator’s right to personal privacy may be violated if the nominee is forced to disclose publicly the identity of the nominator. In high risk jurisdictions, the public disclosure of the identity of the nominator may
expose the nominator to criminal activity (such as kidnapping) or other form of personal harm. In some business transactions, it may be prudent for legitimate business reasons not to disclose the identity of the nominator. Mandating disclosure in all cases of the identity of the nominator seems excessively broad and promises to create more challenges than it cures.

Other Legal Persons; Proposed Exemptions (paragraph 11, page 6)

With respect to the comment in paragraph 11 that measures similar to that outlined in paragraph 10 should be applied to other legal persons, we believe that whatever reasonable and appropriate measures regarding maintenance of ownership information are ultimately adopted should be applicable to all types of entities (with the exceptions noted and perhaps others). To provide additional flexibility to one type of entity over another merely will drive the growth of use of the more flexible entities because the compliance costs that will be inherent in whatever scheme is adopted will be significant, particularly for the millions of small business entities formed by legitimate citizens every year. Thus, it would be inappropriate to exempt one type of entity (such as a limited partnership) while requiring compliance by a corporation or a limited liability company.

In terms of the proposed exemptions, clarity is needed in defining a “recognised stock exchange” and “state-owned enterprises.” Who confers the recognition on the stock exchange? Are regional and second-tier stock exchanges “recognised” for purposes of Recommendation 33? Ambiguity also lurks in the meaning of a state-owned enterprise. For example, Exxon Mobil recently announced a business arrangement with Rosneft, the Russian state oil company, to explore for oil in the Russian portion of the Arctic Ocean. Would Exxon Mobil be a state-owned enterprise for purposes of the FATF exemption (in addition to being exempt because it is listed on the New York Stock Exchange)? Does a state-owned enterprise have to be 100% owned by the sovereign? Would investments by others in this enterprise remove it from the definition of a state-owned enterprise?

1.3 Recommendation 34—Legal Arrangements (paragraph 12, pages 6-7)

This portion of the Consultation Paper seeks input on an effective set of measures to prevent the misuse of trusts. The Consultation Paper enumerates five possible measures. The comments below will discuss these measures in turn. We understand that the American College of Trust and Estate Counsel (“ACTEC”) has submitted comments on the Consultation Paper to the FATF. The comments below highlight and expand on several key points made by ACTEC in its well-reasoned comment letter.

- **Giving trustees a legal obligation to obtain and hold beneficial ownership information about trusts** (as noted above in the context of Recommendation 5).

The trustee of a trust is responsible for the custody, protection, conservation, and care of the trust assets. The trustee needs to know the beneficiaries and their details and will know how
to effectuate the distribution of the assets to the beneficiaries. Among those involved in a trust arrangement (i.e., settlor, beneficiary, and trustee), the trustee is best positioned to perform anti-money laundering due diligence on the settlor and the beneficiaries.

- *Ensuring that competent authorities in all countries are able to access information on the identity of the trustee, the beneficial ownership of the trust, and the trust assets from one or more sources including financial institutions and DNFBPs: registries of assets or trusts; or other competent authorities (e.g., tax authorities); of any trusts with a nexus to their country (i.e., where trusts are managed; trust assets are located, or where trustees live in the country).*

The trustee is the “legal owner” (possesses legal title) of the trust assets and the beneficiaries are their “beneficial owners.” The settlor thus has no continuing role with respect to the trust or its assets unless the settlor is also a beneficiary.

Because the first measure places the legal obligation on the trustee, and, if that measure is fulfilled, the following four measures will likewise be fulfilled, it is unnecessary to require other sources of information. Although financial institutions that are not the trustee may conduct their own due diligence, requiring them to demand all the details of the trust would be excessively burdensome and necessarily violate legitimate privacy rights of the parties to the trust. The same is true with respect to any DNFBP who is involved but who is not acting as a trustee.

A trust registry is impractical from any number of perspectives. The identity of beneficiaries under a trust is not static. Indeed, it is not unusual for a trust to have multiple beneficiaries whose identity may change based on evolving circumstances. Further, if there are contingent beneficiaries, they may not be aware of the trust and may never receive a distribution from the trust. As ACTEC explained in its comment letter, “[t]hese contingent beneficiaries have few or limited rights. To require a trustee to obtain and file in some registry information on all such contingent beneficiaries would be unduly burdensome and time consuming, would produce information of little or no value, and would not further the goals of the FATF.”

Thus, when addressing trusts, the focus should be solely on the trustee. It is the trustee who receives the assets from the settlor, who administers the trust and has all the records, who controls the assets and who must be able to identify the beneficiaries who receive distributions.

- *Requiring trustees to disclose their status to relevant authorities; and to financial institutions and DNFBPs when entering a business relationship.*

No comment.
Competent authorities should have powers to obtain information regarding trusts and share it as necessary; and

As noted in the comments to Recommendation 33 above, the ability of competent authorities to obtain and share trust information must be tempered by privacy, legal ethics, and constitutional considerations. These comments apply with equal force in the context of Recommendation 34.

Analogous requirements should also apply to other legal arrangements including Treuhand, Fiducie, and Fideicomisos.

No comment.

5. Targeted financial sanctions in the terrorist financing and proliferation contexts (paragraphs 20 and 21, page 9)

As drafted, it appears that Paragraph 20 is calling for the wholesale freezing of persons designated pursuant to relevant United Nations Security Council Resolutions. In order to more accurately reflect United Nations, European Union, United States and other local law accommodations for humanitarian purposes, we suggest that Paragraph 20 recognize that exceptions and exemptions (for humanitarian purposes) are present and that the United Nations Security Council Resolutions contemplate that some frozen assets will be released for certain purposes. For example, in many jurisdiction, including the United States, persons who have been designated are eligible for licenses allowing the release of funds to pay for legal expenses, living expenses, medical treatment and other humanitarian purposes.

Because the UNSCRs are not generally self-implementing, local jurisdictions must implement the freeze or block pursuant to relevant local law. To do so in the United States, the Treasury Department, in consultation with the Departments of Justice and State (and others), designates persons who meet the local law criteria for designation; there is not a mirror image overlap between the United Nations Al-Qaeda list and those designated pursuant to Executive Order 13224. Rather than mandating that persons’ assets should be frozen without delay, Special Recommendation III should acknowledge the implementation process and state that, to the extent possible, persons should freeze without delay those designated pursuant to a UNSCR.

Paragraph 21 poses challenges within the United States if the intent is to mandate that a government authority maintain periodic audit or regulatory authority over DNFBPs because not all financial institutions and DNFBPs are subject to compliance monitoring. For example, under the U.S. Bank Secrecy Act, neither lawyers nor persons involved in corporate formation are regulated. All U.S. persons must comply, however, with the Treasury designations. Perhaps Paragraph 21 should more appropriately provide that financial institutions and DNFBPs should be subject to fines (rather than an audit function) if they fail to comply with relevant legislation, rules, or regulations governing their obligations.
6. **The Financial Intelligence Unit: Recommendation 26 (paragraph 23, pages 9-10)**

To the extent any bar association or other entity is designated as a Financial Intelligence Unit ("FIU") for lawyers, there must be accommodations made that recognize the same concerns the ABA has articulated for regulation of lawyers themselves. For example, an FIU for lawyers would most assuredly not be willing or able to receive STRs from lawyers since the ABA has steadfastly opposed the application of STR requirements on lawyers.

8.3 **Further Consideration of Politically Exposed Persons (paragraph 30, page 11)**

Although it may be logical to expand Politically Exposed Persons ("PEP") obligations to family members and close associates, the FATF will need to provide meaningful guidance on the scope of covered individuals. The Standards do not define "family members and close associates," and it is unclear how one is expected to inquire and verify whether someone is a "close associate" of a PEP. The expansion of this requirement will obviously impose additional compliance burdens on lawyers. Information is already abundant that the PEP obligations are more difficult to comply with as international and national standards cast a wide net in defining a PEP and provide no guidance on who is a PEP. Expecting small firms and sole practitioners in an on-off relationship to spend the resources required to determine if a client is a PEP is unrealistic and will further undermine the already low compliance with this and other FATF standards.

The ABA appreciates the opportunity to provide its comments to the FATF on the Consultation Paper. If we can address any of these comments in more detail or if we can be of further assistance, please feel free to contact me at 410.244.7772 or klshepherd@venable.com.

Very truly yours,

Kevin L. Shepherd

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