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February 1, 2018

The Honorable Charles E. Grassley
Chairman
Committee on Judiciary
United States Senate
Washington, D.C. 20510

The Honorable Dianne Feinstein
Ranking Member
Committee on Judiciary
United States Senate
Washington, D.C. 20510

Re: Hearing on "Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency" and Concerns Regarding S. 1454, the "True Incorporation Transparency for Law Enforcement (TITLE) Act," and Other Similar Legislation

Dear Chairman Grassley and Ranking Member Feinstein:

On behalf of the American Bar Association (ABA), which represents over 410,000 members, I write to express our concerns regarding key provisions in S. 1454, the "True Incorporation Transparency for Law Enforcement (TITLE) Act," and other similar legislation that would undermine the attorney-client privilege and impose burdensome and intrusive regulations on millions of small businesses, their agents, and the states. In particular, the ABA opposes the provisions of the bill that would regulate many lawyers and law firms as financial institutions under the Bank Secrecy Act (BSA) when they help clients to establish small corporations and limited liability companies (LLCs). We also oppose the provisions in the bill that would require small businesses, their agents (including lawyers and others) who help them form corporations or LLCs, and the states to gather and maintain extensive beneficial ownership information on those businesses and then disclose that information to many other federal, state, and foreign governmental agencies and financial institutions upon request.

We ask that this letter be included in the record of the hearing on "Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency" that the Committee has scheduled for February 6.

The ABA has worked diligently for years with the legal community, federal law enforcement authorities, international stakeholders, and states to advance reforms to combat money laundering and terrorist financing. Indeed, the ABA supports reasonable and necessary domestic and international measures to fight these illicit activities, and we commend the sponsors of the legislation for their efforts in this regard. However, the ABA opposes the proposed regulatory approach set forth in S. 1454 and other similar legislation[1] for several important reasons.

[1] S. 1454 and S. 1717/H.R. 3089 are updated versions of similar legislation that was originally introduced in the 110th Congress by then Senator Carl Levin (D-MI) and reintroduced in each of the three succeeding Congresses. The ABA consistently opposed each of these bills. See, e.g., the ABA's December 2011 letter opposing S. 1483 (112th Congress), http://www.americanbar.org/content/dam/aba/uncategorized/2011/gao/2011dec16_incorptransparency_l.authcheckdam.pdf.

First, the ABA opposes S. 1454 because it would improperly subject many lawyers and law firms to the anti-money laundering (AML) and suspicious activity reporting (SAR) requirements of the BSA. This would undermine the attorney-client privilege, the confidential lawyer-client relationship, and traditional state court regulation of the legal profession. Under the bill, lawyers and law firms that help clients to form small corporations or LLCs would be considered "formation agents" (and hence a new category of "financial institution") under the BSA and would be subject to the strict AML and SAR requirements of the BSA. These SAR requirements would compel lawyers to report certain privileged or confidential client information to government authorities.

Such aggressive reporting requirements may be appropriate for banks or certain other financial institutions, but requiring lawyers to report confidential client information to the government—under penalty of harsh civil and criminal sanctions—is plainly inconsistent with their ethical duties and obligations established by the state supreme courts that license, regulate, and discipline lawyers.[2] These requirements would also seriously undermine the attorney-client privilege, the confidential lawyer-client relationship, and the right to effective legal representation by discouraging full and candid communications between clients and their lawyers.

S. 1454 would exempt lawyers from the AML and SAR requirements of the BSA when they use "paid formation agents" to form new companies for their clients, but this limited exemption is flawed and ineffective. The limited attorney exemption falls short because it would require 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 the requirement to hire separate paid formation agents would also impose excessive and unnecessary new costs on clients.[3] In addition, because the exemption only applies to Section 4 of the legislation, lawyers who help clients form corporations or LLCs and are deemed to be "applicants" or "formation agents" would still be subject to the extensive beneficial ownership recordkeeping and reporting requirements in Section 3 of the bill.

Second, the ABA opposes S. 1454 because it would impose burdensome, costly, and unworkable new regulatory burdens on small businesses, their agents who help them form corporations or LLCs, and the states.

The bill would require millions of small businesses and their agents to disclose detailed beneficial ownership information to state authorities and then update that information continuously during the lifespan of the businesses. Failure to submit this information or to update it within 60 days of any change—regardless of when actual knowledge of the change occurs—could subject them to harsh

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[2]Imposing 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 previous versions of S. 1454 would undermine the attorney-client privilege and the confidential lawyer-client relationship as well as the inadequacy of the bills' attorney exemptions, please see the ABA's December 2011 comment letter opposing S. 1483 (112th Congress), *supra*, footnote 1, at pages 3-5.

civil and criminal penalties, including stiff fines and prison sentences, for essentially paperwork violations. The bill would also require the state incorporation authorities to maintain the sensitive beneficial ownership information in a massive database—thus subjecting it to possible cyberattacks—and to disclose it to any state or federal agency, congressional committee, foreign government, or financial institution that requests it.

The bill's definition of "beneficial owner" is vague, overly broad, and unworkable. It includes every natural person who directly or indirectly exercises "substantial control" over the company or who has a "substantial interest" in or receives "substantial economic benefits" from the assets of the company, subject to several exceptions. This definition could include not just the actual stockholders of the company, but also many other people associated with the business, including officers and directors, lenders, creditors, contractors, and lien holders. Because the definition is so expansive and unclear and would cover many individuals whose personal information is not even within the knowledge or control of the businesses or their lawyers, it would be almost impossible for many of them to comply with the bill's disclosure requirements.

The new federal regulatory regime created by S. 1454, combined with the broad and confusing definition of beneficial owner, would be costly; impose onerous burdens on legitimate businesses, their agents, and state authorities; subject small businesses and their agents to harsh criminal and civil penalties for essentially paperwork violations; and sow confusion into the company formation process.

Third, the burdensome beneficial ownership reporting requirements in S. 1454 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 much more effective and practical in fighting money laundering and terrorist financing than the bill's mandates.

For example, the Internal Revenue Service (IRS) and financial institutions already collect (or will soon be collecting) useful entity-related information needed to fight money laundering and terrorist financing, and that information is currently available to law enforcement authorities. Since 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 is able to "control, manage, or direct the entity and the disposition of its funds and assets." In addition, FinCEN issued its new Customer Due Diligence Rule in May 2016 (scheduled to take effect in May 2018), which will require banks and other financial institutions to collect certain specific beneficial ownership information regarding entities that establish new bank accounts.[4] Because federal law enforcement authorities are already able to access responsible party information from the IRS—and will soon be able to access beneficial ownership information from financial institutions once the CDD Rule takes effect this year—it is simply unnecessary to create a costly and duplicative new regulatory regime that would impose unfair burdens and costs on millions of small businesses, their agents, and the states.

In addition to these federal law enforcement tools, the legal profession has taken aggressive steps to detect and fight money laundering and terrorist financing in ways that minimize the impact on the confidential lawyer-client relationship, small businesses, state regulators, and the U.S. economy.

[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.

The ABA developed and is actively promoting the "Voluntary Good Practices Guidance for Lawyers to Detect and Combat Money Laundering and Terrorist Financing" (Guidance) [5], which is designed to help lawyers fight these problems by taking prudent, proportional, risk-based steps tailored to the individual situation rather than the burdensome and costly rules-based approach of the legislation. Unlike S. 1454, the Guidance helps lawyers to combat these illicit activities while still complying with their existing court-imposed ethical duties and other legal obligations.

Since adopting the Guidance in August 2010, the ABA has worked diligently to educate lawyers, judges, state and local bars, and the public on how to detect and prevent money laundering and the benefits of following the Guidance. The ABA sent the Guidance to all state and local bars and urged their members to follow it, and the ABA Standing Committee on Ethics and Professional Responsibility issued its Formal Ethics Opinion 463 in May 2013 that expressed support for the Guidance and encouraged lawyers to follow its provisions. Significantly, 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 Guidance in 2014.

The ABA, the International Bar Association (IBA), and the Council of Bars and Law Societies of Europe (CCBE) also jointly published the "Lawyer's Guide to Detecting and Preventing Money Laundering" (Lawyer's Guide) in 2014, which provides practical tips to help lawyers around the world 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 has worked 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. Substantive law groups within the ABA worked with the Uniform Law Commission to develop a proposal that would require business entities to collect, maintain, and disclose more information regarding their owners within the existing state company formation system. Such a proposal 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 S. 1454 or any other similar measures. Although the ABA opposes this legislation, we will continue our efforts to disseminate the Guidance, the Lawyers' Guide, and other important educational materials to lawyers, courts, and the entire legal profession, both in the U.S. and abroad, and to promote these materials through national and local continuing legal education courses. The ABA will also continue to support efforts by federal law enforcement agencies and the states to fight money laundering and terrorist financing in ways that minimize the impact on the confidential lawyer-client relationship, state regulation of the business formation process and legal profession, and the U.S. economy.

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

[6] 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

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 Associate Governmental Affairs Director Larson Frisby at (202) 662-1098 or larson.frisby@americanbar.org.

Sincerely,

Hilarie Bass
President, American Bar Association

cc: Members of the Senate Judiciary Committee