

June 19, 2019

The Honorable Michael Crapo
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

The Honorable Sherrod Brown
Ranking Member
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Re: Hearing on “Outside Perspectives on the Collection of Beneficial Ownership Information” and Concerns Regarding S. _____, the “Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings Act” (ILLICIT CASH Act)

Dear Chairman Crapo and Ranking Member Brown:

On behalf of the American Bar Association (ABA), I write to express our views regarding the draft “Improving Laundering Laws and Increasing Comprehensive Information Tracking of Criminal Activity in Shell Holdings Act” (ILLICIT CASH Act). We ask that this letter be included in the record of the hearing on “Outside Perspectives on the Collection of Beneficial Ownership Information” that the Committee has scheduled for June 20.

The ABA supports reasonable and necessary domestic and international measures to combat money laundering and terrorist financing. We commend the sponsors of the draft bill for their efforts in this regard and would welcome the opportunity to continue to meet and discuss workable options for addressing these problems. However, the ABA opposes the overly broad language in Section 402 (“Expansion of Geographic Targeting Orders”) requiring attorneys representing clients in real estate transactions to file detailed reports with the Treasury Department, as well as the proposed regulatory approach set forth in Section 401 (“Beneficial Ownership”), for the following important reasons.

First, the ABA opposes Section 402 of the draft bill because it is overly broad and would undermine client confidentiality, the attorney-client privilege, and the confidential attorney-client relationship.

Section 402 of the bill instructs the Treasury Secretary to issue a new rule requiring “any person involved in a transaction related to the purchase and sale of real estate” to file a detailed report containing the name of the natural person purchasing the real estate, the amount and source of the funds received, the date and nature of the transaction, and “such other information, including the identification of the person filing the report, as the Secretary may prescribe.” Because transactional attorneys often represent and assist clients in the purchase and sale of real estate, Section 402 would cover many attorneys engaged in the practice of law and subject them to this reporting requirement.

Although the ABA takes no position on whether the buyers or sellers of real estate should be required to file these types of reports with the Treasury Department’s Financial Crimes Enforcement Network

(FinCEN), the ABA is concerned that by requiring attorneys to report the identity of their clients, the amount and source of funds used by clients in real estate transactions, and other confidential client information to FinCEN, Section 402 is plainly inconsistent with 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.¹

The range of client information that attorneys are not permitted to disclose under ABA Model Rule 1.6 is broader than that covered by the attorney-client privilege. Although Model Rule 1.6 prohibits attorneys from disclosing information protected by the attorney-client privilege and the work product doctrine, it also forbids attorneys from voluntarily disclosing other non-privileged information that the client wishes to keep confidential. In most jurisdictions, this category of non-privileged, confidential client information includes the identity of the client as well as other information related to the legal representation that the client may choose to reveal to the attorney but does not wish to be revealed to third parties.² Because Section 402 would require attorneys representing clients in real estate transactions to disclose the identity of those clients and other confidential information concerning the transaction, the legislation conflicts with Model Rule 1.6 and the binding state rules of professional conduct that mirror the ABA Model Rule.

These reporting requirements in Section 402 would also undermine the attorney-client privilege, the confidential attorney-client relationship, and the right to effective legal representation by discouraging full and candid communications between clients and their attorneys.

Although the identity of the client is not protected by the attorney-client privilege in most jurisdictions, other information specifically required to be disclosed by Section 402—such as details about the real estate transaction, the amount or source of its funding, or “other information...the Secretary may prescribe”—could be privileged in certain circumstances. Therefore, requiring transactional attorneys to disclose this information to FinCEN would undermine the attorney-client privilege.

In addition, attorneys for clients buying or selling real estate play a key role in helping those clients to understand and comply with the applicable law and to act in their best interest. To fulfill this important societal role, attorneys must enjoy the trust and confidence of their clients, must be provided with all relevant information necessary to properly represent them, and must be able to consult with them confidentially. Only in this way can the attorney engage in a full and frank discussion of the relevant legal issues with the client and provide appropriate legal advice.

¹ ABA Model Rule of Professional Conduct 1.6 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, at http://www.americanbar.org/groups/professional_responsibility/policy.html.

² See, e.g., Alabama Ethics Op. 89-111 (1989) (attorney may not disclose name of client to funding agency); Texas Ethics Op. 479 (1991) (law firm that obtained bank loan secured by firm's accounts receivable may not tell bank who firm's clients are and how much each owes); South Carolina Ethics Op. 90-14 (1990) (attorney may not volunteer identity of client to third party); and Virginia Ethics Op. 1300 (1989) (in absence of client consent, nonprofit legal services corporation may not comply with federal agency's request for names and addresses of parties adverse to certain former clients, since that may involve disclosure of clients' identities, which may constitute secret).

By requiring transactional attorneys to file detailed reports with FinCEN stating the identity of their clients, the amount and source of funds used by the clients in real estate transactions, and other confidential or privileged client information, Section 402 would chill and undermine the confidential attorney-client relationship. In addition, by imposing these unfair reporting burdens on transactional attorneys, the legislation will discourage many buyers and sellers of real estate from seeking the expert legal representation that they need, thereby effectively denying them their fundamental right to counsel.

Second, the ABA opposes Section 401 of the draft bill because it would impose burdensome, costly, and unworkable new regulatory burdens on millions of small businesses.

Section 401 of the bill would require small businesses with twenty or fewer employees and gross receipts or sales of \$5 million or less to disclose detailed information about their beneficial owners—including their legal names; dates of birth or formation; business or residential addresses; nationalities or jurisdictions of formation; and passport, driver’s license, personal identification card, or employer identification numbers—to FinCEN and then update that information continuously during the lifespan of those businesses. Failure to timely submit this information or to update it within 90 days of any change could subject the businesses to harsh civil and criminal penalties, including stiff fines and prison sentences, for essentially paperwork violations.

Unlike the definition of “beneficial owner” under FinCEN’s Customer Due Diligence (CDD) rule (as discussed below), the bill’s definition of “beneficial owner” is vague, overly broad, and unworkable. The bill’s definition includes every natural person who directly or indirectly exercises “substantial control” over the company, owns 25 percent or more of its equity interests, or receives “substantial economic benefits” from its assets, subject to several exceptions. The bill further defines a person with “substantial control” to mean a natural person who “has an entitlement to the funds or assets of the entity that, as a practical matter, enables the person, directly or indirectly, to control, manage, or direct the entity” or is otherwise able to control the entity as defined by a future Treasury Department rule. But other key phrases—such as “directly or indirectly” and “as a practical matter”—remain undefined, making the definition even more ambiguous and unworkable. Because the beneficial owner definition is so expansive and unclear and would cover many individuals whose personal information is not even within the businesses’ knowledge or control, it would be almost impossible for many small businesses to comply with the bill’s disclosure requirements.

The new federal regulatory regime created by the bill, combined with the broad and confusing definition of beneficial owner, would be costly, impose onerous burdens on legitimate businesses, and subject them to harsh civil and criminal penalties if they fail to comply. In addition, it is difficult to see how the legislation would be effective in fighting money laundering, terrorist financing, or other crimes.

Third, the draft bill raises serious privacy concerns for small businesses and the many individuals who would be designated as beneficial owners.

Section 401 of the bill would require FinCEN to maintain this sensitive personal information in a government database and disclose it upon request to any federal, state, tribal or local governmental agency or to any foreign law enforcement agency if certain conditions are met. While similar

beneficial ownership legislation considered by the 115th Congress would have required an agency to secure a criminal or civil subpoena or summons before obtaining the information, the current draft bill would require FinCEN to disclose the information in response to a simple agency request pursuant to undefined “appropriate protocols.”

FinCEN would also be required to disclose the information to any financial institution with “customer consent.” But because financial institutions will likely require all customers to provide such one-time consent when opening new accounts, the beneficial owners’ identities and other personal information will be freely shared with the financial institutions and their affiliates without further permission by, or knowledge of, the customers. As this personal information is shared with more and more entities, the potential for cybersecurity breaches, misuse, or unauthorized disclosure will grow exponentially.

In recognition of these risks, the draft bill would create criminal penalties for the misuse or unauthorized disclosure of beneficial ownership information and would require the Treasury Department’s Inspector General to investigate cybersecurity breaches that result in “substantial unauthorized access and disclosure of sensitive beneficial ownership information.” But because both remedies would address the problems only *after* the damage has already occurred, the relief is simply too little, too late.

Fourth, the burdensome beneficial ownership reporting requirements in Section 401 of the draft bill are unnecessary and duplicative because the federal government already has other, more effective tools to fight money laundering and terrorist financing.

In 2016, FinCEN issued its new CDD rule requiring banks and other covered financial institutions to collect certain specific beneficial ownership information regarding entities that establish new accounts, and the rule became fully effective in May 2018.³ But unlike the draft bill, the CDD rule includes a specific, understandable, sensible definition of “beneficial owner” consisting of each individual who owns 25 percent or more of the entity and a single individual with significant responsibility for managing the entity. Other FinCEN regulations also require financial institutions to collect or update beneficial ownership information on certain customers with existing accounts on a risk basis during normal monitoring if the institution becomes aware of information relevant to assessing or reassessing the customer’s risk profile. Therefore, FinCEN’s existing rules already require the collection of information about key individuals who own or control most business entities with a new bank account, as well as the beneficial owners of existing account holders with an elevated risk profile.

In addition to the beneficial ownership information collected under FinCEN’s CDD rule and other regulations, the Internal Revenue Service (IRS) collects 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”

³ 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>. For additional information concerning the CDD Rule, see FinCEN’s “Frequently Asked Questions” available at https://www.fincen.gov/sites/default/files/2016-09/FAQs_for_CDD_Final_Rule_%287_15_16%29.pdf and https://www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf.

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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.”

Together, FinCEN’s CDD rule and other regulations, combined with the IRS’ SS-4 Form, provide the federal government with access to substantial beneficial ownership information on almost every business entity in the United States (i.e., almost all business entities with at least one employee, a new account, or an existing account with elevated risk). Unlike the draft bill, which requires small corporations, LLCs, and other similar entities to disclose their beneficial owners, the CDD rule and SS-4 Form are more expansive and require many more types of businesses of all sizes—including not just corporations and LLCs, but also general and limited partnerships, business trusts, and other entities—to report their beneficial owners. Therefore, because federal law enforcement authorities are already able to access the information they need to fight money laundering and terrorist financing, it is unnecessary to create a duplicative new regulatory regime that would impose unfair burdens, excessive costs, and the risk of severe civil and criminal liability on millions of small businesses.

For all these reasons, the ABA urges you to amend Section 402 of the draft bill by exempting attorneys representing clients in the purchase or sale of real estate. In addition, we urge you to oppose Section 401 of the draft bill and any similar legislation. Thank you for considering our views on these important issues, and if you have any questions or would like to meet to discuss other possible measures to combat money laundering and terrorist financing, please contact ABA Associate Governmental Affairs Director Larson Frisby at (202) 662-1098 or larson.frisby@americanbar.org.

Sincerely,

A handwritten signature in black ink that reads "Robert M. Carlson". The signature is written in a cursive, flowing style.

Robert M. Carlson

cc: Members of the Senate Banking, Housing, and Urban Affairs Committee