

Senate Judiciary Committee

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# Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency

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Chairman Grassley, Ranking Member Feinstein, and other distinguished members of the Senate Committee on the Judiciary, I am honored by your invitation to testify before you today.

I am particularly grateful for the opportunity to testify in support of company formation reform, and to urge this Committee and this Congress to end the routine practice of creating anonymous legal entities under laws in the United States.

For far too long, these and other such anonymous entities created abroad have masked and enabled terrorist organizations, human traffickers, drug smugglers, and proliferators of weapons of mass destruction to access and exploit the international financial system. The range of abuse does not end here. Money laundering, tax evasion, grand scale corruption, sanctions evasion, fraud, and organized crime at large are regularly perpetrated or enabled on a worldwide basis through the systematic creation and use of anonymous legal entities. Even as the United States continues to enhance and expand its financial tools and power to combat various national security threats, these efforts are increasingly undermined by such exploitation of anonymous legal entities.

The continual creation of such legal entities right here at home may represent the most dangerous systemic vulnerability that the United States presents today to the global counter-illicit financing mission.

Closing this vulnerability requires Congressional action to reform company formation processes in the United States. In accordance with global standards that our country has urged others to adopt, such reform efforts must generally require the collection, maintenance, and disclosure of accurate beneficial ownership information for certain legal entities created under laws in the United States. The True Incorporation Transparency for Law Enforcement Act (“TITLE Act”) provides a legal basis for doing so.

In considering the need for such action, it is important to recognize that we have been here before. For several years and through at least four consecutive administrations, various arms of the Executive Branch – including several law enforcement agencies and the Department of the Treasury – have called for meaningful action on this issue. For an even longer period, the Congress, beginning with the prior leadership of Senator Levin, has proposed legislation requiring the collection and disclosure of accurate beneficial ownership information on companies created under laws in the United States.

A generation of such previous company formation reform bills has died in various Congressional committees over the past several years due to a combination of factors. For some, the gravity of risk posed by anonymous legal entities may seem academic, episodic, or exaggerated. Others misconstrue what an anonymous legal entity is and what it is not, thereby distorting the scope, objective, costs, and benefits of company formation reform. For others still, the solution should lie elsewhere, whether in the form of greater due diligence requirements for financial institutions, stronger law enforcement authorities, or better cooperation from foreign jurisdictions. Finally, for many, effective solutions seem prohibitively costly or unworkable, or workable solutions appear

ineffective. Policy disputes have prevented even those dedicated to company formation reform from forming a consensus around any meaningful action. For more than a decade, we have become paralyzed by such thinking.

Enacting effective and workable company formation reform is a complex challenge. But without it, we will continue to fight financial crime and the collective security threats we face with one hand tied behind our back. Without such reform, U.S. and other financial institutions around the world will be burdened with heightened risk and additional liability from anonymous companies continually created under laws in the United States. And without U.S. leadership, company formation reform in other countries will be absent, stillborn, or undercut.

My testimony today will focus on addressing the doubts that have prevented prior Congresses from adopting legislation to end the formation of anonymous legal entities in the United States:

- First, I will explain the prohibitive risks presented by anonymous legal entities and clarify their relationship to other entities that pose substantial risk but which also serve legitimate interests.
- Second, I will summarize and underscore the gravity of the threat that anonymous legal entities present to the integrity of the international financial system and to collective security.
- Third, I will explain the need for company formation reform as a key outstanding element of a well-established, three-pronged strategy to address this risk.
- Fourth, I will summarize key principles of company formation reform, assess the TITLE Act against such principles, and offer recommendations that this Committee may consider to further strengthen this proposed legislation.

## **I. Understanding the prohibitive risk of anonymous legal entities and their relationship to specific types of legal entities**

Anonymous legal entities are those that lack beneficial ownership information and ultimately operate on behalf of unknown persons and interests. Anonymous legal entities enable such unknown persons and interests to avoid any accountability for actions undertaken by or through such anonymous legal entities. This is extraordinarily dangerous.

Such entities present a dead end for law enforcement, regulators, and national security authorities responsible for enforcing the rule of law, protecting the integrity of the financial system, and combating criminal activity and national security threats that exploit anonymous entities. As a matter of law, such entities also present prohibitive risk for financial institutions and other regulated sectors that are required to understand their customers and manage the risks that such customers may present to the integrity of the financial system. For other businesses and sectors, anonymous legal entities may mask sanctioned threats that hide behind such entities to conduct prohibited activities that undermine collective security.

The anonymity afforded by companies created in the United States offends the most basic premise of our global efforts to combat illicit finance. Such efforts rely fundamentally on financial transparency achieved by understanding the persons and interests who gain access to the international financial system. By routinely authorizing or allowing the creation of anonymous legal entities, the United States and other jurisdictions systematically generate and unleash extraordinarily high risks to the integrity of the international financial system and our collective security.

Anonymous legal entities are often shell companies that lack beneficial ownership information. In general, shell companies are legal entities without active business operations or a physical presence, and that often lack any employees. Shell companies are necessary for certain legitimate business activities, but their characteristics make them particularly attractive for illicit actors seeking to avoid detection. Unless such companies are required to disclose beneficial ownership information, they can easily frustrate investigators because there often is no readily identifiable, available, or accountable individual who knows anything about the shell company. There are also no business operations or a physical place of business that can provide any basis for advancing an investigation.

Anonymous legal entities may also be front companies that have real business operations and a physical presence but which also lack beneficial ownership information. Such operational front companies may provide law enforcement and other investigators with more information and lead opportunities than shell companies, but they can also commingle legitimate and illegitimate activity and assets in ways that can be more difficult to initially detect or ultimately differentiate. However, the larger the operating company is, the more difficult it becomes for such companies to effectively front for illicit interests or actors seeking to evade detection. This does not make large operating companies lower risk for purposes of illicit finance or conduct, but it does make them lower risk as anonymous vehicles fronting for illicit actors or interests.

Some may consider front companies, like shell companies, as necessary to service legitimate interests, particularly with respect to protecting the identity, market interest, liability, or brand of legitimate actors. Reasonable differences of opinion exist with respect to the legitimacy of such interests. However, as in the case of shell companies, any legitimate interests in establishing front companies can be advanced without inviting the dangers presented by anonymity. As with shell companies, front companies should be required to make legal and beneficial ownership information available to law enforcement, other competent authorities, and other essential interests such as financial institutions. Moreover, it is often impossible to tell whether a company is in fact fronting for other interests without obtaining beneficial ownership information.

Finally, anonymous legal entities may also include certain trusts or other legal arrangements or entities that hold or transact in significant assets, but which operate on behalf of unknown persons or interests.

These risks, distinctions, and relationships between anonymous legal entities and specific types of legal entities and arrangements lead to a number of important conclusions:

- First, anonymous legal entities should be banned because they are unnecessary and invite a broad range of severe and prohibitive risk.
- Second, anonymous legal entities can assume any one of a variety of forms but are often identified and reported as shell companies or front companies.
- Third, shell companies and front companies, like trusts and other legal forms that may be particularly vulnerable to masking the identity of illicit actors or interests, can serve important and legitimate interests in different jurisdictions, markets, and situations.
- Fourth, these interests can be accommodated without providing anonymity by obtaining accurate beneficial ownership information from all companies that lack a substantial and transparent onshore operating presence, personnel, and records – with certain exceptions for companies that are government owned or controlled or that are already subject to significant reporting requirements and government oversight.

As summarized below, the severe and prohibitive risk presented by anonymous legal entities is increasingly evident across an expansive range of illicit finance and activity.

## **II. Anonymous legal entities pose a direct and growing threat to our collective security**

The risk posed by anonymous legal entities is not theoretical. It is evident in the headlines on a regular basis, as such entities are exposed in servicing a broad range of illicit actors and conduct that undermine the rule of law, corrupt markets and countries, erode the integrity of the international financial system, and threaten our collective security. Beyond the well-known examples cited in the findings of the TITLE Act, prominent reporting of illicit activity involving anonymous legal entities includes the following cases:

- Members of Venezuela’s cabinet used an Andorran bank to launder \$2.5 billion in bribes. The money was concealed in 37 accounts under the name of Panamanian shell companies before being moved to tax havens such as Switzerland and Belize. ([El Pais](#))
- Between 2011 and 2014 well-connected Russians used 5,140 shell companies that had accounts with 732 banks in 96 countries to move \$20.8 billion out of Russia. The anonymous companies signed ‘loan agreements’ between themselves and used fake ‘defaults’ to obtain orders from corrupt courts that allowed them to transfer the money out of Russia. ([Organized Crime and Corruption Reporting Project](#))
- Reuters reported that 118 U.S.-based [shell companies](#) in 25 states served as “phantom companies” for an Armenian crime ring whose members posed as medical providers and billed Medicare for than \$100 million.
- Convicted cocaine trafficker [Darko Šarić](#) used the names of associates to register at least [four companies](#) in Delaware. Profits from cocaine smuggled from South America to Europe

were channeled through those shell companies, and were then used to invest in businesses in Šarić's native Serbia. (Organized Crime and Corruption Reporting Project)

- According to the Panama Papers, a single [Nevada firm](#) formed over 2,400 shell companies, all headquartered at the same residential address and used by customers to evade over \$30 million in federal taxes.
- Corrupt FIFA official Chuck Blazer is alleged to have used five shell entities, registered in the U.S. and the Cayman Islands, to hide the bribes he extracted from companies seeking to do business with the global soccer association. Among other tricks, Blazer, hiding behind a shell company, would make himself the beneficiary of “consulting agreements” in order to receive illegal commissions on broadcasting rights. ([EDNY Indictment](#))
- [In a \\$6 million human trafficking scheme](#), a Moldovan gang ran employment companies that supplied hundreds of foreign nationals to hotels, resorts and casinos across the U.S. The gang hid their real identities behind a web of shell companies registered in Kansas, Missouri, and Ohio. (International Bar Association)
- [Kingsley Iyare Osemwengie](#) of Las Vegas, Nevada, was part of a sophisticated drug trafficking organization that diverted legitimate medicine such as oxycodone into the black market. He laundered profits through six bank accounts, including those for two Nevada shell companies: High Profit Investment and First Class Service. (The Oregonian)
- [Teodoro Nguema Obiang Mangue](#), the vice president of Equatorial Guinea, was convicted of money laundering and embezzlement of more than \$100 million, which was hidden in California-based shell companies. (Time)
- On June 17, 2017, the U.S. Department of Justice reported that Malaysian sovereign wealth [Fund officials](#) and their associates diverted more than \$4.5 billion using fraudulent documents and representations to launder funds through a series of complex transactions and shell companies with bank accounts located in the U.S. and abroad. Among other purchases, conspirators used a New York shell company, headquartered at an accommodation address, to purchase a \$4.5 million dollar apartment. The shell company was itself a wholly-owned subsidiary of a private wealth-management firm, so that the transaction was completely anonymous. ([DOJ Complaint](#))
- As widely reported last year, hackers allegedly tied to North Korea stole \$81 million from accounts maintained by the Federal Reserve Bank of New York for the Central Bank of Bangladesh. The hackers used the SWIFT messaging system to send more than three dozen fraudulent money transfer requests for the benefit of invented individuals and entities in the Philippines, who then laundered it through casinos. ([Reuters](#))
- [The Islamic Republic of Iran Shipping Lines](#), or IRISL, a state-owned enterprise, has used a web of shell companies stretching across Europe and Asia to obscure the true ownership

of its fleet by changing the country of registration and names of companies and owners in order to evade sanctions. (The New York Times)

- Over a period of six years, [Zhongxing Telecommunications Equipment Corporation](#) (ZTE) engaged in a scheme to ship more than 20 million U.S.-origin items to Iran. ZTE used multiple avenues to evade U.S. sanctions and export control regulations, including establishing shell companies and falsifying customs documents. (U.S. Department of the Treasury)
- [Room 2103, Easey Commercial Building](#), Wan Chai, Hong Kong is the registered office of Unaforte Limited, a company accused by the United Nations of violating sanctions North Korea. When CNN visited the office, it found neither Unaforte nor its listed company secretary, Prolive Consultants Limited. Instead, room 2103 was home to a seemingly unrelated company: Cheerful Best Company Services. (CNN)
- A 2017 asset forfeiture suit against Velmur Management, a Singapore-based “real estate management firm” with no physical office space, shows how a layered network of shell companies with access to the U.S. financial system was used to allow North Korea to buy \$7 million in petroleum from a Russian company. Velmur would receive payments made on behalf of North Korea and transfer them to the Russian seller. ([DOJ Complaint](#))
- On August 22, 2017 and September 26, 2017, OFAC [designated](#) Mingzheng International Trading Limited, a China- and Hong Kong-based front company, for its involvement in evading sanctions and laundering funds on behalf of North Korea.
- [Thompson Reuters](#) reported that former Ukrainian Prime Minister Pavlo Lazarenko, once listed as the 8<sup>th</sup> most corrupt leader in the world, ultimately controlled a shell company that, itself acting through other shell companies, owns an estimated \$72 million in real estate in Ukraine.
- Jose Trevino Morales, [the brother of two kingpins](#) of Mexico's infamous Zetas drug cartel used their main shell company, named "Tremor Enterprises" and registered in Texas, to launder at least \$16 million over the course of three years. (CNBC)
- [Mihran and Artur Stepanyan](#) used several anonymous companies to distribute over \$393 million in drugs and launder the profits. (U.S. Department of Justice)
- In 2014, Business Insider reported that [Semion Mogilevich](#), listed on the FBI's list of the Ten Most Wanted Fugitives, used a vast network of Russian shell companies to cheat the U.S. stock market and steal over \$150 million from investors in the U.S. and overseas.

These and numerous other high-profile cases present a strong argument against allowing the ongoing creation of anonymous legal entities, whether in the United States or abroad.

The far more powerful argument lies in the cases we do not see.

For decades, law enforcement officials have testified before Congress and other authorities about their consistent inability to pursue high priority cases involving anonymous legal entities that present a dead end for investigators. Similarly, sanctions authorities and compliance officers in financial institutions around the world struggle to track the myriad of shadow companies ultimately created and controlled by designated national and collective security threats.

For these reasons, it is entirely unclear just how pervasive the exploitation of anonymous legal entities is. What is clear is that the ability to pursue investigations implicating such entities is severely limited by incorporation practices in the United States and other jurisdictions.

It is also clear that this limitation contributes to the broader inability of law enforcement to identify and pursue the overwhelming majority of illicit financing activity. Various estimates of money laundering, testimony from law enforcement, and the official recognition of organized crime as a national security threat all demonstrate that we may be losing the battle against transnational organized crime and illicit finance in the criminal justice domain.

To reverse this sobering trend, we must assist rather than hinder the efforts of law enforcement and other counter-illicit financing authorities responsible for identifying, tracking, and tracing illicit actors that access and exploit the international financial system and global economy. Ending the creation of anonymous legal entities in the United States through company formation reform is an essential element of a broader and longstanding beneficial ownership strategy to do this.

### **III. Company formation reform as a key element of a broader beneficial ownership strategy to combat illicit financing**

Company formation reform is a key element of a broader beneficial ownership strategy to combat illicit financing. Understanding this requires both historical context and a review of the substantive basis and ongoing need for a three-pronged approach first articulated by the U.S. Department of the Treasury in 2009. Each of these is discussed in turn below.

#### **1. Historical context of the three-pronged approach to beneficial ownership**

In November of 2009, the U.S. Department of the Treasury explained its comprehensive, three-pronged approach to enhance access to beneficial ownership information of legal entities for purposes of combating global illicit finance, safeguarding the integrity of the international financial system, and protecting collective security. In testimony before the Senate Committee on Homeland Security and Government Affairs, then Treasury Assistant Secretary David Cohen outlined the elements of this three-pronged approach as follows:

- *Enhance the availability of beneficial ownership information of legal entities created in the United States:* Promote legislation that requires (a) the submission of beneficial ownership information at the time of company formation; (b) the obligation to keep that information updated throughout the entity's existence; and (c) the availability of that information upon proper request by law enforcement. To ensure compliance, the legislation must impose significant penalties for failure to abide by these requirements. We are focusing our current efforts on working with our interagency partners and the Congress to amend S. 569 so that it more effectively and efficiently accomplishes these goals.

- *Clarify and strengthen customer due diligence requirements for U.S. financial institutions with respect to the beneficial ownership of legal entity accountholders:* Treasury is currently working with the federal financial regulatory agencies to consider guidance for U.S. financial institutions that will clarify when and how financial institutions should identify and verify beneficial ownership as a component of conducting customer due diligence of accountholders that are legal entities. We are also working with the regulatory and law enforcement communities, and consulting with the private sector, to determine whether and, if so, how such due diligence requirements should be strengthened through rulemaking or otherwise.
- *Clarify and facilitate global implementation of international standards regarding beneficial ownership:* In 2003 the FATF reviewed and updated its 40 Recommendations for jurisdictions to implement appropriate countermeasures against money laundering. Three of those Recommendations – Recommendations 5, 33 and 34 – specifically address obtaining beneficial ownership information. These Recommendations, however, have created implementation challenges for the overwhelming majority of jurisdictions around the world. As we move forward in addressing the issue of beneficial ownership in the United States, we are also working with our counterparts in the FATF to ensure that its standards evolve in a way in which compliance is both achievable and effective. Even if we make progress domestically, failure to achieve consistency internationally will merely shift the locus of the problem to another jurisdiction and fail to address the problems that flow from lack of beneficial ownership transparency.

As further noted in this prior testimony, this three-pronged approach was developed over the course of several years of study and consideration by the Treasury, in collaboration and discussions with state authorities, the private sector, the Congress, departmental partners across the federal government, and financial centers around the world. This three-pronged approach continues to reflect and inform global standards to combat illicit finance today.

Since 2009, the United States and financial centers around the world have come a long way towards executing on the second and third prongs of this approach.

After years of rulemaking and exhaustive consultations with industry, law enforcement, and other stakeholders, Treasury's final rule on customer due diligence ("CDD") requirements for covered financial institutions will come into effect on May 11, 2018. This CDD rule requires covered financial institutions to collect and verify identification information (including name, address, date of birth, and social security or ID number) not just for their individual customers but also for the beneficial owners of certain legal entity customers.

In issuing the final CDD rule on May 11, 2016, Treasury acknowledged and reinforced the importance of the three-prong approach to beneficial ownership information as follows:

Finally, clarifying and strengthening CDD is an important component of Treasury's broader three-part strategy to enhance financial transparency of legal entities. Other key elements of this strategy include: (i) Increasing the transparency of U.S. legal entities through the collection of beneficial ownership information at the time of the legal entity's formation and (ii) facilitating global implementation of international standards regarding CDD and beneficial ownership of legal entities.

This final rule thus complements the Administration's ongoing work with Congress to facilitate adoption of legislation that would require the collection of beneficial ownership information at the time that legal entities are formed in the United States. This final rule also advances Treasury's ongoing work with the Group of Twenty Finance Ministers and Central Bank Governors (G-20), the Financial Action Task Force (FATF), the

Global Forum on Transparency and Exchange of Information for Tax Purposes, and other global partners, who have emphasized the importance of improving CDD practices and requiring the disclosure of beneficial ownership information at the time of company formation or transfer. Moreover, this proposal furthers the United States' Group of Eight (G-8) commitment as set forth in the United States G-8 Action Plan for Transparency of Company Ownership and Control, published on June 18, 2013. This Action Plan is in line with principles agreed to by the G-8, which the Administration noted "are crucial to preventing the misuse of companies by illicit actors." It is also found in the U.S. Action Plan to Implement the G-20 High Level Principles on Beneficial Ownership, published on October 16, 2015. While these elements are all proceeding independently, together they make up a comprehensive approach to promoting financial transparency of legal entities.

As reflected in the final CDD rule and the notices and comments associated with the CDD rulemaking process, the U.S. commitment to this three-pronged approach to beneficial ownership information was an important factor in ultimately gaining the support required from financial institutions and other stakeholders impacted by the CDD rule.

This CDD rule also complies with revised and strengthened CDD global standards issued by the Financial Action Task Force ("FATF") in 2012. In 2012, FATF additionally clarified and strengthened global standards governing the transparency and beneficial ownership of legal entities. The United States, together with other leading financial centers, led the revision of these global standards. This was a critical step in creating a level playing field for jurisdictions to improve the transparency of the international financial system and assist global counter-illicit financing efforts in identifying, tracking, and tracing illicit actors and activity through otherwise anonymous legal entities.

Like the United States, financial centers and jurisdictions around the world have strengthened CDD requirements for their financial institutions to implement and comply with the revised FATF global standards governing beneficial ownership and CDD. Unlike the United States, many of these jurisdictions have also strengthened company formation processes to implement and comply with the revised FATF global standards governing beneficial ownership of legal entities created within their jurisdiction. Despite repeated efforts both before and since Treasury's testimony in November 2009, the United States continues to fall far short of meeting these revised global standards governing beneficial ownership of legal entities from formation and through the life of the entity.

As noted by the FATF in its 2005 and 2016 comprehensive assessments of the United States, this deficiency has become a primary vulnerability in the U.S. anti-money laundering and countering the financing of terrorism (AML/CFT) regime. Moreover, as the United States has led the global expansion of AML/CFT regimes to combat an expanding range of collective security threats over the past several years, this deficiency has also become a critical weakness in global counter-illicit financing efforts.

## 2. Substantive basis and ongoing need for the three-pronged approach to beneficial ownership

To overcome chronic opposition to company formation reform, it is important to understand not only the historical context of the three-pronged approach to beneficial ownership outlined above, but also the substantive basis and ongoing need for such an approach. For decades, financial

institutions and other interests in the United States and abroad have argued that the responsibility for collecting accurate beneficial ownership information on legal entities should lie with company formation authorities and processes. At the same time, company formation authorities and other interests have maintained that such responsibilities should sit with financial institutions that guard access to the international financial system. The justification for global standards and policies imposing beneficial ownership requirements on both financial institutions and company formation authorities must be understood to fully appreciate the ongoing need for company formation reform – even after the imposition of beneficial ownership CDD requirements for financial institutions.

Several factors and interests call for defense in depth of the international financial system through the three-pronged approach. In addition to imposing beneficial ownership requirements on financial institutions, the factors and interests justifying beneficial ownership information requirements on company formation and maintenance authorities generally fall into the following four related categories:

- (i) Responding to the globalized nature of the international financial system;
- (ii) Supporting global law enforcement and counter-illicit financing authorities;
- (iii) Supporting financial institutions in implementing CDD requirements; and
- (iv) Creating a level playing field and sharing responsibilities across jurisdictional authorities and financial institutions.

*Responding to the globalized nature of the international financial system*

The global nature of the international financial system requires beneficial ownership information of legal entities independent from CDD obligations on financial institutions. Simply guarding the doors of our own financial institutions through CDD requirements governing beneficial ownership of legal entities does not prevent companies formed in the United States from going abroad to seek financial services. And given the dense web of correspondent banking relationships that enable the international financial system to function, such U.S. companies may eventually gain access to the U.S. financial system through foreign financial institutions.

*Supporting law enforcement and counter-illicit financing authorities*

Obtaining beneficial ownership information from company formation and maintenance authorities can significantly enhance the ability of law enforcement and counter-illicit financing authorities to identify, track, and trace illicit actors and conduct masked behind anonymous legal entities. This is true even where such entities may already be subjected to similar beneficial ownership disclosure requirements by financial institutions:

- First, such a comprehensive approach would create a dual record requiring bad actors misrepresenting beneficial ownership of their companies to lie on at least two separate occasions – when forming a company and when opening an account at a financial institution. This may enable competent authorities to cross-check beneficial ownership of

legal entities under investigation and identify and pursue discrepancies. If the information is consistent but false, it also gives competent authorities the ability to pursue enforcement actions with respect to each misrepresentation.

The benefits of such a dual record approach can be particularly powerful if beneficial ownership information is aggregated across company formation authorities and financial institutions within a jurisdiction. This is an active issue of ongoing discussion and interest among policymakers and stakeholders exploring how best to exploit new technologies in aggregating and analyzing bulk data to significantly enhance the effectiveness of current counter-illicit financing efforts.

- Second, such a comprehensive approach may also be necessary for U.S. authorities that lack timely and secure access to beneficial ownership information held by financial institutions abroad. Personal data protection and privacy interests in many jurisdictions may obstruct or delay the ability of U.S. authorities to obtain such information. Other jurisdictions may not cooperate with U.S. authorities on cases implicating political sensitivities, such as in cases involving corruption or sanctions evasion.

Even when such information can be obtained in a timely manner, the sensitivity of the investigation at issue may be compromised by working through foreign authorities and financial institutions. This can be particularly important in instances where the companies created in the United States are accessing financial services through foreign financial institutions that may not be able to share information quickly or effectively.

- Third, requiring applicants to record beneficial ownership at the point of formation as well as when obtaining an account at a financial institution also eliminates a single point of failure in either CDD processes by financial institutions or company formation and maintenance processes by jurisdictional authorities. Such an approach makes the United States less reliant on financial institutions all over the world to identify – let alone share – beneficial ownership information of companies created in the United States. Many such financial institutions suffer from lax regulation, supervision, and examination, as well as weak enforcement of effective CDD practices. Numerous compliance enforcement actions by various U.S. authorities against the world’s most well-regulated banks demonstrates this point.

### *Supporting financial institutions in implementing CDD requirements*

Requiring company formation and maintenance authorities to obtain beneficial ownership information also assists financial institutions in meeting their CDD requirements and broader risk management obligations:

- First, such an approach helps educate companies and their owners from inception that they will need to understand the definition and importance of beneficial ownership to meet current CDD requirements across the international financial system and increasing due diligence demands by other sectors vulnerable to sanctions evasion. Such an understanding

will assist financial institutions and other vulnerable sectors who must otherwise explain to their legal entity customers what beneficial ownership information is, why such information is needed, and how to obtain it. For U.S. financial institutions implementing beneficial ownership requirements in accordance with the new CDD rule, such customer outreach and engagement has been a primary source of concern and expense.

- Second, for financial institutions seeking to verify the status of beneficial ownership as reported to them by certain higher risk legal entity customers, similar beneficial ownership requirements by company formation authorities can provide a basis for verification. It is important to recognize that such verification of beneficial ownership status should not impose additional obligations on financial institutions, which ordinarily should rely on representations and documentation from their customer regarding beneficial ownership. Even in high risk scenarios where a financial institution may seek independent verification of beneficial ownership status by certain legal entity customers, the financial institution may be able to rely on standardized documentation produced by their customer reflecting beneficial ownership information reported to company formation and maintenance authorities.

*Creating a level playing field and sharing responsibilities across jurisdictional authorities and financial institutions*

Finally, requiring company formation and maintenance authorities to obtain beneficial ownership information creates a level playing field and shares responsibilities for managing illicit financing risks between and across jurisdictional authorities and financial institutions. Such an approach enhances overall efforts to combat illicit financing, safeguard the integrity of the international financial system, and protect collective security by strengthening partnerships that are essential to these core interests:

- First, the three-pronged approach outlined above establishes a supportive relationship between state-based incorporation authorities and federal counter-illicit financing authorities. The current state-level practice of creating anonymous legal entities is utterly incompatible with the counter-illicit finance mission that has become an essential element of protecting national security. However, as discussed in the next section, it is critical that reforms to end this practice be accomplished in a manner that preserves and protects the entrepreneurial and economic growth and development interests that rely on company formation processes. Requiring company formation and maintenance authorities to obtain beneficial ownership information pursuant to a common federal framework will establish a supportive rather than combative relationship with counter-illicit financing authorities. Such a supportive relationship will be essential to appropriately balance and advance the fundamental interests implicated by company formation reform.
- Second, the three-pronged approach will strengthen the partnership between jurisdictional authorities and financial institutions. This is most immediately apparent in the ways that company formation reform can assist financial institutions in meeting their CDD and risk management obligations, as discussed above.

- More fundamentally, however, company formation reform also demonstrates that jurisdictional authorities – and in particular, state incorporation authorities – are true partners rather than challenges to be managed by financial institutions. If jurisdictional authorities believe that company formation reform is either too complex or too costly to implement, it is difficult for those same authorities to take issue with similar arguments by financial institutions. CDD requirements for financial institutions are complex. And they are expensive. Some individual banks in the United States spend hundreds of millions of dollars a year to meet heightened AML/CFT regulatory expectations and legal requirements. These individual costs far exceed the funding allocated in the TITLE Act to implement systemic company formation reform across the entire United States. Sending a message that such costs are prohibitive does not facilitate a culture of compliance in our financial institutions. And it certainly doesn't send a message of partnership.
- Finally, the three-pronged approach strengthens international partnerships by establishing a necessary baseline and level playing field across an increasingly globalized economy, financial system, and threat environment. If the United States fails to meet beneficial ownership requirements of legal entities through company formation reform, we will weaken these partnerships. We will also undermine the efforts of those jurisdictions that are moving forward with such reform. This is completely at odds with the leadership position that the United States has assumed in the development, implementation, and expansion of the global counter-illicit financing regime. Ignoring the primary and proven vulnerability that our incorporation practices present to the global counter-illicit financing mission will weaken this global regime and invite skepticism about the depth of our commitment to it.

Company formation reform is thus a critical element of the longstanding three-prong approach to enhancing access to beneficial ownership information of certain legal entities. However, as evidenced by the repeated failure of the United States to adopt prior draft legislation requiring company formation reform, such reform is neither simple nor easy. Legislators and other authorities must balance the need for beneficial ownership information with the need to keep company formation as simple and cost-effective as possible.

Many of our jurisdictional partners all over the world are implementing beneficial ownership requirements for legal entities through company formation and maintenance reform processes. Despite lagging behind in these efforts, the United States has the opportunity to regain its leadership on this issue by supporting those jurisdictions that have already moved forward and by establishing a model for other deficient jurisdictions to follow.

#### **IV. Key Principles of Company Formation Reform and Application to the TITLE Act**

Several approaches exist for achieving company formation reform to facilitate access to beneficial ownership information of legal entities formed under laws in the United States. Regardless of the specific approach that Congress adopts, any solution must be both effective and workable. On the

one hand, company formation legislation and implementing regulation must establish meaningful beneficial ownership information requirements and hold accountable those who fail to meet such requirements. On the other hand, such legislation and regulation cannot impose significant impediments for the vast majority of legitimate interests seeking to create legal entities in the United States.

To ensure effectiveness and workability in facilitating access to beneficial ownership information of legal entities, legislation enacting company formation reform should address a number of key principles. The TITLE Act clearly meets most of these key principles; however, as explained below, there are specific areas where Congress could improve both the effectiveness and workability of this proposed legislation. These key principles, and their application to the TITLE Act, may be summarized as follows:

1. ***Definition of beneficial ownership:*** Legislation enacting company formation reform should apply a definition of beneficial ownership that is broadly consistent with global standards and current U.S. law and regulation. In particular, such legislation should consider the definition of beneficial ownership adopted by Treasury in the final CDD rule. However, such legislation should empower the Treasury to tailor this definition as appropriate through rulemaking to address specific risks and cost/benefit considerations of company formation and maintenance processes in the United States.

The TITLE Act generally addresses this principle in both its definition of beneficial ownership and its delegation of rulemaking authority. Although the TITLE Act definition differs from the definition in the final CDD rule, these two definitions are compatible. However, given the primary responsibility that Treasury has in regulating the Bank Secrecy Act, Congress should consider amending the delegation of rulemaking authority to Treasury specifically, in consultation with the Departments of Justice and Homeland Security. This may facilitate clearer accountability and efficiency in the rulemaking process, while requiring the participation and incorporating the expertise of Justice and Homeland Security.

2. ***Beneficial ownership information requirements:*** Legislation enacting company formation reform should require legal entity applicants to provide beneficial ownership identification information similar to financial institutions' customer identification program requirements for individual customers under the Bank Secrecy Act. These requirements formed the basis for establishing beneficial ownership information requirements under the new CDD rule. If the applicant is not the anticipated beneficial owner(s) of the entity to be created, then the applicant should also submit beneficial ownership information of itself, in addition to that of the anticipated beneficial owner(s) of the legal entity.

The TITLE Act clearly addresses this principle in the sections governing identification of beneficial owners in general and with respect to certain foreign beneficial owners.

3. ***Verification of beneficial ownership:*** Legislation enacting company formation reform should require verification of beneficial ownership information submitted by legal entity

applicants. The legislation should empower Treasury to define such verification requirements through rulemaking to ensure the integrity of such information in a workable manner.

The TITLE Act clearly addresses this principle in the delegation of rulemaking authority. As explained above, Congress should consider amending the delegation of authority to Treasury specifically, in consultation with the Departments of Justice and Homeland Security.

4. ***Maintaining the currency of beneficial ownership information:*** Legislation enacting company formation reform should require legal entities to update beneficial ownership information as necessary in a timely manner. Such updates should be subjected to verification requirements applicable to the initial submission of beneficial ownership information.

The TITLE Act appears to address this principle in requiring legal entities to update beneficial ownership information, and in delegating rulemaking authority to ensure verification of such information, as described above. Congress should consider clarifying the applicability of verification requirements to such updated beneficial ownership information.

5. ***Collection of beneficial ownership information and documentation:*** Legislation enacting company formation reform should require the collection of beneficial information of legal entities at a centralized registry or registries. Such legislation should also consider the collection of documentation verifying beneficial ownership identification. Ideally, such identification information and verification documentation should be collected by FinCEN to centralize this data with other Bank Secrecy Act information. This would greatly facilitate analytic exploitation of such data by law enforcement and other counter-illicit financing authorities.

The TITLE Act partially addresses this principle by requiring the collection of beneficial ownership information by each State under whose laws the entity is created. While this will facilitate clear access to such information by law enforcement and other authorized interests, it would be significantly more effective and materially less burdensome to centralize this collection at FinCEN. As explained in Section III above, the aggregation of beneficial ownership information can be particularly powerful when paired with enhanced analytics presented by new technologies. For this reason, Congress should consider amending the TITLE Act to require the collection of beneficial ownership information by FinCEN.

In addition, the TITLE Act should consider requiring beneficial owners to submit documentation verifying beneficial ownership identification to FinCEN. As in the case of the new CDD rule, such a requirement could be met through submission of photocopies of identification documentation. It is not clear whether such a document collection requirement could be issued through the verification rulemaking authority contained in the

TITLE Act. For this reason, Congress should consider amending the TITLE Act to require the collection of documentation verifying beneficial ownership information.

6. ***Retention of beneficial ownership information:*** Legislation enacting company formation reform should require that beneficial ownership information of legal entities be retained for at least five years after dissolution of the entity, consistent with global standards.

The TITLE Act clearly addresses this principle through retention of beneficial ownership information requirements. If Congress were to centralize the collection of beneficial ownership information from States to FinCEN as recommended above, such retention requirements should also move from the States to FinCEN.

7. ***Access to beneficial ownership information:*** Legislation enacting company formation reform should ensure that law enforcement, other counter-illicit financing authorities, financial institutions, and potentially other interested parties have timely access to beneficial ownership information.

The TITLE Act partially addresses this principle by imposing disclosure requirements on States in response to information requests from certain authorities and financial institutions. However, this access is fundamentally transactional in nature and defeats the systemic analysis that policymakers and counter-illicit financing authorities and stakeholders are seeking. As discussed above, consolidating the collection of beneficial ownership information at FinCEN enables such systemic analysis, thereby significantly enhancing the effectiveness of company formation reform. Such an approach would also substantially reduce burden on States, which must otherwise invest significant resources in responding to information requests. Finally, consolidating this information at FinCEN would address concerns about both protecting and providing access to such information through permissions and gateways that FinCEN has already implemented with respect to the security and access to the Bank Secrecy Act database.

8. ***Penalties:*** Legislation enacting company formation reform should impose dissuasive penalties on applicants (company formation agents or otherwise) and beneficial owners who fail to meet beneficial ownership requirements of legal entities. Such accountability is fundamental to making any company formation reform effective.

It is important to recognize that any company formation reform is unlikely to produce truthful declarations from bad actors seeking to remain hidden while operating behind legal entities. Nonetheless, as in the case of CDD requirements for financial institutions, beneficial ownership requirements for legal entities and dissuasive penalties will force accountability from those purporting to be beneficial owners. They will also provide essential lead information for law enforcement and other authorities. And such requirements will force bad actors to pursue costlier, riskier, and more difficult avenues into the financial system and global economy.

The TITLE Act clearly addresses this principle by imposing clear and dissuasive civil and criminal penalties on those who knowingly or willfully fail to comply with beneficial ownership requirements for legal entities.

9. ***Scope of legal entities and exemptions:*** Legislation enacting company formation reform should carefully scope beneficial ownership requirements to exempt those legal entities that do not present risks of anonymity. Such legislation should also focus on those legal entities that are most prone to anonymity and which are currently created and documented in centralized registries. Such an approach will eliminate unnecessary burden, protect the reputation of companies created in the United States, and enable further study of arrangements such as trusts and partnerships, which may require a different solution to the problem of anonymity.

Notwithstanding this approach of tailoring the scope of company formation reform to minimize burden and address workability interests, many opponents of such reform continue to argue that the scope is overbroad. Concerns of “chasing the innocent” have been voiced by many over the years because the scope of any meaningful company formation reform – as in the case of CDD requirements for financial institutions – will necessarily impact far more legitimate interests than illicit actors.

As a baseline matter of transparency, this argument is hollow. Company formation reform cannot foresee which specific entities will be exploited by bad actors seeking anonymity any more than airport screening requirements can foresee which passengers may be carrying explosives in their suitcases. The scope and depth of beneficial ownership requirements for legal entities must provide competent authorities and financial institutions with sufficient transparency to then determine which entities may warrant additional scrutiny.

The TITLE Act clearly addresses this principle by generally covering corporations and limited liability companies formed under the laws of the States, and by enumerating several exemptions for those entities that present minimal risk of anonymity. As explained in Section I above in describing anonymous legal entities, such exempt entities may not present a low risk of illicit financing, but law enforcement already has clear ability and significant information to investigate these entities as needed.

10. ***Company formation agents:*** Legislation enacting company formation reform should subject company formation agents to AML/CFT program requirements under the Bank Secrecy Act. The abuse of legal entities through company formation agents has been well established and well understood for decades. For this reason, global standards and several prior legislative efforts to enact company formation reform impose such AML/CFT program obligations on company formation agents. Such action is necessary to share the responsibility of ensuring the integrity of legal entities with those who benefit professionally from creating such entities. Moreover, such agents are in the best position to assess and protect the integrity of legal entities through the businesses they operate and the clients they serve.

Ideally, legislation enacting company formation reform would also impose suspicious activity reporting requirements on company formation agents, consistent with global standards. As in the case of financial institutions and other industries covered by AML/CFT program requirements, such additional responsibility provides a logical outcome in cases where implementation of AML/CFT program requirements indicates suspicious activity by a current or potential customer.

Opponents to imposing any AML/CFT requirements on company formation agents have raised concerns about creating a potential conflict with attorney-client privilege for law firms engaged in company formation activity. For suspicious activity reporting requirements, this is a complex issue that bears further study. However, this concern should not be used to shield company formation agents – including law firms that wish to engage in such activity – from implementing AML/CFT program requirements.

Policies, procedures, training, and governance stemming from such AML/CFT program requirements would go a long way towards protecting not only the integrity of legal entities formed in the United States, but also the integrity of company formation agents, including law firms. Any such legitimate firm publicly exposed to undercover reporting of highly suspicious company formation activity conducted within the firm – as in the case of the *Anonymous Inc.* episode of 60 Minutes – should agree. AML/CFT program requirements would better prepare such firms and their principals to recognize and handle such suspicious activity in a proactive and responsible manner.

The TITLE Act clearly addresses this principle by imposing AML/CFT program requirements on company formation agents under the Bank Secrecy Act. The TITLE Act also creates a specific exemption for law firms that use paid formation agents operating within the United States to form corporations or limited liability companies for their clients. This approach adequately balances effectiveness and workability concerns associated with such proposed requirements.

11. **Ongoing study:** Legislation enacting company formation reform should ensure that such reform is achieving effective outcomes through ongoing study and follow-up reporting requirements. Such requirements should ensure that States and other interested parties are meeting the expectations of company formation reform. Such requirements should also examine whether similar reform efforts should be extended to non-company forms of legal entities – including trusts, partnerships, and charitable organizations.

The TITLE Act clearly addresses this principle by requiring reports studying whether the lack of beneficial ownership information of non-company legal entities presents vulnerabilities exploited by illicit actors and impedes investigations of conduct by such actors. The proposed legislation also requires follow-up reporting of the effectiveness of incorporation practices.

## **V. Conclusion**

As reflected by the analysis in Section IV above, the TITLE Act provides an outstanding foundation for moving forward with necessary company formation reform. I am hopeful that my recommendations offered above will assist the Committee in considering further ways to strengthen this proposed legislation. More importantly, I am hopeful that my testimony will help address the doubts and concerns that have prevented prior Congresses from adopting similar legislation in the past.

The United States has one of the most effective AML/CFT regimes in the world. As we have relied more on this regime to address various threats to our national and collective security, our efforts are increasingly undercut by anonymous legal entities masking such threats. Our willingness to address this weakness through company formation reform will impact our credibility and effectiveness in driving financial integrity and security forward, at home and abroad.