Questions for the Record from Senator Charles E. Grassley
To Gary Kalman
Executive Director, FACT Coalition
U.S. Senate Committee on the Judiciary
"Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency"
Submitted on February 12, 2018

1. Opponents of S.1454 claim that the burdens to comply with the bill would be excessively onerous on small businesses. Opponents also suggest complex legal analysis is necessary in order to identify and disclose all relevant information.

    a. Can you please describe the information required to be disclosed under the bill.

The bill requires three basic pieces of information. The language in the bill states: "name, current residential or business street address, and a unique identifying number from a nonexpired passport issued by the United States or a nonexpired driver's license or identification card issued by a State."

There is no financial reporting, no description of the type of company nor any details regarding operations. Despite claims to the contrary, the bill would mean adding three lines to existing state incorporation forms.

The plain language of the statute is clear regarding the requirement of three readily available pieces of information.

    b. In your view, would the disclosure requirements place an undue burden on small businesses?

It would not. The information is readily available and known to business owners. FACT Coalition Member Small Business Majority noted in a letter dated December 6, 2017 to the House on a similar bill collecting beneficial ownership information:

> "The definition in the discussion draft is clear, easy to follow, and workable for small businesses who have no need to hide their owners' identity."

And, further in the same letter:

> "While the benefits are significant, the costs of providing a name and address are minimal, on a par with obtaining a library card."

In the hearing, a concern was raised regarding gathering this information for more complex ownership arrangements that includes private investors. The concern was that businesses do not know who their shareholders are. The business groups in our coalition assure us that their members know their investors and the investors, expecting returns on their investment, are timely and forthcoming about where and to whom to send dividends or other payments.

Finally, and importantly, according to a GAO study (Company Formations, GAO-06-376: Published: Apr 7, 2006. Publicly Released: Apr 25, 2006), all states already require companies to know their shareholders. On page 43, they note:

> *Our review of state statutes found that all states require corporations to prepare a list of shareholders, typically before the mandatory annual shareholder meeting, and that almost all states require that this list be maintained at the corporation's principal or registered office. Industry experts told us that LLCs also usually prepare and maintain operating agreements that generally name the members and outline their financial interests.*

It is not perfect. The report notes that the list of shareholders is of the owners of record, not the beneficial owners, and may include legal entities. However, this suggests that the collection of the information is not burdensome and, for many legitimate businesses, may already be in hand.

c. Can you also help explain what "complex legal analysis" would be needed under S.1454 to provide the required information?

No complex legal analysis would be required. The definition of beneficial owner is clear for those not purposely looking to disguise ownership for nefarious purposes. Companies are well aware of who their owners and investors are, and who controls or benefits from the company. The terms "directly" and "indirectly" are common concepts in law as well as common sense terms. Both are necessary to avoid loopholes that undermine the law. For example, Fusion TV taped a segment – available on YouTube -- in which a reporter created a company, naming her cat, Suki, as the owner. The transaction was legal and demonstrates the problem with definitions that allow nominee owners to be listed on incorporation papers without also identifying the true owners standing behind those owners of record.

The definition in the TITLE Act is the same as the definition already adopted by the Senate in the National Defense Authorization Act for Fiscal Year 2018. In Section 2876 of H.R. 2810, the relevant part reads:

> *(A) IN GENERAL.—The term beneficial owner— (i) means, with respect to a covered entity, each natural person who, directly or indirectly— (I) exercises control over the covered entity through ownership interests, voting rights, agreements, or otherwise; or (II) has an interest in or receives substantial economic benefits from the assets of the covered entity*

The terms "directly" and "indirectly" have long been part of the Foreign Accounts Tax Compliance Act adopted by Congress and signed into law as a part of the HIRE Act, P.L. 111-147 (3/18/2010). The relevant statutory provision is Section 1473(2) which states:

> *"(2) Substantial United States Owner.—*

(A) In General.—The term 'substantial United States owner' means—
(i) with respect to any corporation, any specified United States person which owns, directly or indirectly, more than 10 percent of the stock of such corporation (by vote or value),
(ii) with respect to any partnership, any specified United States person which owns, directly or indirectly, more than 10 percent of the profits interests or capital interests in such partnership, and
(iii) in the case of a trust … any specified United States person which holds, directly or indirectly, more than 10 percent of the beneficial interests of such trust.

That same language appears in the implementing regulation, 26 CFR 1.1473-1(b)(1). The phrase "directly or indirectly" appears repeatedly throughout 26 CFR 1.1473-1(b).

In short, the concept of direct and indirect ownership has been an established element of US tax law since at least 2010, and has been used in multiple US agreements with foreign governments and foreign financial institutions.

Additionally, US securities laws use the "directly/indirectly" language and have done so for decades to define who must file disclosure forms related to the ownership of shares in a publicly traded corporation.

Section 13(d) of the Securities and Exchange Act of 1934 imposes the disclosure obligations on major shareholders of publicly traded corporations, defined as persons who acquire, directly or indirectly, beneficial ownership of certain shares of a publicly traded entity. The section is codified at 15 USC 78m(d)(1) which states in pertinent part:

(d) REPORTS BY PERSONS ACQUIRING MORE THAN FIVE PER CENTUM OF CERTAIN CLASSES OF SECURITIES

(1) *Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 78l of this title, or any equity security of an insurance company which would have been required to be so registered except for the exemption contained in section 78l(g)(2)(G) of this title, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940 [15 U.S.C. 80a–1 et seq.] or any equity security issued by a Native Corporation pursuant to section 1629c(d)(6) of title 43, or otherwise becomes or is deemed to become a beneficial owner of any of the foregoing upon the purchase or sale of a security-based swap that the Commission may define by rule, and is directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition or within such shorter time as the Commission may establish by rule, file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investor…*

The rule goes on to state additional information to be collected.

The implementing regulation, 17 CFR 240.13d-3(a), defines a "beneficial owner" of a security as

> *"any person who, directly or indirectly, through any contract, arrangement, understanding, relationship, or otherwise has or shares: (1) Voting power which includes the power to vote, or to direct the voting of, such security; and /or, (2) Investment power which includes the power to dispose, or to direct the disposition of, such security."*

Subsection (b) of the implementing regulation also uses the direct/indirect language to prohibit any scheme to evade the reporting requirement:

> *"Any person who, directly or indirectly, creates or uses a trust, proxy, power of attorney, pooling arrangement or any other contract, arrangement, or device with the purpose of effect of divesting such person of beneficial ownership of a security or preventing the vesting of such beneficial ownership as part of a plan or scheme to evade the reporting requirements of section 13(d) or (g) of the Act shall be deemed for purposes of such sections to be the beneficial owner of such security."*

2. Opponents of S.1454 also claim that information required to be collected under the bill is not restricted to use by law enforcement personnel and will be placed in the "public domain." First, the bill makes clear that information from the States may only be provided through (1) "a civil, criminal, or administrative subpoena or a summons, or an equivalent of such a subpoena or summons, from a local, State, or Federal agency or a congressional committee or subcommittee," (2) a request under a mutual legal assistance treaty, (3) a written request from FinCEN, or (4) a written request by a financial institution in order for the financial institution to comply with its customer due diligence obligations. S.1454, Sec. 531 (a)(1)(D). Furthermore, the bill provides that the legislation would not limit the authority of any state to disclose or not disclose to the public any beneficial ownership information provided to the State under the Omnibus Crime Control and Safe Streets Act of 1968.

    a. Please explain how the beneficial ownership information provided by entities can be protected, outside of lawful access by law enforcement agencies and others as set forth in the bill, in order to address privacy concerns.

The information is not available on a public registry as is done in the United Kingdom. If law enforcement organizations want access to the information they need to obtain a subpoena or summons meaning that there is a check on the person requesting the information to assure it is for a legitimate inquiry. Similarly, financial institutions need permission from the customer before accessing the information. Foreign entities have to work through the treaty process to ensure the request is for legitimate purposes.

As noted in the question, the bill includes a provision to ensure states have full authority to restrict access to beneficial ownership information. Nothing in the bill requires states to make the information public. Additionally, the bill explicitly includes a provision to clarify that it is not inconsistent with the legislation for states to impose "additional limits on public access to the beneficial ownership information obtained by the State than is specified under this Act or an amendment made by this Act." This provision means that other than making the information available to the specific entities properly using the information for law enforcement purposes, there is no obligation for the information to be available through state public disclosure laws.

Some bill opponents claim that state sunshine laws will compel all beneficial ownership information to be made public without exception. However, all states currently have discretion in how they implement their sunshine law requirements; for example, states operating under those laws routinely determine not to disclose the credit card or bank information of persons requesting formation of a company. States could make a similar non-disclosure determination with respect to beneficial ownership information.

b. Please explain if there are other measures that can serve to safeguard the privacy of beneficial ownership information.

The bill currently allows Congress to access the information using a subpoena that has been signed only by a Committee Chairman. If there are concerns about partisan uses of the information, the bill could be amended to require a subpoena signed by both the chairman and ranking member of a committee to assure bipartisan agreement on any request.

The bill does not explicitly exempt certain nonprofit organizations from the disclosure requirements. Charities registered as 501c3 organizations with the IRS including religious groups are currently explicitly exempt, but nonprofits registered as 501c4 organizations are not. The bill could be amended to specifically exempt 501c4 entities from the reporting requirements.

3. Some opponents of S.1454 and other beneficial ownership transparency measures suggest that legislation imposing disclosure obligations is useless because the "smart" criminals will be unlikely to voluntarily disclose their beneficial ownership interest in a shell company; and, moreover, because the "smart" criminals will avoid such disclosures, any legislation in this area will therefore negatively impact the law-abiding corporations who will be burdened by additional disclosure requirements.

    a. Could holding registration agents criminally or civilly liable for knowingly providing false or fraudulent beneficial ownership information provide a significant deterrent effect to establishing shell companies in the United States to advance nefarious purposes? If so, please explain how.

Yes. In 2010, in Senate hearings on anti-money laundering issues and corporate transparency, witnesses testified that if they were subject to anti-money laundering requirements to know their customers, they would both follow the law and be far more careful when taking on clients.

Creating civil and criminal penalties for formation agents who knowingly or willfully file false information would provide a strong deterrent effect. It would also make it much more difficult for criminals to access our financial system and cloak themselves with the legitimacy of U.S.-formed companies. Criminal enterprises need to get their illicit proceeds into the mainstream economy, and there is substantial evidence that companies with hidden ownership are the vehicle of choice.

b. In your view, if the law provides incentives to deter bad actors from engaging in criminal conduct in the United States, would that be a positive outcome?

Yes. We do not want our financial system compromised by increasing amounts of illicit money for two primary reasons.

First, without corporate beneficial ownership information, we cannot stop activities that threaten our communities. We often hear that law enforcement should "follow the money." That is, after all, the reason that most criminal enterprises engage in the activities they do. But anonymous companies make following the money a difficult and sometime impossible goal.

Experts estimate that we capture only about .1% of laundered money in large part because of anonymous shell companies. We are, according to Raymond Baker of Global Financial Integrity when speaking of recapturing illicit finance, "a decimal point away from total failure." The opioid crisis continues to ravage communities across the nation and drug cartels make and launder their proceeds largely with impunity. The same can be said of any number of criminal operations. We need to make it easier for law enforcement to follow the money handled by shell corporations with hidden owners.

The illicit money also makes it harder for legitimate businesses to thrive. Representative Steve Pearce, Chairman of the House Subcommittee on Terrorism and Illicit Finance, said in February 2017, "In my home county in New Mexico it's a big problem. Drug cartels send money across the [border and] create shell companies of trucking…it weakens the economic framework by which other companies can be successful."

Significant progress in combatting crime and protecting legitimate businesses from criminal competitors would be among the greatest benefits of the TITLE Act.

c. In your view, does the hypothetical "smart criminal" scenario justify ***not*** legislating in this area, thereby avoiding efforts to bring more transparency to beneficial ownership?

No. No law aimed at protecting the safety and security of our communities and our nation is perfect. But no one would credibly suggest that we should repeal laws against trafficking in counterfeit goods, illegal drugs or theft because those activities continue.

All the testimony from law enforcement experts confirms that, if adopted, the bill would disrupt current money laundering operations. The law would provide law enforcement an opportunity to catch a number of bad actors as well as gain insight into money laundering operations to improve enforcement efforts in the future. It would also simplify and reduce the cost of prosecutions.

In addition to keeping more of this money out of the U.S. by deterring "smart" criminals, it should be noted that catching "dumb" criminals is important. A 2017 report by FinCEN on the results of the geographic targeting orders (pilot programs in 6 metro areas to collect beneficial ownership information for certain high end, cash financed real estate transactions) found that 30% of the transactions involved individuals on whom there were suspicious activities reports filed.

In 2016, Paul Fitzgerald, Sheriff of Story County, Iowa, noted that

> "…anonymous shell companies are a popular tool to hide all sorts of bad behavior. Think of them as financial getaway cars … Law enforcement has trouble pinning the criminal to the crime, as the identities of the criminals and their connection to dirty money are shielded by layer after layer of anonymous companies."

To paraphrase a statement from Global Witness, if anonymous companies are the getaway car, it is time to take away the keys.

One last consideration is that, as other countries strengthen their corporate transparency laws, wrongdoers looking for places to hide their corporate activities will increasingly turn to the United States. We need to coordinate our laws with the rest of the international community to make it harder for even smart criminals to move illicit funds.

Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency Submitted February 13, 2018

QUESTIONS FROM SENATOR WHITEHOUSE

Gary Kalman, FACT Coalition:

1. In addition to LLCs, criminal organizations often use trusts to launder money in the United States.

    a. How are trusts used to evade anti-money laundering regulation?

Most trusts are formed by private parties, and neither their formation documents nor trust instruments are registered with a government agency in the same manner as corporations and LLCs. For that reason, it may be particularly difficult to identify the relevant trustees, grantors and beneficiaries, or learn about the trust's activities.

There are numerous cases of trusts being used for grand corruption, tax evasion, to escape debts and court ordered payments.

Examples of trusts being involved with illicit funds date back as far as 1999, when a Senate hearing disclosed that a numbered trust was used to take ownership of a shell corporation used by Raul Salinas, then the brother of the President of Mexico, to move nearly $100 million in suspect funds out of Mexico. A recent U.S. securities fraud case disclosed how U.S. citizens formed dozens of offshore trusts and used them to establish offshore shell corporations that then invested offshore funds.

The Financial Action Task Force, the preeminent global anti-money laundering standards setting body, published a report, *Money Laundering Using Trust and Company Service Providers,* in 2010. The report details numerous examples of trusts used for shielding illicit financial activities. Common among the comments found in the report are ones like this:

> *The TCSP [trust and corporate service provider] played an integral role in establishing and managing the accounts used by the criminal network to defraud its victims and then carry out the laundering process which followed.*

Mounting evidence suggests trusts play a significant role in illicit finance schemes facilitated by secrecy.

    b. What additional problems does the use of trusts create for anti-money laundering regimes?

The secrecy around trusts, even greater than anonymous companies, includes both ownership and their very existence. As such, trusts are a popular vehicle for hiding and laundering money. FACT Coalition Member Tax Justice Network (TJN) also notes additional concerns in its 2010 report, *Trusts: Weapons of Mass Injustice*:

"…trusts go beyond secrecy by shielding assets from the rest of society. They do this by placing assets into 'ownerless limbo', where the assets have legally been 'given away' but not yet received by a real, warm blooded person – thus unreachable even by legitimate personal creditors of the parties to the trust, or tax authorities or crime-fighting agencies."

The World Bank produced a report in 2011 called *The Puppet Masters* in which they looked at the role of trusts in illicit finance. They found the following:

Investigators …argued that the grand corruption investigations in our database failed to capture the true extent to which trusts are used. Trusts, they said, prove such a hurdle to investigation, prosecution (or civil judgment), and asset recovery that they are seldom prioritized in corruption investigations […] Investigators and prosecutors tend not to bring charges against trusts, because of the difficulty in proving their role in the crime. . . . they may not actually be mentioned in formal charges and court documents, and consequently their misuse goes underreported."

Secrecy presents insurmountable hurdles for law enforcement and leaves in place unnecessary threats to communities. For this reason, international anti-money laundering standards have long called for beneficial ownership information and anti-money laundering obligations to be applied to trusts, but most countries have not taken the steps necessary to do so.

c. <u>Can the TITLE Act be improved to help prevent the abuse of trusts to launder money and hide illicit financial networks?</u>

Yes, although it would require a significant addition to the legislation. The TITLE Act's current definition of 'beneficial owner" is strong and meaningful in the context of corporations and LLCs. This definition is among the most important provisions of the legislation and must not be weakened, even if in service to a laudable goal such as more expansive coverage of secret entities.

Trusts are different types of entities from those currently covered in the legislation. The ownership concept for a trust is not the same as a corporation or LLC. A second definition of owner covering trusts would need to be added to the bill.

As other jurisdictions have moved forward on transparency of trusts, there are examples of definitions that can be instructive. The United Kingdom is beginning to collect ownership information for trusts as a part of its transparency efforts. The ownership information for U.K. companies is publicly available. At this time, the information for U.K. trusts is not. Additionally, the fourth and fifth anti-money laundering directives of the European Union include requirements for the collection of ownership information for trusts. Both are potential sources of information for how to advance transparency of trusts here in the U.S..

I would also note that the TITLE Act appropriately recognizes the potential for harm in the secrecy of trusts and other entities not currently covered in the legislation. The bill instructs

the Comptroller General to produce a report within two years on, among other items, whether the lack of beneficial ownership information for trusts, et al. raises concerns regarding terror financing, money laundering, tax evasion, securities fraud, trafficking in illicit drugs or other criminal or civil misconduct.

2. The Cook Islands have been singled out as a particularly attractive haven for trusts.

    a. What about the Cook Islands makes it a preferred destination for money launderers?

The Cook Islands are credited with having pioneered asset protection trusts. Their laws offer secrecy that goes above and beyond the normal rules associated with tax havens. The TJN report cited above details the specific ways in which the Cook Islands frustrate international law enforcement – including the U.S. -- in service to those seeking to hide assets. The success in shielding money has made the Cook Islands a favorite jurisdiction for wealthy American clients.

In 2013, a New York Times investigation found:

> *The Cayman Islands, Switzerland and the British Virgin Islands capture headlines for laws and tax rates that allow multinational corporations and the rich to shelter income from the American government. The Cook Islands offer a different form of secrecy. The long arm of United States law does not reach there. The Cooks generally disregard foreign court orders, making it easier to keep assets from creditors, or anyone else.*

Jack Blum, an expert on financial secrecy and advocate for transparency, said of the Cook Islands:

> *"It's the idea of being outside the rule of law: that you can put money into a trust, do something wrong and not have to worry about answering in court for your actions. It's a way of making that money disappear. It's not … right."*

    b. What problems do these present financial regulators both in the US and abroad?

The legal standards to break into a trust are, for all practical purposes, impossible to meet affording clients unparalleled protections to hide assets.

The Cook Islands do not generally recognize foreign court orders, which, according to news reports on the matter, have meant that anyone seeking to file suit against a Cook Islands Trust must travel to the Cook Islands (located in a remote region of the South Pacific) and litigate their case there, in a local Court under local law.

The New York Times reports that Cook Island trusts were created with American clientele in mind. One story reports that Cook Island officials sought out the help of a Denver based lawyer that was pioneering the concept of asset protection trusts for

assistance in writing what became the 1989 law that created these trusts in the Cook Islands.

The Times investigation also found that the Cooks Islands provided a safe haven to individuals and enterprises engaged in Medicaid fraud, Ponzi schemes, the looting of pension funds, tax evasion and more. They wrote:

> *One notorious name linked to Cook Islands Trusts is R. Allen Stanford, who "is serving a 110-year term for masterminding a $7 billion Ponzi scheme, had a "Baby Mama Trust" in the Cook Islands, named after a mistress with whom he had two children and who was the trust's beneficiary. "Baby Mama" contained proceeds from the sale of a $2.5 million Florida home — proceeds that were held in Swiss and Isle of Man accounts and are now among 30 offshore accounts subject to a forfeiture order to pay Mr. Stanford's victims."*

The government of the Cook Islands recognizes that their trust laws are so destructively protective of bad actors that no resident of the Cook Islands is, by law, allowed to establish a trust. The trust industry is entirely foreign.

c. What other jurisdictions present similar problems?

According to TJN, some of the greatest problems involving trusts stem from the following jurisdictions:

Nevis
Belize
Bermuda
Cayman Islands
British Virgin Islands
New Zealand

While these jurisdictions are cited for any number of abusive features in their laws regulating trusts, a common problem is that they do not recognize or fully recognize foreign claims or laws. Most have blanket rejections of foreign claims. The Cayman Islands, while slightly better, still does not allow for claims of fraudulent activity to break into a trust.

It is important to note that, while the degree of secrecy or lack of transparency surrounding trusts and other legal instruments in certain problematic locations like the Cook Islands is cause for concern, the other factor that should be taken into account is the volume of money moving through that jurisdictions.

The Financial Secrecy Index of 2018, developed by the Tax Justice Network, has developed a methodological approach to analyzing the degree of financial secrecy in any given jurisdiction. That methodology not only evaluates the degree of secrecy found in a location according to a

number of key indicators, but also the percentage of the global market share of financial services that particular jurisdiction controls. This is important because, while grave financial secrecy in a small jurisdiction can present real challenges to tackling the money laundering associated with criminal or corrupt activity, even lesser amounts of secrecy in a country with a larger share of the financial services market can have a similar or greater deleterious overall impact.

As such, if we are serious about tackling financial secrecy that enables criminal and corrupt activity, the US must take responsibility for addressing the ways in which our own financial system enables those activities.

3. Beyond the Cook Islands, how is the rest of the world responding to combat the problems raised by anonymous shell companies?

    a. Is there a trend towards increased incorporation transparency?

Yes. The United Kingdom has up and running a corporate registry with beneficial ownership information that is available to the public. So does Norway and the Ukraine. The European Union member nations have agreed to follow suit. South Africa, Ghana and Nigeria are considering doing the same, as are other countries.

It is widely acknowledged that if the U.S. were to take the same action, many other nations would follow.

In the U.S., the US Treasury Department recently extended and expanded pilot programs that now require the collection of beneficial ownership for certain high end, cash financed real estate transactions in seven geographic areas.

The Defense Department will soon collect corporate ownership information before leasing high security office space as part of the National Defense Authorization Act For Fiscal Year 2018.