Questions for the Record from Senator Charles E. Grassley
To Brian O'Shea
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U.S. Chamber of Commerce
U.S. Senate Committee on the Judiciary
"Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency"
Submitted on February 12, 2018

1. **In your testimony, you noted the Chamber's opposition to S.1454 stemmed in part from "overly broad and vague definitions."**

    a. **Please explain precisely to which definitions the Chamber is referring.**

Answer:

My testimony refers to the vague and expansive definition of "beneficial owner" included in S. 1454, the Whitehouse/Grassley TITLE Act. The TITLE Act defines as a beneficial owner of a corporation or LLC someone who directly or indirectly:

- Exercises substantial control over a corporation or limited liability company through ownership interests, voting rights, agreement, or otherwise; or
- Has a substantial interest in or received substantial economic benefits from the assets of a corporation or the assets of a limited liability company.

The terms "substantial control," "substantial interest," and "substantial economic benefits" are all undefined in the legislation, and there is no definition or clarity of what the term "otherwise" means in the control prong of the beneficial ownership definition. These subjective terms will create a great deal of uncertainty and present difficult questions for businesses that would be mandated to comply with the reporting requirements under the TITLE Act.

As I note in my written testimony, these definitions also contradict the definition of "beneficial owner" that was ultimately adopted by the Financial Crimes Enforcement Network (FinCEN) during its years-long process to develop the customer due diligence (CDD) rule for financial institutions. The CDD rule defines a beneficial owner as 1) those individuals who hold a 25% or greater equity interest in an entity and 2) a "single individual with significant responsibility to control, manage, or direct" the entity. Thus, the CDD rule essentially limits the number of individuals that would have to be reported to five (one individual under the control prong, plus up to four individuals under the economic benefit prong.) The TITLE Act's vague and expansive definition, by contrast, could lead to essentially an unlimited number of individuals having to be reported under the legislation.

2. **The definition of "beneficial owner" in S.1454 means "each natural person who, directly or indirectly (i) exercises substantial control over a corporation or limited liability company through ownership interests, voting rights, agreement, or**

otherwise; or (ii) has a substantial interest in or receives substantial economic benefits from the assets of a corporation or the assets of a limited liability company.

a. **Please explain in detail what "complex legal analyses" would be necessary to determine a "beneficial owner" under the definition in S.1454. Please provide specific examples.**

Answer:

S.1454, the Whitehouse/Grassley TITLE Act, compels the individuals responsible for *every* corporation or limited liability company (LLC)—including certain non-profit entities—currently in existence in the United States or to be formed in the future to either be subject to its ongoing reporting regime or to make a filing identifying an exemption applicable to them. If they are not one of the types of entities exempted from the bill, such as a bank or insurance company, then the responsible person must report and provide periodic updates on every individual human being who satisfies any one of these standards for being a "beneficial owner" of a corporation or LLC:

1) "directly or *indirectly*" "has a *substantial* interest in" the corporation or LLC; or
2) "directly or *indirectly*" "receives *substantial economic benefits* from" the assets of the corporation or LLC; or
3) "directly or *indirectly*" "exercises "*substantial control*" over the corporation or LLC through "ownership interests, voting rights, agreement, or *otherwise*." (S.1454, p. 18) (emphasis added).

As written, each one of these three separate standards for being a "beneficial owner" goes well beyond identifying what any ordinary person would deem the "owners" or "controlling persons" of a corporation or LLC. It is simply inaccurate to state that the legislation is focused on getting at just these individuals or that it just targets "shell companies." While the Treasury Department defines a "shell company" as "a legal entity that has been registered with a state but has no physical operations or assets,"[1] this bill regulates every existing or to be formed corporation or LLC in the nation. Moreover, the TITLE Act is not limited to just a very small number of relatively sophisticated entities that are already on notice that they will be subject to scrutiny in the interests of national security, such as the government contractors covered by the requirements in the recent National Defense Authorization Act provision Mr. Kalman cited at the hearing concerning lessors of office space to security sensitive defense agencies. And in contrast to FinCEN's Customer Due Diligence regulations, the TITLE Act is not restricted to entities with dedicated compliance departments.

<u>The TITLE Act's failure to define beneficial owners based on objective, clear, quantifiable thresholds and constructs will compel people running law-abiding corporations and LLCs to seek legal counsel</u>

[1] CDD Rule at 29400, FN 13.

The TITLE Act does not define or set any numeric threshold for the vague term "substantial" that defines a direct or indirect interest, economic benefit, or degree of control that makes someone a "beneficial owner." These vague definitions contradict the judgment of FinCEN in defining beneficial ownership based on a direct or indirect ownership interest. In its final rule regarding "Customer Due Diligence Requirements for Financial Institutions" (CDD rule) the Financial Crimes Enforcement Network (FinCEN) set a quantifiable threshold of 25% for a direct or indirect ownership interest triggering the identification and reporting of an individual as a beneficial owner. The Agency rejected calls to lower this threshold to 10%. FinCEN never even considered the approach in the TITLE Act of refusing to provide any quantifiable threshold for an ownership interest triggering disclosure.

FinCEN acknowledged that a lower 10% threshold "would make it more difficult for illicit actors to structure ownership interests to evade the reporting threshold."[2] But the Agency nevertheless rejected the lower numeric threshold. After an approximately six-year rule-making process FinCEN determined that "the incremental benefit of this approach does not outweigh the burdens associated with [banks] having to collect and verify the identities of more than twice as many beneficial owners"[3] as under the 25% threshold. [T]he proposed 25 percent threshold is consistent with that of many foreign jurisdictions (including EU member states) and with the FATF standard, which in turn is used to define the controlling persons of an entity in the intergovernmental agreements that the United States has entered into with more than 110 other jurisdictions.

In the context of regulating banks with dedicated compliance departments, FinCEN concluded that "a 25 percent threshold strikes the appropriate balance between the benefit of identifying key natural persons who have substantial ownership interests in the legal entity and the costs associated with implementing this information collection."[4] While the Chamber does have serious concerns about the CDD Rule and how it is being implemented by FinCEN, it is worth noting that the CDD Rule does not impose on banks the same onerous verification and continuous 60-day updating requirements that the TITLE Act imposes on individuals operating corporations or LLCs.

By contrast, the TITLE Act has no quantifiable ownership threshold delimiting the number of people who could have to be disclosed in relation to a corporation or LLC on the basis of an ownership interest. At the Judiciary Committee hearing, Mr. Kalman asserted that under the TITLE Act "it could potentially be 99 people" who could qualify and be disclosed as beneficial owners in relation to a single corporation or LLC. In fact, in some cases it could be substantially more than 99 people who would have to be reported as beneficial owners based on the bill's operating company exemption.

Under this legislation business owners would be compelled to consult counsel as to what constitutes a "direct or indirect" "substantial" "interest in" a non-exempt corporation or LLC. For example, would the people responsible for a corporation or LLC be required to measure how substantial an ownership interest is based on some measure other than the percentage of

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[2] CDD Rule at 29410.
[3] CDD Rule at 29410.
[4] CDD Rule at 29410.

ownership? Would they also need to assess the substantiality of the perceived economic value of the ownership rights? Or would they need to undertake "a comparative analysis of every owner"—a standard rejected as unworkable by FinCEN in the CDD Rule?[5] It is simply unclear how to determine whether an ownership interest is sufficiently "substantial" under the terms of the TITLE Act.

Additional legal questions certain to perplex small business owners are whether non-minor children with a contingent interest in an entity by means of estate planning need to be disclosed as "direct or indirect" beneficial owners on the basis of a "substantial interest" in a corporation or LLC that a parent bequeaths to them. Would other contingent interests, such as spousal rights that operate by state property laws require disclosure of the spouse of a "beneficial owner" as also being a beneficial owner on the basis that they have a "direct or *indirect*" "substantial interest" in the enterprise, particularly in a community property state?

While the TITLE Act seeks to preclude employees who get shares of their company as compensation for employment from being beneficial owners, it does not clearly address other common scenarios related to employee stock awards. These include whether an employee's former spouse who gets shares through a divorce settlement would have to be reported as a beneficial owner on the basis of the shares he or she acquires in a divorce rather than through employment. Similarly, shares inherited by the non-minor children of employees by operation of trust and estate laws and documents are also not clearly addressed by the legislation and will compel business owners to seek counsel.

The "control" prong of the TITLE Act also ignores the judgment of FinCEN by relying on inchoate notions of "effective control" that impose no quantifiable limit on the number of potential beneficial owners. In its final CDD rule, FinCEN created a standard requiring entities to "provide identifying information for one person with significant managerial control."[6] By contrast, the TITLE Act requires the disclosure of every single individual who can be deemed to directly or indirectly exercise "substantial control" through not just ownership, but also "voting rights, agreement, or otherwise"—whatever that may be determined to mean. FinCEN rejected using such attenuated notions of "effective control" that require the identification of a potentially vast number of people citing the admission of advocates of such an approach that it can be "difficult to determine" everyone who meets such a standard.[7] FinCEN concluded that its approach of requiring identification of just one person who exercised day-to-day managerial control, rather than everyone who exercised "effective control" "strikes the right balance." In rejecting the type of vague "effective control" standard used in the TITLE Act, FinCEN explained that "the challenges associated with identifying and verifying additional natural persons outweigh any incremental benefit to the information" provided by such a standard.[8]

Under the TITLE Act, many people responsible for reporting all of the beneficial owners of corporations and LLCs, including certain non-profits covered by the bill, will have to seek counsel to understand when someone exercises "substantial control" directly or indirectly,

[5] CDD Rule at 29410.
[6] CDD Rule at 29411.
[7] CDD Rule at 29412.
[8] CDD Rule at 29412.

through “ownership interests, voting rights, agreement, or otherwise” because of the absence of any clear, quantifiable definition of substantial and other defects with the bill’s definition of a beneficial owner. Questions will arise as to whether the TITLE Act requires listing individuals who have a temporary or permanent power of attorney over voting rights in an entity pursuant to estate plans or some other “agreement or otherwise.” Or would the individual responsible for reporting beneficial owners have to obtain the name, address and driver’s license of the individuals on whose behalf such powers are being exercised because the agent acting under the power of attorney is excluded from the bill’s definition of being a beneficial owner? Would the rights of control that early investors often seek in start-up ventures they fund require reporting of the individuals controlling the entity that provided the start-up capital? What is meant by the term “or otherwise”?

Questions will arise as to issues such as who must be disclosed when a trust holds whatever may be defined as “substantial control” based on a trust agreement. Will it be the trustee? This is unclear since the bill precludes from the definition of a beneficial owner “a person acting as a nominee, intermediary, custodian, or agent on behalf of another person.” Will it depend on the terms of the trust? Will it depend on how state law defines words such as “intermediary,” “custodian” or “agent” under its property and trust and estate laws? Will the beneficial owners be the beneficiaries of the trust given that the bill does not except people with rights in a corporation or LLC by virtue of inheritance, or through trusts and other estate planning vehicles? What if it is a generation-skipping trust?

Business owners will also seek legal counsel as to how the individual responsible for initially reporting this information in relation to their corporation or LLC and then updating it “not later than 60 days after the date of any change” is supposed to obtain it and be aware of any changes to it if they are not the settlor or trustee of the trust with access to the original documents and any subsequent amendments made to them. Would not such information be subject to legal privileges that could be vitiated by providing such information to third parties?

This legal conundrum associated with obtaining beneficial ownership information also arises outside of scenarios involving trusts. This is because the legislation does not impose any obligation on third parties to initially provide or send timely updates on their name, address and driver’s license or passport number to the individual obliged to initially file and provide periodic and annual updates on this information. This stands in stark contrast to the British laws advocates of the TITLE Act so often cite favorably as a model for the United States. In Britain, the people charged with reporting beneficial ownership information are “given statutory tools to help them obtain this information, including the ability to serve notice on a person (as specified in the legislation) to obtain information.”[9] Simply put, under the British law “[i]ndividuals will be required to disclose this information,”[10] but they are not required to do so under the TITLE Act. This fact will compel many business owners to seek legal counsel when they encounter individuals or organizations unwilling to provide a reporting party the information initially required on direct and indirect beneficial owners and any subsequent changes within the 60 days period required under the bill and for the annual update required by the legislation.

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[9] U.K. Department for Business Innovation & Skills, *Transparency and Trust* at 7 (June 2014).
[10] U.K. Department for Business Innovation & Skills, *Transparency and Trust* at 7 (June 2014).

Very real, common scenarios that may arise compelling a small business owner to seek counsel in Iowa and other states include instances such as when a corporation or LLC owns a building, makes improvements to it and a mechanic's and materialmen's lien arises on the property. Under the laws of many states, including Iowa, every person who furnishes any material or labor for, or performs any labor upon, any building or land for improvement, alteration, or repair thereof, including those engaged in the construction or repair of any work of internal or external improvement, and those engaged in grading, sodding, installing nursery stock, landscaping, sidewalk building, fencing on any land or lot, by virtue of any contract with the owner, owner-builder, general contractor, or subcontractor shall have a lien upon such building or improvement, to secure payment for the material or labor furnished or labor performed.[11] Under the TITLE Act, many business owners will have to seek legal counsel to determine if the individuals who have the right to these liens could be deemed beneficial owners on the basis of direct or indirect "substantial economic benefits" from the assets of the corporation or LLC.

Many business owners will also have to seek legal counsel to determine if the individuals who have the right to these liens could be deemed beneficial owners on the basis of direct or indirect "substantial economic benefits" from the assets of the corporation or LLC. The bill's purported exemption for creditors fails to answer this question because it is circular. It merely states that a "creditor of a corporation or limited liability company" is not a beneficial owner "unless the creditor also meets the requirements of subparagraph (A)," which is the definition of a "beneficial owner" on the basis of ownership, control, or economic benefits.

Therefore, Iowa business owners who have improvements made to property owned by their corporation or LLC will seek counsel as to whether the value of a materialman's or mechanic's lien constitutes "substantial economic benefits" from the assets of the corporation or LLC. Will it depend on the overall dollar value of the lien? Will it be based on the proportion of the value of the property that the lien represents? Or will the substantiality of the economic benefits be defined by their economic significance to the party with the lien rights?

Additionally, if a lien is posted to the Iowa state registry, can the business owner rely on the information in the registry, such as the name and address of the lienholder to report lien holders as beneficial owners? Or does the information have to come directly from the individuals who constitute beneficial owners? Even if the lien is held by an individual and legal counsel concludes that the registry data for their address can be used in initially reporting a beneficial owner, individuals will still have to be contacted to obtain their driver's license or passport number, which is not included in the Iowa lien registry, and for the annual update as well as to confirm there have been no changes to the information within 60 days.

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[11] Iowa Code § 572.2 (2018).

Indirect Beneficial Owners under the ownership, control and economic interest prongs

Another aspect of the TITLE Act's definition of a beneficial owner that will require business owners to seek legal assistance and raise complex legal questions is the fact that the ownership interest, effective control and economic benefits standards for beneficial ownership can all be met *indirectly* through an individual's interest in other entities separate from the corporation or LLC for which beneficial ownership information must be reported. The individuals controlling these other entities have to be disclosed as beneficial owners of the reporting corporation or LLC if, through such other entity they, "directly or indirectly" have "a substantial interest in" or receive "substantial economic benefits from" or exercise "substantial control" through "ownership interests, voting rights, agreement, or otherwise" over the reporting corporation or LLC (S.1454, p. 18).

The TITLE Act imposes this "look-through" requirement even though non-exempt corporate or LLC interest-holders in a company would presumably have their own obligation to report their beneficial owners to the state under the bill. This "look through" obligation is only relieved when a corporation or LLC falls under the "Exempt Entities With An Ownership Interest" provision of the bill, in which case the business owner merely has to disclose identifying information for the entity and not individuals associated with it (S.1454, p. 15). If the entity with the requisite interest in a corporation or LLC is not exempt from the bill's definition of a corporation or limited liability company, then the individual responsible for reporting a corporation's or LLC's beneficial ownership information may have to look through multiple layers of entities to ascertain all of the individuals who indirectly have a "substantial interest in" "exercise substantial control over" or derive "substantial economic benefits from" the corporation or LLC.

This look through obligation can become quite onerous and require legal assistance. Consider the Iowa lien holders referenced above. If the liens are held by an entity, such as a construction company that is itself a corporation or LLC—which they often are in the Iowa registry—then parties charged with reporting beneficial owners for a corporation or LLC on the basis of a lien interest will have to contact the entities to ascertain the individuals behind them for purposes of identifying potential beneficial owners who may indirectly receive "substantial economic benefits from the assets of the corporation or LLC" by virtue of the liens or payments made to terminate the liens. Some complex legal analysis may be required to advise a business as to what to do for their reporting when such other entities do not provide the necessary data. As noted above, nothing in the TITLE Act empowers a business owner to compel another entity or individual to disclose or update the beneficial ownership information a covered corporation or LLC must report.

The TITLE Act with its vague and flawed terms is expressly drafted to take effect even if there is no clarifying or delimiting guidance or rulemaking issued concerning key terms and concepts in the legislation.

Proponents of the TITLE Act cannot assert that the uncertainties created by the vague and undefined terms they chose to use will be clarified by regulators before any reporting occurs under the legislation. This is because the sponsors of the bill made a conscious choice to

expressly provide that this legislation, which has an effective date of "3 years after the date of enactment," (S.1454 at page 7, line 14), will take effect if clarifying guidance or regulations are not issued before this effective date. The bill mandates that "a failure to issue guidance or a rule . . . shall not delay the effective date of the requirements under this subpart." (S. 1454 at page 17, lines 23-24 – page 18, lines 1-2).

Three years is not a long time to propose, take comment on and finalize rules addressing anti-money laundering standards, such as those in the TITLE Act. The FinCEN CDD Rule took approximately six years to go from a proposed rule to a final, effective rule. Keep in mind that rule was the product of the Treasury Department and not a joint rulemaking by multiple Departments. Notably, any regulations implementing the TITLE Act must involve not just the Treasury Department, but also the Department of Homeland Security and the Justice Department issuing "*joint* guidance or a *joint* rule" (S.1454 at page 17, line 11) (emphasis added). Any joint rulemaking or clarifying guidance will be hampered by the uncertainty the TITLE Act casts on the ability of these Departments to clarify key elements of the statutory definition of the term beneficial owner. The bill expressly prohibits these Departments from issuing any "guidance or rule" that could be deemed to "amend or alter the definition of the term 'beneficial owner" through changes to the definition directly or through the manner of implementation" (S. 1454 at page 17, lines 15-22). If the regulators cannot discern the scope of their authority and reach agreement on clarifying joint rules or guidance within three years of enactment of the TITLE Act, people will have to discern beneficial owners under the vague, broad and ill-defined terms of this legislation.

b. **What alternative definition of "beneficial owner" would the Chamber suggest?**

The Chamber suggests the following, very straightforward definition of individuals who are beneficial owners:

> *"(1) Each individual, if any, who, directly or indirectly, through any contract, arrangement, understanding, relationship or otherwise with an applicant to form an entity, owns 25 percent or more of the equity interests of a corporation or limited liability company;*
>
> *(2) A single individual with significant responsibility to control, manage, or direct a legal entity customer, including:*
>
> *i. An executive officer or senior manager (e.g., a Chief Executive Officer, Chief Financial Officer, Chief Operating Officer, Managing Member, General Partner, President, Vice President, or Treasurer); or*
>
> *ii. Any other individual who regularly performs similar functions."*

Using this very clear, easy to understand, and objective definition avoids the cost, uncertainty and burden associated with the definition currently in the bill. Moreover, based on FinCEN's

assessment in the CDD Rule, this definition provides an adequate, but finite, universe of people for law enforcement to follow-up with regarding an entity suspected of illicit activity. It is also practicable and administrable for both the government and regulated entities.

3. The Chamber objects to the "operating company" exception S.1454, Sec. 531(d)(2)(B)(XIV).

a. Does the Chamber advocate for specific carve-outs for larger corporations?

For years the Chamber has urged that an effective and sensible operating company exemption be included in the TITLE Act given that the legislation's onerous and ill-defined beneficial ownership reporting mandates apply to any existing "entity formed under the laws of . . . [a] State before . . . [the] effective date [of the TITLE Act]." (S.1454 at page 14, lines 12-21). An effective exception would prevent the millions of law-abiding and legitimate small and medium-sized businesses already in existence and those formed in the future from being subject to the beneficial ownership reporting in S.1454. Regrettably, as drafted, the operating company exemption in S. 1454 does not constitute a workable solution to achieve this goal.

As currently drafted in the TITLE Act, the operating company exemption only applies to a corporation or LLC that meets all four of the following criteria:

1) "employs more than 20 employees on a full-time basis;
2) "files income tax returns in the United States demonstrating more than $5,000,000 in gross receipts or sales";
3) "has an operating presence at a physical location in the United States"; <u>and</u>
4) "has more than 100 shareholders" (S.1454 at page 23, lines 14-25, page 24, lines 1-2).

According to the United States Small Business Administration's 2017 Economic Profile of the State of Iowa, just the single requirement to have "more than 20 employees on a full-time basis" precludes the ability of 259,000 existing Iowa small businesses to utilize the operating company exemption. The Chamber simply disagrees that over a quarter of a million small businesses should be burdened with onerous requirements in an attempt to catch a relatively small number of bad actors.

As drafted, just the first requirement of this four-part exemption mandating more than 20 full-time employees also prevents millions of legitimate, law abiding small business in other states from using the operating company exception. According to the SBA's 2017 Small Business Profiles, there were 379,516 businesses in Alabama that did not employ more than 20 people. In Colorado, there were 583,362 businesses that did not employ more than 20 people. In Idaho, there were 150,824 businesses that did not employ more than 20 people. In Indiana, there were 490,283 businesses that did not employ more than 20 people. In Kentucky, there were 335,711 businesses that did not employ more than 20 people. In Maine, there were 140,795 businesses that did not employ more than 20 people. In Mississippi, there were 246,853 businesses that did not employ more than 20 people. In Missouri, there were 501,631 businesses that did not employ more than 20 people. In South Dakota, there were 81,968 businesses that did not employ more than 20 people. In Texas, there were 2,511,984 businesses that did not employ

more than 20 people. In Utah, there were 262,403 businesses that did not employ more than 20 people. In Wisconsin, there were 431,003 businesses that did not employ more than 20 people. In Wyoming, there were 62,918 businesses that did not employ more than 20 people.[12] This data also reflects that reality that most small businesses will not be able to avail themselves of the TITLE Act version of an operating company exemption.

Even many businesses that do employ more than 20 employees on a full-time basis will still not be able to avail themselves of the TITLE Act's Operating Company exemption. Some of them will certainly not meet the second requirement of having filed tax returns in the U.S. demonstrating "more than $5,000,000 in gross receipts or sales." And if they do, it will still be just a small subset of the businesses with more than 20 full-time employees and more than $5,000,000 in receipts that can satisfy the requirement in the TITLE Act operating company exception to have "more than 100 shareholders." Even some fairly sizable privately-held manufacturing, farming and other types of companies in Iowa and around the nation are unlikely to meet the 100 shareholder requirement for this exception.

This is one of the main reasons why organizations that represent and have small businesses as their members oppose this legislation. This includes: the U.S. Chamber, NFIB, NAM, The Real Estate Roundtable, Associated General Contractors of America, International Franchise Association, Air Conditioning Contractors of America Angel Capital Association, Associated Builders and Contractors, Inc., National Lumber & Building Material Dealers Association, National Retail Federation, National Small Business Association National Venture Capital Association, Petroleum Marketers Association of America, Promotional Products Association, International Service Station Dealers of America and Allied Trades, Small Business & Entrepreneurship Council, Specialty Equipment Market Association, Specialty Tools & Fasteners Distributors Association, and Tire Industry Association.

Given the millions of law-abiding and legitimate small and mid-size businesses that are precluded from claiming the operating company exemption as drafted in the TITLE Act, it is inaccurate to describe this provision as a meaningful exception. The Chamber has no issues with the bill's existing exemptions carving out from the ongoing beneficial ownership disclosure provisions of the bill public companies, banks, bank holding companies, credit unions, registered broker dealers, exchanges and clearing agencies, registered investment companies and advisors, insurers, registered commodities and futures brokers, certain public accounting firms, utilities, and 501(c)(3) entities. Clearly, this involves a large number of businesses that are not involved in money laundering or illicit activities. The Chamber strongly supports revising this provision. It should be revised to exempt the many pre-existing small businesses that are law-abiding and legitimate and do not pose a high risk of being "shell companies" laundering the proceeds of terrorists, drug dealers and human traffickers.

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[12] U.S. Small Business Administration, 2017 Small Business Profiles for the States and Territories, *available at* https://www.sba.gov/advocacy/2017-small-business-profiles-states-and-territories. (Numbers referenced above come from combining number of nonemployer firms and firms with 1-20 employees in each state.)

b. **If so, what should those carve-outs be?**

In addition to supporting a revised operating company exception that prevents the millions of pre-existing, law abiding small and medium-sized businesses in America from being subject to the vague, onerous and ongoing beneficial ownership reporting provisions of the TITLE Act, the Chamber believes other improvements can be made to the existing carve-outs. For example, exception XIII for certain types of non-profit entities should be revised to cover all 29 types of entities exempt from taxation under section 501(c) of the Internal Revenue Code, as well as the religious and apostolic organizations under section 501(d). The concept of a beneficial owner of such entities is very hard to ascertain and risks disclosing confidential donor information.

The Chamber also believes that exception XV for a corporation or limited liability company which is owned, in whole or in substantial part by an exempt entity needs to be amended. To ensure clarity, this provision should be revised to exempt "any corporation or limited liability company which is owned more than 50 percent by" an entity exempt under any other exemption in the bill. This change will preclude the uncertainty associated with the undefined term "substantial part" and preclude this term being materially redefined by successive administrations over time.

4. **The Chamber claims 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 identify the states in which beneficial ownership would become public when filed.**

Answer:

Throughout the discussion on beneficial ownership legislation over the last decade, the National Association of Secretaries of State (NASS) has continuously pointed out the relationship of these reporting requirements to existing state law. NASS has determined that beneficial ownership information collected under the TITLE Act or any similar legislation would be made public in all states. As NASS has stated, "Entity information filed with the State business registry is public information, thus beneficial ownership information filed with the state would be public information."[13] The TITLE Act provision which does not limit the authority of any state to

[13] http://www.nass.org/initiatives/state-incorporation-collection-company-ownership-info

disclose or not disclose beneficial ownership information it collects does not change the underlying reality that under current law, information collected under the bill would be made public.

b. **Please also explain how that state's law would cause such information to be made public.**

Answer:

According to NASS, because beneficial ownership information is business entity information, the laws of each state would require it to be reported in a public registry. While state public record laws generally exempt certain personal information from public disclosure (e.g. social security numbers), I am unaware of any state law or policy that would exempt the names of beneficial owners from public disclosure.

Brian O'Shea, Senior Director, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce
Senate Judiciary Committee Hearing on Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency
Questions for the Record
Submitted February 13, 2018

QUESTIONS FROM SENATOR COONS

1. **In most states, entity information filed with state business registries is made public. What potential risks would a state-based approach to the collection of beneficial ownership information pose with respect to privacy?**

Answer:

According to the National Association of Secretaries of State (NASS), state business entity formation documents and periodic reports are by nature public filings and the information contained therein becomes part of the public record in each state. There are a number of legitimate and benign reasons, both business and personal, for businesses to want to maintain the privacy of this information.

A primary argument for maintaining privacy when it comes to ownership stakes in small business is for competitive reasons. Early stage investors – whether they are individuals, venture capital firms, or angel capital firms – often do not want their investment portfolios to be broadcast to the general public. For venture capital firms, the time, research, and analysis they perform on a potential investment is effectively the "intellectual capital" of that firm – disclosing that to the public would make it more difficult for venture capital or other types of entities to invest in early-stage companies and thus choke off an important source of capital in the economy.

Beneficial owners of an entity could also easily be intimidated out of certain investments through lawsuits or other means if their involvement with an entity was made public. Activists could also harass or target beneficial owners if they are known to be involved with an entity whose business or industry happens to be disfavored by an activist group. Given the significant rise in activism against corporate entities in the United States, that is not a concern that should be taken lightly.

Another concern would involve an immigrant who has come to the United States from countries with unstable governments, and has become a successful entrepreneur with investments in potentially dozens of businesses. Public disclosure of the businesses that individual is invested in could give indications as to their overall wealth, and corrupt or violent governments in that individual's home country could then use that information to target the individual's relatives or anyone close to them. Mr. Fuller pointed this out in his oral testimony for the February 6th hearing by saying that "[public] data could be gathered and used by dictatorships around the world to identify and oppress elite dissidents that routinely hype their wealth and assets in democracies away from the realm of authoritarian control."

2. **Could the TITLE Act in its current form have a chilling effect on the availability of venture capital to fund innovative start-ups and small businesses within the United States?**

Answer:

In its current form, beneficial ownership information collected under the TITLE Act would be publicly disclosed. For a venture capital firm, this means that their proprietary early-stage portfolios would also become public. This would absolutely have a chilling effect on the ability of venture capital firms to provide much-needed capital to start-up businesses in America. U.S. Census data found that in 2016, startups in the United States had reached a 40-year low,[1] and the TITLE Act would likely only exacerbate that decline.

It is also important to note the distinct differences between the United States economy and that of many countries in Europe, where beneficial ownership requirements have become more common. European countries do not have anything that resembles the venture and angel capital ecosystem we have in the United States, and the "garage start-up" is something that is largely unique to the United States. In the U.S., when someone has a business idea they often first go to friends or relatives to raise capital, then eventually maybe secure an investment from a venture capital firm. Under the TITLE Act, that startup business would have to continually track the personal information of all of those investors, or else become subject to civil or potentially criminal penalties for failing to do so. This ongoing paperwork headache would only make it less attractive to start or invest in a business in the United States, which would have obvious and severe long-term consequences for our economy.

3. **I'm concerned with the administrative burden the TITLE Act would place on each state.**
    a. **What kinds of resources would states need to collect beneficial ownership information in compliance with this Act, if passed?**
    b. **In general, what steps would a state need to take beyond modifying existing forms in order to administer a new beneficial ownership reporting regime?**
    c. **Do Secretaries of State have the resources required to implement the TITLE Act?**

Answer:

The resources needed to collect beneficial ownership information would vary by state, but it is unlikely states currently have the resources to implement the Act. States would have to face the costly challenge of updating forms and databases and developing administrative procedures for collecting, processing and storing ownership information by multiple entities (including those exempted from the law). If states were able to change their public records laws to exempt beneficial ownership information from public disclosure, that would likely require states to develop and maintain a separate database for that information. States would also likely have to dedicate a considerable amount of time and resources to educating the public about the new requirements and dealing with inquiries about definitions such as "beneficial owner" and "exempt entity" which, as a ministerial filing office, they would be unable to provide any clarification on.

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[1] http://money.cnn.com/2016/09/08/news/economy/us-startups-near-40-year-low/index.html