

Senate Committee on the Judiciary

“Combatting Kleptocracy: Beneficial Ownership, Money Laundering, and Other Reforms”

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June 19, 2019

Chairman Graham, Ranking Member Feinstein, and distinguished members of this committee, thank you for hosting this hearing on the dangers of U.S. shell corporations. Unfortunately, these opaque entities remain a glaring hole in what is otherwise a very strong U.S. anti-money laundering system. As a result, we have seen adversaries from Iran to al Qaida to organized criminal groups, taking advantage of our system to hide and move their illicit funds. Congress has the opportunity to address this problem and I would urge you to act.

Terrorist and criminal money has been my focus for the last 18 years. In the ashen weeks after September 11, I turned my career to focus on combating terrorist financing and illicit finance, first at the Justice Department and later at the Treasury Department. I was appointed Director of the Office of Foreign Assets Control under President George W. Bush and held that position for nine years. I was then nominated by President Obama to become the Under Secretary for the Office of Terrorism and Financial Intelligence, and served in an acting capacity in that role for two years. My testimony today reflects my own views as a former government official and a practitioner, and not those of Sullivan & Cromwell or its clients.

I. The Risk

The global response to 9/11 was powerful and united. There is perhaps no better example of that international response than the tectonic shift in efforts to disrupt terrorist financing. Governments enacted tougher laws and devoted more resources towards tracking bad actors and holding them accountable. Banks and other private sector companies overhauled their policies, staffed up compliance teams to find and report suspicious transactions, and brought the power of big data and machine learning to bear on tracking dirty money. And international expert bodies set out standards for how all jurisdictions should be tracking and stopping illicit money.

The U.S. has been a leader in this global effort. We are rightly seen as a role model of how a sophisticated and high-functioning economy can ensure that its companies and financial institutions are profitable, efficient, and clean. But there is a glaring exception. When it comes to shell companies, we are not a leader – we are one of the world’s biggest problems.

The problem is simple. One can form a corporation in any U.S. state quickly and without disclosing who the true owners of the company are. This means that wealthy criminal enterprises can hire an agent to form dozens of U.S. companies, whose records will list only the names of the agent and whoever is put forward as the nominee shareholders and officers. None of those listed individuals will have any link to the actual individuals owning and controlling the money—the real beneficial owners. It should not be that simple to launder money in the United States.

The true scale of the problem was brought home to me many years ago, on a Treasury Department trip to Latvia to discuss money laundering. Our delegation met with the Latvian Financial Intelligence Unit, a small team of investigators charged with tracking dirty money in a jurisdiction rife with problems. Despite their small size, they were smart and dedicated. They showed us large and complex link charts, depicting how they had followed the money trail of criminals across borders and through different types of corporate vehicles. At the edges of the link charts were several grey boxes with question marks on them. We asked what these represented. They did not want to embarrass us, but they haltingly told us that these were U.S. shell companies, and that they had been unable to identify the true owners of any of them. The American system that we were so proud of had real problems, problems that looked bad even in Latvia.

U.S. law enforcement officials face the same problem. Forensic investigators at the FBI, IRS, and DEA employ great skill and cutting-edge tools to trace money across international borders and untangle sophisticated money laundering schemes. It is a painful irony, but the obstacle to many of these illicit finance investigations will be a U.S. company incorporated in Nevada, Delaware, or Wyoming.

Unlike many of the other national security challenges we face, this one can be solved. With a short piece of legislation, Congress could ensure that all entities incorporated in the U.S. have verifiable information recorded as to their true ownership. Indeed, I believe that this would be the single most impactful step that Congress could take to combat criminal and terrorist financing in the United States.

II. Receding on the Global Stage

In the years following September 11, the United States led the charge to augment efforts against money laundering and the financing of terrorism, both at home and abroad. Internationally, this has meant raising the bar for international standards at the Financial Action Task Force (FATF), the global standard-setting body for combatting terrorist financing and money laundering. It has also meant working with regional organizations and individual countries to press for higher standards and tougher enforcement, and to provide technical assistance where needed.

Over the last few years, other developed countries have recognized the threat posed by shell companies and have moved to address the vulnerability. The European Union now requires all

member states to establish public registries for legal entities.¹ Since 2016, the United Kingdom, Norway, and Ukraine have established public beneficial ownership registries, while others including Ghana, Mexico, and Nigeria have committed to creating their own.

Our inaction has been noted. In its most recent assessment of the United States, FATF generally found the United States' anti-money laundering regime to be "well developed and robust."² However, FATF identified the lack of beneficial ownership identification requirements at the company formation phase as a "significant gap" and a "serious deficiency." It found that only minimal beneficial ownership information is available to law enforcement authorities for non-public companies.³ As a result of these deficiencies, FATF rated the United States as "non-compliant"—effectively a failing grade—with the organization's recommendations on beneficial ownership.⁴

This failing assessment is not merely a black eye for the U.S. It undermines our efforts to address serious problems in jurisdictions around the world. U.S. Government officials urging progress from other governments will not have the impact we want if the world thinks we do not have our own house in order.

Finally, as our allies and partners put in place beneficial ownership rules, our inaction risks the United States becoming an even more attractive haven for those who seek to hide the proceeds of illicit activity behind a veil of corporate anonymity.

The U.S. financial system is the global leader in so many areas; let us not become the global leader in criminal shell companies.

III. Efforts to Date

The Treasury Department has taken steps where it has the authority to help mitigate the risks of shell companies. In 2016, the Financial Crimes Enforcement Network (FinCEN) issued a Global Targeting Order requiring U.S. title insurance companies in three major metropolitan areas—later expanded to 12—to gather beneficial ownership information from companies involved in all-cash purchases of residential real estate. This order has yielded significant data on the

¹ Organization for Economic Cooperation and Development (OECD) and the Inter-American Development Bank, *A Beneficial Ownership Implementation Toolkit* (March 2019), available at <https://www.oecd.org/tax/transparency/beneficial-ownership-toolkit.pdf>.

² Financial Action Task Force, *Anti-money laundering and counter terrorist financing measures – United States*, Fourth Round Mutual Evaluation Report (2016), available at <https://www.fatf-gafi.org/publications/mutualevaluations/documents/mer-united-states-2016.html>.

³ *Id.* at 153.

⁴ *Id.* at 20, 118, 257.

owners—often wealthy foreign individuals—behind companies buying some of the most expensive real estate in the country.

Separately, in 2018, FinCEN issued a Final Rule requiring U.S. financial institutions and broker/dealers to identify beneficial ownership information of legal entity customers opening accounts. Just as these institutions perform “know your customer” checks on new individual customers, they have to ask basic questions of new corporate customers, including who their true beneficial owners are. This was a step in the right direction. But the primary responsibility for identifying the owners of a company cannot lie with banks. It should lie with the companies themselves, at the time of incorporation or when their ownership changes. And FinCEN’s rule does nothing to illuminate the ownership of shell companies incorporated in the U.S. that exclusively open bank accounts abroad, a route that many dirty companies have followed.

IV. The Harm

According to the 2018 National Money Laundering Risk Assessment (NMLRA), the U.S. government estimates that approximately \$300 billion in illicit proceeds from domestic financial crime is generated annually.⁵ Every year, criminals abuse the U.S. financial system to launder funds gained through narcotics trafficking, organized crime, the sale of counterfeit goods, fraud, and other criminal activities. Much of this dirty money is funneled through anonymous shell corporations. As the Treasury Department noted in the 2018 NMLRA:

Bad actors consistently use shell companies to disguise criminal proceeds and U.S. law enforcement agencies have no systemic way to obtain information on the beneficial owners of legal entities. The ease with which companies can be incorporated under state law, and how little information is generally required about companies’ owners or activities, raises concern about a lack of transparency.⁶

Law enforcement officials have—with increasing urgency—begun sounding the alarm about the systemic vulnerability caused by a lack of accessible beneficial ownership information. Just last month, FinCEN Director Kenneth Blanco testified before the Senate Banking Committee that the use of shell companies is “one of the most useful tools used by criminals to perpetrate their crimes, hide their proceeds, and subvert law enforcement.”⁷ An FBI official noted that “the

⁵ United States Department of the Treasury, *National Money Laundering Risk Assessment* (2018), available at https://home.treasury.gov/system/files/136/2018NMLRA_12-18.pdf.

⁶ *Id.* at 28.

⁷ *See Combatting Illicit Financing by Anonymous Shell Companies Through the Collection of Beneficial Ownership Information: Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 116th Congress (2019) (statement of Kenneth A. Blanco, Director, Financial Crimes Enforcement Network, U.S. Department of the Treasury), available at <https://www.banking.senate.gov/download/blanco-testimony-5-21-19>.

pervasive use of shell companies, front companies, nominees, or other means to conceal the true beneficial owners of assets is a significant loophole in this country's Anti Money Laundering (AML) regime.”⁸

During my tenure as OFAC Director and acting Under Secretary, I saw literally thousands of examples of terrorists, WMD proliferators, sanctions violators, narcotics traffickers, and other criminals moving money to fund their illicit goals. No matter what type of threat we were combating, U.S. shell companies were there. To cite just a few examples of the threat:

A. 650 Fifth Avenue

In 2008, the Justice Department filed a civil complaint alleging that a Manhattan skyscraper located at 650 Fifth Avenue was jointly owned by the Iranian government-controlled Alavi Foundation and Bank Melli, an Iranian financial institution first designated in 2007 pursuant to Executive Order 13382 for providing services to entities involved in Iran's nuclear and ballistic missile programs. Bank Melli's ownership interest in the building was disguised through the use of two shell companies, New York-incorporated Assa Corporation, which in turn was wholly owned by Assa Company Ltd., established in Jersey, an offshore UK-dependency. According to DOJ, Assa Company was in fact owned by Iranian citizens representing the interests of Bank Melli. Through its disguised ownership of 650 Fifth Avenue, the Iranian government was able to evade U.S. sanctions and illicitly funnel proceeds from the building back to Iran.⁹

B. The Panama Papers

Information released as a result of the “Panama Papers” leak demonstrate the lengths that tax evaders, money launderers, and other criminals will go to hide illicit funds through the use of shell companies. In 2015, an anonymous source leaked a vast trove of data, which revealed how the Panamanian law firm Mossack Fonseca used thousands of shell companies on behalf of tax cheats, international narcotics traffickers, as well as corrupt foreign politicians and other Politically Exposed Persons. The firm's U.S. subsidiaries also registered thousands of shells in U.S. states with lax or non-existent beneficial ownership requirements. When law enforcement officials sought to investigate some of these companies, the only beneficial information they could gather led back to Mossack Fonseca. Because the firm refused to cooperate, further investigation proved exceedingly difficult.¹⁰

⁸ See *Combating Illicit Financing by Anonymous Shell Companies Through the Collection of Beneficial Ownership Information: Hearing before the S. Comm. on Banking, Housing, and Urban Affairs*, 116th Congress (2019) (statement of Steven M. D'Antuono, Acting Deputy Assistant Director, Criminal Investigative Division, Federal Bureau of Investigation), available at <https://www.banking.senate.gov/imo/media/doc/D'Antuono%20Testimony%205-21-19.pdf>.

⁹ Press Release, United States Department of Justice, Manhattan U.S. Attorney Announces Settlement Relating to Iranian-Owned Manhattan Office Tower That Will Provide Recovery to Terrorism Victims (April 17, 2014), available at <https://www.justice.gov/usao-sdny/pr/manhattan-us-attorney-announces-settlement-relating-iranian-owned-manhattan-office>.

¹⁰ See Testimony of Steven M. D'Antuono, *supra* note 9.

C. ZTE

In 2016, the Commerce Department's Bureau of Industry and Security (BIS) added Chinese telecom manufacturer ZTE to the Entity List as a result of its efforts to reexport U.S.-origin dual-use goods to Iran. ZTE would later enter into a global resolution with U.S. regulators, paying over \$1 billion in penalties and submitting to a variety of remedial compliance measures. In order to conceal its illicit activities from U.S. investigators, ZTE established a series of shell companies to disguise the ultimate Iranian end-users of export controlled goods.¹¹

D. Khalid Ouazzani

In 2010, Khalid Ouazzani of Kansas City, Missouri, pleaded guilty to conspiracy to provide material support to a terrorist organization. As part of his scheme to fundraise for al-Qaeda, Ouzzi created a company incorporated as Hafssa LLC but doing business as Truman Used Auto Parts to fraudulently obtain a \$175,000 commercial loan from a U.S. bank. He used these funds to purchase an apartment in the United Arab Emirates; he later donated \$17,000 generated from the sale of the apartment to al-Qaeda. Ouzzani also sent funds generated from the sale of his business to the bank account of a co-conspirator who donated \$6,500 to al-Qaeda on Ouzzani's behalf.¹²

V. Widespread Support for Beneficial Ownership Requirements

Experts from across the political spectrum and in every key sector have called for action to address the threat from shell companies, including business associations, anticorruption and human rights NGOs, law enforcement groups, and state officials. The Financial Accountability & Corporate Transparency (FACT) Coalition has gathered endorsements for beneficial ownership transparency from dozens of these organizations and individuals, including the American Bankers' Association, National Association of Realtors, National District Attorneys Association, National Fraternal Order of Police, Freedom House, Human Rights Watch and many others.¹³ The FACT Coalition also recently released a letter from 91 bipartisan national security professionals, including myself, to the House Financial Services Committee, urging the adoption of beneficial ownership legislation.¹⁴

¹¹ Additions to the Entity List, 81 Fed. Reg. 12004 (March 8, 2016), *available at* <https://www.govinfo.gov/content/pkg/FR-2016-03-08/pdf/2016-05104.pdf>.

¹² FACT Coalition, "FACT Sheet: Anonymous U.S. 'Shell' Corporations: A National Security Code Red" (April 10, 2014), *available at* https://thefactcoalition.org/fact-sheet-anonymous-u-s-shell-corporations-national-security-code-red?utm_medium=policy-analysis/fact-sheets.

¹³ FACT Coalition, "Endorsements for Beneficial Ownership Transparency" (June 10, 2019), *available at* https://thefactcoalition.org/endorsements-beneficial-ownership-transparency?utm_medium=policy-analysis/briefing-memos.

¹⁴ FACT Coalition, "Bipartisan Letter from 91 National Security Experts Urging Lawmakers to End Anonymous Companies" (June 10, 2019), *available at* <https://thefactcoalition.org/bipartisan-letter-from->

VI. Addressing Concerns

Let me briefly address some of the concerns expressed regarding the various beneficial ownership proposals floated in the past several years.

First, it is alleged that requiring companies to report beneficial ownership information would be unduly burdensome for small businesses. The reality is that the vast majority of firms in the United States do not have complex ownership structures of the type that might make gathering beneficial ownership information difficult. According to the U.S. Census Bureau's 2016 Annual Survey of Entrepreneurs, 94% of firms with paid employees have fewer than 5 owners, a number which does not include firms owned by a parent company or other entity.¹⁵ Completing a beneficial ownership form for such small companies should be a negligible burden.

Furthermore, small business owners suffer from the abuse of anonymous companies. Earlier this year, a federal judge in the Southern District of Florida ordered the Woodbridge Group of Companies LLC and its former owner to pay \$1 billion in penalties and disgorgement as a result of a \$1.2 billion dollar Ponzi scheme. The former owner, who was arrested in April, is alleged to have funneled proceeds of the scheme through a web of shell companies, ultimately defrauding thousands of real estate investors, including many seniors who had invested their retirement savings.¹⁶ Improved beneficial ownership requirements would allow law enforcement to more easily identify and stop fraudsters who seek to bilk Americans out of their hard-earned savings.

Second, some have criticized beneficial ownership requirements on federalism grounds, claiming that gathering beneficial ownership information should be left up to the states. Unfortunately, this would perpetuate the race-to-the-bottom system that exists today, where those seeking to establish shell companies flock to jurisdictions gathering the least amount of information. In fact, under the current system in many jurisdictions, establishing a shell company requires less information than signing up for a library card.¹⁷ Law enforcement agencies would be required to sift through inconsistent and often incomplete state-provided data of varying levels of reliability. These gaps allow criminals to slip through the cracks to mask their ownership, hiding behind

[91-national-security-experts-urging-lawmakers-to-end-anonymous-companies?utm_medium=policy-analysis/letters-to-congress/related-letters.](https://www.fintegrity.org/report/the-library-card-project/)

¹⁵ United States Census Bureau, Annual Survey of Entrepreneurs – Characteristics of Business (2016), available at <https://www.census.gov/data/tables/2016/econ/ase/2016-ase-characteristics-of-businesses.html>.

¹⁶ Press Release, Securities and Exchange Commission, Court Orders \$1 Billion Judgement Against Operators of Woodbridge Ponzi Scheme Targeting Retail Investors (Jan. 28, 2019), available at <https://www.sec.gov/news/press-release/2019-3>.

¹⁷ Global Financial Integrity, *The Library Card Project: The Ease of Forming Anonymous Companies in the United States* (March 2019), available at <https://gfintegrity.org/report/the-library-card-project/>.

nominee directors or shareholders or other intermediaries.¹⁸ As recommended by FATF, gathering beneficial ownership information at the federal level would allow law enforcement the timely access to information they need in order to keep our country secure.

Third, some claim that requiring the provision of beneficial ownership information at the company formation stage would unnecessarily infringe on Americans' privacy rights. While countries such as the United Kingdom have established public beneficial ownership registries, I do not believe that such a step is necessary. The key is to ensure that the information exists in a secure database where it can be accessed by law enforcement agencies when they have a legitimate investigatory purpose.

VII. Conclusion

It is time for Congress to act against the threat posed by the criminal exploitation of anonymous companies. The U.S. has made tremendous strides post-9/11 in hardening our financial system against exploitation by terrorists and criminals. It is imperative that law enforcement have access to beneficial ownership data where appropriate to take on the array of significant threats that we face.

I hope Congress will take this opportunity to address this serious vulnerability and give our law enforcement and national security professionals the information they need to protect us and our financial system.

¹⁸ FATF – Egmont Group, *Concealment of Beneficial Ownership 5* (2018), available at https://www.egmontgroup.org/sites/default/files/filedepot/Concealment_of_BO/FATF-Egmont-Concealment-beneficial-ownership.pdf.