

February 6, 2018

Senate Judiciary: Beneficial Ownership: Fighting Illicit International Financial Networks Through Transparency

The Senate Judiciary Committee held a full committee hearing to examine beneficial ownership as a means of combating funding and payment flows to illicit international crime networks. In the two-panel hearing, five witnesses presented testimony:

**Panel I**

1. **Mr. Kendall Day**, U.S. Department of Justice

**Panel II**

1. **Mr. Gary Kalman**, FACT Coalition
2. **Mr. Chip Poncy**, Financial Integrity Network
3. **Mr. Brian O'Shea**, Senior Director, Center For Capital Markets Competitiveness, U.S. Chamber of Commerce
4. **Mr. Clay Fuller**, American Enterprise Institute

## Opening Statements

**Chairman Chuck Grassley (R-IA)** expressed disappointment that the Treasury Department did not provide a witness for the hearing, despite previous promises to do so. Revenue is the lifeblood of transnational criminal organizations, and these criminals need to find ways to launder their ill-gotten gains. While dirty money often comes from the most corrupt countries around the globe, it often ends up in the U.S. because of our rule of law, respect for property rights, and stable financial system. He recalled previous hearings in the Drug Caucus, in which experts pointed to the importance of incorporation in the United States. Further, a recent Treasury report estimated that around \$300 billion in illegal proceeds is generated annually within the U.S. Over the past few years, money has flooded into the U.S. as the UK and other European countries have enacted laws and regulations to improve beneficial ownership transparency. The U.S. has fallen behind our friends overseas in the area of beneficial ownership, and is second behind only Switzerland as the most secretive and non-transparent country in the world. Bad actors from all over the world come here for a financial safe haven; this issue impacts our national security. He described DOJ prosecutions of Iran-based groups financing illicit acts through Manhattan real estate purchases, adding that secretive beneficial ownership laws help prop up corrupt countries. In the defense industry, anonymous companies can obtain contracts with DOD; he recalled an Afghan company contracted to supply our troops that was secretly owned by the Taliban. Likewise, the real estate market poses threats. Real estate prices have tripled in New York, driven in part by anonymous shell companies.

**Senator Sheldon Whitehouse (D-RI)** associated himself with all of Grassley's remarks, stating that this is a very bipartisan process. The Panama and Paradise papers exposed what we already knew: kleptocrats, terrorists, and others routinely use shell companies to hide assets and fund illegal activities. Thanks to

our lax laws, the U.S. is now a haven for money laundering. We are a facilitator as well as a target in this racket. A shell corporation serves no economic purpose and does no business, but merely hides the true human owners. FinCEN found that 30% of cash purchases of high-end real estate by shell companies in 6 major cities involved a suspicious buyer. As Grassley pointed out, this is affecting and warping the real estate market. The answer is simple: require private corporations to report and update their true beneficial ownership information, and make this information available to law enforcement. This is what the [TITLE Act](#) does. He cited numerous instances previous testimony touting the importance of beneficial ownership, and the lack of this information as a critical vulnerability. Transparency in business ownership is not a novel idea, and the rest of the world is moving ahead. The UK has already implemented its own transparency law. Our European partners are doing their part to combat crime facilitated by shell corporations. We don't want America to be a bigger, better Cayman Islands—we want it to stand for something.

## Panel 1- Witness Statements

**Mr. Kendall Day** stated that money laundering facilitates some of the most serious threats to our nation's safety and security. Money laundering is estimated at \$2 trillion annually, and its threat to the U.S. is acute and specific. Here, we enjoy some of the deepest, most liquid, and most stable financial markets in the world. This attracts trade and investment, but also attracts criminals. Criminals exploit gaps and vulnerabilities in existing laws and regulations, and the ability to conceal beneficial ownership is one of the biggest loopholes in our regime. Determining the true ownership of assets can require law enforcement investigation and may be a very time-consuming process. While it will soon change, the lack of a legal requirement to collect beneficial ownership information harms banks' ability to guard against money laundering. Proper law enforcement access to beneficial ownership information will allow DOJ to bring more cases and act more quickly. Legislative attention to this issue will reduce U.S. vulnerability and will bring us into compliance with international AML and counterterrorism standards.

## Panel 1- General Questions

**Chairman Chuck Grassley (R-IA)** asked Day to discuss the particular problems the lack of beneficial ownership information creates in law enforcement investigations, and whether these issues come up in other types of investigations. Day stated that this information does come up in other cases, as most crimes rely on the ability to move money. Discussing law enforcement investigations, Day described an example involving high-end real estate purchased with drug money. The process of obtaining subpoenas to determine layers of corporate ownership can take weeks or months, thus delaying other investigative steps. Having a depository of such information would help law enforcement bring more cases more quickly. Grassley then asked about the May 2016 FinCEN final rules concerning beneficial ownership. The rule requires financial institutions to identify natural people owning (directly or indirectly) 25% or more of the equity interest and those with significant control. Covered financial institutions will have to comply with this rule, beginning May 11, 2018. Grassley asked how this will help law enforcement, and whether this regulation is enough. Day replied that this is helpful, but because it is just limited to bank accounts and does not extend to incorporation information, it can only take us so far. Grassley stated that the TITLE Act would require Secretaries of State to hold beneficial ownership information, and asked how a more uniform structure for information would assist law enforcement. Day replied that the early access to information would allow law enforcement to bring more cases and have a higher impact.

**Senator Sheldon Whitehouse (D-RI)** asked whether Day feels that it is necessary for beneficial ownership information to be made public, or whether its collection is sufficient. Day replied that the law enforcement point of view stresses the importance of law enforcement access. Whitehouse asked whether the IRS SS-4 form provides an adequate alternative to beneficial ownership information. Day replied that it does not, as it is insufficient for law enforcement purposes. Whitehouse referenced Day's testimony that money laundering undermines our rule of law and democracy by supporting corruption and organized crime. He asked Day to elaborate on this point. Day stated that the U.S. is at risk of falling behind our counterparts who are implementing beneficial ownership regimes; we also become more of a haven for criminals.

**Senator Amy Klobuchar (D-MN)** reviewed the beneficial ownership issue from her perspective as a former prosecutor. Day described the prosecutor process of attempting to obtain corporation information, though this often must be repeated several times as new front companies are discovered. Each time this process is repeated, weeks are spent trying to uncover new information. Klobuchar expressed interest in the way the luxury real estate market is used to launder money, and asked whether the anonymity associated with shell companies used to buy real estate harms law enforcement investigations. Day replied that this does impede investigations, and agreed that it would be helpful for Treasury to use its existing authority to promote more greater transparency. He noted that FinCEN's geographic targeting process has focused on this issue. Klobuchar noted her priority focus on human trafficking, stating that it is in the top three criminal enterprises in the world. She noted that while the aggregate revenue of trafficking can be large, the amount held by individual traffickers can be small and easy to conceal. She asked Day to speak to how traffickers take advantage of our financial system to conceal their crimes, and how beneficial ownership transparency would help track trafficking. Day agreed that individual trafficking accounts may be low, beneficial ownership information would allow us to see the aggregate structure and broader network.

**Senator Chris Coons (D-DE)** asked what efforts behind customer due diligence rules are currently being reviewed by DOJ. Day agreed that a complexity of this issue is who holds the responsibility of gathering information and where it is stored. Day noted that a federal repository (likely held at FinCEN) would be subject to federal standards and is familiar already to law enforcement. Coons asked whether Congress should align any beneficial ownership definition with what exists in the customer due diligence rule. Day stated that the definition will soon become clearer when the rule comes alive in May; at that time, any discrepancies will become apparent. Coons asked whether Day agreed that there is some concern with regard to new, smaller entities frequently reporting beneficial ownership information. Day replied that law enforcement understands the importance of not interfering with legitimate businesses, and that the focus is on shell companies.

## Panel 2- Witness Statements

**Mr. Gary Kalman** stated that in the U.S., one can form a company without naming the natural person profiting from the company. This is problematic—he cited opioid trafficking companies benefiting from anonymity to contribute to the opioid crisis. He noted the 2016 Global Fraud Survey, in which 91% of CEOs agree that it is critically important to know the person profiting from a company. Kalman also cited the example of the Taliban-owned Afghan company contracting with DOD. There is meaningful progress being made; the UK has a database up and running, and the EU has adopted plans for member-states to collect beneficial ownership information. The global trend is toward transparency. Numerous

players in the U.S. including FSR, ABA, NAFCU, CUNA, and others all support the collection of beneficial ownership information. He also stated that the current definition is easy to understand and apply. He quoted the Small Business Majority in saying that their membership does not find reporting true owner information to be burdensome. The TITLE Act is a necessary first step to modernizing our regime.

**Mr. Chip Poncy** stated that the TITLE Act provides a basis for company information reform. In considering the need for urgent action, Poncy recalled that we have been here before—beneficial ownership bills have died in Congress in previous years. Some consider that the solution should lie elsewhere—in due diligence reform or greater law enforcement effort. Others feel that beneficial ownership information would be costly. And some distort the true costs and benefits of such a solution. Poncy warned against being paralyzed by such views, stating that beneficial ownership information is a true complement to customer due diligence efforts. He stated the importance of a clear definition that ensure accountability for at least one natural person per each entity created. This information should be verified through documentation, and should be updated in a timely fashion. Law enforcement should have real-time access to this information through a centralized database. He recommended exempting companies that pose little risk, but levying heavy fines on companies that do not comply.

**Mr. Brian O’Shea** stated that the Chamber of Commerce is as committed as any to combating criminal behavior, but added that our nation has strong history of balancing law enforcement efforts with the right to privacy. Any legislation put forward to combat illicit financing must be targeted and must do more to deter illicit activity than it will to dissuade legitimate commerce. Many beneficial ownership proposals in recent years, especially the TITLE Act, do not strike this balance. The TITLE Act would impose onerous burdens on small businesses, and goes far beyond what is generally referred to as a shell company. The TITLE Act’s definition of who is a beneficial owner is very large and vague, causing small businesses to rely on costly outside counsel to determine to whom the definition applies. The legislation also requires small business owners to continually report and update personal information. Such updates of any changes in this information must be reported within 60 days of the change taking place, even though the business owner may not be aware of such smaller changes like new addresses. O’Shea pointed to the retention of personal information associated with millions of small businesses as a potential threat, and stated that the bill would distract from the important mission of keeping bad actors out of our financial system.

**Mr. Clay Fuller** stated that anonymously held companies are currently the most widely-used vehicle for securing illicit networks. Registry of beneficial owners is a pragmatic and necessary step, though Congress should be careful to retain privacy rights of individuals. Most legislative proposals in Congress restrict database access to law enforcement and financial institutions. This is the right move, and strikes an important balance of removing legal anonymity while preserving individual privacy. Fuller drew a string distinction between individual privacy and legal anonymity. Anonymity can have benefits in the press and other areas, but Fuller stated that he is not aware of any legal or economic benefits stemming from strict anonymity. Fuller believes that if beneficial ownership information is made public, it could encourage international and domestic witch hunts. Illicit financial networks are increasingly global in network, as are the financial institutions they infiltrate. Thus, the structure of the registry should reflect the structure of these networks: they should be at the federal level and in cooperation with international partners such as FATF.

## Panel 2- General Questions

**Chairman Chuck Grassley (R-IA)** asked whether the TITLE Act improves transparency, and how improved transparency is helpful. Mr. Kalman stated that it does improve transparency, as there is no state in the country collecting this type of information. This lack of collection has posed significant difficulties for law enforcement. He agreed with Mr. Fuller that privacy is not violated, but anonymity that poses a danger to our society is eliminated. Grassley asked about burdens to small businesses. Mr. Kalman stated that while he is not a small business owner, he has members who have current concerns about losing bids to anonymous companies (who have no intention of fulfilling contracts). Also, small businesses do not always have due diligence capabilities to know when they are contracting with scam artists housed in anonymous companies. These issues indicate that the benefits of beneficial ownership information far outweigh any burden.

**Senator Sheldon Whitehouse (D-RI)** asked what the scale is for the shell corporation/money laundering market. Mr. Kalman stated that the anonymity and secrecy of the financial system makes it difficult to estimate, but he guessed that the overall money flowing through a shadow financial system is around \$8 trillion. Another study estimates that \$1 trillion leaves the developing world every year. Whitehouse posited that much of this figure flows from countries without rule of law. Whitehouse noted Mr. O'Shea's concern about burden on small businesses, but pointed out that the requirement is merely an additional line on a form. He asked why this would be too burdensome. Mr. Poncey agreed that it is important to look at burden, and review the information required to open a bank account as an indicator.

**Senator Mike Lee (R-UT)** asked why we should think that it would be a significant number of criminals who would provide the correct beneficial ownership information when they register their companies, knowing that they will be involved in criminal enterprises. Mr. O'Shea agreed that this is important, and added that the TITLE Act includes no principles requiring verification of information submitted. Thus, we know that all of the good guys are going to do the right thing and pay associated costs, but we will not address the problem. Lee agreed that this system would only serve to punish those already abiding by the law. Lee also posited that those who engage in anonymous speech through corporations would be burdened by the need to submit ownership information. Mr. O'Shea agreed that it would be burdensome, and reiterated that companies would need to rely on a third party to make updates and changes.

**Senator Richard Blumenthal (D-CT)** clarified Mr. O'Shea's contention as centering on the fact that people must form a corporation to engage in anonymous speech. He asked why this would be the case. Mr. O'Shea pointed to past Supreme Court precedent as making this a preferred route to do so. Blumenthal stressed that while incorporating is one form of engaging in anonymous speech, it is not required. Thus, the balance is between preserving an option to engage in anonymous speech and the benefits of having disclosure of criminal elements who use the corporate form to launder money. Mr. Kalman noted that the bill is going after shell companies, and is targeted at the most-abused form of incorporation. Thus, it is not going after the political speech portion. The bill gets rid of anonymity but preserves privacy, and is a very targeted first step that does not include the type of entity used by people engaging in political speech. Mr. Poncey stated that beneficial ownership information would assist in tracking Russian kleptocrats and organized crime. In response to the concern that bad guys lie, Poncey noted that of course they lie, but the question lies in whether the person lying for them is held

accountable. Having dissuasive penalties, as the TITLE Act does, is essential to ensuring that people are held accountable. Mr. O'Shea argued that the bill does not achieve an adequate balance between competing interests.

**Senator Chris Coons (D-DE)** asked about aligning definitions. Brian O'Shea pointed to the importance of a strict definition. He pointed to FinCEN's 25% rule, as well as their warning against a vague and broad definition. As a starting point, O'Shea recommended limiting the number of beneficial owners that need to be reported, as the TITLE Act currently does not do. Mr. Kalman noted that the number required by the TITLE Act is not unlimited, though it could be large. He further pointed out that the Senate already adopted the definition of beneficial owner from the NDAA, and noted that this is a strong, clear definition and a good place to start. Coons worried about the potential chilling effect on venture capital, and also expressed concern about the responsibility of state governments to store personally identifiable information. He asked what safeguards the TITLE Act includes to ensure the safety of such information. Mr. Fuller agreed that the more fragmented a data collection structure is, the more difficult it will be to leverage the information. Coons asked whether it would be better to have a single federal database. Fuller replied that a 50-state system increases the potential loopholes for criminals to jump through.

**Senator John Kennedy (R-AL)** also expressed concern with the state model, as well as the possibility of harming those who simply want to maintain privacy. He asked why we would punish the 99% of people who do things correctly to catch the 1% who don't. Mr. O'Shea recalled a November hearing in the House on similar legislation, in which it was discovered that states would have to redo all their incorporation forms. Kennedy stated that this is not problematic, but states do not have the resources to inspect and verify all the information submitted. O'Shea agreed with this concern. Mr. Kalman agreed that there have been several approaches, and noted that both federal and state approaches have merits. The state approach requires the least amount of change, but the federal approach offers centralization and ease of access to law enforcement. He stated that this information is not meant to be public. Kennedy argued that the government would have the information, and stated that Kalman must have missed a day in history class, failing to learn that governments can misuse information.

**Senator Mike Lee (R-UT)** asked whether the bill exempts 501(c)4s. Mr. Kalman stated that it does. Mr. Poncey agreed that all nonprofits are exempt. Lee stated that he is not sure of this; his understanding was that (c)4 companies are not exempt. Kalman then clarified that the bill refers to "charitable organizations," which could potentially be interpreted as 501(c)3 organizations, but the intent of the bill was to include 501(c)4 organizations as well. Lee stated that he understands the problem, which is that corporate forms are sometimes abused to serve illicit purposes. That said, we must create solutions that do not unduly burden or chill free speech. We can start by expanding the exemptions for nonprofits; he stated that he cannot possibly support the bill in its current form.

**Senator Sheldon Whitehouse (D-RI)** asked Mr. O'Shea to submit the Chamber's proposal for a solution. He doesn't want to be in a position in which the Chamber is unsupportive of any proposal, with no solution of its own, until the issue eventually dies out. He stated that powerful interests oppose this idea because they can make significant money servicing illicit markets. If the Chamber's issues are technical, he encouraged them to show their ideas to the Committee, given the strong national security issues at stake. He thanked the witnesses for their testimony and adjourned the hearing.