

Testimony of Assistant Secretary for Terrorist Financing David S. Cohen

United States Department of the Treasury

Senate Committee on Homeland Security and Governmental Affairs

“Business Formation and Financial Crime: Finding a Legislative Solution”

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I. Introduction

Chairman Lieberman, Ranking Member Collins, distinguished members of the Committee, thank you for inviting me to testify today. I am pleased to have the opportunity to present the Department of the Treasury’s views on the global challenge of enhancing access to beneficial ownership information in order to combat the abuse of legal entities by those engaging in financial crime.

I would like to begin by thanking Senator Levin for his leadership on this important and pressing topic, and for raising awareness in the U.S. and globally of an issue that is of paramount importance in our efforts to combat financial crime. I would also like to extend my appreciation to colleagues across the government and private sector, here at home and internationally, who have worked with the Department of the Treasury and invested a tremendous amount of time and energy in attempting to address the challenges of making beneficial ownership information more readily available.

My colleagues across the Department of the Treasury, including from the Office of Terrorism and Financial Intelligence, Domestic Finance, International Affairs and Tax Policy, have all contributed to Treasury’s thinking on how best to require the disclosure of beneficial ownership information in a way that effectively combats the criminal misuse of legal entities while, at the

same time, ensuring that we do not unduly complicate the company formation process, which plays such an important role in our nation's economic prosperity. I look forward today to outlining Treasury's approach to this critically important and difficult challenge, explaining the basis for our current thinking, and offering the Administration's views on S. 569, the "Incorporation Transparency and Law Enforcement Assistance Act".

At the outset, it is important to recognize a number of key considerations that have informed our thinking:

First, the ability of criminal and other illicit actors to form corporations in the United States without disclosing their true identity presents a serious vulnerability. It creates a pathway for criminal actors to gain access to the international financial system, and creates significant obstacles in our ability to investigate financial crime. As I will explain, there is ample evidence that criminal organizations and others who threaten our national security exploit this vulnerability.

Second, information on the true beneficial ownership of a legal entity – at the time a business is formed, as ownership changes during its lifespan, and when it seeks to open accounts at financial institutions – is critical to stopping the exploitation of legal entities by criminal actors.

Third, the challenge of enhancing access to the beneficial ownership information of legal entities is complex and requires a global solution. While we work within the Administration and with Congress to address this issue domestically, Treasury is also working with our foreign counterparts to improve global understanding and capability to address this challenge worldwide.

Fourth, in seeking to make beneficial ownership information available in ways that effectively address the misuse of legal entities, we are keenly aware of the need to preserve an efficient and straightforward entity formation process in the United States, and not to create

unnecessary impediments to accessing the financial system for the vast majority of new and existing businesses that pose no threat whatsoever.

Finally, because we are starting from a situation in which beneficial ownership information is not required at the time of company formation, we believe that even incremental progress in this area is likely to yield substantial positive results.

These considerations inform and shape our views on S. 569. This bill addresses a key issue – namely, helping ensure that information on the beneficial ownership of legal entities created in the United States is readily available to law enforcement for investigative purposes. As I will explain in detail, the Administration believes that S. 569 is an important step in the right direction on this issue, and provides a useful platform on which to construct an effective legislative solution, provided that it is amended and modified in the manner that I describe below. We are fully committed to working with the Congress and our interagency partners to craft legislative text to amend the Bill in order to address our concerns.

My testimony will focus on the following three areas:

- (i) The ways in which lax company formation laws are abused by criminals to perpetrate crime while hiding behind the corporate form;
- (ii) Treasury’s comprehensive approach to enhance access to information on the beneficial ownership of legal entities; and
- (iii) Our views on S. 569, in particular the amendments and modifications that we think are necessary to craft legislation that will effectively and efficiently enhance the availability of beneficial ownership information of legal entities created in the United States.

II. Challenges Posed by the Misuse of Legal Entities

In order to develop an effective way forward in combating the criminal abuse of legal entities through enhanced access to beneficial ownership information, it is essential at the outset to recognize and balance the substantial threat presented by the abuse of legal entities to facilitate financial crime, and the countervailing importance of maintaining efficient processes in creating legal entities and in promoting access to financial services.

The substantial threat presented by abuse of legal entities to facilitate financial crime

Criminal organizations abuse legal entities to obscure the beneficial ownership and control of businesses they operate. This allows criminal actors to gain access to the international financial system – because the true risk associated with providing accounts to these entities is masked – and thus facilitates financial crime. Years of research and law enforcement investigations have conclusively demonstrated the link between the abuse of legal entities, on the one hand, and, on the other hand, WMD proliferation, terrorist financing, sanctions evasion, tax evasion, corruption and money laundering for virtually all forms of serious criminal activity.¹

As these reports and investigations indicate, this abuse is particularly prevalent with respect to legal entities created in the United States. We know how easy it is for illicit actors around the world to create a legal entity in the United States. And we know that these actors then use the presumed legitimacy of a US-based entity to gain access to the international financial system and disguise the source of their funds or the purpose of their financial transactions. We also know that some disreputable company formation agents in the United States have facilitated

¹ See, e.g., 2007 National Money Laundering Strategy at 63-65; "Potential Money Laundering Risk Related to Shell Companies," FinCEN, FIN-2006-G014, November 9, 2006; S.539, 111th Cong. 1st Session, Section 2 Findings; Senate Committee on Homeland Security and Governmental Affairs: 'Examining State Business Incorporation Practices: A Discussion of the Incorporation Transparency and Law Enforcement Assistance Act.' June 18th, 2009: http://hsgac.senate.gov/public/index.cfm?FuseAction=Hearings.Hearing&Hearing_ID=ef10e125-2c1d-4344-baf1-07f6061611c1; House Committee on Financial Services: 'Capital Loss, Corruption, and the Role of Western Financial Institutions.' May 19th, 2009. http://www.house.gov/apps/list/hearing/financialsvcs_dem/hrfc051309.shtml

this activity by promoting the ease of setting up a legal entity – in some cases it can be done in a matter of minutes – together with techniques that legally enable individuals behind the legal entity to maintain anonymity even when the legal entity becomes the subject of a criminal investigation.

These practices have been highlighted in a number of public reports, such as the 2006 GAO Report on Company Formation, the 2006 Financial Crimes Enforcement Network (FinCEN) Guidance on Potential Money Laundering Risk Related to Shell Companies, and the 2007 National Money Laundering Strategy. The two prior hearings on beneficial ownership held by this Committee and the Permanent Subcommittee on Investigations also provided detailed testimony from the Department of the Treasury, the Department of Justice, the Department of Homeland Security, the New York District Attorney and others on the extent of this problem.

These reports, and the testimony previously presented to this Committee and its subcommittee, are replete with examples of how criminals and other illicit actors abuse the lax company formation processes in the United States to facilitate their endeavors. These reports and prior testimony from the Treasury Department and other agencies describe in great detail how our existing company formation laws undermine efforts to promote transparency across the international financial system and impede investigations of significant cases of money laundering, terrorist financing, and other financial crime.

It is important to note, however, that the United States is not alone in grappling with this question. Jurisdictions all over the world continue to struggle to find ways of making meaningful beneficial ownership information about legal entities available to relevant authorities. The Financial Action Task Force (FATF), the international policy and standard-setting body for combating financial crime, has issued an international standard stating that “[c]ountries should ensure that there is adequate, accurate, and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.” Out of over 125 jurisdictions assessed against this standard

by the FATF, FATF-Style Regional Bodies, the International Monetary Fund or the World Bank, the overwhelming majority have failed to substantially comply. In the case of legal entities created in the United States, the FATF has stated that “there are no measures in place to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.” Bringing our company formation laws in line with FATF’s standards is an important objective, especially when, as here, it reinforces a clearly articulated law enforcement priority.

The importance of maintaining efficient processes in creating legal entities and in promoting access to financial services

In working to enhance access to beneficial ownership information, Treasury is also mindful of the very significant interests in preserving efficient processes in creating legal entities and in promoting access to financial services, both of which are essential to a well-functioning economy and the efficient operation of the domestic and international financial system. Foreign and domestic persons with legitimate economic interests rely upon the ability to create legal entities quickly and easily for a variety of entirely beneficial and lawful reasons. In addition, ensuring the ability of legal entities to open bank accounts and otherwise access financial services facilitates entrepreneurship, economic growth and development. In considering ways to enhance the availability of beneficial ownership information of legal entities, we must be careful not to infringe on these entirely legitimate, and fundamentally important, interests.

III. Treasury’s Comprehensive Approach to Enhance Access to Beneficial Ownership Information of Legal Entities

The Department of the Treasury has been focused for several years on the question of how best to enhance access to beneficial ownership information to combat the abuse of legal

entities, and we are currently pursuing a three-pronged approach to advance these interests. Our approach generally balances the need to enhance access to beneficial ownership information of legal entities with the need to maintain efficient processes in creating legal entities and in promoting access to financial services. Our comprehensive approach includes the following elements:

- ***Enhance the availability of beneficial ownership information of legal entities created in the United States:*** Promote legislation that requires (a) the submission of beneficial ownership information at the time of company formation; (b) the obligation to keep that information updated throughout the entity's existence; and (c) the availability of that information upon proper request by law enforcement. To ensure compliance, the legislation must impose significant penalties for failure to abide by these requirements. We are focusing our current efforts on working with our interagency partners and the Congress to amend S. 569 so that it more effectively and efficiently accomplishes these goals.
- ***Clarify and strengthen customer due diligence requirements for U.S. financial institutions with respect to the beneficial ownership of legal entity accountholders:*** Treasury is currently working with the federal financial regulatory agencies to consider guidance for U.S. financial institutions that will clarify when and how financial institutions should identify and verify beneficial ownership as a component of conducting customer due diligence of accountholders that are legal entities. We are also working with the regulatory and law enforcement communities, and consulting with the private sector, to determine whether and, if so, how such due diligence requirements should be strengthened through rulemaking or otherwise.
- ***Clarify and facilitate global implementation of international standards regarding beneficial ownership:*** In 2003 the FATF reviewed and updated its 40 Recommendations for jurisdictions to implement appropriate countermeasures against money laundering. Three of those Recommendations – Recommendations 5, 33 and 34 – specifically address obtaining beneficial ownership information. These Recommendations, however, have created implementation challenges for the overwhelming majority of

jurisdictions around the world. As we move forward in addressing the issue of beneficial ownership in the United States, we are also working with our counterparts in the FATF to ensure that its standards evolve in a way in which compliance is both achievable and effective. Even if we make progress domestically, failure to achieve consistency internationally will merely shift the locus of the problem to another jurisdiction and fail to address the problems that flow from lack of beneficial ownership transparency.

IV. Amending S. 569 to Enhance the Availability of Beneficial Ownership Information of Legal Entities Created in the United States

The Treasury Department clearly recognizes the need for federal legislation to enhance the availability of beneficial ownership information of legal entities created in the United States. The gravity and complexity of the ongoing abuse of legal entities by a broad spectrum of criminals and others who threaten our national security demand nothing less. And we view S. 569 as a productive step in the direction of requiring the availability of meaningful beneficial ownership information about legal entities created in the United States. We believe that with modifications, S. 569 could serve as the appropriate legislative vehicle to address this issue.

I also want to be clear that Treasury recognizes that there is no perfect solution to this complex problem. Whatever action we take will not prevent all criminals from misusing legal entities to perpetrate financial crime. And whatever action we take will entail some cost and burden in the company formation process. Our goal is meaningful progress, capitalizing on what we have learned over the past few years in studying this problem, and laying the groundwork for future action if it proves necessary.

While Treasury fully supports the objective of enhancing law enforcement access to beneficial ownership information of legal entities created in the United States, in order for us to support S. 569, we believe it must be amended to address the following key issues:

- ***Clarify and limit the beneficial ownership definition and corresponding information disclosure requirements:*** Under S. 569 as currently drafted, the ambiguity and breadth of the definition of beneficial ownership, coupled with burdensome disclosure requirements, makes compliance uncertain, time-consuming and costly. The definition and application of beneficial ownership information requirements should be sufficiently straightforward and simple in application to work for the full range of covered legal entities – from small, start-up businesses to large, complex legal entities – and regardless of whether the applicant is a foreign or U.S. person.
- ***Eliminate expansion of anti-money laundering obligations to company formation agents in favor of broader civil and criminal federal liability for noncompliance:*** As currently drafted, S. 569 would effectively require Treasury to subject attorneys who provide company formation services for their clients to anti-money laundering regulation, thereby raising substantial legal, policy and practical challenges. Subjecting company formation agents in general to such regulation would also present tremendous administrative challenges for Treasury, largely due to the lack of an existing functional regulator for this industry. We believe S. 569 should not attempt to regulate company formation agents under the Bank Secrecy Act, but instead should establish clear and significant federal criminal and civil liability for persons who fail to provide accurate beneficial ownership information as required by law.
- ***Establish documentation requirements:*** As currently drafted, S. 569 does not establish any documentation requirements for beneficial owners who are U.S. persons, although it does require foreign persons to provide a copy of a passport page on which the beneficial owner’s photograph appears. In our view, S. 569 should require robust documentation for all beneficial owners, foreign and domestic, to be held within the State and made available upon proper demand by law enforcement. Generally, that documentation would be a credible and legible copy of government-issued photographic identification, such as driver’s license or a passport.

- ***Require further study of illicit finance vulnerabilities associated with the transfer of legal entities and potential solutions for updating beneficial ownership information:*** S. 569 allows for company formation applicants to update their beneficial ownership information in an annual filing with the State. This time gap introduces a significant vulnerability for abuse upon the transfer of a legal entity and requires further study.
- ***Preserve State Homeland Security Grant funds:*** As currently drafted, S. 569 authorizes States to use State Homeland Security Grant funds to carry out the obligations imposed by the Bill. These funds, however, are already relied upon by States to finance first responders in preparing for and responding to emergency situations. In our view, S. 569 should not authorize States to draw from the State Homeland Security Grant program to defray the costs of implementation.

Based on recent discussions with our interagency partners and the Congress, we firmly believe that S. 569 can be amended to address these key issues. We are fully committed to working with our interagency partners and the Congress to make this happen, and we have already begun to draft proposed legislative text to address the five concerns I have described above.

V. Conclusion

Looking ahead, Treasury intends to make progress on each of the elements of our comprehensive beneficial ownership strategy to address the abuse of legal entities in facilitating all forms of financial crime:

- Treasury will work in earnest with the Congress and our interagency partners to have S. 569 amended along the lines described above in order to enhance the availability of beneficial ownership information of entities created in the United States in an effective and workable manner.

- In consultation with the federal financial regulators, Treasury will be considering guidance to the financial community, and will consider engaging in rulemaking, to clarify and enhance customer due diligence obligations for financial institutions regarding the identification and verification of beneficial ownership information of legal entity accountholders under a risk-based approach.
- Treasury will continue to work with the Financial Action Task Force to clarify and facilitate implementation of international standards addressing beneficial ownership, building from our domestic experience.

Although we know that there is still much to do, we have seen tremendous progress over the last several years. We have developed and are moving forward with a comprehensive approach to address the challenges of beneficial ownership. With respect to the particular challenge of enhancing the availability of beneficial ownership information of legal entities created in the United States, we have moved from discussions about the problem to discussions about solutions. This is no simple accomplishment, especially considering that the issue involves the highly sensitive issue of modifying the process by which corporate entities are created.

On behalf of the Department of the Treasury, I would like to thank the Committee for inviting me to testify today, and I look forward to answering your questions.