



# NASS

National Association  
of Secretaries of State

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CO-CHAIR, NATIONAL ASSOCIATION OF SECRETARIES OF  
STATE (NASS) COMPANY FORMATION TASK FORCE

TESTIMONY BEFORE THE SENATE  
HOMELAND SECURITY AND  
GOVERNMENTAL AFFAIRS COMMITTEE

AMENDED TESTIMONY SUBMITTED  
JUNE 18, 2009

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**Testimony of Hon. Elaine Marshall, North Carolina Secretary of State**  
**Co-Chair, Company Formation Task Force, National Association of Secretaries of State**  
Before the Senate Homeland Security and Governmental Affairs Committee – June 18, 2009

*“Examining State Business Incorporation Practices: A Discussion of S. 569:  
the Incorporation Transparency and Law Enforcement Assistance Act”*

Chairman Lieberman, Ranking Member Collins, and Members of the Committee, on behalf of my colleagues at the National Association of Secretaries of State (NASS), I would like to extend our appreciation for your invitation to participate in this hearing. I am wearing two hats today; one as North Carolina Secretary of State, a job I have proudly held since 1997, and the other as the Co-Chair of the Company Formation Task Force formed by the National Association of Secretaries of State (NASS) in February 2007.

As Co-Chair of the NASS Company Formation Task Force, I oversaw the drafting and release of the body’s report and recommendations, which were adopted by the full membership in July 2007 and reaffirmed in July 2008. I also helped to introduce a resolution to oppose the first iteration of the bill we are here today to discuss, S. 2956: “The Incorporation Transparency and Law Enforcement Assistance Act,” a resolution which was unanimously supported by my peers and adopted by NASS in July 2008.

As such, I remain opposed to the enactment S.569 because of the additional record keeping requirements it will place on states and the uncertainty of the costs associated with implementing such broad changes. In making the case against this bill, I would like to discuss the mechanics of business formation and record keeping at the state level and highlight how the passage of S.569 will negatively alter those processes. I will also explain why the NASS approach is more prudent and less expensive. To the extent that much of the information sought by law enforcement already resides with financial institutions and in IRS files, we respectfully suggest that Congress redirect its attention to requiring those institutions to share it, instead of having state agencies collect it.

First, a bit of background on how NASS became involved in this issue. Along with many of my colleagues, I became aware that several federal agencies were examining the issue of ownership information collection by state governments at the beginning of 2006, just before the U.S. Government Accountability Office (GAO) released its April 2006 report on this topic.<sup>1</sup> As you may know, GAO concluded that the laws of incorporation in most states allow company owners varying degrees of anonymity and privacy, which led some in Washington to wonder if the process was being used by criminals hoping to elude detection by authorities. Just prior to the release of the GAO report, a separate report from the U.S. Treasury and other agencies raised related concerns about limited beneficial ownership information.<sup>2</sup> In November 2006, Senator Levin (D-MI) chaired a hearing in the Permanent Subcommittee on Investigations and heard testimony from the federal agencies responsible for these reports, as well as the state corporate division directors from Massachusetts, Delaware, and Nevada. At the conclusion of the hearing, Senator Levin announced

that he was not satisfied with the efforts of the states to collect ownership information, warning that more aggressive state action was needed to improve what he saw as inadequate practices.

In early 2007, I sent a letter to Senator Levin on behalf of NASS asking that he hold off on introducing federal legislation until our association had an opportunity to convene a Task Force to review the issue and develop meaningful recommendations for federal and state consideration.<sup>3</sup> In February 2007, Nebraska Secretary of State John Gale and I agreed to serve as Co-Chairs of the NASS Company Formation Task Force, along with other members, including Secretaries from Georgia, Indiana, Minnesota, Nevada, New York, and Wyoming. Senior corporations division staff from Delaware, Massachusetts, and Maine also agreed to participate.

In July 2007, members approved the NASS Company Formation Task Force Report and Recommendations,<sup>4</sup> which include the following:

- A ban of bearer shares and interests in bearer form, a practice that was for all intents and purposes prohibited by states' case law, but not clearly outlined in state statute.<sup>5</sup>
- A requirement that entities file a periodic report that includes the name and address of a natural person in the U.S. who has responsibility for providing access to the list of owners of record for a business entity. That name would be a part of the public record and, therefore, available to law enforcement without a subpoena.<sup>6</sup>

These basic recommendations have served as the basis for drafting the Uniform Law Enforcement Access to Entity Information Act, which is scheduled for a final vote before the Uniform Law Commission in July 2009. You will hear more details about this body and its draft language from Harry Haynsworth, but it is important to note that we have worked with this group since they began their drafting in 2007.

In May 2008, Senator Levin expressed his dissatisfaction with the NASS approach and introduced the Incorporation Transparency and Law Enforcement Assistance Act (S.2956). He reintroduced this bill in March 2009 as S.569. NASS and a number of other prominent organizations are currently on record in opposition to this bill, including: the Uniform Law Commissioners, the American Bar Association (ABA), and the National Conference of State Legislatures (NCSL).

During the past several years, this coalition has been working together to find appropriate state legislative and administrative answers that would:

1. Avoid the federalization of the company formation process, which has always been a state function. Federal legislation will bring federal rulemaking and regulatory authority into an area that has traditionally been the jurisdiction of states;
2. Create a way for company ownership data to be held by private individuals designated by the entities, rather than the Secretary of State or other state agency;

3. Require that law enforcement agencies use subpoenas to inspect the ownership records rather than mandating that the Secretaries of State or state governments secure and provide them;
4. Avoid an immense, unfunded mandate requiring states to fund the hardware, software and staffing to collect, update, preserve and make accessible such data. There would also be a substantial cost for public education efforts regarding the complete change to filing requirements;
5. Prevent the office of the Secretary of State from becoming a law enforcement agency if compelled to regularly cross-check the entity ownership data against the Office of Foreign Asset Control's Specially Designated Nationals (SDN) List and report any suspicious matches. States are concerned that if required to collect and maintain beneficial ownership information, they will ultimately be required to verify the information and cross-check it all with the SDN List. This issue is especially important because while verification and cross-checking are not required in S.569, Senators Levin and Grassley, as co-sponsors, have said that states should verify the ownership information and run the information against the SDN List.

Here are some additional reasons why the NASS approach is more desirable:

The NASS recommendations strike an appropriate balance by supporting the goals of law enforcement without unnecessarily restructuring state governments or negatively impacting the business community. In its 2006 report on ownership information laws for corporations, GAO concluded that, "if a requirement to collect company ownership is considered, it would be useful for policymakers to consider options that balance the conflicting concerns among states, agents and law enforcement agencies."<sup>7</sup>

With nearly two million corporations and limited liability companies (LLCs) currently being formed within the United States each year, the NASS approach does not place an enormous unfunded mandate on state governments. Redirecting state agencies away from their current, ministerial role to one of collecting and processing ownership information will be an extremely costly venture.

As part of cost comparison research that is currently being conducted by NASS, initial state responses indicate that the costs associated with implementing S.569 are generally higher than the costs associated with the state uniform law approach being drafted by the Uniform Law Commissioners; and in some cases, substantially higher. For even the most technologically advanced states, maintaining beneficial ownership in a database will require the development and design of a new system. In some cases, this move will involve multiple state agencies (i.e. Secretary of State and Department of Licensing.) It will also require the states to conduct extensive, comprehensive and costly public education campaigns to ensure compliance.

Furthermore, there is concern regarding the competitive grant program in S.569 that is supposed to provide funding for states to carry out the mandates of the federal law. We believe this funding is already overcommitted with original requirements to support state and local homeland

security efforts. Much of the funding is also required, by law, to go straight to local government for first responders. Therefore, it is unlikely that the Secretary of State's office would ever see any of this funding.

Finally, states have spent tens of millions of dollars in recent years improving their online transactions in order to make state government more responsive to the needs of citizens and business communities. Transactions that used to take substantial time are now conducted swiftly and efficiently with Internet-based, online technologies. We are concerned that S.569 will turn back the clock and undo such state progress and technological investments. States need to meet the needs of the American legal and business community to facilitate important and legitimate commercial transactions worth trillions of dollars.

Additionally, the NASS approach does not overburden small businesses, many of whom are struggling economically right now. In crafting its recommendations, one of the major goals of the NASS Company Formation Task Force was to avoid any increased financial or filing burdens on small businesses, particularly "mom and pop" or family-owned businesses. These entities are easily identified by bankers and chambers of commerce as legitimate, small business enterprises. NASS also recognizes the millions of entities that consist of owners who are licensed by the states to perform specialized services, such as doctors, lawyers, accountants, engineers and realtors. Since these professionals are already vetted under state law and must have their licenses renewed on a regular basis, we believe it is important to avoid adding to their document filing duties and related costs.

It is also important that any changes in law remain simple and straightforward so as not to result in unintentional non-compliance. Definitions used for "beneficial owner" in S.569 assume that whoever controls the funds of the entity also controls the management. This is not necessarily the case and confusion about definitions could lead to problems for small businesses. Definitional clarity/consensus is an issue that is specifically acknowledged by the Financial Action Task Force (FATF) in its 2005-2006 report entitled, "Annual Review of Non-Cooperative Countries and Territories."<sup>8</sup> The FATF report states,

....the exercise was a useful tool for FATF members to identify several areas where there were differences of interpretation within the FATF regarding certain FATF NCCT criteria ("horizontal issues"), for instance:...difficulties in establishing beneficial ownership with regards to legal entities, including bearer shares and trusts. The FATF decided that no reviewed jurisdiction would be listed based on these issues.<sup>9</sup>

Unlike S.569, the NASS Company Formation Task Force recommendations also support the protection of privacy for investors and family members and would not make their personal business matters a part of the public record. While S.569 does leave it up to each state as to how it would

handle the public nature of the additional information that must be collected, that simply means the state would be forced to establish and maintain costly redaction and parallel systems – one public and one protected. We hope that representatives from the small business community, venture capitalists, and other business-related entities will be asked to discuss the impact that S.569 would have on them and that they will be involved in any deliberations on this legislation. It does not appear that any are here today to testify.

In summary, the NASS approach and the work of individual states reflects significant progress in addressing the Financial Action Task Force (FATF) Recommendations. To date, only one nation in the world – Italy – is in compliance with their recommendation on the collection of beneficial ownership information.<sup>10</sup> In its mutual evaluation of the United States in June 2006, FATF notes of its Recommendation 33 on beneficial ownership,

While the investigative powers are generally sound and widely used, there are no measures in place to ensure that there is adequate 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. There are no measures taken by those jurisdictions which permit the issuance of bearer shares to ensure that bearer shares are not misused for money laundering.<sup>11</sup>

The official FATF recommendation for corrective measures on Recommendation 33 was to,

Undertake a comprehensive review to determine ways in which adequate and accurate information on beneficial ownership information may be available on a timely basis to law enforcement authorities for companies which do not offer securities to the public or whose securities are not listed on a recognized U.S. stock exchange. It is important that this information be available across all states as uniformly as possible.<sup>12</sup>

That is exactly what the NASS Task Force and collaborating organizations have done by proposing an alternative approach to S.569.

In the meantime, the states that have been scrutinized in those early federal government reports have moved forward to strengthen their processes and to address real or perceived loopholes in the law. For example, Nevada, which was featured during the subcommittee hearing in 2006, passed legislation in July 2007 that requires any non-publicly traded corporation to maintain a list of its owners of record at a registered office or principle place of business in the state.<sup>13</sup> The entity must also file the name and contact information of the custodian of the list of owners with the Secretary of State's office. Any change to the list of owners must be updated within 10 days. Upon the request of any law enforcement agency in the course of a criminal investigation, the Secretary of State can require the corporation to provide a copy of the list of owners within three business days. Failure to do so could result in suspension or revocation of the entity's charter. For an LLC, the same requirements apply, however the list that is required is of managers and members.

Wyoming and Delaware have also passed significant legislation since the release of the multi-agency, federal government reports in 2006. The NASS Web site ([.nass.](http://nass.gov)) offers summaries of business formation laws and filing requirements if you would like additional information.<sup>14</sup>

In my home state of North Carolina, S.569 would be a significant burden, and we are a state recognized for innovation with technology and maintain an in-house programming staff, who report to me. Other states will experience an even larger burden if they are not as well developed electronically or have to depend upon outside vendors or other state agencies to perform and manage their computer programming work. Our experience with technology has been achieving a high level of customer satisfaction as well as internal efficiencies for filing and cash management functions. We would be very reluctant to consider any rollback on technology with regard to managing the workload in North Carolina.

North Carolina currently has 548,000 entities within our databases, and all filings are examined before filing to prevent our databases from population by legally deficient entities. North Carolina does not permit online creation filings, but does accept Annual Reports online. We have robust online filing abilities in other subject matter areas, including electronic notarization with a well-developed law, national e-notary standards, and a few authorized e-notary vendors. More than 100 individual notarized lobbying reports were filed online for the first quarter of 2009.

To assess the costs to the states under S.569 is almost impossible. Without administrative rules, calculating the cost is an inaccurate undertaking. What the bill states versus what we think it means – or will mean – in order to be effective are quite different. For example, adding additional fields to forms is not very hard, establishing a new searchable database is not overly difficult if you have prior experience in the activity, and committing the business logic rules to text is the tedious “finishing up” activity that requires discipline. All are doable when looking to the future.

My colleagues and I have a serious concern regarding certain provisions of S.569 in that there will be a huge burden on both the entity as well as the filing agent at the time of creation. No corporation or LLC has any members or owners of any description at the moment the filing is made. It is only after that filing has been made that ownership interest or other stakeholders can be determined. Therefore, the filing process will be a two-fold filing function rather than a one-time event. Please note that almost every state has an expedited filing process to meet the legitimate needs of the business community, as requested by the business Bar of each state.

In 2008, 58,000 new entities were created in North Carolina. The unknown, but expected, requirement for this bill to be meaningful is the application to existing business entities. If proposed Sec.2009.(a)(1)(B) requires all existing entities to provide beneficial ownership information on an annual basis (not just those businesses created after the effective date), then entirely new processing and educational programs will have to be crafted. Everyone will need to provide citizenship or status information. Screening by physical addresses will be inadequate. Responsibility is placed on formation agents, but the bill is silent as to the responsibility for those entities created without a formation agent, estimated to be sixty percent of North Carolina’s filings. An educational undertaking to all new entities, approximately 58,000 per year, is of one cost. If all 548,000 entities

of record must be informed, the cost is much greater. Theoretically, we have annual contact with 450,000 entities; however, for the 94,000 North Carolina nonprofits that have no current annual report filing requirement, the challenge will be extremely difficult.

If existing entities (548,000) will be made to comply, several staff members will need to be added or redirected from existing workloads to assist filers to understand the changes and to begin the dissolution process for noncompliance. Without additional staff, either current processing becomes delayed for all or backlogs build up for certain other equally valuable functions. Additional personnel costs are hard to determine without addressing concerns expressed by my colleagues as to the application and interpretation of S.569. Attempting an evaluation based on most responsibility falling on the state, I estimate a minimum fifty percent staff increase in the customer service and back office functions of North Carolina's corporations division.

If there is *no* requirement for existing entities to comply, costs for North Carolina would be under \$100,000 to create new forms, a new confidential database, and the associated business rules and search abilities. If S.569 is applied to the existing 548,000 active North Carolina business entities of record, costs seriously escalate. A single mailing (letter size, folded with three sides perforated, mailed at bulk rate) by a competitive bid will cost approximately slightly under \$390,000. A re-mailing of a fifteen percent default group would be almost \$58,000. Storage of paper filings and archiving become costs estimated at \$150,000 per year, as retention schedules are met. As online filings become more common, storage and archiving costs become lower but equipment replacement expenses escalate.

The huge volume of materials S.569 will generate over just a few years needs to be considered. On its face, Annual Report numbers will not increase, but Annual Reports are public in most states. If they contain confidential beneficial ownership information in order to keep current, redaction will need to occur or separate filing systems will need to be maintained, possibly increasing the image load exponentially. North Carolina is currently "burning out" two of our sixteen servers a year as we find ourselves in a constant backup mode with the 20 million images we currently maintain (not all of these are business entity items).

I can predict two significant factors that will occur in North Carolina if nonprofits are made to file Annual Reports. First, general confusion will be the norm as nonprofits seldom have "owners" of any definition; second, resistance and pushback will be huge as church folks especially consider reporting to the state *highly* objectionable (North Carolina knows this from trying to implement nonprofit Annual Reports in the early 1990's); and the Secretary of State's Office will spend vast amounts of resources dissolving and reinstating nonprofits, as well as others, for years. I can't begin to describe the ongoing societal nightmare and administrative difficulties this will create.

Secretaries of State around the country are very concerned that the term "beneficial ownership" is not well-established in American jurisprudence and that it will fall upon us to interpret what that means. It is also of concern that the law would apply to formation agents but does not specify who would be responsible in the case that a formation agent is not used. Filing offices have no desire to be the default keeper and verifier of the identity of non-United States citizen beneficial owners. We are also concerned that verification of such information may ultimately fall on the filing



entity, which would create a larger than imaginable problem for us. Also of concern is that states will be required to compare the list of entities in their databases with the Suspicious Designated National list, unless Secretaries of State or other state filing agencies are exempted from that provision of federal law.

We have a history of cooperation with all law enforcement in North Carolina, and as I now begin my thirteenth year as Secretary of State, we have never had a request from a law enforcement agency that we could not fulfill.

If you sense resistance from my colleagues, you are correct. We understand the concern with money laundering – we all want it discovered and stopped, and we all want to assist law enforcement. But we do feel these efforts are going to be of limited effectiveness compared to other possible avenues of recourse, such as through other government agencies or adding safeguards to the multiple money pathways existing today.

Because of the foregoing, the NASS Company Formation Task Force has been working with the drafting committee of the Uniform Law Commission (ULC) during the past year and a half to craft an alternative that will provide a pathway to find the information that the Senate seeks, without placing the burden on the state administrative filing office.

Given the lack of a clear belief in the efficacy of this plan, additional functions will be necessary. Verification will be needed by someone, cross checking with other lists will be needed, concern that updating will be inconsistent (annual to some, as needed with others), and difficulty with definitions are a few of these layers. Fearing those future costly requirements, NASS requested ULC to propose a uniform law with an expectation that it could provide meaningful assistance to law enforcement with a minimum burden on the large number of legitimate small businesses that populate our databases and provide the economic engines of our states.

S.569 (previously S.2956) has already had a serious beneficial effect and has achieved results. Highlighted states have closed perceived gaps in the law. We have put considerable intellectual effort into an alternative workable process that I believe is doable for states to enact. NASS has not taken an official position on the ULC Uniform Act proposal because ULC has not finished its processing, though it will finish by mid-July. Shortly thereafter, NASS will hold its annual summer meeting. I will honestly tell you I have concerns about the NASS meeting due to state budget travel restrictions, including North Carolina's, but I will be there.

Whether or not beneficial ownership information is public or confidential is of concern. Since beneficial ownership under S.569 is to be provided upon specific legal process, it is deduced the information shall be confidential. Some states have strong open records laws and constitutional provisions that will be problematic. I would intend to have an additional database developed in North Carolina and declared an exception to North Carolina's public records law to avoid all the inquiries and complaints regarding marketing mailings, family law litigants seeking corporate information, debt collectors, the just plain nosey, and more. If we are required to verify the information against the Specially Designated Nationals List that would be a huge challenge of unknown cost. Public education costs could be expensive.

We all must remember that either of these proposals represents a cultural change – not just for the filing offices who view their function as simply ministerial, but a cultural change for everyone engaged in business of most types in the United States of America. Sadly, ground zero for the fallout to these cultural changes will be each state’s filing office, and we are gravely concerned. Viewing the financial and human asset commitment contrasted with the efficacy of the proposal, it is hard to find significant added value and meaningfulness.

In closing, NASS members are wary of any federal law that burdens states and legitimate businesses yet provides lawbreakers with the ability to evade it. The obvious argument is that the extremely small number of entities that are registered to do business that may be engaged in money laundering, terrorist financing and tax evasions are probably not going to file accurate or truthful information to state government. Therefore for the overwhelming number of legitimate, law abiding businesses, trying to stay afloat in these difficult times, we think the NASS approach is a more reasonable, simple and unobtrusive solution which would allow small business owners to comply without having to hire a legal team to decipher filing requirements.

My colleagues and I are thankful for the opportunity to testify today and for the opportunity to submit additional written testimony for the record. I am including the NASS Company Formation Task Force Report and Recommendations, along with the association’s July 2008 resolution to pursue our alternative approach to S.569.<sup>15</sup>

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<sup>1</sup> U.S. Government Accountability Office, *Company Formations: Minimal Ownership Information is Collected and Available*, GAO-06-376, April 2006, available at <http://www.gao.gov/new.items/d06376.pdf>.

<sup>2</sup> U.S. Department of Treasury, et. al., *U.S. Money Laundering Threat Assessment*, December 2005 (Released January 2006), available at <http://www.ustreas.gov/offices/enforcement/pdf/mlta.pdf>.

<sup>3</sup> National Association of Secretaries of State, “Letter to Chairman Levin (D-MI) Regarding Results of Task Force,” September 13, 2007, available at [http://nass.org/index.php?option=com\\_content&task=view&id=113&Itemid=312](http://nass.org/index.php?option=com_content&task=view&id=113&Itemid=312).

<sup>4</sup> National Association of Secretaries of State, *NASS Company Formation Task Force Report & Recommendations*, July 2007, available at [http://nass.org/index.php?option=com\\_content&task=view&id=113&Itemid=312](http://nass.org/index.php?option=com_content&task=view&id=113&Itemid=312).

<sup>5</sup> *Ibid*, p. 6.

<sup>6</sup> *Ibid*, p. 5.

<sup>7</sup> U.S. Government Accountability Office, *Company Formations: Minimal Ownership Information is Collected and Available*, GAO-06-376, April 2006, p. 1 (sidebar).

<sup>8</sup> Financial Action Task Force, *Annual Review of Non-Cooperative Countries and Territories: 2005-2006*, June 2006, available at <http://www.fatf-gafi.org/dataoccd/44/9/37101772.pdf>.

<sup>9</sup> *Ibid*, p. 17.

<sup>10</sup> Information provided in Financial Action Task Force Letter to Congress, January 2007.

<sup>11</sup> Financial Action Task Force, *Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism - United States*, June 2006, p. 237, available at <http://www.fatf-gafi.org/dataoecd/44/9/37101772.pdf>.

<sup>12</sup> Ibid, p. 237.

<sup>13</sup> Nevada Model Registered Agents Act (NRS 77.310), Chapter 77. Sec. 010-270, July 1, 2008, available at <http://www.leg.state.nv.us/Nrs/NRS-077.html>.

<sup>14</sup> National Association of Secretaries of State, *Survey of State Business Entity Laws*, May 2009, available at [http://nass.org/index.php?option=com\\_docman&task=doc\\_download&gid=653](http://nass.org/index.php?option=com_docman&task=doc_download&gid=653).

<sup>15</sup> National Association of Secretaries of State, “NASS Renews Company Formation Task Force for 2008/2009 with Expanded Mission Statement,” July 2008, available at [http://nass.org/index.php?option=com\\_docman&task=doc\\_download&gid=318](http://nass.org/index.php?option=com_docman&task=doc_download&gid=318).



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## **NASS Company Formation Task Force Report & Recommendations**

Approved by the NASS Membership on 7/18/07

Co-Chairs:

Hon. Elaine Marshall (NC)

Hon. John Gale (NE)

## BACKGROUND

At the beginning of 2006, the federal government produced two major reports on the company formation process that raised important questions for Secretaries of State.

At the request of U.S. Senators Carl Levin (D-MI) and Norm Coleman (R-MN), the leaders of the Senate Homeland Security Committee's Permanent Subcommittee on Investigations, the U.S. Government Accountability Office (GAO) released an April 2006 report on the collection of beneficial ownership information during the company formation process. Its conclusion that the laws of incorporation in most states allow company owners to remain anonymous led some to wonder if the process was being used by criminals hoping to elude detection by authorities.

Meanwhile, a separate multi-agency report entitled, "Money Laundering Threat Assessment" raised related concerns about limited beneficial ownership information. Federal agencies contributing to this report included the U.S. Treasury, Internal Revenue Service, U.S. Department of Justice, U.S. Department of Homeland Security, the Federal Reserve and the U.S. Postal Service.

Based upon the findings of these reports, Senators Levin and Coleman arranged for the Senate Permanent Subcommittee on Investigations to hold an oversight hearing in November 2006. The hearing sought to examine how the lack of company ownership information in state files impeded law enforcement efforts in combating criminal activities. Officials from Delaware, Massachusetts, and Nevada joined federal agency representatives in testifying about their state procedures and requirements for forming business entities.

At the time of the hearing, Senator Levin expressed interest in a Massachusetts law that requires companies to maintain their list of beneficial owners and to provide that list to the Secretary of State upon request. In his view, the lack of information gathering practices employed by states could prevent authorities from identifying tax cheats, money launderers, and possibly, terrorists. He also expressed concern over a Financial Action Task Force (FATF)<sup>1</sup> evaluation that gave the U.S. a failing grade in collecting beneficial ownership information. Senator Levin warned that if the states didn't come up with some solutions to address his concerns, he would introduce federal legislation to create greater transparency.

In January 2007, NASS Business Services Committee Chair Elaine Marshall of North Carolina took action. She sent a letter to Senator Levin's office requesting the opportunity to convene a NASS task force to study the company formation process and to develop meaningful recommendations for federal and state consideration. Senator Levin agreed to postpone the introduction of any legislation until NASS had the opportunity to issue its findings.

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<sup>1</sup> World leaders established the Financial Action Task Force on Money Laundering (FATF) at the G-7 Summit held in Paris in 1989.

The following month at the NASS 2007 winter conference, Secretary Marshall (NC) and Secretary of State John Gale of Nebraska agreed to serve as co-chairs of the NASS Company Formation Task Force. Other Secretaries of State serving on the NASS Business Services Committee volunteered to serve on the task force and some offered to recruit their state director of corporations to assist with this endeavor.

As such, the NASS Company Formation Task Force consisted of the following members:

<b>Secretaries of State</b>	<b>Secretary of State Office Staff</b>
Hon. Elaine Marshall, North Carolina (Co-Chair)	Haley Haynes, North Carolina
Hon. John Gale, Nebraska (Co-Chair)	Judy Jobman, Nebraska Colleen Byelick, Nebraska
	Rick Geisenberger, Delaware Eileen Simpson, Delaware
Hon. Karen Handel, Georgia	Chauncey Newsome, Georgia
Hon. Todd Rokita, Indiana (NASS President-Elect)	Liz Keele, Indiana Marci Reddick, Indiana
	Laurie Flynn, Massachusetts
	Tim Poulin, Maine
Hon. Mark Ritchie, Minnesota	Bert Black, Minnesota
Hon. Ross Miller, Nevada	Scott Anderson , Nevada
Hon. Lorraine Cortez-Vazquez, New York	Paul LaPoint, New York Denise Lauer, New York
Hon. Max Maxfield, Wyoming	Tom Cowan, Wyoming Genie Sawyer, Wyoming Barb Boyer, Wyoming

## MEETINGS

The NASS Company Formation Task Force met via conference call every two weeks from early March through July 2007. Member participation rates were very high and the calls allowed for lively debate and discussion. During the first few calls, the task force decided upon its mission, goals, and process. Members decided early on to limit task force participation to Secretaries of State and/or their designated staff. However, the following stakeholders received notification about the task force and its work:

- Other state agencies responsible for company formation
- International Association of Commercial Administrators (IACA)
- The American Bar Association (ABA) Corporate Laws Committee
- The ABA Partnership Laws Committee
- National Conference of Commissioners on Uniform State Laws (NCCUSL)

- National Governor's Association
- Registered agent community
- Various federal agencies

The NASS Company Formation Task Force held a conference call with several of the stakeholders in early May and followed that with an in-person meeting later that month during the IACA Annual Conference. These discussions provided an excellent opportunity to explore shared goals and to craft reasonable, workable solutions in a short period of time.

Early conference call discussions focused on first identifying issues with potentially simple resolutions. Another key focus was clarifying Senator Levin's exact concerns and addressing those from a state perspective. Meetings between a task force member, NASS staff and Laura Stuber of Senator Levin's office produced two key directives that the task force recommendations needed to address:

1. Find a way to provide a list of shareholders, members, or beneficial owners kept in the state of organization that would be available to law enforcement without a subpoena.
2. During the company formation process, someone must be required to check the Office of Foreign Asset Control's (OFAC) Specially Designated Nationals (SDN) List to ensure that none of the owners, members, or shareholders is on the watch list.

At the IACA Annual Conference in May, the NASS Company Formation Task Force met in person to begin drafting recommendations. Because so many task force participants attended the conference, it was an ideal time for holding a drafting session. In addition to NASS Company Formation Task Force participants, representatives from the registered agents, the ABA, and NCCUSL observed this drafting session. The task force developed draft language for six recommendations at this meeting with more than thirty participants. In addition, the IACA Business Organization Section passed a resolution endorsing the efforts of the task force.

The task force soon notified both ABA and NCCUSL that their assistance would be requested in drafting amendments to the Model and Uniform Business Entity Laws if NASS members approved the task force's recommendations at the association's July 2007 summer conference. Both organizations needed to get a written notification in order to place the request in their drafting queue.

Additionally, the task force developed a survey on state company formation practices. More than thirty states responded, providing a solid framework for members to use during development of their recommendations.

The results of the survey and other useful resources became part of a web-based information page for task force members. It also includes new and pending company formation legislation from Delaware, Massachusetts, and Wyoming.

## RECOMMENDATIONS OF THE NASS COMPANY FORMATION TASK FORCE

On July 18, 2007, the NASS Membership Approved the approved the following recommendations developed by the NASS Task Force and amended by the NASS Business Services Committee:

1. NASS will draft a letter to OFAC regarding state promotion of the current obligation that individuals and business entities have to comply with the Trading with the Enemy Act (31 CFR, Subtitle B, Chapter V, as amended), and suggest a meeting to discuss usability issues, public education, etc. (attachment 1)
2. NASS and IACA will compile and periodically update a comprehensive overview of state business entity laws for federal and international law enforcement use. The report would cover how each U.S. business entity statute handles the collection of ownership information, filing requirements, and periodic reporting requirements. It will also explain how law enforcement can access ownership and other relevant information.
3. States are encouraged to engage in educational outreach to the relevant communities about checking the OFAC SDN List. Pending resolution of the issues contained in recommendations 1 and 4, states are encouraged to examine their statutes and other requirements for annual or biennial reporting by business entities and determine what amendments to statutes and additional language may need to be added to the statutes, applicable notices, or forms to advise entities of the OFAC SDN List, and to identify specific individuals who may be contacted by federal law enforcement authorities with regard to investigative concerns about owners of record for their business.
4. NASS will draft a letter requesting that ABA and NCCUSL develop language to amend Model or Uniform Business entity laws requiring entities to file a periodic report that includes a name and address of a natural person in the United States that has responsibility for providing access to the list of owners of record for a business entity. That name would be a part of the public record and therefore available to law enforcement without a subpoena. NASS also recommends that NCCUSL and ABA consider the historical precedent of confidentiality of company ownership when developing recommended language for Uniform and Model Business Entity Acts.
5. NASS recommends a two-pronged approach to “bearer shares and interests held in bearer form.” First, NASS will include a request in letters to ABA and NCCUSL that they also address clarifying Model and Uniform Entity Laws that bearer shares and interests held in bearer form are not permitted. In the interest of time, states should also examine their statutes to clarify prohibitions on bearer shares and interests held in bearer form. Currently state laws do not allow bearer shares, but language can be vague.

## NEXT STEPS

If the NASS membership approves and adopts the task force recommendations, a follow-up letter must be sent to both ABA and NCCUSL containing this language and asking them to begin their drafting processes. The ABA drafting timeline could be complete by April 2008, whereas the NCCUSL process will take until July 2008.



NASS will also request a meeting with Senator Levin and Senator Coleman and other concerned members of the Senate Permanent Subcommittee on Investigations to present them with the recommendations and discuss next steps.

Finally, NASS will convene a meeting of business entity law drafters to define and clarify the differences, if any, between “beneficial owners” and “owners of record.”

For more information on the NASS Company Formation Task Force, please contact:

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National Association of Secretaries of State  
444 North Capitol Street, NW-Suite 401  
Washington, DC 20001  
202-624-3525  
reynolds@sso.org  
[://www.nass.](http://www.nass)

## Attachment 1



June 8, 2007

Mr. John Smith  
Associate Director, Program, Policy and Implementation  
Office of Foreign Asset Control  
United States Treasury  
1500 Pennsylvania Avenue, N.W.  
Washington, DC 20220

Dear Mr. Smith:

The National Association of Secretaries of State (NASS) has put together a Company Formation Task Force to address issues of ownership information and the company formation process. The NASS Business Services Committee decided to organize this Task Force to respond to and address concerns raised by Sen. Levin and other members of Congress on these issues.

The NASS Task Force has had regular conference calls on the broad issues and regulatory implications of providing ownership information to investigative authorities. We have also addressed the issues of the OFAC Specially Designated Nationals List (SDN). The Task Force has participants from 12 states and has conferred with other organizations including committee representatives from the American Bar Association (ABA) and the National Conference of Commissioners on Uniform State Laws (NCCUSL). Our Task Force met recently during the annual conference of the International Association of Commercial Administrators (IACA) to begin drafting some recommendations that the NASS membership will consider during our July 2007 Summer Conference.

One of the goals of the NASS Task Force is to find ways to assist OFAC in performing its duty to educate businesses and individuals about the importance of checking the OFAC SDN List.

The states are very willing to provide assistance in the area of public education. However, before we can encourage the public to utilize the SDN List, it is vitally important to clarify and simplify some of the processes first:

1. In earlier discussions with OFAC, we addressed our concerns about the usability and "searchability" of the OFAC SDN List. If states are going to begin referring businesses to the OFAC website and OFAC publications, it will be critical to address the fact that the current SDN List published on OFAC's website is not user-friendly for typical businesses and individuals that are required to check the list. We discussed bringing together a group of filings officers and company formation agents to advise OFAC on ways to make the list searchable and "real-time". We would like follow up on this suggestion. In its current form, the SDN List is not searchable, is not certified by OFAC as accurate and is not updated frequently enough to make any certification that the list has been checked meaningful. Once improvements are made to the list, we think states would be willing to include a link to the SDN list on their website.
2. We would like to help arrange OFAC training seminars for state filing offices. A review of the training seminars on your website indicates that the sessions are targeted to specific industries like banking,

international trade and insurance. We would like to work with you to develop a training class that could be done for state officials so that they could assist in educating the business community about their obligations under federal law, including the SDN List and how to use it.

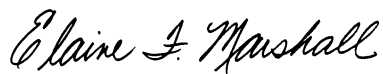
3. We would also like a “talking points” document that could help us to promote compliance with federal law and the specifics and details involved with the OFAC List. We want to ensure that simple, accurate information is provided in print and online that informs individuals and entities of their responsibilities under federal law. Contact information for OFAC so that questions may be answered and clear, simple instructions are essential to ensure compliance by the public. We would also like to work with you to create a list of vendors that might be able to help those states who would like to try and perform searches from their state system.
4. At the above mentioned IACA conference, a representative of the Small Business Administration (SBA) talked about a program they have established through the offices of the Secretaries of State. Representatives from SBA have developed materials and come to the state offices on a regular basis to answer questions for people interested in starting a business. In our discussions with SBA, it became clear that they were not familiar with the SDN List. We would encourage OFAC to reach out to the SBA to include them in any sort of public education campaign.

In short, we are committed to helping OFAC educate the public and the business community at large about the extremely important work you do and the reasons why people need to be vigilant about checking the SDN List. It should not be the duty of the office of the Secretary of State (or other relevant state agency) to check names of beneficial owners against the OFAC SDN List.

The Senate Permanent Subcommittee members have emphasized the importance of our working together and we take that responsibility very seriously. We would like to meet with you to discuss how to move forward on these very important issues. Please contact Leslie Reynolds (202)624-3525 at the National Association of Secretaries of State to coordinate this meeting.

We appreciate your commitment to this issue and we look forward to working with you.

Sincerely,



Hon. Elaine Marshall, NC Secretary of State  
Co-Chair  
NASS Company Formation Task Force



Hon. John Gale, NE Secretary of State  
Co-Chair  
NASS Company Formation Task Force

cc: NASS Company Formation Task Force  
Hon. Deb Markowitz, Vermont Secretary of State, NASS President  
Laura Stuber, Majority Counsel, Senate Permanent Subcommittee on Investigations



## **NASS Renews Company Formation Task Force for 2008/2009 and Expanded Mission Statement**

The NASS Company Formation Task Force is renewed and reauthorized for a full year from this date and the 2008-2009 President of NASS is authorized to appoint such leadership and committee restructuring as he deems appropriate; and

The reauthorized NASS Company Formation Task Force will:

- develop a strategy to oppose S.2956 The Incorporation Transparency and Law Enforcement Assistance Act,
- seek U.S. Senate committee hearings on said bill before any committee markup might occur,
- alert the Secretaries of State when contacts need to be made with their U.S. Senators,
- cooperate with our NASS partners, including but not limited to ABA, NCCUSL, and NCSL to continue developing reasonable, practical, cost-effective and appropriate state-based responses to the issues raised by S. 2956 and,
- continue to meet and negotiate with federal agencies and U.S. Senate staff on the reasons why S.2956 is an extreme approach and why the NASS approach is the most sensible approach.

ADOPTED the    day of July 2008 in Grand Rapids, MI