



# GLOBAL FINANCIAL INTEGRITY

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STATEMENT

OF

RAYMOND BAKER, DIRECTOR

AND

HEATHER LOWE, LEGAL COUNSEL

GLOBAL FINANCIAL INTEGRITY

BEFORE THE

UNITED STATES SENATE

COMMITTEE ON HOMELAND SECURITY AND

GOVERNMENTAL AFFAIRS

Thursday, November 5, 2009

In Consideration of Senate Bill S. 569

“EXAMINING STATE BUSINESS INCORPORATION PRACTICES: A  
DISCUSSION OF THE INCORPORATION TRANSPARENCY AND LAW  
ENFORCEMENT ASSISTANCE ACT”

## Introduction:

Chairman Lieberman, Ranking member Collins, and distinguished Members of the Committee:

Thank you for providing a forum in which Global Financial Integrity (GFI) can discuss a critical issue in global law enforcement: The Incorporation Transparency and Law Enforcement Act, S. 569.

GFI promotes national and multilateral policies, safeguards and agreements aimed at curtailing the cross-border flow of illegal money in order to decrease the flight of capital out of developing countries. My organization has identified five policy areas in the global financial system that have the greatest impact on the ability of corrupt individuals and other criminals to siphon money out of developing countries, launder it, and either hide it in accounts abroad or spend the proceeds. One of the five policy areas that we focus on is incorporation transparency.

The free flow of illicit money, terrorist financing and tax evading funds worldwide is significantly enabled by the lack of transparency in the international financial system. One of the areas where transparency would make a substantial difference in the ability of crime fighters to identify both the origins and ultimate beneficiaries of such illegal acts is in beneficial ownership of corporate entities and trusts. Corporate entities and trusts have been shown to be the vehicle of choice for the transportation of funds derived from illicit acts from one location to another and from one individual to another. At the prior hearing on Senate Bill S. 569 in June, testimony from Immigration and Customs Enforcement, the Department of Justice and the District Attorney for New York should have left little doubt that the availability of beneficial ownership information would significantly assist them in their work on a daily basis. Indeed I understand that this second hearing on S. 569 is not intended to focus on the need for incorporation transparency because that need had already been established. Instead, we understand that the Committee would like to better understand if S. 569 adequately meets the need for greater information and whether there are alternative ways of meeting the same goal.

We believe that S. 569 provides the necessary framework for addressing the many problems created by a lack of incorporation transparency. Any statement that we make herein regarding suggested improvements should not be construed as a criticism of S.

569 or as an effort to sidetrack the process of passing this important piece of legislation.

### The S. 569 Approach

We note that the Organization of Economic Cooperation and Development (OECD) has identified three approaches to the issue of access to beneficial information. The first is up-front collection, which is the model on which S. 569 is based. It is characterized by collecting beneficial ownership information at the corporate formation stage by the authority charged with incorporation. The second approach is for the information to be collected and held by formation agents. The third is to create enough powers for law enforcement to be able to discover the information. The problem with the third approach is that unless the beneficial ownership information is adequately captured somewhere, powers of investigation are meaningless. The United States currently follows this third approach, but relies on financial institutions with a strong commercial reason for collecting as little information as possible to be the information resource that law enforcement would tap. This has proven ineffective. The first and second approaches both have merit, but the first approach— up-front collection— has several advantages. First, from an administrative standpoint it affects one government office in each state. On the other hand, placing the onus on formation agents to be the repository for data that law enforcement will need to tap into creates an arguably greater burden on an entire industry in the United States. It also opens the implementation of this law to greater interpretation and therefore less certainty for American corporations. Keeping the requirements transparent and the information private at the secretary of state level is the simplest approach without adversely impacting any one industry. We believe that altering this approach would be an error.

### Entities Covered by S. 569

FATF Recommendation 33 states that “countries 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.” The term “legal persons” would include partnerships and trusts. As you know, S. 569 requires beneficial ownership information to be gathered at the corporate formation stage for non-public corporations and LLCs. It does not create the same

requirements for partnerships or trusts, but does compel a study into the necessity and feasibility of doing so. We do not recognize a need for different regulations with respect to partnerships and trusts and believe that mandating uniform changes would actually make compliance easier for incorporators (removing any doubt as to whether the information is necessary) and for the states (allowing them to implement one uniform change to their corporate information systems). We therefore recommend that beneficial ownership information with respect to partnerships and trusts also be collected at the state level and that this provision be enacted at the same time as the provisions with respect to corporations and LLCs.

#### Application of AML Laws to Formation Agents: Implications for Legal Representation

Formation agents are a front line defense in the battle against the use of corporations to launder or hide funds from illicit activities because they have the first opportunity to determine the purpose for which a legal entity is being formed and the ability to collect identifying information regarding the beneficial owners. Under S. 569, formation agents would collect the beneficial ownership information to be included on incorporation forms. There does not appear to be a concern with subjecting formation agents generally to anti-money laundering (AML) requirements, but concerns have been raised with respect to lawyers who act as formation agents in their regular course of business. One of the criticisms is that it is not clear whether AML reporting requirements would apply to all the activities of a lawyer just because he acts, in some circumstances, as a formation agent.

Perhaps the European model can provide guidance here. The European Union's Money Laundering Directives require lawyers to comply with AML reporting requirements while carrying out their transactional work, including corporate and trust creation, operation and management of corporations, providing tax advice, buying and selling real property and businesses, and managing client money, securities or other assets and related accounts. A distinction is made between a lawyer acting in the aforementioned capacity and a lawyer approached by a client for legal advice or who becomes a client for the purpose of legal defense. As a result, the ability of a lawyer to provide a zealous defense and ensure the right to a fair trial is not compromised. We recommend that a similarly limiting proviso be added to the amendments contemplated by Section 4 of the Bill.

Another possible approach to this issue would be to permit lawyers to choose to either report suspicious activity or withdraw their representation of or services to the client in question. This would not be a new concept. While every state has its own laws and rules regarding legal representation, they all have some provision stipulating when a lawyer may, and when he must, withdraw his representation. Law breaking, and suspicion of law breaking, are usually valid bases for withdrawal. Therefore, if a lawyer suspects that he is forming a company for illegal purposes, withdrawal is justified. Finally, all lawyers are required to establish the terms of their representation with their client, usually including an avis that they will not be able to represent the client if the lawyer discovers a conflict of interest. This is usually done in writing. It would be appropriate for a client to be informed of a lawyers AML responsibilities at that stage as well, stating that the lawyer will be complying with his duties under AML laws and that as a result of those duties it may be necessary for him to withdraw his representation.

#### The Definition of Beneficial Owner

S. 569 adopts a United States Treasury definition of Beneficial Owner. Given that this definition is already in use in U.S. law, it is a sensible approach. It is, however, still a subject of great debate even within the Treasury. It may be helpful to take a step back, however, and think of what we are trying to accomplish. We are trying to create a definition of beneficial ownership that is appropriate for this piece of legislation. We do not have to define the term in such a way that it changes existing use in other laws, nor do we have to find a definition that will work for all future laws that might be drawn.

The concern with the definition of beneficial ownership in S. 569 seems to be that with respect to companies with a large number of shareholders, and those that change regularly, reporting all beneficial owners and updating that information whenever a change occurred would be burdensome. If one felt sympathetic to this argument, and it should be noted that many do not, there are ways to limit the reporting requirement in ways that would still provide significant amounts of the information that S. 569 seeks to gather. For example a beneficial owner could be defined as someone who, directly or indirectly, owns 5% of the interest in the company or received 5% or more of the profits of the company. The top 10 recipients of the largest amount of profit and/or percentage ownership of the company could be used as a definition. We are not trying to place unreasonable demands on a company through this definition; we are trying to identify

significant and, if possible, multiple leads for law enforcement should they need to understand who is really benefitting from the activities of a given company.

We would also point out that the European Union's Third Money Laundering Directive not only contains this sort of threshold definition of beneficial owner, but also excludes certain types of companies from needing to provide beneficial ownership information for various reasons. It might be worthwhile for the Committee to review these exclusions.

### Answering the Critics

One of the main criticisms of S. 569 has been that this legislation is too financially and technologically burdensome on the states. As a threshold matter, we would like to point out that the Bill provides a source of federal funds that may be used to pay for the implementation and maintenance of a system to collect and retain beneficial ownership information. In addition to this initial observation, however, we would like to make the following points:

1. The "technologically burdensome" argument is based on the need to keep the beneficial ownership information private (not accessible by the public). The states already have the mechanisms in place to prevent the disclosure of information to the public. Taking a few minutes to access corporate information on any state's corporations division website, it will be noted that some initial information regarding the corporation is available simply by typing in relevant corporation details, but a fee must be paid in order to access other types of information, such as a company's certificate of incorporation, tax status, etc. The argument that the states are unable to restrict access to a particular type of information and will need to incur substantial costs in order to comply is simply false. States restrict access to information every day.

2. The Secretary of State for North Carolina has testified before you that it would cost her state in the hundreds of thousands of dollars to draft new corporation forms and laws to reflect the new requirements, undertake a public mailing campaign to spread the word of the changes, and add to and maintain the state's paper filing system (noting that, of course, this would decrease over time with the use of electronic filings). We encourage the Committee ask for greater detail with respect to these estimates because we do not see how the addition of either (a) one line on an incorporation form, or (b) one

page with one question regarding beneficial ownership (a separate page being provided to ensure that the information could be kept confidential), and the addition of one question on the online filing system could cost hundreds of thousands of dollars. We are also similarly dubious that the addition of one extra piece of paper per entity will cause an insupportable burden on their paper filing abilities, as was claimed by the Secretary of State for North Carolina. Some corporations already have corporate files held with the Secretary of State's office that include formation, merger, split, restatement, change of address and other filings that can easily run an average of between 10 and 50 pages. An additional page will hardly overburden the system.

3. The Secretary of State for North Carolina does not make the North Carolina Corporations Division budget available for public review, but we note that Delaware's 2007 Annual Report states that the revenue raised by the Division of Corporations alone was \$700.8 million while its operating expenses were a mere \$12 million. We will let these numbers speak for themselves.

### Conclusion

We appreciate the time and effort that the Members of Congress are dedicating to S. 569; it is indeed a subject worthy of your attention. Given all of the advances that have been made in recent years to fight cross-border crime, terrorism and our own home-grown criminal element, it behooves us to provide law enforcement with the tools that are badly needed to keep not only America safe, but also have a positive impact on global security. Incorporation transparency is a key part of this process. As citizens we have the expectation that our elected representatives will choose to support measures such as this for the benefit of all persons. We encourage you to meet this expectation.