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BRANDON L. MILHORN, MINORITY STAFF DIRECTOR

## United States Senate

COMMITTEE ON  
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
WASHINGTON, DC 20510-6250

November 13, 2007

VIA U.S. MAIL AND EMAIL (Reynolds@sso.org)

The Honorable Elaine Marshall  
North Carolina Secretary of State  
NASS Company Formation Task Force Co-Chair

The Honorable John Gale  
Nebraska Secretary of State  
NASS Company Formation Task Force Co-Chair  
Hall of States  
444 N. Capitol Street, N.W., Suite 401  
Washington, DC 20001

Dear Secretaries Marshall and Gale:

Thank you for your September letter regarding the Task Force's plans to address concerns related to the state formation of U.S. companies whose owners are unidentified.

As you know, the U.S. Senate Permanent Subcommittee on Investigations, as well as a number of federal law enforcement agencies, have a long-standing concern about the failure of the states to collect, update, and maintain beneficial ownership information for the legal entities they form, such as corporations and limited liability companies. Under current practice, states are forming nearly 2 million companies each year without knowing who is behind them.

In November 2000, at the request of the Subcommittee, the Government Accountability Office (GAO) conducted an investigation and released a report entitled, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*. This report revealed, among other information, that a Russian immigrant living in the United States was able to set up more than 2,000 Delaware shell corporations and, without disclosing the identity of the beneficial owners, open bank accounts for those corporations, which then collectively moved about \$1.4 billion through the accounts. In April 2006, again at the Subcommittee's request, GAO released a report entitled, *Company Formations: Minimal Ownership Information Is Collected and Available*, which reviewed the formation laws in all 50 states. GAO reported that most states do not collect any information on the beneficial owners of the legal entities they establish. Both GAO reports also discuss the problems for law enforcement caused by this lack of beneficial ownership information.

On November 14, 2006, the Subcommittee held a hearing on these matters. At the hearing, representatives of the U.S. Department of Justice, the Internal Revenue Service, and the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) all testified that the failure of the states to collect adequate information on the beneficial owners of the legal entities they form had impeded federal efforts to investigate and prosecute criminal acts such as money laundering, securities fraud and tax evasion. For example:

The Department of Justice testified: "We had allegations of corrupt foreign officials using these [U.S.] shell accounts to launder money, but were unable – due to lack of identifying information in the corporate records – to fully investigate this area."

The IRS testified: "Within our own borders, the laws of some states regarding the formation of legal entities have significant transparency gaps which may even rival the secrecy afforded in the most attractive tax havens."

FinCEN identified 768 incidents of suspicious international wire transfer activity involving U.S. shell companies.

In addition, the Financial Action Task Force (FATF), the leading international organization combating money laundering and terrorist financing, submitted a written statement to the Subcommittee in which it described its recent review of U.S. anti-money laundering and anti-terrorist financing programs and found that the United States was not in compliance with a key FATF standard requiring jurisdictions to obtain beneficial ownership information for the legal entities they form. The United States apparently has until June 2008 to come into compliance with that standard or risk being removed from this important international organization.

Representatives of three states, Delaware, Nevada, and Massachusetts, also testified at the Subcommittee hearing and responded to questions about shell companies abusing their state status to commit crimes involving money laundering, tax evasion, and other misconduct. Each of the states described a different approach to collecting ownership information. The testimony and evidence at the hearing reinforces concern about the ability of individual states to tackle the ownership issue, given that each is competing against the other states for formation fees, is under pressure to form new entities quickly and cheaply, and if one state were to strengthen its disclosure requirements, applicants could simply turn to other states for their formation needs. As I indicated at the hearing, if the states were unwilling to act quickly to strengthen their formation procedures, federal action might be necessary to set minimum standards for the collection of beneficial ownership information, to ensure adequate assistance to law enforcement investigations of U.S. shell companies, and help the United States meet its obligation to come into compliance with FATF guidelines by June 2008.



At the request of the states, I delayed introducing federal legislation to provide the states with an opportunity to craft a solution. Throughout the states' deliberations leading up to the NASS Report, Subcommittee staff participated in conferences and meetings, suggested key principles, and provided comments on draft Task Force proposals. Unfortunately, the final Task Force Recommendations contained in your letter do not reflect my concerns, lack a number of key elements, and propose an unsatisfactory timetable for state action.

In my view, the Recommendations should satisfy the following five key principles:

1. **Identification of the natural individuals who will beneficially own the entity being formed.** The most important objective in this matter is a requirement that the states collect the names of the individuals who will be the true owners of the legal entities that the states are being asked to form. The NASS proposal as currently drafted, however, calls only for the compilation of a "list of owners of record." This approach is wholly inadequate, since it is common practice for those who want to hide the real owners to name as the "owner of record" an attorney, corporate nominee, trust, or third party with no true ownership interest in or ability to control the entity being formed. The proposal also fails to require the list to name natural individuals, rather than legal entities. In contrast to this proposal, I believe that, to ensure adequate assistance to law enforcement investigations of U.S. shell companies suspected of wrongdoing and to ensure U.S. compliance with the FATF disclosure standard, the states must obtain identification of the natural individuals who will beneficially own the entities being formed.
2. **Annual information updates.** The NASS proposal also fails to recommend that ownership information be updated on a regular basis, instead advising states only to "examine their statutes and other requirements for annual or biennial reporting." Without a requirement for updated information, unscrupulous operators can list a set of beneficial owners on a company's initial formation documents and immediately transfer the company to new owners not named in the state records. Most states already require companies to file annual updates of their corporate records and pay annual fees. To assist law enforcement and meet the FATF standard, the states should also require the entities they form to update a list of their beneficial owners on at least an annual basis.
3. **Reliable access to ownership information.** In addition to collecting updated beneficial ownership information for the entities they form, the states must be able to provide this information to law enforcement in a reasonable amount of time after a request. The NASS proposal, however, does not contain that type of clear requirement. Instead it recommends that the states simply maintain the "name and address of a natural person in the United States" responsible for providing access to an entity's owners of record. This approach is, again, wholly inadequate. First, the proposal does not specify that the person have any relationship to the entity at issue.



Second, it does not require the person to reside in the state that formed the entity or to agree to be subject to that state's regulation. There is no requirement that the person maintain the names of the beneficial owner. Finally, the proposal does not specify that the information be furnished to law enforcement within a reasonable period of time upon request. In contrast to this flawed approach, a better recommendation would be for the state itself to retain the ownership information or, at a minimum, to require the information to be maintained by a state resident who is subject to state regulation, whose identity and address are updated annually, and who agrees to promptly supply the information to law enforcement upon request.

4. **Adequate record retention.** Beneficial ownership information should not only be collected and made accessible to law enforcement, it should be maintained for a reasonable period of time. The NASS proposal is silent on how long ownership records must be maintained. I believe that beneficial ownership records should be maintained not only during the period in which the entity is registered, but also for a minimum period after that registration expires. Since it is common for problems to surface after an entity's registration has lapsed, unless there is a requirement for adequate record retention, it will often be impossible for law enforcement to secure needed ownership information for an entity no longer in operation.
5. **Timely implementation of reforms.** Finally, there is the proposed timetable for state implementation. The NASS proposal suggests that the National Conference of Commissioners on Uniform State Laws complete a model statute by July 2008. States would then be responsible for enacting implementing legislation. This proposed timetable makes it impossible for the United States to meet the FATF deadline of June 2008.

I am disappointed that the states, despite the passage of nearly one year, have been unable to devise a better proposal to meet the needs of law enforcement and the U.S. obligation to comply with the FATF standard regarding beneficial ownership information. Given the many deficiencies in the NASS proposal, I am planning to introduce federal legislation setting minimum standards for beneficial ownership disclosure, create a level playing field among the states, and put an end to the practice of states creating millions of legal entities each year without knowing who is behind them.

Sincerely,



Carl Levin  
Chairman  
Permanent Subcommittee on Investigations

cc: The Honorable Norm Coleman  
Ranking Minority Member  
Permanent Subcommittee on Investigations