



# Department of Justice

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**STATEMENT OF**

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**BEFORE THE**

**COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS  
UNITED STATES SENATE**

**ENTITLED**

**“BUSINESS FORMATION AND FINANCIAL CRIME: FINDING A  
LEGISLATIVE SOLUTION”**

**PRESENTED**

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**Before the U.S. Senate Committee on the Homeland Security and Governmental Affairs**  
**November 5, 2009**

Good afternoon, Chairman Lieberman, Ranking Member Collins and distinguished Members of the Committee. I am honored to appear before the Homeland Security Committee to discuss S. 569 which addresses the need for greater transparency in corporate formation in the United States.

Several months ago the Department testified before this Committee about the difficulties both foreign and domestic law enforcement agents face when investigating U.S. shell companies. The testimony identified the need for improved access to beneficial ownership information of U.S. companies and the four areas of concern: (1) the need to identify the beneficial owner of a legal entity at the point of formation; (2) the need for law enforcement to obtain accurate and timely information about the owners of existing U.S. legal entities; (3) the appropriate means of addressing the challenge of the transfer of corporate ownership—especially from corporate formation agents to corporate brokers; and (4) the penalties necessary to discourage the misuse of U.S. companies.

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 consistent with several recommendations that I describe below. We are fully committed to working with Congress and our interagency partners to craft legislative text to amend the legislation in order to address our concerns.

**The Lack of Transparency in Corporate Formation Inhibits Law Enforcement Efforts**

While the topic of corporate transparency does not readily evoke images of the criminal and extremist underworld, it must not be overlooked that some of the worst actors seek to exploit the lack of transparency associated with U.S. companies to harm our national and economic security. For example, Viktor Bout, designated by the U.S. Department of Treasury, Office of Foreign Assets Control as an arms merchant and war profiteer, used U.S. shell companies to further his illegal arms trafficking activities. The Sinaloa Cartel, one of the major Mexican drug trafficking organizations, is believed by U.S. law enforcement to use U.S. shell companies to launder its drug proceeds. Semion Mogilevich, recently named to the Federal Bureau of Investigation's Ten Most Wanted Fugitives List, and his criminal organization are charged with using U.S. shell companies to hide their involvement in investment activities and to launder money.

Each of these examples involves the relatively rare instance in which law enforcement identified the perpetrator misusing the U.S. shell companies. Far too often, we are unable to do so. Take for example the instance in which a foreign partner notified U.S. law enforcement after uncovering a plot to send military cargo, mislabeled as farm equipment, to Iran. Why contact

U.S. law enforcement? Because the seller listed in the shipping documentation was a U.S. shell company. Unfortunately, through this case and others, our foreign partners have learned that, in most instances, U.S. law enforcement cannot identify the individuals who own and misuse U.S. legal entities.

The following case example further details how a lack of corporate transparency prevented investigators from identifying the perpetrators of a large cyber fraud and provides some insight into why such an experience discourages law enforcement from even pursuing such investigations.

In this case, numerous U.S. individuals complained to law enforcement about losing money when attempting to purchase automobiles over the Internet via an online auction website. A subsequent investigation revealed that the criminal participants would identify a legitimate vehicle for sale on the Internet site and then pose as the purported sellers of that vehicle. To appear legitimate, the criminal participants would direct interested buyers to transfer payment for the cars to entities that had the same name as licensed and bonded escrow companies located in the United States.

Victims were then directed by the false escrow companies to wire funds to “Bank A,” a financial institution located in New York, for further credit to a named U.S. shell company. Based upon the wiring instructions, the victims believed that they were sending money to a U.S. bank account held by the escrow company in New York. In reality, the victims were being tricked into sending their funds to an account maintained under the name of the U.S. shell company at a bank located in Eastern Europe – “Bank B.” Investigators discovered that Bank A in New York merely held a correspondent account in the name of Bank B such that any money the victims sent to Bank A went into the account of Bank B. As is common practice, the correspondent account records for Bank B, held at Bank A, did not contain details on the beneficial owners for each of Bank B’s account holders in Eastern Europe, and thus no information on the beneficial owners of the U.S. shell company.

Corporate documents for the U.S. shell company obtained from the Secretary of State of the relevant state provided names of two individuals acting on behalf of corporate entities in Tortola, British Virgin Islands, both with addresses in Tortola. The U.S. shell company was associated with two U.S. addresses, both of which were addresses of a U.S. corporate formation agent and used simply as mail drops. The U.S. corporate formation agent did not know and is not required to know, by law, who controls the U.S. shell company.

It required three formal treaty requests, over the span of nearly two years, to obtain documentation from the Eastern European country in the example above that specifically identified the individual who was the signatory on the bank account held in Bank B in the name of the U.S. shell company. A copy of this individual’s foreign passport (which was from yet another country) had been maintained by Bank B. However, a review of the bank records for the account in the name of the U.S. shell company revealed that funds from the U.S. victims received into that account had been transferred out of that account into another account in the name of another U.S. shell company, thereby necessitating a repeat of the entire process,

including additional treaty requests to identify additional bank account signatories. Those signatories all held foreign passports, none of which were from the Eastern European country.

Ultimately, this case was never charged because investigators were unable to establish whether the signatories on the bank accounts had knowledge of the underlying fraud that generated the funds or whether they were the beneficiaries of those funds as opposed to merely financial service providers responsible for moving the funds. In essence, the investigators could not establish the beneficial owner of the U.S. shell company and its assets (the fraud proceeds).

This case illustrates how a lack of corporate transparency in the United States can frustrate an investigation at several different junctures. First, the success or failure of a U.S. investigation requiring the identification of a beneficial owner of a U.S. shell company depends upon the existence and effectiveness of a U.S. treaty relationship with a foreign country. An investigation is often hindered when no treaty relationship or an ineffectual treaty relationship exists with another involved country and the case reaches a dead end. However, the investigation can also be frustrated even when, as in this case, a viable treaty relationship exists due to the significant investigative delays associated with treaty requests that result in criminal participants staying several steps ahead of law enforcement, the trail turning cold, or the case being terminated for statute of limitations or other delay-related reasons.

### **Extent of Problem**

In criminal investigations, law enforcement often faces a problem uncovering the criminals responsible for using shell companies to further their criminal schemes. This is due, in large part, to the lack of beneficial ownership information gathered on shell companies. Although the Department does not collect statistics on the scope of this problem, the following information reported by investigators and prosecutors indicates that the problem is widespread:

When questioned about whether a lack of information about a U.S. shell company had hindered their investigations, nearly all of a 75-person audience consisting of federal investigators and prosecutors from throughout the country responded that it had. The audience — including investigators from nine federal law enforcement agencies and prosecutors from a variety of districts and offices — was attending a financial investigation seminar designed to teach them how to investigate the financial aspects of international criminal organizations. The instructor, who was lecturing on U.S. shell companies, asked the members of the audience to raise their hand if they had ever reached a dead end in one of their investigations because of a U.S. shell company. Nearly every person in the room raised his or her hand. Departmental instructors report that such a response is common in money laundering courses delivered both domestically and abroad.

Likewise, participants in Suspicious Activity Report (SAR) Review Teams report that many investigations involving U.S. shell companies are never even pursued. SAR Review Teams exist in most judicial districts around the country and are comprised of prosecutors, federal investigators, and often state and local law enforcement. Their mission is to review SARs and uncover links that can lead to criminal prosecutions, forfeitures, and seizures. The teams report that often they do not pursue leads contained in the SARs under review because the

reported suspicious financial activity was done through an account held in the name of a U.S. shell company. Realizing that beneficial ownership information for the U.S. shell company is not available in the United States and the underlying account under review was established in a foreign country, the teams never pursue an investigation. The total amount of money associated with suspicious financial transactions involving U.S. shell companies that is reported in SARs on an annual basis is quite high, often in the billions of dollars.

Finally, as detailed in the Department's earlier testimony, the lack of beneficial ownership information for U.S. entities also provides challenges for the United States when responding to requests for assistance from our foreign partners. In particular, we testified about the scope of the problem and the rise in requests for information related to shell companies during 2004 and 2005. The Department's Office of International Affairs (OIA) reports that, since that time, OIA has spent considerable effort educating our foreign counterparts about our inability to obtain and provide beneficial ownership information. As a result, OIA reports that it has seen the number of requests drop. Not unexpectedly, foreign investigators and prosecutors continue to approach DOJ speakers at foreign events to complain about investigations that were terminated due to their inability to obtain beneficial ownership information about U.S. companies. This problem not only damages our reputation but is also counterproductive to our efforts to join with foreign counterparts in a global offensive against organized crime and terrorism.

### **Discussion of S. 569**

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. We have a number of recommendations that should strengthen S 569 and are fully committed to working with the Congress and our interagency partners to craft legislative text to amend the Legislation in order to address our concerns. The Administration recognizes, however, that no legislation can provide a perfect solution to this problem. Whatever legislation we enact will have some costs to legitimate businesses and will have some weaknesses that criminals can exploit. Despite this fact, the Administration is committed to taking what it has learned from studying this problem and working with Congress to craft a legislative solution that has maximum effectiveness with minimum burden on legitimate businesses.

As noted in the Department's previous testimony, the first and most critical issue facing law enforcement is the ability to identify the living, breathing beneficial owner of a legal entity. As currently drafted, S. 569 takes a significant step forward on this point by including a definition of beneficial ownership that would apply across all 50 States and ensure that criminals cannot exploit definitional gaps between differing State systems. However, the Administration would like to work with this Committee to amend and further refine that definition to address concerns in the business community that the ambiguity and breadth of the definition will make compliance uncertain, time-consuming, and costly. We believe the interests of law enforcement can be met, while also ensuring that the definition is sufficiently straightforward and limited in application to work for the full range of covered legal entities.

Once a more limited application is achieved, the Administration recommends that S. 569 also be strengthened to require a credible and legible photocopy of government-issued

identification for each beneficial owner to be held within the State. The provision and retention of such information is critical to any meaningful effort to promote transparency by assuring that law enforcement will have a “name and a face” for all beneficial owners. Currently, S. 569 requires beneficial owners to provide their names and addresses to the State -- a requirement that should remain in place. However, the Legislation only requires foreign beneficial owners to take the additional step of providing a legible photo identification. The Administration recommends that this requirement be extended to all beneficial owners. Recognizing the challenges, both fiscal and technological, that come with this effort, we believe it would be sufficient for the photo identification to be maintained in the State, and not necessarily with the State, subject to the enhanced civil and criminal penalties addressed later in this testimony.

The second critical issue identified by the Department is the need for law enforcement to be able to obtain beneficial ownership information in an accurate and timely manner. S. 569 fully addresses this concern.

Third, the Department noted that many problem companies encountered by law enforcement are so-called “shelf”, or aged, companies. Law enforcement has seen time and again that criminals can easily throw investigators off the trail by purchasing shelf companies and then never officially transferring the ownership. In such cases the investigation often leads to a formation agent who has long ago sold the company with no records of the purchaser and no obligation to note the ownership change. To address this vulnerability and prevent criminals from simply wholesale shifting their operations to “shelf” companies to avoid the reach of S. 569, we believe the Legislation should address the transfer of beneficial ownership. While S. 569 partially addresses this problem, the Administration recommends further study of the vulnerabilities associated with the transfer of legal entities and potential solutions for updating beneficial ownership information so that we can close any remaining vulnerability gaps.

The Department’s fourth and final concern is that any bill should contain a persuasive enforcement regime. Federal criminal penalties, in particular, are an essential ingredient for law enforcement to target professional money launderers and their clients in the criminal and extremist underworld. To this end, the Administration recommends eliminating the expansion of anti-money laundering obligations to company formation agents – a significant administrative and regulatory burden -- in favor of broader civil and criminal federal liability for noncompliance. Specifically, the federal penalties in S. 569 could be amended to include federal criminal and civil liability for persons obligated to hold beneficial ownership information, if they fail to meet their statutory obligations, including an obligation to maintain the confidentiality of subpoenas and other legal process.

Finally, the Department notes that S. 569 authorizes states to use State Homeland Security Grant funds to carry out the obligations imposed by the legislation. These funds are already relied upon by States to finance first responders in preparing for and responding to emergency situations. The Administration believes that S. 569 should not authorize states to draw from the State Homeland Security Grant program to defray the costs of implementation.

I would like to conclude by expressing the gratitude of the Department of Justice for the continuing support that this Committee has demonstrated for anti-money laundering enforcement. In particular, the Department would like to thank Senator Levin and the Committee for its hard work on S. 569. The Department believes that we must continue to

strengthen our anti-money laundering laws, not only to disrupt and dismantle drug trafficking and other international criminal organizations, but also to fight terrorism, white collar crime and all forms of criminal activity that generate or utilize illegal proceeds.

The Department is committed to safeguarding the privacy and civil liberty interests of Americans and is confident that those interests are not at risk when the federal government takes sensible steps to rein in the abuse of shell corporations. We in the Department of Justice look forward to working with Congress and with our colleagues in the Department of Treasury and the Department of Homeland Security, to address the issues identified in this hearing.