



# HELSINKI COMMISSION REPORT

October 4, 2018

## IN BRIEF Incorporation Transparency

### *The First Line of Financial Defense*

“Steal in Russia and spend in the West” is how Kremlin critic Vladimir Kara-Murza describes the behavior of Russian President Vladimir Putin and his associates. A similar principle has become commonplace in most authoritarian regimes. Countries in which the rule of law is strong find themselves at risk from ill-gotten gains that autocrats have hidden within their borders. Not only does this make them complicit in the perpetuation of corruption abroad, but it also provides hidden “sleeper capital” through which autocrats and their cronies can exert influence domestically.

The countries in which money is most often hidden—the United States, the United Kingdom, and many countries of the European Union, especially France and Germany—have a strong rule of law system and desirable markets. In their large cities, representatives of autocratic systems can purchase real estate, retain lawyers and PR firms to conduct influence operations and reputation laundering, and access elite circles and high society thanks to their illicit wealth. However, in the last few years, these countries have become more aware of the infiltration of their markets by authoritarian finance and have taken steps to curb its flow into their borders.



They have sought to fortify themselves through a variety of measures, including beneficial ownership transparency (BOT). BOT is a government policy which requires incorporated entities to report their “beneficial owners”: the real individuals who ultimately enjoy the benefits of ownership of a company or property, or the underlying asset

of value. Beneficial ownership data is then available to law enforcement or the public. This is vital to transparency because, in many jurisdictions, beneficial owners do not necessarily need to be listed on legal paperwork—they may list “nominee owners” who hold assets on their behalf.

While anonymous shell companies have legitimate uses, they are often abused to launder money. Autocrats can create a chain of such companies across many jurisdictions, evading law enforcement and moving stolen money from company to company until that money is nearly untraceable. At that point, the money is considered “washed” and can be used for all manner of ostensibly legitimate purposes.

### **The European Union**

The European Union, currently comprising 28 sovereign countries, faces a unique challenge in

fighting authoritarian finance given that most criminal concerns continue to be handled at the national level. However, because of the common market, which guarantees the free movement of goods, services, capital, and labor, it does have a certain level of jurisdiction over financial regulation, most notably where BOT is concerned.

The most recent EU legislation in this area, the Fifth Anti-Money-Laundering Directive (5AMLD), requires member states to collect BOT information and make it available in public registers. This directive was enacted on June 19, 2018 with an implementation date of January 20, 2020. As such, no member state is required to have national laws that fulfill the conditions of 5ALMD until this date.

Though the European Union has strong laws on the books regarding BOT information collection, the European Union’s compliance process can make it difficult to ensure that various member states are adequately enforcing provisions. While the European Court of Justice (ECJ), the European Union’s top judicial body, has the power to hear cases in which the European Commission sues a Member State for non-implementation, non-enforcement of implemented EU legislation is a more difficult problem to remedy. Given that several states within the EU are known for their money laundering industries—especially Cyprus, Czech Republic, Latvia, and Malta—non-enforcement of anti-money laundering laws is a well-documented problem.

### **The United Kingdom**

The United Kingdom has become so inundated with Russian money that that London is sometimes referred to by commentators as “Londongrad.” However, the United Kingdom has also been one of the first to awaken fully to the threat of authoritarian finance and act to curb it, especially in the aftermath of the attempted assassination of Sergei Skripal by Russian agents.

The United Kingdom is the most advanced country in the world with regard to the collection of BOT information. It is the only country in the transatlantic sphere to have an operational public BOT register, complete with data on more than four million

### **EU Law and Legislation**

Legislation is drafted by the Commission and requires approval by the Council and the Parliament under the ordinary legislative procedure. The Commission considers legislation only when it believes an EU-level remedy is necessary for a problem that cannot be solved by national or local governments. Legislation takes different forms, depending on the objective to be achieved.

- Laws, called regulations, are binding in their entirety, self-executing, directly applicable, and obligatory throughout EU territory. They can be compared to U.S. federal laws passed by Congress.
- Directives are binding in terms of the results to be achieved and are addressed to individual Member States, which are free to choose the best forms and methods of implementation.
- Decisions are binding in their entirety upon those to whom they are addressed—Member States, companies, or persons.
- Recommendations and opinions are not binding and can be initiated by institutions other than the Commission.

*From “The European Union: A Guide for Americans,” Delegation of the European Union to the United States*

companies incorporated in the United Kingdom. Civil society organizations such as Global Witness<sup>1</sup> have used this data to draw helpful conclusions and recommend improvements to the register.

The United Kingdom has also passed a law that will require its overseas territories to implement public beneficial ownership registers. These territories include notorious havens for illicit funds such as Bermuda, the Cayman Islands, and the British Virgin Islands. However, Crown Dependencies, a different classification of territories for which the United Kingdom is responsible, do not fall under this requirement.

### **The United States**

Authoritarian capital also poses a threat to the national security of the United States, finding its way

into major real estate markets like New York City and Miami. This has led to the presence of “sleeper capital” used for influence operations and reputation laundering; the corruption of charitable giving; and the abuse of the U.S. legal system, otherwise known as “lawfare,” to silence opponents and bury past misdeeds. This has also contributed to a massive spike in the cost of living in these cities as rents have shot up due to skyrocketing property values. Oftentimes, this property is left empty.

Unfortunately, the United States has no permanent policy for the collection of BOT information. Because incorporation occurs at the state level in the U.S. federal system, attempts to find a countrywide solution have been complicated. Under the USA PATRIOT Act, the Department of the Treasury can issue geographic targeting orders (GTOs), which impose specific additional recordkeeping and reporting requirements to prevent money laundering, to financial institutions in certain geographic areas.

Since 2016, Treasury has used its GTO authority to require certain financial institutions involved in luxury real estate deals to collect beneficial ownership information on entities making cash-based purchases of such real estate. A GTO on Miami-Dade County led to a 95 percent drop in the amount of cash anonymous entities used to purchase real estate.<sup>2</sup> However, these orders are time-limited and are a poor substitute for a permanent BOT policy.

With the one notable exception of GTOs, law enforcement in the United States has been hampered by the lack of accessible BOT information, and the country has transformed into a major money laundering haven. When asked about BOT at a congressional hearing on July 12, 2018, Secretary of the Treasury Steve Mnuchin said, “We’ve got to figure out this beneficial ownership [issue] in the next six months. I don’t want to be coming back here next year and we don’t have this solved.”

Two bills currently under consideration would do just that. One is the Corporate Transparency Act of 2017, sponsored by Rep. Carolyn Maloney (NY-12) and cosponsored by Rep. Peter King (NY-02) in the House and sponsored by Senator Ron Wyden (OR) and cosponsored by Senator Marco Rubio

(FL) in the Senate. This bill would require the Department of Treasury’s Financial Crimes Enforcement Network (FinCEN), an office of Treasury tasked with the collection of financial intelligence, to collect BOT information from companies formed in the United States, unless a state already collects the information.

The other is the True Incorporation and Transparency for Law Enforcement (TITLE) Act, sponsored by Senator Sheldon Whitehouse (RI) and cosponsored by Senator Chuck Grassley (IA). This bill would instead require each U.S. state and territory to collect BOT information at the time a company is formed.

A strong coalition has formed in support of BOT. Advocates on both sides of the aisle have highlighted the national security risks of anonymous shell companies, including the FACT Coalition, the Hudson Institute, and Global Witness. Chip Poncy and Juan Zarate of the Foundation for the Defense of Democracies, Dr. Clay Fuller of the American Enterprise Institute, and Anders Åslund of the Atlantic Council have also been highly supportive.

Police and prosecutors at the local,<sup>3</sup> state,<sup>4</sup> and federal<sup>5</sup> levels are increasingly calling for reform as anonymous shell companies routinely stymie investigations. Even the state of Delaware, which makes the anonymous incorporation of companies easy in an effort to attract business, supports<sup>6</sup> mandating that FinCEN collect BOT information.

However, opposition remains. The American Bar Association claims BOT information collection would violate attorney-client privilege, though some human rights attorneys<sup>7</sup> and legal scholars<sup>8</sup> have spoken out in favor of reform. The business community is also divided. Several financial services trade groups, including the American Bankers Association, the Financial Services Roundtable, and the Independent Community Bankers of America, recently endorsed BOT legislation. The National Association of Realtors,<sup>9</sup> the National Foreign Trade Council,<sup>10</sup> and several multinational businesses<sup>11</sup> have also voiced their support for reform.

The U.S. Chamber of Commerce historically has been opposed to any legislation because it claims that BOT information collection would create a burden for small business. However, a recent poll<sup>12</sup> suggests that over three-quarters of small business owners in the United States support BOT disclosure requirements. Additionally, with 87 percent of active companies in the United Kingdom filing at least one beneficial owner within two years of the UK register's implementation, there is a strong indication that the burden on small business may be negligible.

BOT remains low-hanging fruit in the fight to protect the transatlantic region against the threat of authoritarian finance. The democratic, rule of law systems of the United States and Europe should work together to build a resilient financial sphere and, ultimately, a fair and just international financial system that is difficult for autocrats to abuse. These countries should learn from one another's successes and missteps to implement the most effective BOT standards possible.

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## About the Helsinki Commission

The Commission on Security and Cooperation in Europe, also known as the U.S. Helsinki Commission, is an independent agency of the Federal Government charged with monitoring compliance with the Helsinki Accords and advancing comprehensive security through promotion of human rights, democracy, and economic, environmental and military cooperation in 57 countries. The Commission consists of nine members from the U.S. Senate, nine from the House of Representatives, and one member each from the Departments of State, Defense, and Commerce.

Learn more at [www.csce.gov](http://www.csce.gov).

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<sup>1</sup> "The Companies We Keep: What the UK's open data register actually tells us about company ownership." *Global Witness*. Last modified July 2018. <https://www.globalwitness.org/en/campaigns/corruption-and-money-laundering/anonymous-company-owners/companies-we-keep/>.

<sup>2</sup> Nicholas Nehamas and Rene Rodriguez, "How Dirty is Miami Real Estate? Secret Home Deals Dried Up When Feds Started Watching," *Miami Herald*, July 18, 2018, <https://www.miamiherald.com/news/business/real-estate-news/article213797269.html>.

<sup>3</sup> Chuck Canterbury to Michael D. Crapo and Sherrod C. Brown, July 20, 2018. <https://thefactcoalition.org/wp-content/uploads/2018/08/FOP-S1717-Support-Letter-20180720.pdf>.

<sup>4</sup> Washington State Office of the Attorney General. 2018. "Ferguson Calls on Congress to Require Shell Company Transparency." <https://www.atg.wa.gov/news/news-releases/ferguson-calls-congress-require-shell-company-transparency>.

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<sup>5</sup> Dominick L. Stokes to Jeb Hensarling and Maxine Waters, July 15, 2017. <https://thefactcoalition.org/letter-from-the-federal-law-enforcement-officers-association-to-the-house-committee-on-financial-services-supporting-corporate-transparency>.

<sup>6</sup> Jeffery W Bullock to Jeb Hensarling and Maxine Waters, June 8, 2018. <https://www.scribd.com/document/381712112/Delaware-Letter-Supporting-Beneficial-Ownership-Transparency>.

<sup>7</sup> Amol Mehra, "My law degree wasn't meant for money laundering. But boy, it would make it easy," *Washington Post*, March 29, 2018, [https://www.washingtonpost.com/opinions/my-law-degree-wasnt-meant-for-money-laundering-but-boy-it-would-make-it-easy/2018/03/29/f7cbfa4c-320b-11e8-8bdd-cdb33a5eef83\\_story.html](https://www.washingtonpost.com/opinions/my-law-degree-wasnt-meant-for-money-laundering-but-boy-it-would-make-it-easy/2018/03/29/f7cbfa4c-320b-11e8-8bdd-cdb33a5eef83_story.html).

<sup>8</sup> Matthew Stephenson, "The Flawed and Flimsy Basis for the American Bar Association's Opposition to Anonymous Company Reform," *The Global AntiCorruption Blog* (blog), February 13, 2018, <https://globalanticorruptionblog.com/2018/02/13/the-flawed-and-flimsy-basis-for-the-american-bar-associations-opposition-to-anonymous-company-reform/>.

<sup>9</sup> Elizabeth Mendenhall to Charles Grassley and Dianne Feinstein, February 6, 2018. <https://thefactcoalition.org/wp-content/uploads/2018/02/NAR-Support-Letter-2018-02-06-to-Senate-Judiciary-Re-Hearing-on-Beneficial-Ownership.pdf>.

<sup>10</sup> Richard Sawaya, "New sanctions would hurt Russia but hurt American industry more," *The Hill*, August 8, 2018, <https://thehill.com/opinion/international/400984-new-sanctions-would-hurt-russia-but-hurt-american-industry-more>.

<sup>11</sup> The B Team. 2017. "U.S. government action crucial to fighting corruption." <http://www.bteam.org/announcements/u-s-government-action-crucial-to-fighting-corruption/>.

<sup>12</sup> Small Business Majority. 2018. "Small Business Owners Support Legislation Requiring Transparency in Business Formation." <http://smallbusinessmajority.org/our-research/entrepreneurship-freelance-economy/small-business-owners-support-legislation-requiring-transparency-business-formation>.