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before the
House Financial Services Subcommittee on Financial Institutions and Consumer Credit
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on
Examining the BSA/AML Regulatory Compliance Regime

Thank you for the opportunity to testify before you today on the subject of Examining the BSA/AML Regulatory Compliance Regime. I hope that my contributions to today's hearing will help you take measured and informed decisions that are in the public's interest with respect to the U.S.'s anti-money laundering (AML) regime as set forth in the Bank Secrecy Act (BSA).

Money laundering is a vast subject and there are many different facets that it would be worthwhile for this Subcommittee to examine. I will discuss some of those areas in my testimony today but, as I am sure you will discover as we delve deeper into the topic, there may be a great deal more that you wish to explore moving forward. I am happy to assist to the extent that I can.

The topic of this hearing is BSA compliance challenges facing financial institutions, including compliance trends, the effectiveness of the suspicious activity report (SAR)/currency transaction report (CTR) reporting regime, and how the compliance regimes might be improved.

In my testimony I will provide information and opinions regarding the following: Trends in compliance, Suspicious Activity Reports (SARs), Know Your Customer (KYC)/Customer Due Diligence (CDD), and the balance of activity and obligations between the Financial Crimes Enforcement Network (FinCEN) and the private sector. Some of my remarks will directly address recent proposals by The Clearing House in their publication *A New Paradigm: Redesigning the U.S. AML/CFT Framework to Protect National Security and Aid Law Enforcement*. (CFT refers to countering the financing of terrorism.)

<u>Some of the key points that I will be making in my testimony are</u>:

1. Money laundering and the technology that can help us combat it are both evolving and, in light of this, it is appropriate to consider whether changes to our regulatory structure should be made. Equally, however, it is critical that Congress consider and carefully weigh the potential benefits against potential negative ramifications before making decisions in this area. Regulation and enforcement are primarily dissuasive measures because they carry potential liability, and we should be very careful when we look to decrease those dissuasive measures.

2. AML compliance and reporting is undertaken by a wide range of entities and persons, going far beyond the banking sector. Any proposed changes should consider the implications for all of these types of entities and persons.

3. Some types of entities and persons should be required to have AML programs in place that currently do not, such as those involved in real estate closings, lawyers, and others. The banking sector cannot and should not carry this responsibility alone, especially where these persons act as a proxy to open the door to the financial system for criminals and their money.

4. Congress should request from the various regulators data regarding formal and informal enforcement actions pertaining to AML/BSA violations and deficiencies so that they are able to independently asses the appropriateness of the enforcement regime currently in place.

5. Both small banks and large banks have been the subject of major money laundering cases.

6. Enforcement against money laundering is primarily through identification of regulatory infractions as opposed to through criminal charges of actually laundering money. This may be because it is much easier to find evidence of regulatory infractions, the burden of proof is lower, the cost of doing so is far less than pursuing a criminal money laundering charge, and the dissuasive effect is just as great. However, when one looks at the cases where enforcement was merely through identification of deficiencies of AML systems and filing requirements, the hallmarks of serious criminal money laundering are there in the cases. As a result, decreasing the ability to enforce using the regulatory approach may have serious, negative repercussions on compliance and, ultimately, criminal access to the U.S. banking system.

7. Suspicious Activity Reports are meant to be just that, reports of “suspicious” activity. Requiring bank employees to determine if activity is in fact illegal before filing a SAR would be counterproductive for a number of reasons, including increasing the burden on bankers who would consequently have to make a new, legal determination.

8. The Clearing House recommends greater information sharing among banks and with the government in a number of ways. While we generally support greater sharing of information in the AML area, it must be done with appropriate privacy safeguards. Where it may result in a person being denied banking services at all, there must be a system for redress for people to be able to restore that access if they can demonstrate that they are involved in legitimate activity.

9. It is critical that information about the natural person(s) who own or control companies (the beneficial owners) is finally collected by either the state or federal government and is made available to law enforcement and to financial institutions. Companies with unknown or hidden ownership are the number one problem in the AML world and the U.S. cannot continue to allow our failure to act to put the U.S. and global financial system at risk.

10. I would strongly caution against transferring responsibility for setting AML priorities for individual banks from those banks to FinCEN. Banks are best placed to understand their business and their systems and the money laundering risks inherent therein, and create the systems that work best in their business models to combat money laundering. FinCEN and/or other regulators should review those assessments but cannot be responsible for carrying them out.

11. Transferring raw baking data from banks to FinCEN to analyze (with appropriate privacy safeguards) is not a bad idea. However, not absolving banks of the responsibility to carry out their own analysis as well, which they have the ability to review within the context of the additional client information that they have, is essential because they are the gatekeepers to the financial system. The federal government cannot do this alone.

12. Money laundering and sanctions violation cases over the past few years relate to willful, knowing, and egregious violations of U.S. laws and regulations that have resulted in U.S. and foreign banks granting access to hundreds of millions of dollars in funds supporting genocide and funds supporting major, violent South American drug cartels into our system, to name a few examples. The fines that have resulted from these cases have been seen by the banking industry as heavy and so banks have begun to take AML regulations that have been in place for many years more seriously as the possibility and repercussions of enforcement have increased. I would therefore remind Members of Congress that the regulatory "burden" has not actually been increasing, the threat of being found out is what has actually increased.

Preface: Who Has AML Compliance Responsibilities?

One thing to keep in mind for the purposes of AML is that the term "financial institution" (FI) is defined very broadly and encompasses a much wider range of types of entities than most people realize. Being classified as a financial institution means that an entity must generally have some sort of AML compliance in place, with the main types of FI's[1] being required to have an AML compliance program, conduct customer due diligence and know your customer checks, monitor accounts, and file suspicious activity reports and currency transaction reports. I have included the definition of "financial institutions" at the end of this testimony for information. Today you have before you representatives from three banking associations, but it is important to consider that any changes to the AML/CFT regime will affect a much wider range of entities and persons, such as currency exchanges, casinos, dealers in precious metals, stones or jewels, pawn brokers, and insurance companies, which you should also factor into your decision-making.

[1] This includes insured banks, commercial banks, agencies or branches of a foreign bank in the U.S., credit unions, savings associations, corporations acting under section 25A of the Federal Reserve Act 12 USC 611, trust companies, securities broker-dealers, futures commission merchants (FCMs), introducing brokers in commodities (IBs), and mutual funds. FATF Mutual Evaluation Report of the United States, December 2016, available at http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf.

There are also a few persons that ought to have U.S. AML obligations but currently do not. Although banks serve as an immediate gateway into the U.S. financial system and must therefore bear significant responsibility for preventing criminals and other wrongdoers from finding safe haven here, they shouldn't bear that responsibility alone. Other actors that handle large sums of money, such as persons involved in real estate transactions, escrow agents, investment advisors, lawyers, corporate service providers, and accountants must also take responsibility for knowing with whom they are doing business and guard against their services being used to launder dirty money. Excluding these non-bank sectors renders the U.S. financial system vulnerable to serious, ongoing money laundering threats as shown by multiple media reports about how, for example, anonymous ownership of high-value real estate facilitates money laundering[2], a 60 Minutes segment showing how lawyers facilitate money laundering by corrupt foreign government officials[3], and of course the Panama Papers which disclosed how corporate formation agents and lawyers help wrongdoers hide and launder criminal proceeds.

Technically, persons involved in real estate closings are already classified as FIs per the definition established by the USA PATRIOT Act in 2001, but they were given a "temporary exemption" (which had no sunset clause) from AML compliance requirements in 2002. Despite Treasury conducting a comment period with respect to AML compliance in the real estate sector in 2003, they have not removed that temporary exemption. Congress should consider doing so.

Addressing the money laundering risks posed by these non-bank sectors and actors would finally bring us in line with international anti-money laundering standards—agreed to by the U.S., as a leading member of the Financial Action Task Force (FATF), the international anti-money laundering standard-setting body. In FATF parlance, most of these persons are referred to as "Designated Non-Financial Businesses and Professions". Members of FATF, including the U.S., are supposed to require most of these persons to have AML compliance programs, and many of its member countries have already done so.

I. <u>Trends in Compliance</u>

A. Understanding Regulatory Enforcement Data

As you know, the money laundering realm is governed by statutes which both criminalize the act of laundering money[4] and impose civil and criminal penalties for the failure of a financial institution to have an effective AML program.[5] Under federal law, the type, nature, and scope of a financial institution's AML systems and controls depend upon the institution's risk profile, which differs significantly for banks that, for example, serve a local, rural community versus a global institution that operates in high-risk foreign environments. A financial institution's risk profile depends upon its

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[2] See, e.g., *The New York Times* series "Towers of Secrecy" available at https://www.nytimes.com/news-event/shell-company-towers-of-secrecy-real-estate.

[3] Can be accessed at http://www.cbsnews.com/news/anonymous-inc-60-minutes-steve-kroft-investigation/.

[4] 18 U.S.C. §§1956-1957.

[5] The Currency and Foreign Transactions Reporting Act of 1970, 31 U.S.C. §5311 et seq. (regulations at 31 C.F.R. Ch. X).

assessment of the types of risks it faces, which are a function of where it operates, what products and services it offers, and what clients it takes on, among other variables.

Developing accurate risk assessments and AML compliance regimes is therefore an art and not a science, and requires a great deal of judgment. It is the job of the regulators to determine if a financial institution has gotten it right – whether the FI's risk assessment is comprehensive and reasonable, whether its AML systems and controls are appropriately responsive to those risks, and whether those systems and controls are effective. The examination reports that result from regulators' reviews are highly confidential and exempt from public records requests,[6] although this Subcommittee has the authority to review those examination reports should it want to review their content and reasonableness.[7]

My organization was hired by a third party in 2015 to undertake a confidential study of AML enforcement in the U.S. and the U.K. between 2001 and 2015. That study was carried out by myself and our Policy Counsel Elizabeth Confalone. I have permission to share some of our observations from that report with you today, but unfortunately I am unable to share the entire report.

- One of our primary observations was that, apart from the rather small number of publicly available deferred prosecution agreements (DPAs) and non-prosecution agreements (NPAs) that financial institutions have entered into with respect to AML-related activity, it is extremely difficult to determine the number and nature of the formal and informal enforcement actions taken by regulators in response to BSA/AML deficiencies.

- A second observation was that, based upon a review of the enforcement actions that could be identified as related to AML deficiencies, the federal government rarely charged a financial institution with the criminal offense of money laundering, favoring instead a finding that the institution had violated federal requirements to have an effective AML program and report suspicious activity to law enforcement. Charging financial institutions with an ineffective AML program dominated enforcement actions, even when the hallmarks of criminal money laundering seemed clearly present in the cases. This may be because it is easier to prove deficiencies in AML compliance than it is to meet the criminal standard of proof for money laundering. In light of this, it is important to carefully consider how, for example, shifting responsibility for AML risk analysis for FIs and aggregate data analysis from the private sector to FinCEN (as has been proposed in different ways by The Clearing House) could hamper the government's use of civil enforcement actions to combat money laundering using less time and fewer government resources than criminal prosecution would entail, with the same dissuasive results.

[6] Exemption of examination reports from public availability. See 12 CFR §261.14 (Federal Reserve Board); 12 CFR §309.5(g)(8) (FDIC); 12 CFR §4.12(b)(8) (OCC).

[7] Prohibition on banks disclosing information from their examination reports. See 12 CFR §261.20(g), 12 CFR §261.2(c)(1) (Federal Reserve Board); 12 CFR §350.9 (FDIC); 12 CFR §18.9 (OCC).

The bottom line is that it is unclear how much policymakers really know about enforcement related to BSA/AML. The regulatory agencies can take both formal and informal enforcement actions against FIs. While formal enforcement actions are typically public, informal actions may result in a non-public memorandum of understanding (MOU), which requires a bank to take remedial actions to resolve AML deficiencies.

The amount of information available from each agency about their informal enforcement action varies. When we examined annual reports for the regulators as part of our research in 2015, the FDIC was the most transparent agency with respect to statistical reporting, reporting both formal and informal actions and further disaggregating these figures for BSA/AML actions specifically.[8] The U.S. Federal Reserve Board[9] and the U.S. Office of the Comptroller of the Currency[10], report some information about the number of MOUs undertaken, but the nature of the conduct giving rise to the agreements was not available. The National Credit Union Administration and FinCEN did not report any comprehensive figures on their enforcement actions.

The nonpublic nature of most informal enforcement actions plus the lack of useful statistical data about them leaves policymakers in the dark about the number, nature, and impact of current informal AML enforcement actions, a problem that could be remedied in part if this Committee were to request and analyze the related documents.

Another problem is that, while formal enforcement actions were publicly available, the summary information that was searchable and sortable did not include any reference to the type of infraction that gave rise to the action (AML, sanctions, mortgage related, consumer lending, etc.), nor did it reference the laws or regulations that were violated. We constructed a database of public agency enforcement data that spanned from 2001 to early March 2017 and were able to locate approximately 7400 enforcement records. Without being able to sort these actions into infraction categories it is not practicable to conduct a thorough analysis of the BSA/AML violations that may be found in these records. The only alternative is to open and review each of these records to determine the nature of the enforcement action. The exception is the actions by FinCEN, which must all be AML/BSA related, as discussed below.

A final, counter-intuitive problem is that a formal enforcement action does not always indicate misconduct, and where it does address misconduct, the misconduct exists on a spectrum. Depending on

[8] *See e.g.*, FDIC, 2014 Annual Report, at 25, Mar. 2015 (reporting 41 consent orders and 180 MOUs, of which 20 consent orders and 23 MOUs addressed at least some BSA/AML violations), https://www.fdic.gov/about/strategic/report/2014annualreport/2014AR_Final.pdf.

[9] *See e.g.*, Board of Governors of the Federal Board System, 100th Annual Report: 2013, at 51, May 2014 (reporting 50 formal enforcement actions and 161 informal enforcement actions), *available at* http://www.federalreserve.gov/publications/annual-report/files/2013-annual-report.pdf.

[10] *See e.g.*, OCC, Annual Report Fiscal Year 2013, at 39 (reporting 97 formal enforcement actions and 46 informal enforcement actions, including 7 MOUs), *available at* http://www.occ.gov/publications/publications-by-type/annual-reports/2013-OCC-Annual-Report-Final.pdf.

the agency, these enforcement actions can range from something routine and not indicative of actual wrongdoing, for example the FDIC terminating deposit insurance for a banking unit whose deposits were transferred to another bank within the group,[11] to the exceptional, like the willful and systematic violation of sanctions laws. As a result, one cannot even equate the number of enforcement actions against FIs with actual wrongdoing.

An additional feature of this multiple-regulator system is that banks within the same banking group may be subject to supervision by different regulators, so that frequently there will be more than one enforcement action against the same banking group for the same violations (perhaps one against the bank actually engaged in the misconduct and another against its holding company or parent). Therefore, the presence of numerous records related to one bank does not necessarily indicate a higher degree of misconduct, as each record shown on agency websites is not necessarily a separate case. In addition, there may be more than one record (or document) issued by the same agency on the very same matter.

In other words, out of 7,400 actions there may be only 5,500 different cases, 1,000 of those notices may have been simply notice of a routine change in supervision, and perhaps 2,500 of the remaining 4,500 actions were AML related. 2,500 AML related enforcement actions over 14 years is about 180 action notices per year. These are simply guestimates and the numbers may be substantially different, but this should be part of Congress' analysis.

B. <u>What Does an Overview of Selected Enforcement Tell Us?</u>

The best source of data on AML/BSA-specific enforcement actions providing sufficient detail for adequate analysis are (i) non-prosecution agreements ("NPAs") and deferred-prosecution agreements ("DPAs"), and (ii) FinCEN data, as discussed above. My organization, Global Financial Integrity, reviewed those data sets in order to conduct a more detailed analysis of AML/BSA-specific violations and trends in enforcement. I will analyze each of these in turn.

FinCEN Enforcement Actions

The first body of materials we reviewed were the FinCEN enforcement actions. Unlike bank regulatory agencies that tend to be more concerned with ensuring the general health and stability of our financial system, FinCEN's specific mission is to "safeguard the financial system from illicit use and combat money

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[11] *See e.g.,* FDIC, *In the Matter of Wells Fargo Bank Michigan, National Association*, Order of Approval of Termination of Insurance, No. FDIC-04-185q, Sept. 4, 2004 ("Wells Fargo Bank, National Association, San Francisco, California ("Wells Fargo"), has provided to the FDIC on August 16, 2004, satisfactory evidence that it has assumed the liabilities for deposits of Wells Fargo Bank Michigan, National Association, Marquette, Michigan ("Insured Institution"), as of February 20, 2004, as required by section 307.1 of the FDIC's Rules and Regulations, 12 C.F.R. §307.1, and that Wells Fargo has notified the Insured Institution's depositors of its assumption of their deposits..."), *available at* https://www5.fdic.gov/EDOBlob/Mediator.aspx?UniqueID=f7299e5f-a4be-4c57-8a09-813447369778.

laundering and promote national security."[12] As a result, FinCEN's enforcement actions relate solely to issues involving money laundering and illicit finance.

Given the available data, GFI analyzed 61 separate actions[13] against 52 different banks.[14] There were 26 American banks subject to FinCEN actions, and 26 foreign banks and U.S. branches and offices of foreign banks that were subject to FinCEN actions. Each case involved multiple failings over a period of years, making categorization of the violations challenging.

Within the FinCEN actions, the most common thread was a failure to file suspicious activity reports. The vast majority of the actions reviewed identified this violation, which was usually accompanied by a large range of other AML system violations such as a failure to carry out customer due diligence, failure to verify the source and use of funds, failure to identify red flag activity, failure to have an adequate AML program, failure to have enough compliance staff, and failure to train staff, among other deficiencies.

Among the full body of 61 cases, 13 of the actions included problems relating to money service businesses (MSBs) (mainly foreign) and the processing of the cash and monetary instruments by those MSBs, including issues with the identification and risk-rating of MSB clients. Ten of the actions involved problems with the management of foreign correspondent accounts and the processing of the cash and monetary instruments for correspondent accounts, including the identification and risk-rating of the clients. Several banks had violations relating to their failure to file required currency transaction reports, and there were a hodge-podge of other specific violations as well, such as fraud and problematic trade finance activity. Five of the actions involved banks that had foreign Politically Exposed Person (PEP) clients, some coupled with failures to carry out adequate customer due diligence on those PEPs, to verify the source and use of funds, or monitor the client accounts appropriately.

The FinCEN actions contained damning details illustrating the banks' failures, but were always drafted to focus on the civil law violations as opposed to the activity that might, in fact, be criminal. For example, The Foster Bank, based in Chicago, was sanctioned by FinCEN for violations relating to having an ineffective money laundering program in place. Illustrating the types of activity that Foster's AML deficiencies permitted to occur, the FinCEN action states:

> For example, from April 1999 through August 2002, one customer who operated a sportswear business purchased approximately $674,390 in cashier's checks, all individually purchased below the $3,000 Bank Secrecy Act recordkeeping threshold for monetary instrument transactions. Concurrently, from April 1999 through August 2002, the same customer engaged

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[12] Financial Crimes Enforcement Network, Mission Statement, available at http://www.fincen.gov/about_fincen/wwd/mission.html.

[13] Technically, the DPAs and NPAs are "cases" and the FinCEN notices are "actions," however for ease of reference we will use the term "actions" here.

[14] In a few instances there was both a FinCEN action, as well as a DPA or NPA relating to the same bank activity, and we have counted those as one case each because they cover the same bank activity.

> in a pattern of structured transactions involving over $6,199,616 in cash deposits in amounts under $10,000 per deposit. Ultimately, in December 2002, the Bank discovered that this customer had conducted nearly $10 million in cash transactions between April 1999 and November 2002.
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> Another Foster customer routinely made cash deposits in the amounts of $9,900 up to four times daily. The Bank retained no documentation in its file to support a legitimate business reason for these deposits.
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> Other customers engaged in large aggregate cash transactions, totaling an average of $300,000 to $600,000 per month, at least some of which appeared to be designed to avoid currency transaction reporting. Foster did not have documentation supporting the legitimacy of the customers' banking activities and failed to file timely suspicious activity reports for these customers.[15]

This description indicates that that these customers were engaging in activities that were likely illegal, given the lengths that they went to in order to the avoid money laundering reporting requirement that deposits of $10,000 or more be reported to FinCEN on a Currency Transaction Report (CTR). The FinCEN action is concerned with Foster's failure to identify these avoidance techniques, but we can find no corresponding case in Illinois where the bank is actually charged with the criminal act of laundering money for its clients. At the time we conducted this research, we did not find any records relating to prosecution of persons in Illinois who used the accounts at Foster Bank, although a case against an individual might not mention the bank's name. Therefore, while this case has multiple hallmarks of money laundering activity, there was no prosecution for the laundering that we could find. Further, we were unable to find evidence that these clients' activities were even investigated by Illinois state or federal authorities.

Having reviewed the FinCEN actions, we are under the impression that the vast majority of the sanctioned banks knew or should have known (as is the standard) that their services were being used to launder proceeds of some sort of illegal activity (although they may not have known precisely what kind of illegal activity), and that some of the banks may have either been established for that specific purpose, or the banks' business was somehow taken over by those clients. This misconduct is most evident in the cases relating to small banks, where in several cases the clients that were engaging in activity that should have raised red flags and caused the banks to file SARs were a large percentage of the small bank's business.

For example, North Dade Community Development Federal Credit Union was a non-profit community development bank based in North Dade County, Florida, with $4.1 million in assets. As a community development bank, its clients were supposed to be limited to people who live, work or worship in the

[15] FinCEN, Assessment of Civil Money Penalty against The Foster Bank, Case No. 2006-8, at 5, http://www.fincen.gov/news_room/ea/files/foster.pdf.

North Dade County area. North Dade had only one branch and only five employees. Despite its small, local focus, North Dade was servicing multiple money service businesses that were located outside of its geographic field of membership and that were engaging in high-risk activities. For example, records showed "(1) deposits in excess of $14 million in U.S. cash that was physically imported into the United States on behalf of nearly 40 Mexican currency exchangers, and (2) hundreds of millions of dollars in wire transfers to foreign bank accounts of MSBs located in Mexico and Israel."[16] It is difficult to believe that the bank's five staff members were unaware of the likelihood that the bank was being used to launder money via their MSB clients, and it is wholly possible that the bank was either illegally established for that purpose or was overtaken by criminal clientele.

DPAs and NPAs

The second body of material we reviewed with respect to BSA/AML violations were DPAs and NPAs, which we drew from the University of Virginia School of Law's *Federal Organizational Prosecution Agreements* collection.[17] As you know, NPAs and DPAs represent a step beyond agency enforcement actions. They represent settlements of criminal and civil cases brought by the government against corporations where the corporation generally admits to certain facts, agrees to take certain remedial measures, and often pays a fine in exchange for the government deferring or discharging the prosecution. In the case of NPAs, the matter is settled once the government has signed the agreement. In the case of DPAs, the government has the option of renewing the prosecution if the company does not implement the required remedial measures or continues to otherwise act unlawfully.

The DPAs and NPAs we reviewed settled actual cases against banks brought by the U.S. Department of Justice. We reviewed 36 DPAs and NPAs involving banks. Eleven of those did not involve AML/BSA-related infractions. Eight of the agreements related to sanctions-busting violations, where the banks were stripping wires of key information, re-routing the wires, or taking other actions to evade U.S. sanctions laws. Fourteen cases involved money laundering violations, ten of which were also the subject of FinCEN actions, and therefore included in the analysis above. Only four banks were the subject of money laundering-related DPAs/NPAs that did not have a corresponding FinCEN action. Five of the cases were against large, international banks for aiding and abetting large-scale tax evasion by Americans. Several cases were included in the count of both the sanction violations and money-laundering categories because their conduct and the terms of their agreements included both types of violations.

Several of the money laundering cases involved funds being moved from developing or middle income countries into the U.S. via money service businesses or correspondent banking activities. The majority of the countries involved were South or Central American (mainly focusing on the Black Market Peso Exchange) or Middle Eastern. One case involved a bank in Nigeria and one case involved Russian banks.

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[16] FinCEN, *In the Matter of North Dade Community Development Federal Credit Union,* Number 2014-07, at 7, 8, 9, Nov. 25, 2014 (hereinafter, "FinCEN North Dade Enforcement Action"), http://www.fincen.gov/news_room/ea/files/NorthDade_Assessment.pdf.

[17] Brandon L. Garrett and Jon Ashley, *Federal Organizational Prosecution Agreements*, University of Virginia School of Law, at http://lib.law.virginia.edu/Garrett/prosecution_agreements/.

The countries that arise in these cases are not surprising in light of the American political priorities of fighting drug crime and terrorist financing.

C. <u>Conclusion of Analysis and Recommendation</u>

Our analysis of the AML enforcement data showed that small banks, even local banks, can be and are used to move illicit funds in the same way that large, international banks are used. In addition, our analysis of the DPAs, NPAs and FinCEN actions establishes that banks of all sizes knowingly and intentionally facilitate the movement of illicit funds. In none of the cases reviewed does it appear that the bank was unwittingly involved in the movement of illicit money, many of which appeared to have been the subject of previous regulatory warnings. SAR filing violations were a factor in almost every single one of these cases, but they were far from the most serious violations.

Due to the data limitations, our analysis is incomplete. Additional analysis should be undertaken prior to making major alterations to the existing U.S. AML regime. **We therefore recommend that the Members of the Subcommittee undertake a more in-depth review of the AML enforcement data prior to making any policy changes.** This review could include requesting each regulator to identify which of their formal and informal enforcement actions over the last ten years relate to AML/BSA or sanctions violations and to include information in the searchable/sortable data fields indicating the type of infraction involved and the laws or regulations that were violated. In addition, we recommend that the Subcommittee obtain the documents related to a sample of the formal and informal enforcement actions taken by each agency to get a better sense of the misconduct involved and the quality of enforcement actions taken. Finally, it would be ideal if all the regulators adopted the same fields and display format on their website. This will allow for more effective and efficient Congressional oversight moving forward, and make it easier for FIs to search the data to identify evolving criminal methods and trends.

II. <u>Suspicious Activity Reports (SARs)</u>

The Subcommittee also asked GFI to discuss issues related to Suspicious Activity Reports (SARs). It is important for the Subcommittee to understand that SARs were intended to be just that, reports of *suspicion* of criminal activity. They are not called *illegal activity reports,* because FI employees are not required to determine if the activity they are seeing is actually illegal. Instead, FI employees are supposed to file reports where they see something out of the ordinary and simply have a suspicion that there is a problem. Requiring bank employees to go further and make a determination that an activity is actually illegal would be an unrealistic and unwarranted expectation. There is no "bright line" test for when a SAR should be filed because that is contrary to the intended nature of a SAR.

The Clearing House has nevertheless proposed that further guidance be provided by FinCEN to "relieve financial institutions of the need to file SARs on activity that is merely suspicious without an indication that such activity is illicit." That recommendation would fundamentally change the nature of SAR reports and would actually make bank employees' tasks much more difficult and risky. After all, it clearly requires a greater amount of effort and legal analysis to determine whether an activity is, in fact, illicit rather than merely suspicious.

One source of tension in this area appears to be that law enforcement wants SARs to include as much information as possible, in as standard a format as possible, and that their demands for greater detail and specificity have grown over time. FI employees may not have the desired level of detail that law enforcement would like, but that is simply a reality of money laundering cases which often involve hidden conduct and individuals. The SAR instructions properly allow FI employees to complete a filed by stating that the information is “unknown”; that option should be honored by law enforcement rather than trying to require FI employees to become detectives uncovering illegal conduct.

The Clearing House has proposed that new regulations allow FIs to share SAR information among foreign affiliates and branches. GFI supports this recommendation; its importance was made clear in the HSBC case. A related issue, however, is what actions FI’s affiliates and branches are required or permitted to take in response to receiving this information. I understand that there have been cases where a person’s accounts have been closed by a bank because it received information that another bank identified the person as suspicious, making it difficult for that person to establish banking relationships elsewhere. If FIs are permitted to close accounts based upon suspicions communicated to them by other banks, Congress should ensure that there is some mechanism for appeal or redress for individuals wishing to establish their bona fides. Such closure of accounts may also serve to “tip off” the account holder that they are the subject of a SAR, contrary to the SAR confidentiality requirements.

It seems that there may need to be a better balancing of expectations in this area. It is possible that there may be new technological approaches that can also be brought to bear and the government should find ways of encouraging new approaches, including through the creation of a technological “sandbox”, as has been proposed by The Clearing House and has been implemented in the UK. The UK structure appears to have some specific safeguards to protect consumers, however, which they consider to be an integral part of their system. I have not had an in-depth look at the UK program, regulators presented it at a recent FATF industry consultation meeting I attended, but they stressed the importance of ensuring that consumers were protected at all times as innovative approaches were being tested, and the U.S. should do the same.

III. <u>Know Your Customer (KYC)/Customer Due Diligence (CDD)</u>

As part of their customer due diligence, or CDD, procedures, FIs are supposed to know their customers by engaging in Know Your Customer, or KYC, procedures. In banking terms, knowing your customer is more than just knowing who the owners or controllers of the company are (known as “beneficial ownership” information), it is also understanding how that legal or natural person will be using the account so that the account can be appropriately monitored for possible money laundering activity. Establishing the expected normal use of the account is imperative if the FI is to effectively monitor for suspicious activity going forward. Moreover, the beneficial owner of the account, the type of business using the account, whether that business is cash intensive, and other factors all contribute to an account’s risk profile, and that risk profile determines what type and level of monitoring the account will be subject to.

However, knowledge of the beneficial owner(s) of a company holding an account is a critical question in KYC. Therefore, one Clearing House proposal that GFI wholeheartedly supports is its proposal that information about the beneficial owners of U.S. companies—the actual individuals who own or control those companies—should be collected at the time that companies are incorporated in the U.S. and that this information should be made available to law enforcement and financial institutions. This is an issue that has been gaining visibility and urgency on a global level. This is because anonymous companies, or companies with hidden owners, are the most frequently used vehicle for money laundering. That's why identifying who owns or controls a company is a fundamental step necessary to combat the problem.

In response to the global movement towards greater corporate ownership transparency, in May 2016, the U.S. Treasury Department adopted a regulation which more explicitly requires banks to obtain beneficial ownership information beginning in May 2018. Unfortunately, that regulation includes some significant loopholes and so has not been deemed compliant with international AML standards in the most recent evaluation of the U.S. AML system by the IMF. Hopefully, Treasury will be making improving that regulation a priority in order to bring the U.S. into compliance with international AML standards and ensure that true beneficial ownership information is being collected.

But whether or not the U.S. improves its regulation, U.S. banks that operate in other countries are already subject to strong corporate transparency standards that are only getting stronger. As a result, the multinational banks that belong to The Clearing House want beneficial ownership information for U.S.-formed entities to be collected by either those who incorporate the companies or by an appropriate government entity so that they can use the information as a key data point in their customer due diligence process. While we do not support banks being allowed to rely on this information alone in their customer due diligence procedures, the information could and should be an extremely helpful starting point in the "know your customer" process and as a tool to verify information supplied by the client. Accordingly, we strongly support The Clearing House beneficial ownership proposal, which is soon to be the subject of bipartisan legislation in the House and Senate.

IV. <u>The Balance of Activity and Obligations Between FinCEN and the Private Sector</u>

The Clearing House has proposed that (i) for the large multinational FIs, all enforcement power should be consolidated within FinCEN, (ii) data collection and analysis should be shifted from the private sector to FinCEN, and (iii) for the large multinational FIs, FinCEN/Treasury should establish priorities for each FI on an annual basis, review progress with each FI every three months, and oversee any examination of an FI. I'll address each in turn.

First, while the proposal to consolidate AML enforcement power in FinCEN has surface appeal, it would also be at odds with a major principle in federal law regulating FIs. Federal law now authorizes different functional regulators to regulate different FI activities in order to make use of their specialized expertise. For example, the SEC is now given primacy over securities activities at FIs because it understands the securities markets and their inherent risks. Similarly, the Commodity Futures Exchange Commission oversees AML issues affecting commodity trading and state insurance regulators examine AML issues affecting FI insurance activities, again because each regulator is expert in their own field. If AML enforcement power were instead consolidated in FinCEN, the sector-specific AML experts now working at the individual regulators would have to be transferred to FinCEN, swelling its ranks and reach. There are strengths and weaknesses to continuing the current disbursed AML oversight system versus concentrating AML oversight at FinCEN, and the issues and tradeoffs would need to be carefully thought through.

The suggestion that FinCEN be given access to bulk data transfers from FIs to enable it to analyze AML trends and patterns across institutions is another potentially useful idea. But questions about the effectiveness and cost of this proposal include whether FinCEN currently has the technological capability and personnel needed to perform that type of data analysis or whether it would need to be built, which could be a significant expense. Privacy issues are another concern. In addition, charging FinCEN with industry-wide data collection and analysis should not be seen as a way for banks to absolve themselves of their AML obligations. The banks would retain their function as the primary gateway into the U.S. financial system, so the first level of responsibility to safeguard the system against money laundering abuses must remain with the individual banks who open their accounts to individuals and entities around the world.

The third proposal, to essentially charge FinCEN with establishing annual AML priorities for every large multinational bank and monitoring every bank's progress every three months, is ill-advised. The FI understands its business and products better than anyone else. It is therefore best-placed to determine what its AML risks are and how best to address those risks within the systems that it has created. We support the idea of an FI working with FinCEN/Treasury to discuss those risks in the context of national and global trends observed by FinCEN, and whether adjustments might be made as a result, however. Review each FI's progress in AML every three months seems like far too short a time frame to observe how an FI is progressing in this respect, however, and entirely impractical from a government resource allocation perspective.

Overall, it is critical that the Subcommittee understand that changes of the magnitude suggested by The Clearing House would require a huge appropriation from the federal budget to pay for, among other things, a very large staff increase and procedural and technological improvements at FinCEN. In addition, many new regulations would have to be drafted to give effect to these changes. The result would be a much bigger government agency and a bigger FinCEN impact on AML activities. Careful analysis is needed to determine whether the benefits of each of these changes would outweigh the costs.

Finally, I am in favor of exploring the ways in which today's (and tomorrow's) technology can be used to innovate in the AML compliance sphere and believe that the government should be supporting such innovation (usually referred to as "FinTech"). Northern Europe seems to be leading in this space, and it would be helpful to create a better environment for such innovation in the U.S.

V. <u>Conclusion</u>

In conclusion, positive changes can be made to the AML regulatory structure, but they must be made carefully, with good data, and only after thinking through as many of the potential ramifications as possible.

Unfortunately for the banking community, many of the high profile, incredibly egregious cases that involve the biggest banks in the world have eroded public trust that banks will indeed act in a manner that is law-abiding and actively try to turn away proceeds of crime. The Members of this Subcommittee may find a 2015 study by the University of Notre Dame and the law firm of Labaton Sucharow, entitled *The Street, the Bull, and the Crisis*, to be of interest. The researchers surveyed more than 1,200 U.S. and UK-based financial services professionals to examine views on workplace ethics, the nexus between principles and profits, the state of industry leadership and confidence in financial regulators. As the report states, "The answers are not pretty. Despite the headline-making consequences of corporate misconduct, our survey reveals that attitudes toward corruption within the industry have not changed for the better."[18]

Some of the banks that have been the subject of these high-profile, egregious cases are members of The Clearing House, whose proposals for regulatory change are before this Subcommittee. That does not necessarily mean that the proposed changes are unwarranted, but it is the responsibility of Congress to make informed decisions about the extent to which each of these proposals is also in the public interest. Deregulation for the sake of deregulation in the AML area is most certainly not in the public's interest. Making it easier for banks, knowingly or unknowingly, to take in greater inflows of drug money, the proceeds of human trafficking, the ill-gotten gains of foreign dictators, and terror financiers is not in the best interest of anyone.

Thank you for the opportunity to share my views on such an important topic.

[18] *The Street, the Bull and the Crisis* is available at https://www.secwhistlebloweradvocate.com/pdf/Labaton-2015-Survey-report_12.pdf.

Definition of Financial Institution (31 U.S.C. §5312(a)(2))

(2) “financial institution” means—

(A) an insured bank (as defined in section 3(h) of the Federal Deposit Insurance Act (12 U.S.C. 1813(h)));
(B) a commercial bank or trust company;
(C) a private banker;
(D) an agency or branch of a foreign bank in the United States;
(E) any credit union;
(F) a thrift institution;
(G) a broker or dealer registered with the Securities and Exchange Commission under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.);
(H) a broker or dealer in securities or commodities;
(I) an investment banker or investment company;
(J) a currency exchange;
(K) an issuer, redeemer, or cashier of travelers’ checks, checks, money orders, or similar instruments;
(L) an operator of a credit card system;
(M) an insurance company;
(N) a dealer in precious metals, stones, or jewels;
(O) a pawnbroker;
(P) a loan or finance company;
(Q) a travel agency;
(R) a licensed sender of money or any other person who engages as a business in the transmission of funds, including any person who engages as a business in an informal money transfer system or any network of people who engage as a business in facilitating the transfer of money domestically or internationally outside of the conventional financial institutions system;
(S) a telegraph company;
(T) a business engaged in vehicle sales, including automobile, airplane, and boat sales;
(U) persons involved in real estate closings and settlements;
(V) the United States Postal Service;
(W) an agency of the United States Government or of a State or local government carrying out a duty or power of a business described in this paragraph;
(X) a casino, gambling casino, or gaming establishment with an annual gaming revenue of more than $1,000,000 which—
(i) is licensed as a casino, gambling casino, or gaming establishment under the laws of any State or any political subdivision of any State; or
(ii) is an Indian gaming operation conducted under or pursuant to the Indian Gaming Regulatory Act other than an operation which is limited to class I gaming (as defined in section 4(6) of such Act);
(Y) any business or agency which engages in any activity which the Secretary of the Treasury determines, by regulation, to be an activity which is similar to, related to, or a substitute for any activity in which any business described in this paragraph is authorized to engage; or

(Z) any other business designated by the Secretary whose cash transactions have a high degree of usefulness in criminal, tax, or regulatory matters.

Exempted anti-money laundering programs for certain financial institutions. 31 C.F.R 1010.205(b)(1)

(b)Temporary exemption for certain financial institutions. [no sunset clause]

(1) Subject to the provisions of paragraphs (c) and (d) of this section, the following financial institutions (as defined in 31 U.S.C. 5312(a)(2) or (c)(1)) are exempt from the requirement in 31 U.S.C. 5318(h)(1) concerning the establishment of anti-money laundering programs:
(i) Pawnbroker;
(ii) Travel agency;
(iii) Telegraph company;
(iv) Seller of vehicles, including automobiles, airplanes, and boats;
(v) Person involved in real estate closings and settlements;
(vi) Private banker;
(vii) Commodity pool operator;
(viii) Commodity trading advisor; or
(ix) Investment company.