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"A Legislative Proposal to Counter Terrorism and Illicit Finance"

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Chairmen Pearce and Luetkemeyer, Ranking Members Perlmutter and Clay, and distinguished members of the House Financial Services Subcommittees on Terrorism and Illicit Finance and Financial Institutions and Consumer Credit, I am honored by your invitation to testify before you today.

We are confronting a pivotal moment in our 48 years of combatting illicit finance under the Bank Secrecy Act ("BSA"). As our counter-illicit financing efforts have expanded and become ever more important, they are also increasingly challenged – provoking fundamental questions of effectiveness, cost, roles and responsibilities, and, ultimately, sustainability. The combination of these developments necessitates fundamental reform of the BSA and the expanded anti-money laundering / countering the financing of terrorism ("AML/CFT") regime it supports.

This hearing marks an important and welcome opportunity to discuss how best to pursue such fundamental reform in modernizing the BSA and the U.S. AML/CFT regime. I am grateful for your leadership in addressing these issues, including through the proposed Counter Terrorism and Illicit Finance Act and the proposed End Banking for Human Traffickers Act of 2017 under consideration by your Subcommittees.

Our BSA and broader AML/CFT reform efforts require both immediate action and enduring attention by Congress. These efforts must consider:

I. The need for a strategic approach to address mounting frustrations of all AML/CFT stakeholders;

II. The modern evolution of our AML/CFT regime to understand the expanded interests, heightened complexity, unprecedented importance, and global reach that it now encompasses; and

III. Legislative action amending the BSA to establish a comprehensive framework for guiding and managing our expanded AML/CFT regime in an effective, efficient, and enduring manner.

My testimony below follows this roadmap and concludes by offering detailed recommendations for Congress to expand, amend, and strengthen the proposed Counter Terrorism and Illicit Finance Act.

My recommendations are broadly guided by the following three fundamental principles of AML/CFT reform:

(i) Promote more complete, effective, and efficient financial transparency, including by facilitating systemic reporting and sharing of information at a lower cost to financial institutions;

(ii) Exploit such financial transparency and information more effectively and consistently by investing in targeted financial investigative and analytic capabilities; and

(iii) Create an inclusive and clear management structure that empowers Treasury to govern the ongoing development and application of our expanded AML/CFT regime.

In accordance with these three fundamental principles of AML/CFT reform, my recommendations – detailed in Section III of my testimony below – are summarized as follows:

1. Incorporate into the proposed Counter Terrorism and Illicit Finance Act a new section expanding the objectives of the BSA to explicitly include protecting the integrity of the international financial system and our national and collective security.

2. Incorporate into the proposed Counter Terrorism and Illicit Finance Act a new section to: (i) restructure and enhance financial investigative expertise at Treasury; and (ii) provide protected resources to law enforcement, the intelligence community, and counter-illicit financing targeting authorities to pursue illicit financing activity and networks.

3. Strengthen Section 3 of the proposed Counter Terrorism and Illicit Finance Act to direct a more aggressive approach for Treasury to enhance financial transparency in a methodical, systematic, and strategic manner that: (i) addresses longstanding and substantial vulnerabilities in our financial system; and (ii) pursues reporting obligations based on straight-through processing that leverages new technologies, provides more bulk data for counter-illicit financing authorities, and ultimately reduces burdens on financial institutions.

4. Expand, strengthen, and clarify the relationship between Sections 4 and 7 of the proposed Counter Terrorism and Illicit Finance Act to encourage the broadest innovation and application of technologies to combat illicit financing – including through expanded information-sharing between and among financial institutions and governmental authorities under Section 314 of the USA PATRIOT Act.

5. Strengthen and expand Section 6 of the proposed Counter Terrorism and Illicit Finance Act by directing Treasury to strengthen, expand, institutionalize, and lead consultations with financial sectors and other industries covered by AML/CFT regulation in establishing and implementing priorities for U.S. AML/CFT policy.

6. Amend sub-Section 9(a)(3) and sub-Section 9(a)(1) of the proposed Counter Terrorism and Illicit Finance Act to support implementation of Treasury's CDD rule.

7. Otherwise consider Section 9 of the proposed Counter Terrorism and Illicit Finance Act and swiftly enact company formation reform to require the systemic reporting and maintenance of beneficial ownership information pursuant to an effective and workable framework.

As discussed in detail below, these recommendations are informed by the need for a strategic approach to address the current challenges and frustrations confronting our AML/CFT regime. They are also based on the modern evolution of the AML/CFT regime, including with respect to its expanded scope and objectives, heightened complexity and importance, and global reach. Understanding this evolution is critical in providing the clarity of purpose and importance that must guide the strategic reform of our AML/CFT regime. Understanding this evolution is also essential to achieving the stakeholder cooperation and public support necessary to accept the responsibilities, share the costs, and deliver the resources required to modernize our AML/CFT regime in a manner that is both effective and sustainable. Finally, understanding this evolution – coupled with a clear appreciation of the challenges and frustrations confronting our current AML/CFT regime – informs the three key principles outlined above that should drive our reform efforts.

In offering this testimony, I am grateful for the incredible dedication of my partners, colleagues, and friends at the Financial Integrity Network, the Center on Sanctions and Illicit Finance, the Treasury and across the U.S. Government, and in the global AML/CFT community – including the other expert witnesses who are testifying before you today. The primary basis of my testimony is the experience that I have gained in working with these experts and stakeholders all over the world to help shape and implement AML/CFT policy over the past fifteen years in the U.S. Government, the international community, and in the private sector.

I. Challenges and Frustrations Confronting Our Current AML/CFT Regime and the Need for a Strategic Approach to Reform

The BSA is the foundation of our AML/CFT regime. Over the past five decades, our AML/CFT regime has evolved in complex and fundamentally important ways. Beyond enabling traditional money laundering investigations against drug trafficking and fraud, our AML/CFT regime has become essential to combating the full range of serious criminal activity. Law enforcement now relies upon information generated by our AML/CFT regime to support the full range of counter-illicit financing efforts – from terrorist financing and WMD proliferation, to corruption and tax evasion. Even more broadly, this expanded AML/CFT regime has become essential to protecting the integrity of the financial system, the global economy it supports, and our national and collective security – including by providing the financial transparency required for effective sanctions implementation. These vital interests have driven the necessary expansion of our AML/CFT regime at home and have shaped our leadership abroad in developing and implementing a global AML/CFT framework in partnership with other financial centers and allies.

Yet, our expanded AML/CFT regime is increasingly challenged by the heightened complexity and globalization of the financial system and the world economy. It is also increasingly challenged by the heightened complexity, globalization, and rise of criminal and national security threats that prey upon and hide within our financial system and underlying economy.

The combination of these developments – underscoring the unprecedented importance of our expanded AML/CFT regime and the unprecedented challenges it faces – has led to mounting frustration from all AML/CFT stakeholders:

- Law enforcement is increasingly overwhelmed by the complexity and volume of money laundering activity that fuels an expanding range of serious organized crime – from trafficking in human beings, drugs, and weapons, to fraud and grand scale corruption. The growth of such organized crime now threatens our national security, requiring the application of sanctions and other national security authorities and resources.

- Sanctions and other national security authorities and resources are increasingly stretched to disrupt evolving and emerging threats – from terrorism, WMD proliferation, and malicious cyber activity, to serious human rights abuses and rogue regimes that destabilize regions around the world and threaten our collective security.

- Regulators increasingly struggle to understand how best to prioritize, balance, and translate efforts to counter these threats in governing and enforcing effective implementation of an ever-expanding compliance regime within and across a highly diversified and complex financial system.

- Banks and other financial institutions are increasingly burdened by the costs of such expanding compliance obligations, the threat of enforcement actions for noncompliance, and the rise of competitive service providers that may not share their compliance obligations. More fundamentally, such financial institutions are increasingly challenged in managing unclear or competing expectations associated with protecting the integrity of our financial system from illicit financing risks they often cannot assess.

- Businesses and various segments of the general public are ultimately frustrated by the demands of a financial system whose compliance regimes appear increasingly invasive, costly, or outright prohibitive to legitimate economic interests. Policies of financial exclusion by financial institutions recalibrating their risk tolerances may drive legitimate and urgent demand for financial services underground – particularly with respect to vulnerable sectors and communities that present high risk and low profitability to banks.

Addressing any one of these stakeholder frustrations in isolation threatens to compound frustration from other stakeholders. Relief for financial institutions may heighten challenges for law enforcement and national security authorities. Additional demands for financial information and financial action by such authorities may lead to even greater costs and regulatory burden for financial institutions and their customers. Solving these challenges requires a comprehensive and strategic approach.

Such a comprehensive and strategic approach must begin with clarity of purpose. It must embrace innovative thinking and the application of new technologies to discover and drive efficiencies in

advancing the vital interests of our expanded AML/CFT regime. It demands leadership and integrated efforts from across the financial services industry and the regulatory, law enforcement, national security, and policymaking communities. It requires an inclusive but clear management framework. It requires the understanding and support of the general public. And it must be grounded in a firm appreciation of the expansion, complexity, importance, and global reach of our AML/CFT regime, as reflected by its modern evolution.

II. The Modern Evolution of Our AML/CFT Regime

Since the initial adoption of the BSA almost 50 years ago, and particularly over the past generation since the terrorist attacks of 9/11, our AML/CFT regime has evolved dramatically in the following interrelated ways:

(i) Expansion of scope, stakeholder interest, and objectives;

(ii) Heightened complexity and importance; and

(iii) Globalization of the AML/CFT regime and the broader financial integrity and security mission.

Understanding this evolution, described in greater detail below, is critical to guiding our BSA and broader AML/CFT reform efforts.

(i) Expanding substantive scope, stakeholder interest, and objectives of the AML/CFT regime

As described in greater detail below, the significant expansion of our AML/CFT regime in scope, stakeholder interest, and objectives is reflected by:

a. The expansion of predicate offenses to money laundering;

b. The increasing reliance of sanctions compliance and broader risk management on effective implementation of our AML/CFT regime; and

c. The essential role of our AML/CFT regime in protecting the integrity of the financial system and our national security.

a. *Expansion of AML predicate offenses*. Our AML/CFT regime, launched with the introduction of the BSA, initially focused on reporting bulk cash movements to assist in tax compliance, the criminalization of drug money laundering, and the detection and confiscation of drug trafficking proceeds. Through the expansion of predicate offenses, our AML/CFT regime now encompasses practically all serious criminal activity – including various forms of fraud, corruption, terrorist financing, and WMD proliferation achieved through the violation of export controls or smuggling.

This expanded scope has significant consequences for traditional AML risk management across our financial system, as these different types of predicates expose additional financial products, services, relationships, institutions, markets, and sectors to different kinds and degrees of illicit financing risk. It also expands the range of law enforcement agencies that rely upon financial information to pursue various criminal networks that launder their proceeds through our financial system.

b. *Increasing reliance of sanctions compliance and broader risk management on effective implementation of our AML/CFT regime.* The scope of our AML/CFT regime has also expanded as sanctions compliance has increasingly relied upon and blended with AML/CFT risk management. It is often impossible to know whether any given financial account or transaction may involve a sanctioned party, activity, or jurisdiction without performing robust due diligence driven by AML regulatory requirements.

As sanctions programs have become more complex, their effective implementation relies upon more sophisticated development, integration, and application of underlying AML programs to assess and manage sanctions risk. Consequently, sanctions policy, targeting, compliance, and enforcement authorities – as well as sanctions compliance programs and officers in financial institutions – have become increasingly reliant upon and integrated into the AML/CFT regime and AML compliance programs.

This reliance presents challenges and opportunities for integrating the governance, implementation, and enforcement of our AML/CFT regime and sanctions compliance.

c. *Expanding objectives of our AML/CFT regime.* The objectives of our AML/CFT regime have also evolved, consistent with the expansion of the regime's scope and stakeholder interests. Following the terrorist attacks of 9/11, Congress expanded the purpose of the BSA "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism." While this expansive criminal justice, tax compliance, regulatory, intelligence, and counter-terrorism set of objectives is more important than ever, it is also incomplete.

Protecting the integrity of the financial system has also become an essential objective in its own right. In addition to law enforcement and other investigative and intelligence authorities, financial institutions – together with the customers, markets, and global economy they service – are direct beneficiaries of AML/CFT regimes. Financial institutions are end users of BSA recordkeeping and reporting, relying on such information to identify and manage all manner of illicit financing risk for purposes of protecting the integrity of the financial system. Such integrity is fundamental for the financial system to maintain not only the security of the customer assets it holds, but also the confidence of markets and the general public.

This reality is evident in the way we talk about actions taken under various AML/CFT authorities – both under our own AML/CFT regime, and in concert with AML/CFT authorities abroad. Such actions are intended in large part to protect the integrity of the financial system.

Recognizing this expansive objective underscores the primary role of financial institutions in both implementing and informing our AML/CFT regime. It also underscores the importance of establishing robust public-private partnerships, including at policy and operational levels, to effectively implement and inform our AML/CFT regime.

Perhaps most importantly, our AML/CFT regime has evolved more broadly into a financial security regime, essential to protecting our national security. The financial transparency and accountability created through our AML/CFT regime enable effective development and implementation of sanctions policies and other targeted financial measures to combat a growing array of threats to our national security. Such transparency and accountability also generates financial information that our intelligence and national security community increasingly relies upon to identify and disrupt these threats.

These concepts associated with the expanding scope, stakeholder interest, and objectives of our AML/CFT regime must also inform our AML/CFT reform efforts.

(ii) Heightened complexity and importance of the AML/CFT regime

As AML/CFT regimes have expanded across scope, stakeholder interest, and objectives, they also have become more complex and important. This is true for public sector authorities, the private sector, and the general public.

a. *Heightened complexity of our AML/CFT regime*. The heightened complexity of our AML/CFT regime has inevitably followed the globalization and increased sophistication and intermediation of the financial system. This includes within and across financial products and services; banks, non-bank financial institutions, and designated non-bank financial businesses and professions; and countries, sub-national jurisdictions, and supra-national jurisdictions.

In combating various forms of illicit finance, AML/CFT authorities and financial institutions are increasingly challenged to understand and keep pace with these evolving complexities of the modern financial system. Such an understanding is required as a baseline for identifying and combating illicit financing threats that exploit the vulnerabilities that such a complex financial system presents.

The heightened complexity of our AML/CFT regime has also been driven by the globalization of criminal and illicit financing networks and the blending of illicit financing risk – including across money laundering, terrorist financing, sanctions evasion, bribery and corruption, proliferation finance, tax evasion, and state and non-state actors. Such heightened complexity of criminal activity challenges AML/CFT and national security authorities – as well as compliance regimes in financial institutions – to enhance specialization of counter-illicit

financing expertise while simultaneously integrating counter-illicit financing strategies, policies, and risk management programs.

Addressing such heightened complexity requires heightened and integrated expertise across the core stakeholders of our AML/CFT regime. Such expertise, in turn, demands heightened and integrated training about how the financial system works, and how illicit actors abuse it. These considerations must also inform the reform of our AML/CFT regime.

b. *Heightened importance of our AML/CFT regime.* As our AML/CFT regime has expanded and become more complex, it also has become more important – for law enforcement, national security, and the integrity of the financial system itself.

The heightened complexity and globalization of criminal and illicit financing networks has made financial information more important than ever before to law enforcement agencies pursuing serious criminal activity. Federal law enforcement agencies have repeatedly testified that the BSA database is among the most important sources of information they have in combating various forms of serious and organized crime, from drug trafficking and fraud to tax evasion and terrorist financing.

In addition, the post-9/11 development and integration of CFT strategies and policies into the AML regime and the rise of transnational organized crime have attached clear national security importance to our AML/CFT regime. As sanctions and other national security authorities have become more reliant upon financial information and disruption in the post-9/11 era, the AML/CFT regime has become a crucial foundation for applying financial and economic pressure as an instrument of national and collective security. This is evident in the financial and economic pressure, isolation, and disruption campaigns the U.S. has led against al Qaeda, Iran, ISIS, North Korea, and rogue financial institutions such as Banco Delta Asia or Liberty Reserve. It is now difficult to think of any response to a national security threat that does not involve a significant financial element reliant on implementation of AML/CFT regimes.

The pervasive rise of transnational organized crime has also emerged as a clear threat to our national security. This is most evident in our 2011 National Security Strategy to Combat Transnational Organized Crime, including Executive Order 13581. Quite simply, we now need national security authorities to complement traditional law enforcement authorities to combat this threat. Given the expansion of AML predicates across the full spectrum of transnational organized criminal activity, our AML/CFT regime has clearly become an integral part of protecting our national security, including through the use of national security authorities to attack criminal activities traditionally targeted by AML/CFT regimes.

Finally, as discussed above, our AML/CFT regime is crucial to protecting the integrity of the financial system itself. This importance is underscored by the rise of cybercrime, identity theft, and other forms of fraud that increasingly and systematically target our financial institutions and our financial system as a whole.

Recognizing this heightened complexity and importance of our AML/CFT regime in combating the full range of serious criminal activity, protecting our national security, and safeguarding the integrity of our financial system is essential in guiding reform of the BSA and our AML/CFT regime more broadly. We must be clear-eyed about the resources required to advance and protect such complex and important interests. We must also be attentive to the fair distribution of costs and responsibilities across the beneficiaries of our AML/CFT regime – including AML/CFT and national security authorities, financial institutions and other vulnerable industries, the customers they service, and the general public. And we must focus on directing our AML/CFT policies and resources in a manner that drives efficiency and effectiveness.

(iii) Globalization of AML/CFT regimes and the broader financial integrity and security mission

For almost three decades, the United States has led the globalization of AML/CFT regimes in regions and jurisdictions around the world, including with its partners in the G7, the G20, the Financial Action Task Force ("FATF"), eight FATF-Style Regional Bodies ("FSRBs"), the World Bank, the IMF, and the United Nations. This sustained effort and commitment has been grounded in the recognition of the growing transnational and ultimately global threat presented by an expanding range of illicit financing activity. This effort has also created a truly global framework essential for combatting serious criminal activity, protecting our national and collective security, and safeguarding the integrity of the international financial system.

After 9/11, the global CFT campaign led by the United States became an instrumental factor in accelerating a global understanding of the importance of AML/CFT regimes to our collective security. Combating financial crime, protecting the integrity of the financial system, and promoting effective implementation of sanctions against threats to our national and collective security have since become central to Treasury's mission and to that of finance ministries around the world. Together with partner jurisdictions and organizations around the world, the United States has led a global commitment to expanding AML/CFT regimes and strengthening their implementation to advance these objectives.

This commitment is evident in the rapid evolution of the global counter-illicit financing framework. This framework continues to drive development and implementation of comprehensive jurisdictional AML/CFT, counter-proliferation, and financial sanctions regimes. This framework, largely led by the work of the FATF, manages jurisdictional participation in conducting the following sets of activities:

- Developing typologies of illicit financing trends and methods;
- Deliberating counter-illicit financing policies and issuing global counter-illicit financing standards;

- Conducting and publishing regular peer review assessments of jurisdictional compliance with the FATF's global standards; and

- Managing follow-up processes that both assist jurisdictions and hold them accountable in implementing the FATF standards.

Through the FATF network of assessor bodies, the overwhelming majority of countries around the world are incorporated into this counter-illicit financing framework.

The global standards issued by the FATF and assessed through this global framework cover a broad range of specific measures to protect the integrity of the financial system from the full spectrum of illicit finance – including money laundering, terrorist financing, proliferation finance, serious tax crimes, and corruption. These global standards create a conceptual and technical roadmap for countries and financial institutions to develop the capabilities required to advance and secure the integrity of the global financial system. The FATF standards generally encompass the following areas:

- Jurisdictional and financial institution processes and policies to assess and address illicit financing risks;

- Preventive measures covering the entirety of the financial system;

- Transparency and beneficial ownership of legal entities, trusts and similar arrangements;

- Regulation and supervision;

- Targeted financial sanctions;

- Criminalization of money laundering and terrorist financing;

- Confiscation of criminal proceeds;

- Financial analysis and investigation; and

- International cooperation.

Implementing the FATF global standards within and across these different areas of importance requires a whole-of-government approach in collaboration with the private sector, particularly financial institutions. It is a massive undertaking.

And it is essential to combat transnational organized crime, safeguard the integrity of the financial system, and protect our national and collective security.

Peer review assessments over the past several years demonstrate that most countries have taken substantial steps towards implementing many if not most of the requirements covered by the FATF

global standards. Collectively, this work represents a tremendous accomplishment in creating a firm global foundation for financial integrity and security, based on effective development and implementation of comprehensive AML/CFT regimes.

Nonetheless, these comprehensive jurisdictional assessments also reveal a number of deep-seated, systemic challenges to AML/CFT regimes. These challenges are also evident from many of the U.S. enforcement actions taken against global financial institutions in recent years, as well as from consistent criminal typologies of illicit finance.

The United States has one of the most effective AML/CFT regimes in the world. Yet many of the global and systemic challenges to AML/CFT regimes abroad also confront our own AML/CFT regime. Our capability and willingness to address these challenges at home will substantially impact our credibility and capability in driving other countries to do the same – and in holding accountable those countries that fail to meet such standards. Our BSA and broader AML/CFT reform efforts must consider these important ramifications.

III. Recommendations for Reforming the BSA and our AML/CFT Regime

My recommendations presented below for reforming the BSA and our AML/CFT regime focus on expanding, amending, and strengthening the draft Counter Terrorism and Illicit Finance Act. These recommendations are driven by the need for both immediate action and strategic reform to address the growing frustrations of our AML/CFT stakeholder community and secure the effectiveness and sustainability of our AML/CFT regime moving forward. These recommendations are also grounded in a clear understanding of the modern evolution of our AML/CFT regime, including its expanded scope and objectives, its heightened complexity and importance, and its global reach.

The draft Counter Terrorism and Illicit Finance Act proposes bold and necessary changes to the BSA and our AML/CFT regime. Several of these changes are consistent with recommendations that I presented before the House Financial Services Committee Task Force to Investigate Terrorist Financing in June of 2015. These changes address many of the urgent challenges we face in modernizing our AML/CFT regime. They also reflect the Congressional leadership required to reform, strengthen, and secure our AML/CFT regime to combat illicit financing, safeguard the integrity of our financial system, and protect our national security in an effective, efficient, and sustainable manner.

However, Congress should take additional steps to further promote the efficiency and strengthen the effectiveness of our AML/CFT regime. Such steps should leverage new technologies and more aggressively advance the following three principles of AML/CFT reform:

(i) Promote more complete, effective, and efficient financial transparency, including by facilitating systemic reporting and sharing of information at a lower cost to financial institutions;

(ii) Exploit such financial transparency and information more effectively and consistently by investing in targeted financial investigative and analytic capabilities; and

(iii) Create an inclusive and clear management structure that empowers Treasury to govern the ongoing development and application of our expanded AML/CFT regime.

By aggressively advancing these principles, Congressional action can establish a clear framework for economizing compliance by financial institutions while validating their efforts with dedicated resources to attack money laundering networks and combat threats to our national security.

Finally, some aspects of the proposed legislation are problematic – particularly with respect to its misconstruction of Treasury's customer due diligence rule ("CDD rule") and the complementary but independent relationship between the CDD rule and company formation reform. Such misconstruction jeopardizes both the effectiveness and workability of the CDD rule, and places significant and unnecessary burden on financial institutions and FinCEN.

My specific recommendations for amending and strengthening the proposed Counter Terrorism and Illicit Finance Act elaborate on these general thoughts and are broadly consistent with those I presented in 2015.

1. ***Incorporate into the proposed Counter Terrorism and Illicit Finance Act a new section expanding the objectives of the BSA to explicitly include protecting the integrity of the international financial system and our national and collective security.***

   As explained above, the scope and objectives of the BSA have continued to expand in important ways. This expansion now clearly encompasses safeguarding the integrity of the international financial system and protecting our national and collective security more broadly – including beyond the ongoing threat of terrorism. Recognizing these truths will enable a more accurate assessment of the benefits of our AML/CFT regime. It will also underscore the importance of the considerable investments that have been made and will be required to ensure our AML/CFT regime's effectiveness in meeting these fundamental interests, in addition to the objectives currently reflected in the BSA.

2. ***Incorporate into the proposed Counter Terrorism and Illicit Finance Act a new section to: (i) restructure and strengthen financial investigative expertise at Treasury; and (ii) provide protected resources to law enforcement, the intelligence community, and counter-illicit financing targeting authorities to pursue illicit financing activity and networks.***

   Despite the expanded coverage and heightened importance of our AML/CFT regime, U.S. law enforcement and other authorities responsible for pursuing illicit financing are severely

stretched. These authorities are the best in the world at what they do, but they are not keeping up with the pace of illicit financing itself. Various estimates of money laundering, testimony from law enforcement, and the official recognition of organized crime as a national security threat all demonstrate that we are losing this battle in the criminal justice domain. And we are not investing enough in law enforcement to try to reverse this.

Our law enforcement community also is not structured in a way that develops and focuses financial investigative expertise to systemically and relentlessly pursue all manner illicit financing as a consistent priority. A fully dedicated law enforcement office – armed with our most advanced financial investigators and the authority to pursue all forms of illicit financing – is required to give teeth to our criminalization of money laundering, terrorist financing, tax evasion, and related financial crimes. The blended complexity of these and other illicit financing threats we face – and of the international financial system they prey upon – require such a focused structure.

Our most advanced financial investigators sit within the Criminal Investigative Division ("CID") of the Internal Revenue Service ("IRS") at Treasury. These investigators are uniquely trained to lead and provide critical support to the most pressing, complex, and sensitive financial investigations in our law enforcement community. All too often, however, their leadership and participation in such investigations is constrained by their dominant focus on criminal tax enforcement. Congress should discuss with Treasury how best to restructure and resource CID in a manner that enables and empowers our best financial investigators to consistently focus on all manner of sophisticated illicit finance. Such a restructuring could involve moving CID from the IRS to the Office of Terrorism and Financial Intelligence, in whole or in part.

Separate and apart from law enforcement, sanctions authorities and intelligence analysts are also straining to keep up with the expanding and increasingly complex dashboard of national security threats they face. In the last four months alone, Congress has passed the most sweeping sanctions legislation in history targeting Iran, North Korea, and Russia. At the same time, the Administration has imposed unprecedented Section 311 financial prohibitions against a Chinese bank; issued additional sanctions-related executive orders; and launched a novel financial sanctions program against the Maduro regime, targeting global bond and energy markets doing business in Venezuelan debt or oil. These steps reflect the growing importance of counter-illicit financing authorities and actions that leverage the financial transparency and legal and operational frameworks of our AML/CFT regime and others worldwide. This also affirms our need to invest more in these authorities as their mission continues to expand.

The critical importance and proven impact of money laundering prosecutions, confiscations, and targeted financial measures represent a compelling investment opportunity for Congress to achieve a high return with relatively marginal costs. These investments are also essential to

exploiting the financial information that our financial institutions continue to provide through significant investments of their own.

In addition to working with Treasury to restructure and resource CID to focus on all manner of illicit finance, Congress should provide protected resources to the Money Laundering and Asset Forfeiture Section of the Department of Justice and to Treasury's Office of Terrorism and Financial Intelligence. Such resources should be specifically protected to support: (i) criminal pursuit of money laundering and other illicit financing networks; (ii) targeting of primary money laundering concerns under Section 311 of the USA PATRIOT Act; and (iii) targeting of illicit financing networks under various sanctions authorities.

3. ***Strengthen Section 3 of the proposed Counter Terrorism and Illicit Finance Act to direct a more aggressive approach for Treasury to enhance financial transparency in a methodical, systematic, and strategic manner that: (i) addresses longstanding and substantial vulnerabilities in our financial system; and (ii) pursues reporting obligations based on straight-through processing that leverages new technologies, provides more bulk data for counter-illicit financing authorities, and ultimately reduces burdens on financial institutions.***

Financial transparency is crucial to advancing the objectives of our AML/CFT regime because it allows us to identify, track, and trace the sources, conduits, and uses of all manner of illicit finance that transit the financial system. Without financial transparency, financial institutions and regulators cannot identify, manage, or avoid risks ranging from financing al Qaeda to brokering nuclear proliferation to banking corruption. Law enforcement cannot track or trace progressively globalized criminal networks or their illicit proceeds. States cannot identify or recover stolen assets or proceeds of tax evasion. And financial pressure to address gross violations of international law by North Korea, Iran, Syria, Russia, or others becomes a hollow talking point rather than an operational instrument of global security.

Section 3 of the proposed legislation, when coupled with Sections 6 and 8, generally presents a clear, necessary, and ongoing framework to assist Treasury strategically lead the management of the U.S. AML/CFT regime, including with respect to enhancing financial transparency. In particular, Sections 3 and 6 enable Treasury to enhance the effectiveness and efficiency of AML/CFT regulations under the BSA based on law enforcement and other counter-illicit financing needs and priorities, including through the leading participation of the Department of Justice under Section 8.

However, Congress should also direct a more aggressive approach to enhance financial transparency in methodical, systematic, and strategic manner. Such an approach should include:

(1) Explicitly supporting Treasury's current rulemaking efforts to address clear, outstanding, and substantial counter-illicit financing vulnerabilities; and

(2) Directing Treasury to pursue and study reporting obligations based on straight-through processing that leverages new technologies, provides more bulk data to counter-illicit financing authorities, and ultimately reduces burdens on financial institutions.

(1) Explicitly support Treasury's current rulemaking efforts to address clear, outstanding, and substantial counter-illicit financing vulnerabilities.

As established through years of outreach, study, and rulemaking, Treasury's specific regulatory initiatives outlined below will:

- Provide highly useful information to law enforcement, national security authorities, and financial institutions charged with managing AML/CFT risk under current AML regulations;

- Reduce compliance challenges for banks and other financial institutions currently covered by AML regulation;

- Level the playing field, reduce regulatory arbitrage, and address systemic vulnerabilities in the current coverage of our AML regulations across our financial system; and

- Align our AML/CFT preventive measures with global standards issued under the leadership of the United States and other financial centers, thereby strengthening U.S. efforts to hold other jurisdictions accountable in combating transnational financial crime and protecting the integrity of the international financial system.

To advance these urgent and important interests, Congress should specifically:

a. *Support Treasury's issuance of a final rule extending AML/CFT preventive measures to registered investment advisers, consistent with AML/CFT global standards.* In August 2015, Treasury issued a proposed rule to include certain registered investment advisors as financial institutions under the BSA and requiring them to establish AML programs and report suspicious activity to FinCEN. Such action is required to help address the systemic challenges created by gaps in the financial system that are not covered by AML/CFT preventive measures. As Treasury has reported in the 2015 National Money Laundering Risk Assessment, as of April 2015, investment advisers registered with the SEC have reported more than $66 trillion assets under management. The current lack of AML/CFT regulation over this sector creates a significant blind spot in our understanding of whose interests are represented by this $66 trillion of assets, substantially undermining the transparency of our financial system. As stated by the Director of FinCEN at the time, "Investment advisors are on the front lines of a multi-trillion dollar sector of our financial system. If a client is trying to move or stash dirty money, we need investment advisors to be vigilant in protecting the integrity of their sector."

This gap also puts banks, broker-dealers, and other financial institutions currently covered by AML regulation in the unfair and difficult position of competing with or trying to manage illicit financing risks of the investment adviser sector they service. Failure to address this multi-trillion dollar vulnerability not only enables corrupt governing elites and other national security threats to hide in and profit from our financial system, it also puts more pressure on banks and other covered institutions to manage these risks without understanding the ownership of assets they hold or represent. As with other uncovered or poorly AML/CFT regulated sectors of our financial system, this systemic vulnerability forces banks and other covered financial institutions servicing such sectors to either accept these unknown and substantial risks, or walk away from the business. In turn, these pressures contribute to collateral challenges of financial exclusion or the growth of relatively unregulated "shadow banking" systems, particularly as AML/CFT regulatory enforcement actions continue to focus squarely on banks.

Congressional support for Treasury's proposed rulemaking to extend AML/CFT preventive measures to certain registered investment advisors may facilitate such necessary action by the Administration.

b. *Support Treasury's consideration of lowering the recordkeeping and travel rule thresholds for funds transfers from $3000 to $1000, consistent with global standards.* Such action is required to enhance the transparency of lower value funds transfers consistently abused to structure illicit financing transactions. Treasury's 2015 National Money Laundering Risk Assessment provides the latest evidence of such continued abuse. Lowering the thresholds to $1000 would literally triple the costs and risks for illicit financing networks engaged in such structuring.

Such action is also required to better protect the integrity of the money transmitter sector, which has increasingly suffered from financial exclusion associated with the well-established, illicit financing risks generally inherent in the cross-border services provided by this sector. Lowering the recordkeeping and travel rule thresholds – coupled with strengthening the consistency and effectiveness of AML/CFT supervision of this sector – will generate and substantiate greater confidence in the ability of money transmitters to assess and manage such illicit financing risk. In turn, such enhanced confidence will help address ongoing financial exclusion concerns that have plagued vulnerable corridors of the money transmitter sector for several years.

Maintaining a threshold of $1000 would also preserve a reasonable threshold well above the average value of cross-border remittances, thereby minimizing any potential collateral and exclusionary impact on legitimate and urgent demand for remittance flows.

Congressional support for Treasury's long-standing consideration to lower this threshold may facilitate such necessary action by the Administration.

c. *Support Treasury's consideration to extend AML/CFT preventive measures to the real estate industry, consistent with FATF global standards.* The longstanding global vulnerability of the real estate industry to money laundering is well-known. For this reason, FATF global standards direct countries to extend AML/CFT preventive measures to cover the real estate industry. Several historical and recent cases and investigative reporting by the media demonstrate that this vulnerability continues to be exploited in the United States, including most prominently in cities such as New York, Los Angeles, and Miami.

   As in the case of investment advisors and money transmitters, failure to address the proven and systemic vulnerability of the real estate industry to money laundering not only undermines our counter-illicit financing efforts, it also places additional burden on banks and other AML-covered financial institutions servicing this industry. Such financial institutions must now apply heightened due diligence to real estate transactions to manage these risks effectively. This task would be much easier if the due diligence efforts of covered financial institutions were shared with the real estate industry itself through the extension of AML regulation.

   Congress originally required Treasury to enact AML rulemaking to address the money laundering vulnerabilities associated with the real estate industry in October 2001, with the adoption of the USA PATRIOT Act. Treasury has long considered such rulemaking and has gathered important information to guide this effort through the ongoing issuance of geographic targeting orders. Congressional support may facilitate such action by the Administration to address this longstanding AML vulnerability in an effective, efficient, and systematic way.

(2) <u>Direct Treasury to pursue and study reporting obligations based on straight-through processing that leverages new technologies, provides more bulk data to counter-illicit financing authorities, and ultimately reduces burdens on financial institutions.</u>

The clear emergence of new technologies that can collect, protect, and analyze bulk data should facilitate AML/CFT reform efforts focused on reporting more financial data to counter-illicit financing authorities at a lower cost to financial institutions via straight through processing. As discussed below with respect to Section 7 of the proposed legislation, counter-illicit financing authorities should develop these technologies to exploit such bulk data and find patterns and networks of criminal or sanctioned activity operating within our financial system.

In order to facilitate systemic and low cost financial transparency required for bulk data analysis, Congress should support and direct Treasury action as follows:

a. *Support Treasury's issuance of a final rule requiring the reporting of cross border wire transfers.* Treasury's proposed rule requiring reporting of "Cross-Border Electronic Transmittal of Funds" was issued in September 2010, following six years of study required

by Congress. As anticipated by Congress 13 years ago and confirmed through six years of subsequent study by Treasury and ongoing counter-illicit financing efforts, such a rule would greatly assist relevant authorities in pursuing all manner of illicit finance. Due to the standardized, straight-through processing of such reporting, the comparative burden on industry in implementing this proposed requirement would be modest. As stated by the Director of FinCEN at the time of issuing the proposed rule more than seven years ago, "By establishing a centralized database, this regulatory plan will greatly assist law enforcement in detecting and ferreting out transnational organized crime, multinational drug cartels, terrorist financing, and international tax evasion. FinCEN has examined the cross-border reporting issue, taking into account the exceptional benefit to law enforcement and the modest cost to industry, and we look forward to working closely with both as this rule moves forward through the public comment process."

Such standardized reporting of cross-border wires should help lead to the development of a vastly more effective and efficient approach to AML/CFT reporting, combating illicit finance, and protecting our financial integrity and national security. Such reporting would also help offset traditional law enforcement concerns about raising reporting thresholds under the BSA, particularly with respect to currency transaction reports. Congressional support for Treasury's proposed rule issued more than seven years ago may facilitate necessary action by the Administration to finalize this rulemaking.

b. *Call upon Treasury to study the feasibility, effectiveness, and efficiency of requiring reporting of customer on-boarding and exiting pursuant to standardized reporting forms.* Such standardized and centralized reporting will dramatically enhance financial transparency and the effectiveness of the BSA and our AML/CFT regime in combating the full range of illicit financing. Standardization and centralization of such a reporting requirement should also minimize burden on financial institutions, including by reducing the need for various law enforcement requests for information, such as under Section 314(a) of the USA PATRIOT Act. Developing such a fundamental reporting requirement will take considerable time, effort, and study, but as with cross-border wire reporting, the benefits of such a requirement should far outweigh the costs. This is particularly true if such a requirement enabled relief from other requirements that may prove to be far less effective in delivering the financial transparency that counter-illicit financing authorities rely upon.

   Congress should direct Treasury to commence such a study now, as it did in 2004 with respect to cross border wire reporting.

4. ***Expand, strengthen, and clarify the relationship between Sections 4 and 7 of the proposed Counter Terrorism and Illicit Finance Act to encourage the broadest innovation and application of technologies to combat illicit financing – including through expanded***

information-sharing between and among financial institutions and governmental authorities under Section 314 of the USA PATRIOT Act.

The highly intermediated and globalized nature of today's financial system presents enormous challenges for banks and other financial institutions in assessing and managing illicit financing risks. Such risks are often spread across and through various financial institutions in a manner that is impossible or extremely challenging for individual financial institutions to detect on their own. Section 314(b) of the USA PATRIOT Act begins to address this challenge by enabling financial institutions to share information about these risks under safe harbor protections from legal liability. Section 314(a) of the USA PATRIOT Act also helps address this challenge by enabling Treasury and law enforcement to request financial institutions to search for and report any information they may have about specifically named individuals, entities, or organizations suspected of engaging in money laundering or terrorist financing.

Section 4 of the proposed legislation clarifies and expands information sharing allowances under 314(b) of the USA PATRIOT Act in important ways, ultimately assisting individual financial institutions meet their AML program requirements and manage illicit financing risks in a more effective manner. Section 7 of the proposed legislation encourages the use of innovative technologies by financial institutions in meeting their AML program requirements by providing legal protection for financial institutions that utilize such technological innovation in carrying out their AML programs.

However, it is not clear that the legal protection for financial institutions to use technology under Section 7 extends to information sharing programs under Section 314(b) of the USA PATRIOT Act. Congress should clarify this extension in a manner that encourages financial institutions to apply technological innovations to enhance information sharing with other financial institutions – including the technology companies and advisors they employ – under the safe harbor protections of 314(b).

Moreover, Congress should strengthen, expand, and combine the information sharing provisions under Sections 314(a) and (b) of the USA PATRIOT Act to clearly enable sharing of bulk information on higher risk customers, transactions, and/or markets between and among various combinations of financial institutions, law enforcement, and Treasury. Such action will enable common and joint analysis of various illicit financing risks – including money laundering, terrorist financing, other money laundering predicate offenses, sanctions evasion, and tax evasion. Such information sharing should be protected under the current provisions of Section 314(b) of the USA PATRIOT Act, including safe harbor from legal liability.

By clearly authorizing such information sharing, Congress will enable financial institutions and counter-illicit finance authorities to:

- Capitalize on new technologies that can collect, protect, analyze, and exploit various types of bulk data to find patterns and networks of criminal or sanctioned activity operating within our financial system;

- Combine and leverage counter-illicit financing expertise across financial institutions and counter-illicit finance authorities;

- Facilitate various pilots that inform all counter-illicit financing stakeholders of how best to apply different technologies to financial data in ways that effectively and efficiently identify suspicious activity; and

- Inform the risk-based approach to combating illicit financing by identifying new typologies of illicit financing and by facilitating more effective segmentation of illicit financing risk across different types of customers, products, services, and markets.

5. ***Strengthen and expand Section 6 of the proposed Counter Terrorism and Illicit Finance Act by directing Treasury to strengthen, expand, institutionalize, and lead consultations with financial sectors and other industries covered by AML/CFT regulation in establishing and implementing priorities for U.S. AML/CFT policy.***

   As the BSA has expanded in scope and objectives, it has become substantially more complex and important. Consequently, policy and regulatory expectations for financial institutions with respect to AML/CFT risk management, sanctions compliance, and related matters of financial integrity and security have increased dramatically. These expectations greatly surpass traditional compliance roles in financial institutions, and now cover the entire enterprise of a financial institution or group, including at the board level, senior executive management, lines of business, and audit and operational functions. Such "culture of compliance" and "enterprise-wise risk management" expectations have purposefully forced financial institutions to share ownership in the expanding mission of our AML/CFT regime – including with respect to combating all forms of financial crime, safeguarding the integrity of our financial system, and protecting our national security.

   These increasingly expansive, complex, and important roles and responsibilities of our financial institutions and other industries covered by BSA regulation demand a much stronger partnership with government. Treasury should substantially expand, elevate, and integrate its leadership in consulting with financial institutions and other vulnerable industries on issues of financial integrity and national security advanced through our AML/CFT regime. Such consultation and partnership should directly inform our AML/CFT policies and priorities.

6. ***Amend sub-Section 9(a)(3) and sub-Section 9(a)(1) of the proposed Counter Terrorism and Illicit Finance Act to support implementation of Treasury's CDD rule.***

As explained in greater detail below, Congress should amend sub-Section 9(a)(3) and sub-9(a)(1) of the proposed legislation to support implementation of Treasury's CDD rule for the following reasons:

(1) The fundamental interests and objectives of the CDD rule demand urgent implementation as soon as reasonably possible;

(2) Reopening the CDD rule now will: (i) threaten the careful balance of effectiveness and workability achieved through an exhaustive and unprecedented process of outreach and rulemaking; and (ii) undermine Treasury's credibility and 18 months of compliance preparation and investment by covered financial institutions;

(3) The proposed legislation fundamentally misconstrues Treasury's CDD rule;

(4) The proposed legislation creates a substantial additional and unnecessary burden on financial institutions and FinCEN;

(5) The proposed legislation discounts the compelling basis for differences in the detailed definitions and types of beneficial ownership information that already exist and may be required from various U.S. and other legal entities; and

(6) Treasury already has the authority to amend the CDD rule as necessary to enhance its effective and workable implementation, including for purposes of aligning CDD beneficial ownership requirements to the extent practical with company formation requirements.

(1) <u>The fundamental interests and objectives of the CDD rule demand urgent implementation as soon as reasonably possible.</u>

Treasury's CDD rule – issued on May 11, 2016 – clarifies, consolidates, and strengthens CDD requirements for financial institutions currently covered by AML customer identification program requirements. The final rule gives such financial institutions two years' time – until May 11, 2018 – to align their CDD policies and programs with the requirements set forth in the rule.

As stated and discussed at length in the preamble of the rule, such action is urgently required to:

- Enhance the availability to law enforcement, as well as to the Federal functional regulators and self-regulatory organizations, of beneficial ownership information about legal entity customers obtained by U.S. financial institutions, which assists law enforcement financial investigations and a variety of regulatory examinations and investigations;

- Increase the ability of financial institutions, law enforcement, and the intelligence community to identify the assets and accounts of terrorist organizations, corrupt actors, money launderers, drug kingpins, proliferators of weapons of mass destruction, and other national security threats, which strengthens compliance with sanctions programs designed to undercut financing and support for such persons;

- Help financial institutions assess and mitigate risk, and comply with all existing legal requirements, including the BSA and related authorities;

- Facilitate reporting and investigations in support of tax compliance, and advance commitments made to foreign counterparts in connection with the provisions commonly known as the Foreign Account Tax Compliance Act (FATCA);

- Promote consistency in implementing and enforcing CDD regulatory expectations across and within financial sectors; and

- Advance Treasury's broad strategy to enhance financial transparency of legal entities.

Reopening the CDD rule and delaying its implementation – as proposed by the draft legislation – would complicate implementation of a rule that is long overdue and postpone advancement of the urgent and fundamental interests and objectives summarized above.

(2) Reopening the CDD rule now will: (i) threaten the careful balance of effectiveness and workability achieved through an exhaustive and unprecedented process of outreach and rulemaking; and (ii) undermine Treasury's credibility and 18 months of compliance preparation and investment by covered financial institutions.

Sub-Section 9(a)(3) of the proposed legislation states, "The Secretary of the Treasury shall, simultaneously with issuing the regulations prescribed under paragraph (2) [to carry out the company formation reform presented by Section 9 of the proposed legislation], *revise the final rule titled "Customer Due Diligence Requirements for Financial Institutions"* (May 11, 2016, Fed. Reg. 29397) *as necessary to conform with this Act, and the regulations issued under paragraph (2).*" (Emphasis added).

As discussed in the preamble, the CDD rule incorporates and benefits from exhaustive stakeholder comments collected through an outreach campaign unprecedented in the history of BSA rulemakings. Such outreach included six years of intensive consultations with U.S. financial institutions, regulators, law enforcement, and national security authorities – including through five public hearings hosted by Treasury and the regulators in Washington, DC, New York, Los Angeles, Chicago, and Miami. It also included substantial preparation and comment on formal guidance issued by FinCEN and the federal financial regulators in 2010; notice and comment on a follow-on Advanced Notice of Proposed Rulemaking issued in March 2012; and notice and comment on a subsequent Notice of Proposed Rulemaking issued in August

2014. It also included substantial discussions with the global AML/CFT community, including through several years of CDD standard-setting and follow-up reports by the United States on the FATF's peer review assessment of the U.S. AML/CFT regime. As explained in the section above summarizing the modern evolution of the BSA, the FATF is the global policymaking body that the U.S. helps lead in developing global standards, policies, and processes governing AML/CFT, sanctions, and counter-proliferation finance regimes in countries around the world.

This exhaustive outreach, consultation, and preparation associated with Treasury's CDD rule resulted in a carefully balanced rule that is both: (i) effective in advancing the counter-illicit financing and other fundamental interests summarized above; and (ii) workable in establishing a baseline and level playing field across a highly diversified set of U.S. financial institutions and industries.

Opening the CDD rule up to revision now invites opportunism by special interests to upset the appropriate balances struck by Treasury after so many years of consultation across all interests. Opening the CDD rule up to revision now would also substantially undercut the credibility of Treasury with AML/CFT stakeholders across the domestic and international financial system and across the global counter-illicit finance community. Opening the CDD rule up to revision now would also penalize those U.S. financial institutions that have already invested in policies, programs, training, and systems and controls to comply with the requirements of the final rule, issued over 18 months ago.

(3) <u>The proposed legislation fundamentally misconstrues Treasury's CDD rule.</u>

Sub-Sections 9(a)(1) and 9(a)(3) of the proposed legislation delay and jeopardize implementation of the CDD rule for purposes of conforming beneficial ownership requirements between CDD and company formation and to assist financial institutions meet their compliance obligations under the CDD rule. This fundamentally misconstrues the objectives, scope, requirements, and integrity of the CDD rule.

As discussed exhaustively in Treasury's consultations and outreach in developing, proposing, and finalizing the CDD rule – and as explained in the preamble of the rule – Treasury specifically, deliberately, and necessarily crafted the CDD rule as an essential but independent component of Treasury's three-prong strategy to enhance the transparency of legal entities. As summarized above, this three-prong strategy is also only one of six primary objectives stated in the preamble for advancing the purposes of the BSA through the issuance of the CDD rule. The specific scope, requirements, and integrity of beneficial ownership information in the CDD rule were specifically tailored to effectively advance all six of the BSA objectives summarized above in a consistent and workable manner for our financial system. The scope, objectives, requirements, and integrity of beneficial ownership information may not be the same when considering how best to achieve corporate transparency in the U.S. company formation process.

For example, the scope of the beneficial ownership requirements of the CDD rule equally encompasses both U.S. *and foreign* legal entity customers of covered U.S. financial institutions – subject to qualifications, exceptions, and exemptions carefully drawn through the rulemaking and outreach processes described above. The CDD rule's coverage of foreign legal entities – which are not subject to domestic company formation processes – is necessary given the proven and systematic abuse of foreign as well as domestic legal entities by all manner of illicit financing threats. Yet, necessary company formation reform in the United States – including as proposed by Section 9 – cannot cover the formation of foreign legal entities.

Owing in part to such differences in objectives and scope, beneficial ownership requirements for CDD purposes may not be the same as for company formation purposes. While the counter illicit financing interests in the transparency of legal entities are substantially similar for purposes of CDD by financial institutions and company formation reform, there are other important objectives and interests relevant for each of these initiatives, including with respect to effectiveness and workability. For purposes of CDD by financial institutions, these other objectives as summarized above were heavily explored and discussed through the CDD outreach and rulemaking process. For example, a paramount concern in this process was establishing a consistent approach and consistent baseline requirements for CDD across a range of different types of domestic and foreign legal entities for a highly diversified and intermediated U.S. financial system. This particular concern in establishing beneficial ownership requirements for CDD by financial institutions may not be as relevant as other concerns or objectives associated with establishing effective and workable beneficial ownership requirements for U.S. company formation processes.

The beneficial ownership requirements of the CDD rule are for covered financial institutions to identify and verify the *identity* of the beneficial ownership of certain legal entity customers. In meeting these beneficial ownership requirements, Treasury has explicitly and deliberately clarified that covered financial institutions can and should apply the systems and controls they have already developed and implemented for their customer identification and verification programs. By applying such customer identification and verification program requirements to the identification and verification of beneficial ownership, the CDD rule minimizes burden for financial institutions covered by the CDD rule. In part for this reason, Treasury deliberately issued the CDD rule to cover those financial institutions that have already been subjected to customer identification and verification requirements under Section 326 of the USA PATRIOT Act by law and regulation for well over a decade.

As as explained exhaustively in the CDD rulemaking process and the preamble to the rule, Treasury did <u>not</u> require covered financial institutions to verify the *status* of beneficial ownership. Rather, as stated by FinCEN in the preamble to the rule:

> …[A] covered financial institution may rely on the information supplied by the legal entity customer regarding the identity of its beneficial owner or owners, provided that

> it has no knowledge of facts that would reasonably call into question the reliability of such information. FinCEN anticipates that, in the overwhelming majority of cases, a covered financial institution should be able to rely on the accuracy of the beneficial owner or owners identified by the legal entity customer, absent the institution's knowledge to the contrary….

As discussed elsewhere in the preamble and as required by the CDD rule, this general reliance by a financial institution on the identification of the beneficial owner by the customer does not mitigate a financial institution's requirement to then verify the identity of the beneficial owner. Similar to the requirements of customer identification and verification programs, such verification of a beneficial owner's identity will generally rely on copies of identification documents supplied by the financial institution's customer, or accountholder. Importantly, this reliance allows the financial institution to avoid the substantial burden of systematically verifying the *status* of the beneficial owner.[1]

This reliance raises potential concern about the integrity of beneficial ownership information needed for purposes of effectively advancing the CDD interests and BSA objectives summarized above. Again, this concern was exhaustively discussed in the CDD rulemaking process. As explained by FinCEN in the preamble to the rule, law enforcement has determined that it can effectively use the beneficial ownership information collected and verified (again, with respect to the *identity* of the beneficial owner rather than the *status* of the beneficial owner) under the CDD rule:

> …[W]hile a criminal may well lie regarding a legal entity's beneficial ownership information, verification of the identity of the natural person(s) identified as a beneficial owner will limit her ability to do so in a meaningful way such that she could avoid scrutiny entirely. Furthermore, as the Department of Justice has noted throughout this rulemaking process, a falsified beneficial ownership identification would be valuable evidence in demonstrating criminal intent. Even the verified identity of a natural person whose status as a beneficial owner has not been verified provides law

[1] In cases of elevated risk or where the financial institution has reason to suspect the reported beneficial ownership of a covered legal entity customer, financial institutions should consider verifying the *status* of the reported beneficial owner, including by obtaining supporting documentation of beneficial ownership status from the customer or third parties. In such limited instances, there may be some differences between the definition of beneficial ownership in the CDD rule and the definition of beneficial ownership by the relevant company formation authority, but such differences should be highly manageable in discussions with the customer and / or any relevant third parties as appropriate to understand the beneficial ownership structure of the relevant legal entity customer. It is certainly more manageable than creating an expectation that financial institutions will systematically verify the status of beneficial ownership. And as discussed below, such definitional differences in beneficial ownership are inevitable where a financial institution maintains accounts for various legal entities subjected to various potential beneficial ownership disclosure requirements by different authorities for different purposes.

> enforcement and regulatory authorities with an investigatory lead from whom they can develop an understanding of the legal entity.

At this point, it is unclear how the specific requirements and integrity of beneficial ownership information collected under anticipated and necessary U.S. company formation reform will need to be shaped in a manner that is both effective for the purpose of combating criminal abuse of U.S. legal entities and workable for U.S. company formation processes. Indeed, for this reason, the proposed legislation appropriately delegates rulemaking authority to Treasury to develop such detailed requirements.

It is also unclear what other objectives or interests may be relevant to or may substantially inform beneficial ownership requirements in U.S. company formation reform processes. For example, such requirements may also consider current beneficial ownership disclosure obligations and processes relevant to U.S. legal entities for tax purposes, such as in obtaining employer identification numbers from the IRS. It may be that such requirements and the associated integrity of the beneficial ownership information to be collected under company formation reform necessarily differ in some respects from the beneficial ownership information required under the CDD rule. Again, these are detailed issues that Treasury will need to address in the rule making process.

(4) <u>The proposed legislation creates a substantial additional and unnecessary burden on financial institutions and FinCEN.</u>

The effect of sub-Section 9(a)(3) as drafted will impose substantial additional burden on U.S. financial institutions. By opening up the CDD rule to conform beneficial ownership requirements with those to be established under company formation reform, the proposed legislation creates an expectation that U.S. financial institutions should verify the status of beneficial ownership of their U.S. legal entity customers covered by the CDD rule. As explained above and discussed at length in the CDD rulemaking process, such an expectation was specifically rejected in the CD rule because of the substantial and unnecessary burden this would place on financial institutions.

Moreover, sub-Section 9(a)(1) creates an expectation that financial institutions should independently verify the status of such customers by obtaining company formation information from FinCEN. Specifically, the proposed Transparent Incorporation Practices presented in Sub-Section 9(a)(1) would require FinCEN to provide beneficial ownership information of certain U.S. legal entities upon receipt of, inter alia, "a request by a financial institution, with customer consent, *as part of the institution's compliance with due diligence requirements imposed under the Bank Secrecy Act, the USA PATRIOT Act, or other applicable Federal or State law*." (Emphasis added).

This verification burden is particularly significant and entirely unnecessary. Again, as explained above and discussed exhaustively in Treasury CDD rulemaking process, financial

institutions can and should rely on their customers to produce beneficial ownership information, including any relevant supporting documentation requested by the financial institution. Even in certain high-risk instances where the financial institution should verify the status of the beneficial ownership disclosed to them by their legal entity customers, financial institutions should generally obtain company formation and other corporate documents from their customers, not from company formation authorities or FinCEN.

This verification requirement would also impose an incredible burden on FinCEN, which would have to devote unknown resources to managing potentially thousands of requests for company formation documents from any one of tens of thousands of financial institutions currently covered by the CDD rule, possibly on a daily basis.

(5) The proposed legislation discounts the compelling basis for differences in the detailed definitions and types of beneficial ownership information that already exist and may be required from various U.S. and other legal entities.

Differences in various definitions of beneficial ownership already exist and inevitably will continue to exist for various U.S. legal entities. This is true across the domestic and international financial system and global economy, including for U.S. and foreign tax compliance purposes, for SEC and other disclosure requirements associated with public markets, and for different AML/CFT and sanctions risk management regimes required by different jurisdictional authorities and different financial institutions' risk-based policies. Even within the CDD rule itself, different beneficial ownership requirements or expectations exist for different types of legal entities such as trusts, charities, or certain pooled investment vehicles. And different types of legal entities from different jurisdictions will inevitably have differences in definitions of beneficial ownership, based on illicit financing and other risk factors, legitimate economic interests, and practicality considerations associated with the structures and beneficial ownership implications of such legal entities.

This cursory acknowledgement of the differences in the detailed definitions of beneficial ownership – for different types of legal entities, from different authorities and different financial institutions, for different purposes and different types of risk management, and across different jurisdictions – underscores the importance of the careful, thoughtful, balanced, and consistent approach that Treasury has taken to the beneficial ownership requirements in the CDD rule. It also underscores the challenges and practical impossibility of aligning all definitions and approaches to beneficial ownership that may otherwise apply for various legitimate reasons to U.S. and other legal entities subject to the CDD rule.

(6) Treasury already has the authority to amend the CDD rule as necessary to enhance its effective and workable implementation, including for purposes of aligning CDD beneficial ownership requirements to the extent practical with company formation requirements.

The arguments presented above in support of Treasury's CDD rule and the compelling reasons that support detailed differences in current beneficial ownership requirements for various legal entities should not discount the obvious benefits of harmonizing beneficial ownership requirements and expectations as much as practically reasonable. For this reason, Treasury, U.S. regulators, and their counterparts around the world have invested considerable time and effort over the past generation in developing global standards to govern beneficial ownership and other fundamental requirements of preventive measures associated with AML/CFT regimes. These authorities also coordinate the development and implementation of such requirements with other global standards, including those governing tax compliance and financial and market safety, soundness, and stability. Nonetheless, the particular interests and objectives that drive the need for beneficial ownership disclosure requirements in any given scenario require flexibility that often defies uniformity.

Of course, further guidance for implementing the CDD rule will be necessary. Potential revisions to the CDD rule itself may also be necessary. But any such revisions must carefully consider how the requirements in the current rule carefully balance the types of complexities outlined above. Treasury already has the authority to manage this process. Congress should recognize this, including by supporting Treasury's issuance of the CDD rule.

Moreover, as explained in my recommendation below, giving Treasury the authority to manage implementation of the company formation reform process will enable Treasury to harmonize the beneficial ownership requirements of this process as much as practically reasonable with the beneficial ownership requirements under the CDD rule. And Treasury can always revise the CDD rule as needed to enhance its effectiveness and workability across all stakeholder interests.

Managing these kinds of complexities to meet the compelling law enforcement, financial integrity, and national security interests summarized in the preamble to the CDD rule should be left to the expertise of Treasury, counter-illicit financing authorities, financial regulators, and industry, including through knowledge gained in the unprecedented outreach and rulemaking process that guided the development of the CDD rule over several years.

7. Otherwise consider Section 9 of the proposed Counter Terrorism and Illicit Finance Act and swiftly enact company formation reform to require the systemic reporting and maintenance of beneficial ownership information pursuant to an effective and workable framework.

Congressional action is urgently required to address a longstanding, well-understood, and primary vulnerability in the U.S. AML/CFT regime. The systemic challenges posed by the chronic abuse of U.S. legal entities to mask the identities and illicit financing activities of the full scope of criminal and illicit actors has been well known for far too long. For several years and through at least four consecutive administrations, various arms of the Executive Branch – including several law enforcement agencies and the Department of the Treasury – have called for meaningful action on this issue. For an even longer period, the Senate Permanent

Subcommittee on Investigations, beginning with the prior leadership of Senator Levin, has called for such action.

Unlike in the case of beneficial ownership and CDD, Treasury currently does not have the authority to effectively address this longstanding and fundamental vulnerability in our AML/CFT regime. Aside from the amendments to Section 9 of the proposed legislation discussed above, the particular company formation reform process presented by Section 9 provides Treasury with the authority and flexibility to close down this ongoing abuse of U.S. legal entities pursuant to an effective and workable framework.

It is important to recognize that several alternative approaches exist for addressing this core vulnerability of abuse of U.S. legal entities. Many such alternative approaches have been considered by Congress before, and some of these alternatives also present effective and workable solutions. Of course, Congress may consider further amendments to Section 9 based on these alternative approaches. However, Congress should swiftly adopt company formation reform to require the reporting and maintenance of beneficial ownership information pursuant to an effective and workable framework, such as presented in Section 9 of the proposed legislation. As discussed above, such company formation reform should proceed as an essential but independent complement to Treasury's CDD rule, rather than as an interdependent and co-joined requirement. And such company formation reform should empower Treasury with both the authorities and resources to manage this process moving forward, as reflected by the proposed legislation.