



**global witness**

**House Financial Services Subcommittee on Terrorism and Illicit Finance  
and Subcommittee on Financial Institutions and Consumer Credit**

**Hearing entitled:**

**A Legislative Proposal to Counter Terrorism and Illicit Finance**

**November 29, 2017**

**Testimony of Stefanie Ostfeld, Deputy Head of US Office, Global Witness**

Good afternoon Chairman Pearce, Chairman Luetkemeyer, Ranking Member Perlmutter and Ranking Member Clay. Thank you for holding this important hearing and inviting Global Witness to testify.

My name is Stefanie Ostfeld and I am the Deputy Head of Global Witness' US office. We are an international non-governmental organization with offices in Washington, DC, London and Brussels. For almost twenty five years Global Witness has uncovered corruption in some of the poorest countries in the world, focusing on the role of natural resources in driving state looting and conflict. Through hard-hitting reports and investigations we have exposed how timber, diamonds, minerals, oil and other natural resources in some countries have incentivized corruption, destabilized governments and led to war.

Our experience shows corruption isn't something that just happens in developing countries. Corruption on the scale that we see in our investigations could not happen without the actions of global facilitators. What enables corruption is a financial system that makes it easy to hide and move suspect funds around the world. Our research shows that corruption simply cannot take place without the willingness of the financial system to accept corrupt funds; provide secrecy that allows corrupt individuals to hide their identities and their money; and finance corrupt deals. By 'financial system' we mean not only banks, but those who provide 'professional services': the trust and company service providers, accountants and lawyers whose basic business is to set up the corporate and trust structures behind which the corrupt hide. We also mean the regulatory structure in which they all operate: one which not just permits but encourages secrecy, whether onshore in major financial centers or offshore in the island havens.

This secrecy isn't only utilized by the corrupt; it is what enables the proceeds of all types of crimes—from

drug smuggling to human trafficking to organized crime—to move through the financial system. It is the same secrecy in the financial system that allows money to be funneled to terrorist organizations.

Global Witness welcomes the Committee's interest in requiring transparency around the beneficial owners of American companies and strengthening US anti-money laundering laws to counter terrorism and illicit finance. We believe this is a necessary step to stop the US from being a safe haven for the world's dirty money.

I offer the following testimony today to provide Global Witness' views on how to strengthen the US anti-money laundering framework and offer specific recommendations on how to strengthen the Committee's draft legislative proposal titled "Counter Terrorism and Illicit Finance Act" dated November 14, 2017.

### **Recommendations on the Discussion Draft Dated November 14, 2017**

#### Increase transparency of corporate formation procedures

1. Ensure that domestic law enforcement has access, including federal, state and local, to FinCEN's database of beneficial ownership information. This shouldn't require a subpoena.
2. Ensure that foreign law enforcement has access to beneficial ownership information so that it can be used in criminal and civil prosecutions.
3. Require foreign nationals to file their beneficial ownership information with FinCEN, including submitting a scanned copy of the relevant pages of their non-expired passport to FinCEN and define the term "applicant."
4. Add an enforcement mechanism to the discussion draft. This could be done by making the state incorporation process dependent on beneficial ownership information being provided to FinCEN. It could potentially be done by ensuring FinCEN has the authority to regulate in this area in order to have current listings from the states about all of the corporations and LLCs that are active.
5. Allow identification for beneficial owners to include non-expired state issued identification to meet the requirement if they do not have a non-expired US driver's license or passport.
6. Banks should begin to implement the customer due diligence (CDD) regulation on time, in May 2018.

#### Reporting requirements

7. Do not raise the CTR and SAR reporting thresholds as it would make it easier for drug traffickers and terrorists to move cash without alerting authorities.
8. It is not appropriate for Treasury to assess the utility of SARs and CTRs for law enforcement and the requirement should be removed from the bill.

#### Treasury's role in coordinating AML/CFT policy and examinations across government

9. FinCEN should not be setting AML/CFT priorities for banks on an annual basis or otherwise.

#### Improve information sharing efforts among financial institutions

10. Permit banks to share SARs with any branch or affiliate, but only insofar as the prohibition on banks disclosing the existence of a SAR to clients is a legal requirement applicable to any branch or affiliate with whom SAR information is shared.

### Encourage the use of technical innovation

11. Use of new technology should be encouraged, but must be done responsibly. A section of Treasury should be created or tasked with reviewing, approving and monitoring the use of new technology by financial institutions. There should not be a safe harbor provision.

### Additional opportunities to reform the current BSA regime and anti-money laundering requirements

12. Formation agents and others who are paid to set up corporations, trusts or other legal entities should have anti-money laundering obligations.
13. Congress should lift the “temporary” exemption created in 2002 excusing certain categories of persons from complying with the 2001 law requiring them to establish anti-money laundering programs, including “persons involved in real estate closings and settlements.” A deadline should be established to bring everyone into compliance with the law, which is now 16 years old. As a part of this effort, the Treasury Department should also require public disclosure of the beneficial owners who ultimately own companies purchasing real estate throughout the US.
14. Congress should require transactional lawyers to have customer due diligence and record keeping requirements. The law must specify what due diligence lawyers have to carry out before accepting a client, require lawyers to identify higher risk clients and require them to report suspicious transactions to the authorities.

### **Kleptocrats, drug traffickers and other criminals regularly exploit gaps in US law to hide behind anonymously-owned American companies to access the US financial system and property market**

Last year’s Panama Papers and this year’s Paradise Papers have shown the world that anonymously-owned companies are a large problem and provide unprecedented insight into the shadowy system of tax havens, lawyers, company service providers and anonymous companies. It is common for the corrupt and other criminals to layer anonymously-owned companies, with one owning another and so on, often across jurisdictions, in order to further distance the bad actor from the act and to make it harder for law enforcement to figure out who is ultimately behind the company.

This isn’t a new problem. Global Witness first exposed it in our 2009 report, *Undue Diligence*,<sup>1</sup> and in 2011 the World Bank found that opaque company structures were used in 70% of the grand corruption cases they studied over the last 30 years. Furthermore, contrary to the common misperception that this type of secrecy is mainly provided by sunny tax havens in the Caribbean, the US is at the heart of the problem.<sup>2</sup> A 2014 academic study found that many US states are among the easiest places in the world to set up an untraceable company—even for inquiries that sounded like a front for terrorism or that should have raised a corruption risk.<sup>3</sup>

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<sup>1</sup> <https://www.globalwitness.org/en/campaigns/corruption-and-money-laundering/banks/undue-diligence/>

<sup>2</sup> Halter, E. M., Harrison, R. A., Park, J. W., Does de Willebois, E. v., & Sharman, J. (2011). *The Pupper Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*. Washington DC: Stolen Asset Recovery Initiative- The World Bank and UNODC.  
<https://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf>

<sup>3</sup> Findley, M., Nielson, D., & Sharman, J. (2014). *Global Shell Games: Experiments in Transnational Relations, Crime and Terrorism*. Cambridge: Cambridge University Press. <http://www.globalshellgames.com/>

Importantly, the ability of criminals to hide and move money does not just fuel corruption overseas—it hurts people here in the United States as well. Global Witness’ report *The Great Rip Off* has looked at a whole host of criminals who the authorities are trying to stop, from drug gangs to terrorists to tax evaders to credit card scammers. They had two things in common—they were all anonymous company owners, and they were all hurting US citizens. For example, an Ohio school district employee used a web of fake companies to abuse his position and bill for millions of dollars’ worth of services that school kids never received. And Texas lawyers used sham companies from Delaware and Nevada to trick elderly people into investing their life savings in worthless enterprises.<sup>4</sup>

Anonymously-owned companies have been used to further human trafficking schemes too. A gang used anonymous companies from Kansas, Missouri and Ohio to trick victims from countries overseas into a \$6 million dollar human trafficking scheme throughout the US.<sup>5</sup> According to Polaris, a leader in the global fight to eradicate modern slavery:

“In 2016, [we] analyzed public information to identify human trafficking occurring in businesses fronting as massage parlors in Tampa, Honolulu, Houston, San Francisco, Albany, Columbus, Oklahoma City, and Fairfax County, VA. The inability to identify beneficial ownership was a recurring challenge in every location...In order to ensure accountability for human trafficking, Congress must pass legislation that requires corporations and LLCs to disclose their beneficial owners, thereby guaranteeing that law enforcement has access to this information. Until police and prosecutors can identify the individuals operating illicit massage businesses, criminals engaged in human trafficking will continue acting with impunity across the United States.”<sup>6</sup>

Anonymously-owned American companies have also been used to threaten our national security. A US-Afghan contractor funneled at least \$3.3 million of US taxpayer dollars to notorious Afghan powerbrokers, who deliberately hid their ownership interests in companies within the contractor’s network to avoid association with the insurgency. These individuals in turn funded the purchase of weapons for the Taliban and insurgents.<sup>7</sup> The Iranian government hid behind an anonymous New York company to conceal its ownership of a 5th Avenue skyscraper, in direct breach of sanctions.<sup>8</sup> In a recent report, the Government Accountability Office (GAO) revealed it was unable to identify ownership information for about one-third of the government’s 1,406 high-security leases as of March 2016 because ownership information was not readily available for all buildings.<sup>9</sup>

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<sup>4</sup> <https://www.globalwitness.org/en/campaigns/corruption-and-money-laundering/great-rip-off/>

<sup>5</sup> <https://www.globalwitness.org/en/campaigns/corruption-and-money-laundering/great-rip-off/>

<sup>6</sup> Fact sheet, Polaris, 2017 <https://thefactcoalition.org/wp-content/uploads/2017/08/Polaris-AnonymousCompanies-Fact-Sheet-10-17-2016-FINAL.pdf>

<sup>7</sup> <https://www.globalwitness.org/en/reports/hidden-menace/>

<sup>8</sup> <https://www.globalwitness.org/en/campaigns/corruption-and-money-laundering/great-rip-off/>

<sup>9</sup> <http://www.gao.gov/products/GAO-17-195>

In 2016, Global Witness published an undercover investigation into the role of anonymously-owned companies in money laundering that aired on 60 Minutes.<sup>10</sup> We sent an undercover investigator into 13 New York law firms. He posed as an adviser to an unnamed African minister of mines who wanted to secretly bring suspect funds into the US to buy a mansion, a yacht, and a jet. The results were shocking: 12 of the 13 lawyers provided suggestions on how to move the money using anonymous shell companies and trusts. Eleven of them suggested using American shell companies as part of the structure to hide the fictitious minister's identity.

Many of the lawyers indicated that they would have to do further checks before agreeing to take our investigator on as a "client," no money was exchanged and nobody broke the law. But what is really remarkable about our findings is how consistent the lawyer's suggestions were during the meetings with our investigator. It goes to show you that — from the Panama Papers to our investigation — it is not about the behavior of individuals, however odious. It's about what is wrong with the law, which makes it far too easy for corrupt officials and other crooks to hide behind the secrecy of anonymously-owned companies.

The Financial Action Task Force (FATF), which the US helped to set up and sets the global anti-money laundering standards, issued an evaluation of the US in 2006 that criticized the US for failing to collect beneficial ownership.<sup>11</sup> In December of last year, FATF issued another evaluation of the US that demonstrates that little progress has been made over the last ten years to address this problem. It identified the "lack of timely access to adequate, accurate and current beneficial ownership information" as the Achilles heel in US efforts to combat money laundering and terrorist finance.<sup>12</sup>

Currently, there is not one state that collects beneficial ownership information for the companies it incorporates. Since incorporation happens at the state-level, it varies from state to state what is collected. Some states collect shareholder information, but many do not even collect this. However, the problem with shareholder information is shareholders can be other companies with hidden owners or nominees, which are people who essentially rent out their name, legally, so that the real owner's identity can be kept hidden.

States didn't set out to permit the creation of anonymous companies. Rather, criminals have figured out how to take advantage of gaps in the law. But states have been aware of this problem for many years and have done nothing to address this problem on their own.

### **The US has fallen behind as action is taken around the world**

Momentum has been building globally to deal with this problem. In 2013, the then-G8 endorsed broad principles about beneficial ownership disclosure and created national action plans for how to address

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<sup>10</sup> <https://www.globalwitness.org/shadyinc/>

<sup>11</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20US%20full.pdf>

<sup>12</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>

the problem domestically. In 2014, the G20 agreed to high level principles on beneficial ownership transparency.

There has been significant progress in Europe. In 2015, EU countries finalized a measure requiring all Member States to create central registries of beneficial ownership information for companies established in their countries. As of June 2017, all 28 Member States are now required to make the information available to law enforcement, tax inspectors, lawyers, banks, accountants, as well as those with a “legitimate interest” in the information—such as civil society and journalists. The EU is currently in negotiations to strengthen its Anti-Money Laundering Directive to make this information public. There are a number of countries that have gone further than the directive. Two EU Member States have already set up registers of beneficial owners for companies and made them accessible to the public (UK and Denmark), and six other EU countries are in the process of creating public registries of beneficial ownership – having already changed their laws or in the process of doing so (Estonia, Finland, the Netherlands, Poland, Portugal, and Slovenia).

Outside of the EU, Ukraine has set up a similar public register of company beneficial owners and Afghanistan, Ghana, Nigeria and South Africa have committed to doing so. A further 20 countries engaged in the Extractive Industries Transparency Initiative (EITI) are in the process of setting up public registers of beneficial owners for companies in oil, gas and mining.<sup>13</sup>

#### **Comments on the Discussion Draft Dated November 14, 2017**

##### *Increase transparency of corporate formation procedures (Section 9)*

We are very encouraged that the committee is interested in moving beneficial ownership legislation, but we have several concerns with the language in the discussion draft to increase transparency of corporate formation procedures.

The discussion draft favors bank access to beneficial ownership information over law enforcement access by imposing greater limits on domestic and foreign law enforcement access to the information. Law enforcement is our first line of defense against criminal and terrorist activities, and law enforcement officers need to be able to acquire company ownership information quickly and easily without alerting the subjects of the investigation. Accessing the company ownership records at FinCEN, a federal agency, is critical to that mission.

Common terrorist and criminal scenarios might require law enforcement to obtain company ownership information in connection with suspect wire transfers, real estate transactions, aircraft used to transport illegal persons or substances, business transactions, and more.

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<sup>13</sup> <https://eiti.org/beneficial-ownership>

The discussion draft enables banks to access beneficial ownership information from FinCEN by making a request, whereas federal and foreign law enforcement must produce formal subpoenas and state and local law enforcement can't access it at all. While we are supportive of banks and other stakeholders being able to easily access beneficial ownership information to safeguard the US financial system, it doesn't make sense to allow banks to access it by a simple request and then to make it difficult for law enforcement to do the same, especially given the purpose of the bill and the reason that FinCEN is listed as the sole collector of company beneficial ownership information.

1. Ensure that domestic law enforcement, including federal, state and local, has full access to FinCEN's database of beneficial ownership information.

Law enforcement, including federal, state and local, should have complete access to the database that FinCEN creates to collect beneficial ownership information. The discussion draft severely limits domestic law enforcement's access to beneficial ownership information by only allowing federal law enforcement to access the information through a criminal subpoena. This means state and local law enforcement cannot get access to beneficial ownership for their investigations and federal agencies that only use civil or administrative subpoenas won't be able to access it. At a minimum, the following federal agencies would not have access: Treasury, OCC, FDIC, FinCEN, SEC, OFAC, DOJ Civil Frauds division, DOJ Civil Tax, DEA, CFTC, FTC, FCC, FAA and the IRS.

In addition, no state agency under any circumstance would be given access to the information, even though the bulk of US criminal investigations are performed by state law enforcement agencies. States also do enormous work on civil fraud, securities violations, patent and copyright violations, business misconduct, tax dodging, other types of civil law enforcement where corporate ownership is critical to holding wrongdoers accountable.

Typically, if a law enforcement agency is working with a prosecutor's office, they obtain records through the service of a grand jury subpoena. If the investigation is in an early stage, however, and the agency has not yet brought a case to a prosecutor or teamed up with the prosecutor's office, the agency may seek the same evidence via an administrative subpoena. The most well-known examples include subpoenas issued pursuant to 18 U.S.C. § 3486 in cases involving health care fraud, the sexual exploitation of children, and threats against the President, and DEA subpoenas issued under 21 U.S.C. § 876 in cases involving the distribution of controlled substances. See *Doe v. United States*, 253 F.3d 256, 265-66 (6th Cir. 2001) (administrative subpoena issued under 18 U.S.C. § 3486 may request financial records relevant to a federal health care offense, including records that may lead to the forfeiture of the proceeds of the offense); *United States v. Zadeh*, 820 F.3d 746 (5th Cir. 2016) (affirming use of DEA subpoena under § 876 to obtain patient records from physician in investigation of the distribution of controlled substances via prescription). The DEA, for example, makes frequent use of administrative subpoenas in cases involving the illegal distribution of opioids and analogue drugs.

Administrative subpoenas are used in both criminal and civil investigations. They are distinguished from grand jury subpoenas in that they are issued by the law enforcement agency and not by the grand jury

via the prosecutor's office. Administrative subpoenas are invaluable in cases where it is not possible to use a grand jury subpoena. For example, because it is not proper to use a grand jury subpoena if there is no possibility of bringing criminal charges, administrative subpoenas may be used to obtain evidence in furtherance of a civil investigation when a related criminal case has already concluded.

***Recommendation:***

- Ensure domestic law enforcement, including federal, state and local, has full access to FinCEN's database of beneficial ownership information. This shouldn't require a subpoena.
- If the committee chooses not to do the above, than at a minimum, the language in the discussion draft needs to change from: "(i) a criminal subpoena from a Federal agency;" to: "(i) a civil, criminal or administrative subpoena or summons, or an equivalent of such a subpoena or summons, from a local, State, or Federal agency;"

2. Ensure that foreign law enforcement has access to beneficial ownership information so that it can be used in criminal and civil prosecutions.

It is quite common for foreigners to use US shell companies as part of a global organized crime network as they are easy to create, anonymous and give the appearance of legitimacy. However, the discussion draft severely limits foreign governments' access to beneficial ownership information through mutual legal assistance (MLA) requests, which leaves a giant loophole that will lead to the continued use of US anonymous vehicles in criminal enterprises originating abroad.

First, the discussion draft requires the MLA request to be in connection with a terrorism or criminal investigation. There is no reason to qualify the type of investigation by including "terrorism or criminal" before the word investigation. Cases involving civil misconduct, including securities violations, business misconduct, tax dodging, patent and copyright violations, cybersecurity violations, privacy violations, and more would not be able to get access to the information.

Second, the discussion draft limits law enforcement access even further in a way that severely limits its utility. By including "subject to the requirement that such country agrees to prevent the public disclosure of such beneficial ownership information..." it only enables foreign governments to access beneficial ownership information that serves an intelligence purpose and not a law enforcement purpose. To serve a law enforcement purpose it needs it be able to be introduced in court, which could mean it is discoverable at a later date. As written it appears to prevent this and therefore has little utility to a foreign prosecution.

***Recommendation:***

- Ensure that foreign law enforcement has access to beneficial ownership so that it can be used in criminal and civil prosecutions. Specifically, change the discussion draft language from:



“(ii) a written request made by a Federal agency on behalf of a law enforcement agency of another country under an international treaty, agreement, or convention, or an order under section 3512 of title 18, United States Code, or section 1782 of title 28, United States Code, issued in response to a request for assistance in a terrorism or criminal investigation by such foreign country, subject to the requirement that such other country agrees to prevent the public disclosure of such beneficial ownership information or to use it for any purpose other than the specified terrorism or criminal investigation;”

To:

“(ii) a written request made by a Federal agency on behalf of another country under an international treaty, agreement, or convention, or an order under section 3512 of title 18, United States Code, or section 1782 of title 28, United States Code, issued in response to a request for assistance in an investigation by such foreign country;”

3. Require foreign nationals to file their beneficial ownership information with FinCEN, including submitting a scanned copy of the relevant pages of their non-expired passport to FinCEN and define the term “applicant.”

The discussion draft appears to favor foreign owners over US applicants. It requires applicants that form entities to submit beneficial ownership information to FinCEN for each beneficial owner with a non-expired US passport or US drivers’ license. If the beneficial owner doesn’t have one, the applicant appears to have no obligation to give the beneficial ownership information to FinCEN unless FinCEN requests it. In other words, the bill treats foreigners better than US persons — giving them more secrecy upfront. Given existing AML risks, giving foreigners more secrecy than US persons would be unwise. Both foreign owners and US person owners should be required to file beneficial ownership information with FinCEN.

The original reason for this language being included in previous legislation was opposition from the states that had concerns about their ability to process passport information from foreign countries. Given that it has been almost a decade since this was first included in legislation and now only FinCEN is collecting the information, this language should be updated and a process created that enables scanned passport information for beneficial owners with foreign passports to be submitted to FinCEN directly. Applicants could also be required to take an extra step and verify all foreign beneficial owners’ information submitted to FinCEN. FinCEN is our financial intelligence unit and it already has the capacity to set up a system that accepts foreign passport information and to be familiar with foreign passport credentials.

Furthermore, other beneficial ownership legislation, including H.R. 3089, would impose anti-money laundering obligations on formation agents since they are gatekeepers to the US financial system, and would likely be the key persons collecting beneficial ownership information for foreign-owned American corporations or LLCs. By dropping that section, the bill eliminates an important anti-money laundering safeguard mandated under international standards and creates an undeserved loophole for foreign-owned entities.

Additionally, “applicant” is not defined in this section or in any other part of the bill. One could assume it means the person filing an application with a state to form a corporation or LLC, but that is never spelled out. It should include formation agents and company service providers who file applications on behalf of their clients, but it is unclear. If the obligation does apply to formation agents and company service providers providing beneficial ownership information to FinCEN, it seems reasonable to require them also to file any scanned identifying information from a foreign passport with FinCEN.

***Recommendations:***

- Require foreign nationals to file their beneficial ownership information with FinCEN, including submitting a scanned copy of the relevant pages of their passport to FinCEN.
- Define the term “applicant” and if an applicant can be a company formation agent, you should include the section of H.R. 3089 that was deleted, which would have required AML obligations for individuals whose job it is to set up companies, which includes company formation agents.

4. Add an enforcement mechanism to the discussion draft.

The bill doesn’t contain an enforcement mechanism to ensure “applicants” file beneficial ownership information with FinCEN. In addition, as currently drafted, there is no way to ensure that FinCEN knows a company was formed in a state and didn’t file with FinCEN, or for FinCEN to know all of the existing companies that will need to file after this is passed into law. For example, there is no provision that says that an application to form a corporation or LLC is not valid until the state forming the entity receives written notice from FinCEN that the necessary beneficial ownership information has been filed. Earlier bills were thought to involve the IRS, which has its own enforcement division and ways to do this, but FinCEN doesn’t have a way to ensure the bill is enforced. The bill requires new entities as well as existing entities to file this information so it needs a mechanism for enabling FinCEN to know about their existence so it can cross check filers with active entities to determine which entities did not file with FinCEN.

***Recommendation:***

- Add an enforcement mechanism to the bill. This could be done by barring a state from forming a new entity until it receives notice from FinCEN that FinCEN has received the necessary beneficial ownership information. It could also potentially be done by ensuring FinCEN has the authority to regulate in this area, perhaps by requiring states to provide current listings of all of their corporations and LLCs that are active.

5. Allow identification for beneficial owners to include non-expired state issued identification to meet the requirement if they do not have a non-expired US driver’s license or US passport.

The discussion draft requires “(III) a unique identifying number from a non-expired passport issued by the United States or a non-expired driver’s license issued by a State; and.” This appears to be an oversight as it doesn’t allow other state issued identification to be used for individuals without a license or passport.

***Recommendation:***

- Amend the discussion draft to include “or identification card issued by a State” as follows: “(III) a unique identifying number from a non-expired passport issued by the United States or a non-expired driver’s license issued by a State or identification card issued by a State; and...”

6. Banks should begin to implement the customer due diligence (CDD) regulation on time, in May 2018.

Prior to the publication of the CDD rule in May 2016, which is set to be implemented in May 2018, there has been a longstanding, clearly identified need for banks to explicitly collect beneficial ownership information for their customers in order to create a risk profile and assess risk. When the bank doesn’t know with whom it is doing business, it is not possible to adequately assess risk. Prior to this rule, US banks, with few exceptions, were not required to identify the real people or beneficial owners behind the companies that open accounts. This massive hole in US regulations was noted in the Financial Action Task Force’s (FATF) Third Mutual Evaluation Report on Anti-Money Laundering and Combating Financing of Terrorism: United States of America (2006), when it stated the US Customer Identification Program (CIP) rules “do not require a financial institution to look through a customer that is an entity to its beneficial owners,”<sup>14</sup> and again in the 4<sup>th</sup> Mutual Evaluation of the United States (Dec 2016) which again rated the US non-compliant and identified the lack of customer due diligence requirements to ascertain and verify the identity of beneficial owners, except in very limited cases, as a significant shortcoming.<sup>15</sup>

Once this discussion draft is introduced as legislation and passed into law, regardless of how long Congress gives FinCEN to set up this entirely new database of beneficial ownership information, it will take a significant amount of time to get it up and running and populated with the required beneficial ownership information. Adequate customer due diligence within banks, which is what the regulation requires, cannot stop in the interim because the banks need to know its customers does not stop. Banks have been working to put the necessary processes in place to collect this information for at least the last 18 months, so those that are not already doing so should start collecting it on schedule, in May 2018.

***Recommendation:***

- Do not suspend the CDD regulations from going into force in May 2018.

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<sup>14</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer/MER%20US%20full.pdf> p98.

<sup>15</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf> p205

### Reporting requirements

7. Do not raise the CTR and SAR reporting thresholds as it would make it easier for drug traffickers and terrorists to move cash without alerting authorities.

We support Treasury undertaking a formal review of current financial reporting requirements, however we do not support raising the CTR and SAR thresholds (Section 2 (a)(2), Section 2 (b) and Section 3 (b)(3)).

Raising the reporting thresholds would make it easier for drug traffickers and terrorists to move cash without alerting authorities. The \$10,000 CTR threshold, in particular, has made it very difficult for drug traffickers to operate. This is why they use smurf operations and multiple deposits to avoid the thresholds, and it is this structuring that makes it more likely that they will get caught.

The committee should not raise the reporting threshold from \$10,000 to \$30,000. While I understand you are considering this to adjust for inflation and the reduced value of the dollar since the threshold was enacted in the 1970s, this doesn't take into account that with respect to individuals, depositing large amounts of cash has actually become more unusual. The way the world works has changed. Unlike in 1970, it is rare for a person conducting a legitimate business to need any significant amount of currency. With certain well-known exceptions, such as grocery stores, amusement parks, and other cash-intensive businesses that are already exempt from the currency-reporting laws, payments of significant sums of money are made electronically. Those carrying more than \$10,000 in cash are, by and large, doing so expressly for the purpose of avoiding the creation of a paper trail – because their business is *not* legitimate, or because they intend to evade the payment of taxes. This is why there are a large number of structuring transactions reported by financial institutions on SARs. Raising the reporting limit to \$30,000 would simply create a record-free zone for a much larger number of transactions, and lift the burden on wrongdoers who must deal in cash, while doing little or nothing to relieve any burden on legitimate commerce.

CTRs are often scrutinized to see if suspicious activity is taking place. Raising the CTR reporting threshold would likely lead to fewer SARs, even though as explained above, in today's world it is more unusual for individuals to be carrying, say, \$25,000 in cash. Furthermore, CTR reporting is automated at the majority of banks, so there would be minimal savings by raising the CTR reporting thresholds.

#### ***Recommendation:***

- Do not raise the CTR and SAR reporting thresholds.

8. Treasury should not assess the utility of SARs and CTRs for law enforcement (Section 3 (b)(6)).

Treasury cannot accurately assess the categories, types and characteristics of SARs and CTRs that are of greatest value to, and best support, investigative priorities of law enforcement. First, Treasury is not

familiar with state and local law enforcement which handles the bulk of criminal investigations and prosecutions across the country. Nor is it familiar with the many federal law enforcement efforts that might make use of SAR or CTR data including such varied issues as health care fraud, opiates and illegal drugs, wildlife trafficking, securities and accounting fraud, patent and copyright infringement, immigration violations, food safety violations, antitrust violations, and much more. Second, the utility of SAR and CTR data may depend on what other information happens to be in the hands of law enforcement at any given time when they are investigating. This is situational and varies in ways that would make a Treasury analysis difficult or impossible without extensive and expensive surveys and data collection. Third, law enforcement priorities are different throughout the country and change over time. A Treasury review would only be a snap-shot of one point in time and would therefore be of extremely limited value.

***Recommendation:***

- Treasury should not assess the utility of SARs and CTRs for law enforcement.

***Treasury's role in coordinating AML/CFT policy and examinations across government***

9. FinCEN should not be setting AML/CFT priorities for banks on an annual basis or otherwise.

We have concerns with Section 6 (a) and (b) of the discussion draft. FinCEN should not be setting AML/CFT priorities for banks on an annual basis or otherwise. Banks set their AML/CFT priorities based on their assessment of the unique risks their business model poses after factoring in their unique clientele, the jurisdictions in which they have correspondent relationships, the risks posed by their various business lines and how much of their business is in those riskier lines, etc. This can be informed by information provided by FinCEN in what it is seeing as far as trends in SARs and emerging threats, but FinCEN should not be setting a one-size fits all approach. Subsection (a) will completely eviscerate the idea that banks need to understand the risks their business activities pose and address them effectively. Subsection (b) says that once FinCEN sets those priorities, banks can only be examined for their compliance program in relation to those priorities, which would create a tick box approach to compliance and send the message that banks don't need to worry about anything that falls outside of FinCEN's AML/CFT priorities, regardless of the risk profile of the bank's activities.

***Recommendation:***

- FinCEN should not be setting AML/CFT priorities for banks on an annual basis or otherwise as banks need to understand and address the risks their business activities pose, and it would lead to a tick box approach to compliance.

Improve information sharing efforts among financial institutions

10. Permit banks to share SARs with any branch or affiliate, but only insofar as the prohibition on banks disclosing the existence of a SAR to clients is a legal requirement applicable to any branch or affiliate with whom SAR information is shared.

We are supportive of efforts to improve information sharing among financial institutions. However, the discussion draft should extend the prohibition on banks disclosing to clients about the existence of a SAR to any branch or affiliate with whom SAR information is shared.

**Recommendation:**

- Extend the prohibition on banks disclosing to clients about the existence of a SAR to any branch or affiliate with whom SAR information is shared.

Encourage the use of technical innovation

11. Use of new technology should be encouraged, but must be done responsibly. A section of Treasury should be created or tasked with reviewing, approving and monitoring the use of new technology by financial institutions. There should not be a safe harbor provision.

We are supportive of banks incorporating new technology into their compliance activities. However, we are not supportive of the sweeping nature of the safe harbor provision. The discussion draft could create a new section of Treasury, or task an existing section, with reviewing, approving and monitoring the use of new technology.

**Recommendation:**

- A section of Treasury could be created or tasked with reviewing, approving and monitoring the use of new technology. There should not be a safe harbor.

Additional opportunities to reform the current BSA regime and anti-money laundering requirements

While banks serve as the frontline of defense and must continue to play a primary role and bear significant responsibility against dirty money and terrorist finance entering the US financial system, they shouldn't be alone in bearing that responsibility. Those seeking to move suspect funds utilize the services of a wide range of professional gatekeepers to the financial system who handle large sums of money. Company service providers, the real estate sector, lawyers and accountants should also take responsibility for knowing with whom they are doing business and engage in efforts to prevent their services from being used to launder dirty money.

Requiring these sectors to have anti-money laundering compliance programs would finally bring the US in line with the international anti-money laundering standards that the US was instrumental in creating as a leading member of the Financial Action Task Force (FATF). In its 2016 assessment of the US, FATF

noted that the US regulatory framework “has some significant gaps, including minimal coverage of certain institutions and businesses (investment advisers (IAs), lawyers, accountants, real estate agents, trust and company service providers (other than trust companies),” and that, “the vulnerability of these minimally covered designated non-financial businesses and profession (DNFBP) sectors is significant, considering the many examples identified by the national risk assessment process.”<sup>16</sup> Regulating these sectors would go a long way in preventing the US from being a safe haven for dirty finance from around the world.

12. Formation agents and others who are paid to set up corporations, trusts or other legal entities should have anti-money laundering obligations.

The US should comply with the international anti-money laundering standards that it has already agreed to implement. This means that US law should be aligned with the global standard about which professions should be subject to customer due diligence and record keeping requirements. Congress should ensure that anyone who is paid to form a legal entity with the imprimatur of the United States takes reasonable steps to know their customers, monitor their actions, and report suspicious activity to law enforcement.

***Recommendation:***

- Formation agents and others who are paid to form corporations, trusts, or other legal entities should be made subject to anti-money laundering obligations.

13. Lift the 2002 “temporary” exemption on persons who were required by a 2001 law to have an anti-money laundering program, including persons involved in real estate closings and settlements.

In 2001, the PATRIOT Act required covered financial institutions to establish anti-money laundering programs, but in 2002, the Treasury Department granted what it called a “temporary” exemption to several categories of persons, including persons involved in real estate closings and settlements. Sixteen years later, that temporary exemption is still in place. It is time to eliminate the exemption and set a deadline for those persons to come into compliance with the law. Treasury could also be directed to issue any necessary regulations.

Aside from the fact that the legal requirement has been on the books since 2001, the US should comply with the international anti-money laundering standards that it has already agreed to implement, which require some of the exempted categories of persons to have anti-money laundering programs.

In the case of real estate, it is all too easy for bad actors to use real estate purchases as a vehicle for money laundering. High-end real estate purchases are prone to money laundering risks, according to FATF and the US Treasury. That’s why, since 1988, Congress has made “persons involved in real estate closings and settlements” subject to anti-money laundering obligations. FATF has also issued global

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<sup>16</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf>, p3.

guidance for countries on how to adopt measures that would ensure real estate professionals and others who are involved in real estate transactions are conducting anti-money laundering due diligence properly.

After the New York Times published its Towers of Secrecy series,<sup>17</sup> the Department of the Treasury issued a 6 month geographic targeting order for all cash, high end residential real estate purchases in a handful of locations, and has renewed and expanded it several times. Further illustrating the importance of regulating in this area, Treasury recently found that approximately 30 percent of high end, all cash real estate purchases in six major metropolitan areas involved a “beneficial owner or purchaser representative that is also the subject of a previous suspicious activity report.”<sup>18</sup> While a welcome step, the current GTOs are a poor substitute for the 15-year-old requirement that persons involved with real estate closings and settlements must establish an anti-money laundering program.

**Recommendation:**

- Congress should lift the “temporary” exemption created in 2002 excusing certain categories of persons from complying with the 2001 law requiring them to establish anti-money laundering programs, including “persons involved in real estate closings and settlements.” A deadline should be established to bring everyone into compliance with the law, which is now 16 years old. As a part of this effort, the Treasury Department should also require public disclosure of the beneficial owners who ultimately own companies purchasing real estate throughout the US.

14. Require transactional lawyers to have customer due diligence and record keeping requirements.

The US should ensure that it complies with the international anti-money laundering standards that it has already agreed to implement. This means that the US should pass legislation requiring transactional lawyers, and anyone else who creates companies, to carry out anti-money laundering checks. The American Bar Association (ABA) should also update its Model Rules of Professional Conduct to require lawyers to carry out anti-money laundering checks along the lines of the voluntary guidance provided by the ABA in 2010 on the subject.

Laundering money is, of course, illegal in the US for anyone, including lawyers. In addition, the ABA’s Model Rules of Professional Conduct prohibit lawyers from counseling a client to engage in conduct that the lawyer knows is illegal,<sup>19</sup> and in order to carry out that requirement lawyers need to do some due diligence. However, American lawyers appear to take a “head in the sand” approach where they try not

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<sup>17</sup> The New York Times series “Towers of Secrecy” available at <https://www.nytimes.com/news-event/shell-company-towers-of-secrecy-real-estate>

<sup>18</sup> <https://www.fincen.gov/news/news-releases/fincen-targets-shell-companies-purchasing-luxury-properties-seven-major>

<sup>19</sup> American Bar Association, Rule 1.2: Scope of representation & allocation of authority between client & lawyer (d), [http://www.americanbar.org/groups/professional\\_responsibility/publications/model\\_rules\\_of\\_professional\\_conduct/rule\\_1\\_2\\_scope\\_of\\_representation\\_allocation\\_of\\_authority\\_between\\_client\\_lawyer.html](http://www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/rule_1_2_scope_of_representation_allocation_of_authority_between_client_lawyer.html)



to ask too many questions so they cannot be deemed to have knowledge. This is the same approach that the banks took for years before it was understood that they played a vital role as gatekeepers to the financial system, which is a very similar role that transactional lawyers play.

These risks have been highlighted by the Financial Action Task Force. Its 2016 assessment of the US found that lawyers were not applying basic or enhanced due diligence processes, describing this as a “serious gap.”<sup>20</sup> It went on to note that it also was not clear whether lawyers were complying with the ABA’s voluntary guidelines, as they are not enforceable, and recommended that anti-money laundering rules be imposed on lawyers “as a matter of priority.”<sup>21,22</sup>

The following are a few examples that illustrate how attorney-client accounts are open to abuse.

Court documents in the recent Department of Justice indictment in the 1MDB scandal allege that \$1 billion was laundered in the US, and much of that \$1 billion was also spent in the US.<sup>23</sup> According to the court documents, approximately one-third of it (\$368 million) moved through the client account of a single Manhattan law firm, Shearman & Sterling LLP.<sup>24</sup> Money from this account was then used to buy luxury real estate, a Beverley Hills hotel and a private jet, and to fund the Wolf of Wall Street motion picture.<sup>25</sup> It is important to note that there are no allegations of wrong-doing against Shearman & Sterling and the firm has stated that it “had no reason to believe that any funds transferred to Shearman & Sterling were the proceeds of unlawful activity.”<sup>26</sup>

This wasn’t the first time that US attorney-client accounts have been used to shift corrupt funds into the US. Teodorin Obiang, son of the President of Equatorial Guinea, shifted millions of dollars of suspect funds into the US. Two lawyers helped Obiang circumvent US anti-money laundering controls by allowing him to use attorney-client, law office, and shell company accounts as conduits for his funds and without alerting the bank to his use of those accounts.<sup>27</sup>

These examples are particularly interesting to Global Witness as it highlights a major weakness in the US’ anti-money laundering controls. For our recent report, Lowering the Bar,<sup>28</sup> which was covered on 60 Minutes, a Global Witness investigator, posing as an adviser to a foreign government official, asked thirteen New York law firms (not including Shearman and Sterling) how to anonymously move large sums of money that should have raised suspicions of corruption. In all but one case, the lawyers

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<sup>20</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf> p10, 120

<sup>21</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf> p123

<sup>22</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/mer4/MER-United-States-2016.pdf> p118

<sup>23</sup> <https://www.justice.gov/opa/pr/united-states-seeks-recover-more-1-billion-obtained-corruption-involving-malaysian-sovereign>

<sup>24</sup> <http://www.wsj.com/articles/law-firm-account-held-1mdb-funds-1469141647>

<sup>25</sup> <https://www.justice.gov/opa/file/877166/download> paragraph 106.

<sup>26</sup> <http://westlakelegal.com/law-firms-use-of-trust-accounts-under-scrutiny/>

<sup>27</sup> <https://www.hsgac.senate.gov/download/report-psi-staff-report-keeping-foreign-corruption-out-of-the-united-states-four-case-histories>

<sup>28</sup> <https://www.globalwitness.org/en/reports/loweringthebar/>

provided suggestions on how to get the money into the US without detection, which included the use of anonymously-owned companies and trusts. At least two suggested using the lawyers' escrow account. The meetings were all preliminary; none of the law firms took the investigator on as a client. Nor did they break the law.

In one interview, a lawyer described a method that could enable the minister to reduce the chances of a US bank performing anti-money laundering checks when wiring money into the country. They suggested that the minister could use their law firm's pooled client, or escrow, account to bring the money into the US.

Investigator: And you don't have to declare to bank authorities where the money comes from, because you said you even don't know who they are?

Lawyer: Well, they've asked me twice at [name of bank redacted], I use [name of bank redacted]. They've asked me 'so you have a lot of money coming in'. I said yes, it's real estate deals. 'Oh thank you very much' [said the bank].

Investigator: No other question asked? Even if it's foreign money?

Lawyer: The money came in; they can tell it's from an offshore bank. I said: 'I did a real estate deal'. The money came in day one, it went out on day five, that's the way it works.

Investigator: And the only question asked was?

Lawyer: What's it there for? I did a deal. That's it<sup>29</sup>

These examples demonstrate how attorney-client escrow accounts can be used to bypass checks at financial institutions and move suspect money into the US.

**Recommendation:**

- Congress should require transactional lawyers to have customer due diligence and record keeping requirements. The law must specify what due diligence transactional lawyers have to carry out before accepting a client, require transactional lawyers to identify higher risk clients and require them to report suspicious transactions to the authorities.

**Conclusion**

It is great to see momentum building in the new Terrorism and Illicit Finance Subcommittee and in the Financial Institutions and Consumer Credit Subcommittee to introduce a bill to help keep terrorist finance and other forms of dirty money out of the US.

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<sup>29</sup> <https://www.globalwitness.org/en/reports/loweringthebar/>, p. 8

There have been many voices calling on Congress to take action on these issues and increase beneficial ownership transparency. Approximately forty-five NGOs and ten national law enforcement associations, as well as appointed and elected law enforcement leaders at the state and federal level, have expressed support for legislation aimed at tackling anonymous companies. The Clearing House Association, the Independent Community Bankers of America (ICBA), the Credit Union National Association (CUNA) and the National Association of Federally-Insured Credit Unions (NAFCU) have all expressed support for legislation to end anonymous companies in the US. Scholars from think tanks across the political spectrum, including Hudson's Kleptocracy Initiative; Brookings Institution; American Enterprise Institute; Council on Foreign Relations; the Terrorism, Transnational Crime and Corruption Center (TraCCC) at George Mason University; Foundation for Defense of Democracies and the Carnegie Endowment for International Peace have also called for beneficial ownership disclosure. CEOs from multiple companies, including Allianz, Virgin Group, Salesforce, Dow Chemical Group, Kering Group and Unilever have all endorsed legislation that would increase beneficial ownership transparency, as have investors representing more than \$855 billion in assets.

Requiring the disclosure of the real owners of American companies will stop criminals using companies to cover their tracks. This is a problem Congress can stop and we look forward to working with you and your colleagues on legislation to strengthen the US anti-money laundering framework so that we can stop the US from being a safe haven for illicit money and terrorist financing from around the world.

Thank you for inviting me to testify today and share my views on this important issue.