Insights: U.S. Treasury's Call for Greater Financial Transparency – We Need to Support It

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The following editorial is by a former U.S. Treasury Department official. The views expressed are his own.

It is rare that a single regulation can significantly strengthen our financial integrity, criminal justice system, foreign policy and national security. The Treasury Department has just proposed one. We must support its adoption and demand more effective implementation of similar measures globally.

Treasury's proposed rule describes information U.S. financial institutions must collect and monitor to understand who their customers are and the transactions they conduct. Such customer due diligence (CDD) is not new; it has been an implicit U.S. requirement and an explicit rule elsewhere for decades. But inconsistent global implementation of CDD has helped enable illicit financiers of all stripes to operate with astonishing impunity, while simultaneously raising compliance and enforcement risks for our financial institutions.

The most recent United Nations study estimates that $1.6 trillion of criminal proceeds were laundered in 2009 alone. Authorities around the world routinely capture less than one percent of these proceeds, primarily because they do not know where this sea of illicit money is or where it goes. The depressing reality is that financial crime pays excessively well.

When CDD is not effectively implemented or enforced, financial transparency is compromised. Financial institutions and regulators cannot identify or manage risks ranging from financing al-Qaida 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 Iran, Syria, Russia and others becomes a hollow talking point rather than an operational instrument of global security.

Certainly, CDD and financial transparency alone cannot satisfy these needs. But without it, these needs cannot be met. This is why financial transparency is both a core objective of the global counter-illicit financing community and a driving principle of financial reform by the G-20 and the G-7.

Despite this clarity of reasoning and the longstanding importance of interests reliant on financial transparency, prior U.S. efforts to establish a CDD rule have failed. Treasury's current proposal could suffer the same fate, or be fatally weakened.

How can this be?

Many have argued that CDD already implicitly undertaken to meet other requirements is sufficient. Yet as the U.N. report and other studies suggest, current CDD efforts have failed to achieve the financial transparency required to find trillions of dollars of assets continually laundered through our financial system.

To be effective, CDD obligations must go beyond identifying the front companies, sham corporations and other cut-outs frequently used to open accounts on behalf of criminals. They must also extend past the names of correspondent institutions with lax controls that allow criminals to access our banks through the back door of under-regulated industries or indifferent jurisdictions. In short, CDD obligations must explicitly include gathering meaningful information about the primary individuals who ultimately own, control or benefit from these accounts, as Treasury's proposal requires.

Others will continue arguing these CDD challenges are better addressed through risk-based guidance rather than rulemaking that applies across the board. Such critics fail to recognize that the absence of a CDD rule has spawned incompatible expectations across regulators, law enforcement, policymakers and practitioners. The resulting inconsistencies commercially penalize those that invest in CDD while exposing the entire system to illicit finance through those that do not. In the heightened U.S. enforcement environment, such inconsistencies also encourage regulation by prosecution. This does not reflect a risk-based approach; it is a recipe for bad financial governance.

Treasury's proposed rule would preserve the flexibility of a risk-based approach while grounding expectations through a clear minimum baseline of CDD requirements. Follow-on guidance, developed by regulators in consultation with industry, could then assist financial institutions in applying these requirements to scenarios of particular interest or concern, reducing uncertainties that currently foster compliance risk.

Still others will oppose Treasury's proposal because of other understandable but misguided concerns about today's uneven playing field in global finance. The heightened standard for financial institutions doing business in the United States is due to practically singular U.S. enforcement of global standards to combat illicit finance. Opposing Treasury's proposal will not remedy this. Rather, other countries must enforce their own laws implementing these standards. Ironically, the United States may be the only financial center left currently lacking a basic CDD law on its books.

Many will oppose Treasury's proposal because they believe implementation will be costly. But short-run costs will be manageable because Treasury's proposal builds upon well-established industry practice regarding customer identification and verification. Indeed, many financial institutions are already implementing the requirements proposed by Treasury's new rule. In the long run, a CDD rule may reduce costs for responsible actors by grounding and rationalizing disparate expectations.

Finally, critics will rightly say that Treasury's proposal alone cannot deliver the financial transparency we need. But this is not cause for opposition; it is a call for additional action required to support effective CDD implementation. Such action includes requiring meaningful disclosure of the primary individuals behind the companies that countries authorize. Other steps include strengthening regulation and oversight of non-bank financial sectors, enhancing information-sharing across financial institutions and authorities, and prosecuting those who lie to banks or authorities about the interests they represent. Support from the financial services industries may be critical to advancing these other elements of a broader financial transparency strategy.

Without adequate oversight and enforcement, none of this will matter. As the United States catches up to other financial centers in strengthening and clarifying CDD requirements through an explicit rule, other countries must follow U.S. willingness to enforce these and other global counter-illicit financing standards.

The time to act is now. In an age when financial transparency is more complex yet more important than ever before, we must be more attentive to and supportive of these efforts. It is not only a matter of financial integrity—it is essential to our collective security.

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