Congressional Testimony

Evaluating the Security of the U.S. Financial Sector

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Chairman Fitzpatrick, Vice Chairman Pittenger, Ranking Member Lynch, and other distinguished members of the Task Force, I am both humbled and honored by your invitation to testify today at this third hearing of the Task Force to Investigate Terrorism Financing. Your work is tremendously important, not only to our national and global security, but also to our financial integrity and economic prosperity.

Introduction

I was extraordinarily privileged to serve our country at the United States Department of the Treasury for 11 years following the terrorist attacks of 9/11. I worked with and for an immensely talented and dedicated group of individuals from across the government. This was a pivotal period in the development and institutionalization of an unprecedented global campaign to counter the financing of terrorism (CFT).

From the time of 9/11 through the present, the United States has led this global CFT campaign with unprecedented tenacity and commitment. This commitment has been vindicated by the substantial disruptive and preventive impact of our CFT efforts against our most pressing terrorist threats. Due to these successes, the ongoing global CFT campaign is now unquestionably recognized as a pillar of the broader counter-terrorism mission. Nearly 14 years after the inception of the modern CFT campaign, the ongoing work of this Committee and Task Force is a testament to this fact.

And yet the CFT challenges facing us now are perhaps greater than ever before. The rise of the Islamic State and the resiliency of a balkanized, but continually dangerous, al Qaeda and its global network of affiliates demonstrate the ongoing urgency of the terrorist threat. As we have succeeded in clamping down on more overt forms of support to terrorist organizations, these and other terrorist groups have adjusted their means of obtaining the resources they need.

Many of these terrorist financing methods are not new, but they have become more pervasive. Prominent examples include the rise of kidnapping for ransom and the other criminal activities, increasingly in collaboration with criminal organizations. Fundraising and recruitment over the internet and exploitation of local economies under terrorist control have also grown, exposing limitations of our CFT approach. And despite the potential of a nuclear deal, Iran's continued and aggressive state sponsorship of terrorism presents complex but urgent challenges to the global CFT campaign.

To meet these challenges, we must adjust our CFT campaign to directly confront the shifting terrorist financing methodologies of today's primary terrorist threats. This will no doubt include continued development and adaptation of our CFT operational and targeting capabilities. More fundamentally, this must also include addressing systemic challenges to our financial security. Such challenges increasingly undercut the effectiveness and threaten the sustainability of the global CFT campaign.

My remarks today will focus on these systemic challenges. Such challenges are not new, nor are they limited to the CFT campaign or to the United States. But addressing these systemic challenges is more important than ever before, not only for our CFT campaign, but also for our national and collective security, and for our economic stability.

Addressing these challenges will require us to strengthen global commitments to financial integrity, including through continued implementation and enforcement of global anti-money laundering (AML)/CFT standards and financial sanctions regimes. These are global standards that sustained US leadership has helped to create. The integrity of our financial system relies on their effective implementation, as well as our continued development and application of targeted financial measures.

This ongoing work to strengthen and protect U.S. and global financial integrity will clearly require the continued leadership of the United States and the strong support of this Committee.

I will begin with a brief explanation of the meaning of financial integrity and its importance in today's evolving CFT campaign and to our broader security and economic interests. I will also highlight how the global AML/CFT and financial sanctions regimes led by the United States over the past generation have helped create a foundation of financial integrity essential to the work that lies ahead. I will then outline the key systemic challenges to financial integrity, including with respect to financial transparency and financial accountability. I will close with a series of recommendations for actions that this Committee can take to address these challenges.

The Financial Integrity Imperative

Financial integrity is fundamentally about financial transparency and accountability. These concepts provide the foundation upon which our CFT campaign and broader counter-illicit financing mission rest. They are also crucial to protecting our financial system, national security, and economic interests. And they rely upon effective implementation of global AML/CFT and financial sanctions standards.

Financial Transparency

Financial transparency is crucial to financial integrity because it allows us to identify, track and trace the sources, conduits and uses of terrorist financing that transit the financial system. This is equally true for all manner of illicit finance. 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 Iran, Syria, Russia or others becomes a hollow talking point rather than an operational instrument of global security.

Certainly, 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 G20 and the G7.

Accountability

Accountability is crucial to financial integrity because it gives us confidence that the rule of law is enforced across the financial system. With respect to combating illicit finance, accountability drives financial integrity in two respects. First, accountability is needed to enforce requirements of and responsibilities for financial transparency across the financial system, including with respect to the customers, institutions and ultimately the authorities that access, service and govern the financial system. Second, accountability is needed to pursue, disrupt, punish and deter those who abuse the financial system in pursuit of illicit activity. It is essential to recognize that failure of accountability in either of these two respects undermines the integrity of the financial system.

Economic Stability

Beyond the clear national security imperatives of financial transparency and accountability, financial integrity is also essential to protect our economic stability. When financial transparency and accountability suffer, the integrity of economic markets can erode, and with it market confidence. Short term gains associated with short-cuts around systemic investments in financial integrity are ultimately a losing proposition. When investors realize that their capital is not protected by the integrity of financial markets, they lose confidence in their investments. And they move their capital to markets whose integrity protects their interests. This is particularly true when times are turbulent.

The U.S. market has thrived historically in part because of the integrity of our financial system. The financial transparency and accountability created by the sound implementation of AML/CFT and financial sanctions regimes play an increasingly important role in protecting the integrity of not only our financial system, but also of the economy it supports. The financial transparency and accountability fostered by AML/CFT and financial sanctions regimes guard our economy from various forms of corruption that undermine market principles. Such regimes, when properly implemented and enforced, help protect the market integrity of industries that enjoy the public trust and the confidence of investors. When such regimes are absent, market integrity is threatened.

The globalization of market economies underscores the importance of enforcement actions against those who fail to implement AML/CFT and financial sanctions regimes. Countries and financial institutions with systemic deficiencies in their AML/CFT and financial sanctions regimes present systemic vulnerabilities to the integrity of the international financial system and the global economy it supports. In an increasingly globalized financial system and economy, such deficiencies in any one country or

financial institution present vulnerabilities to other countries and institutions. They also present vulnerabilities to the industries, investors, depositors and other customers they service. Ultimately, these vulnerabilities can jeopardize the health of the general economy.

In an increasingly globalized financial system, economy and threat environment, our financial integrity requires a global commitment to financial transparency and accountability. For decades, the United States has led the development of a comprehensive and global counter-illicit financing framework. This framework is designed to achieve the financial transparency and accountability upon which our CFT campaign and collective security increasingly depend. As discussed below, this global framework represents an accomplishment as tremendous as it is important, providing a financial integrity foundation that is both deep and wide. The financial integrity imperative must now focus on strengthening implementation of the key measures that deliver financial transparency and accountability pursuant to this global framework.

This first requires a brief explanation of the global counter-illicit financing framework as a foundation for securing our financial integrity.

A Global Foundation for Financial Integrity

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 financial integrity to our collective security. Protecting the integrity of the financial system has since become central to the mission of the United States Department of the Treasury and to that of finance ministries around the world. Through the work of 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, the United States has led a global commitment to protecting the integrity of the financial system against all manner of illicit finance.

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 protect the integrity of the financial system.

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.

Nonetheless, these comprehensive jurisdictional assessments also reveal a number of deep-seated, systemic challenges to financial integrity. 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. Such challenges may be broadly divided between those that undermine financial transparency and those that threaten financial accountability.

Systemic Challenges to Financial Transparency

Financial transparency generally requires implementation of the full range of preventive measures included within the FATF global standards. Ongoing systemic challenges to financial transparency primarily stem from important gaps in implementing these preventive measures, including in particular:

(i) Effective customer due diligence by financial institutions;

(ii) Meaningful beneficial ownership disclosure and maintenance requirements for legal entities;

(iii) AML/CFT coverage of the complete financial system; and

(iv) Information-sharing to enable financial institutions to understand and manage correspondent or intermediated illicit financing risks.

These measures, and the systemic challenges that frustrate their implementation, are briefly discussed below.

Customer Due Diligence

Financial transparency fundamentally requires financial institutions to understand the persons and entities with whom they do business, whether on an ongoing or occasional basis. Customer due diligence (CDD), or know-your-customer (KYC) rules, are commonly understood as the bedrock of financial transparency.

Pursuant to FATF global standards, CDD/KYC generally includes the following four elements: (i) customer identification and verification; (ii) beneficial ownership identification and verification; (iii) understanding the nature and purpose of the customer account or relationship, and (iv) monitoring customer account activity. Failure to implement any of these required elements undermines financial transparency, making it more difficult to identify, track or trace illicit financing networks.

Each of these four elements of CDD can present challenges for financial institutions, but the consistent lack of beneficial ownership information collected by financial institutions has historically posed a systemic vulnerability undermining financial transparency. To be effective, CDD obligations must go beyond identifying the front companies, shell companies and other cut-outs frequently used to open accounts on behalf of criminals. Addressing this common method of illicit finance requires gathering meaningful information about the beneficial owners of financial accounts – that is, the primary individuals who ultimately own, control or benefit from these accounts.

In accordance with FATF global standards, financial institutions should be required to obtain such information from their customers as a routine element of CDD. Customers that fail to provide such information should be denied access to the financial system. Customers that deliberately misrepresent such information for purposes of avoiding detection should be subjected to meaningful sanctions, including prosecution for fraud.

In recent years, most financial centers have significantly strengthened CDD requirements for financial institutions, including for purposes of specifically addressing shortcomings in beneficial ownership information collection. However, implementation and enforcement of these requirements, particularly in non-bank financial institutions, remains a systemic challenge. In some countries, including the United States, beneficial ownership information is not yet required as a routine element of CDD. The systemic

vulnerabilities created by these weaknesses in CDD substantially compromise financial transparency.

Beneficial Ownership Requirements for Legal Entities

In higher risk scenarios, financial institutions should verify the beneficial ownership information obtained from their customers through independent corroboration of the beneficial owner's status. This presents significant challenges for financial institutions that lack independent sources of information about their legal entity customers. To assist financial institutions in conducting such verification, countries should demand beneficial ownership information as a condition for granting legal status to those entities formed under their authorities.

Equally importantly, beneficial ownership requirements for legal entities will provide immensely valuable information for law enforcement and other authorities. An abundance of testimony and evidence over the past several years demonstrates that investigations of legal entities implicated in all manner of criminal activity are all too often frustrated by of a lack of meaningful beneficial ownership information.

For these reasons, the FATF global standards clearly require jurisdictions to impose beneficial ownership disclosure and maintenance requirements for legal entities formed under their authorities. Yet few jurisdictions require companies to disclose their beneficial ownership as a condition of obtaining or maintaining their legal status. Of those jurisdictions that do require such disclosure, few have meaningful verification or enforcement processes to ensure the credibility of the beneficial ownership information they collect. This consistent lack of available and credible beneficial ownership information for legal entities – in the United States and most financial centers around the world – presents another systemic challenge undermining financial transparency.

AML/CFT Coverage of the Complete Financial System

Financial transparency is complete only to the extent that it applies across the entire financial system. All financial institutions – including non-banking financial institutions such as broker dealers, investment advisors, and money services businesses – should be subjected to effective AML/CFT regulation. In addition to non-bank financial institutions, certain industries that can operate as de-facto financial institutions or that facilitate access to financial services for their customers may present systemic vulnerabilities to illicit finance. Such industries include casinos, real estate agencies, dealers in precious metals and stones, and trust and company service providers.

Failure to extend meaningful AML/CFT regulation to these non-bank financial institutions or vulnerable industries can allow illicit financing networks to obtain the financial services they need without detection. Once illicit actors gain access to any part of the financial system, the highly intermediated nature of the system facilitates their access to other parts, including by sector or geography.

Any unregulated or under-regulated financial sector or vulnerable industry also puts more pressure on those sectors that are regulated. It is much more difficult to detect illicit financing risks that are intermediated through another financial institution or through a customer or account that represents unknown third party interests. Correspondent relationships with unregulated financial institutions or vulnerable industries that lack AML/CFT controls allow criminals to access even well-regulated financial institutions through the back door.

For this reason, correspondent relationships are generally considered high risk under FATF global standards, even between financial institutions that are well-regulated for AML/CFT. Correspondent relationships with financial institutions that lack AML/CFT regulation may be prohibitively high risk. The same may also be true of accounts with businesses from other vulnerable industries that lack AML/CFT regulation.

In light of these concerns, FATF global standards direct countries to extend AML/CFT preventive measures across all financial sectors and vulnerable industries, including the legal and accounting professions. Covering all of these sectors and industries can challenge considerable political interests and entails substantial costs. As a result, many countries, including the United States, lack full AML/CFT coverage of their financial systems or vulnerable industries. These gaps in coverage put more pressure on banks and other sectors that are covered and present systemic challenges to financial transparency.

Intermediation and Information-Sharing

Illicit financing networks, like the business of most enterprises, almost always implicate more than one financial institution. Whether in the process of raising, moving, using or laundering funds associated with illicit activity, such networks almost invariably transact across multiple financial institutions. For the illicit financing networks of most pressing concern, transactions also often cross multiple jurisdictions. Identifying, tracking and tracing these networks therefore depends critically upon information-sharing across financial institutions and across borders.

FATF global standards require or encourage countries and financial institutions to share information in many ways. However, implementation of such information-sharing measures is routinely constrained or prohibited by data protection, privacy, or business interests, or by liability concerns associated with these interests. Many counter-illicit financing professionals in governments and in financial institutions consider data protection and privacy to be the "new bank secrecy" that was the genesis for much of interest in creating the FATF over 25 years ago.

The systemic challenge posed by these information-sharing constraints is perhaps most evident in the risk management programs of global banks and large financial groups. FATF global standards direct countries to require such banks and financial groups to develop risk management programs that cover their entire enterprise. The wide scope of these programs is deliberately aimed at identifying and addressing illicit financing risks across all branches and affiliates of the bank or financial group, wherever located. Yet

data protection, privacy and other restrictions in many countries prohibit such banks or financial groups from sharing much of the information that is relevant or even essential to such enterprise-wide risk management programs. These restrictions apply even when the information sought is intended to be kept entirely within the financial group's enterprise.

Even more problematic for these institutions, information-sharing requirements and prohibitions from different countries can conflict with one another, making it impossible to comply with the laws or expectations of different financial centers in which global banks and financial groups operate.

Information-sharing challenges associated with financial intermediation and illicit finance are not limited to cross-border scenarios or to risk management programs. Even within jurisdictions, many of the same constraints prevent financial institutions from sharing information that can be critical in identifying or addressing illicit financing risks. This presents opportunities for countries, including the United States, to begin understanding and addressing these challenges through domestic information-sharing enhancement processes, in partnership with their financial institutions.

The sensitivity of financial information and the legitimate interests behind data protection and privacy raise important considerations for policymakers in determining how best to address these information-sharing challenges. Although more work is needed to better understand these challenges and how best to overcome them, it is clear that the lack of proactive or even reactive information-sharing between and among financial institutions presents a systemic challenge to financial transparency.

Systemic Challenges to Financial Accountability

Distinct and global systemic challenges to financial accountability exist with respect to both achieving compliance with financial transparency requirements and pursuing and disrupting illicit financing networks. I will focus primarily on those systemic challenges that directly implicate financial authorities.

Achieving Compliance with Financial Transparency Requirements

Over the past several years, the United States and most countries have undertaken substantial efforts to strengthen and expand AML/CFT preventive measures required to achieve transparency across the financial system and other vulnerable industries. Yet in all jurisdictions, implementation of these measures remains a constant challenge. This is overwhelmingly due to the complexity of the financial system, the global economy, and of illicit financing networks and schemes.

In many instances, however, such challenges of global implementation may also be owing to the lack of effective enforcement and an ensuing lack of compliance culture in the private sector regarding AML/CFT preventive measures. In turn, these industry compliance concerns implicate questions of industry supervision. These issues present

distinct and global systemic challenges of financial accountability associated with achieving compliance with financial transparency requirements.

1. Challenges of Industry Compliance

As a general matter, U.S. enforcement of AML/CFT preventive measures is particularly strong. A long string of U.S. enforcement actions against global banks and other financial institutions in recent years underscores the U.S. commitment to the global AML/CFT regime and financial integrity. At the same time, these enforcement actions have raised questions about the state of industry compliance with AML/CFT preventive measures, both within the United States and particularly abroad.

Many of these enforcement actions reveal systemic deficiencies in AML/CFT policies, procedures, systems and controls, including in many of the world's largest and most well-regulated banks. The immense size and complexity of these banks, and the corresponding illicit financing risks they must manage, help explain the particular focus of AML/CFT authorities in making sure these banks implement effective AML/CFT measures, including those that provide financial transparency. It also helps explain the need for more sophisticated AML/CFT programs that implicate particular compliance challenges in these banks.

However, the fundamental breakdowns that have given rise to these enforcement actions raise important concerns about the general culture of compliance with AML/CFT preventive measures across the core banking sector. This continues to be a dominant topic of concern to U.S. authorities, and is beginning to resonate in other financial centers.

This realization has prompted efforts in the United States, and in some instances in other financial centers, to intensify AML/CFT oversight of key financial institutions. U.S. authorities have placed many of the world's largest financial institutions operating in the United States under intense monitoring and oversight programs as a key condition for settling various AML/CFT enforcement actions. It is unclear whether similar efforts may be underway to the extent that may be required in other financial centers. This is particularly true with respect to non-banking sectors.

Given the importance of this issue and its relatively recent focus, it is also unclear what systemic changes in the AML/CFT culture of compliance across key financial sectors and centers may ultimately result from these efforts. However, it is apparent that the enforcement actions taken by the United States to strengthen compliance with AML/CFT preventive measures and financial sanctions have made a substantial impact, particularly in the global banking sector. The combination of enforcement and outreach by U.S. authorities, particularly in recent years, has led many financial institutions to adopt important structural, policy and programmatic changes that have substantially improved their ability to understand and manage illicit financing risks. This work must continue.

Notwithstanding the significant progress achieved by financial institutions in strengthening compliance with AML/CFT preventive measures and financial sanctions, questions of compliance continue to present an ongoing global and systemic challenge of financial accountability. This may be particularly true in other financial centers that lack the strong enforcement actions taken by the United States.

2. Challenges of Industry Supervision

The above concerns of global industry compliance with AML/CFT preventive measures have also raised global challenges of AML/CFT financial supervision. These supervisory challenges broadly include: (i) the appropriate role of law enforcement in facilitating industry compliance; (ii) supervisory coordination, particularly for larger financial groups that often have multiple regulators in multiple jurisdictions, and (iii) the effectiveness of existing supervisory AML/CFT models in money services businesses (MSBs) and other non-banking or non-financial sectors lacking a functional financial regulator.

In the United States, as in most financial centers, financial functional regulators bear the primary responsibility for examining and ensuring compliance with AML/CFT preventive measures across the covered financial sectors they supervise. In administering this responsibility, U.S. federal and state regulators continue to pursue more active cases of AML/CFT enforcement than any of their financial counterparts around the world, strengthening AML/CFT compliance across the international financial system.

The strong AML/CFT enforcement record of financial functional regulators in the United States has been critically supported by the prominent and unique role of U.S. federal and state law enforcement in enforcing global compliance with AML/CFT preventive measures. These law enforcement authorities are a driving factor in strengthening the integrity of the global financial system.

The essential role of U.S. law enforcement in enforcing global compliance with AML/CFT preventive measures raises systemic challenges of financial accountability on a global level. Other countries, including those whose financial institutions have branches subjected to AML/CFT enforcement actions in the United States, should consider whether compliance with AML/CFT preventive measures in their jurisdictions could be strengthened by giving their AML/CFT law enforcement agencies a more active role in enforcing compliance.

Inside the United States, the compliance enforcement role of law enforcement raises systemic challenges of how best to coordinate law enforcement's independent investigative authority with the independent supervisory authority of U.S. regulators. Such coordination is essential to provide financial institutions with a clear, consistent and reasonable set of AML/CFT expectations that they must meet to effectively implement their AML/CFT obligations. This is particularly true when considering the necessary discretion that financial institutions must have to manage illicit financing risks. Such

discretion is essential to preserving the risk-based approach that guides U.S. and global implementation of AML/CFT preventive measures.

In 2012, the United States Department of the Treasury began to address these concerns and related issues through the work of a federal AML Task Force that included the Department of Justice and the financial functional regulators. This Task Force developed a number of initiatives to strengthen coordination among federal law enforcement and financial regulatory authorities on a wide range of AML/CFT matters. These initiatives were generally designed to facilitate a common understanding of the illicit financing risks facing the U.S. financial system and align corresponding risk management expectations in supervising and enforcing compliance with AML/CFT preventive measures.

Such initiatives likely assisted the Department of the Treasury in developing the 2015 National Money Laundering and Terrorist Financing Risk Assessments issued earlier this month. These risk assessments provide incredibly valuable information to financial institutions and all AML/CFT stakeholders about the money laundering and terrorist financing threats, vulnerabilities and risks currently facing the United States and our financial system.

The initiatives of the AML Task Force will become important in aligning law enforcement and supervisory expectations for financial institutions that must consider the National Money Laundering and Terrorist Financing Risk Assessments in developing their own illicit financing risk assessment and risk management programs.

The systemic challenge of aligning supervisory expectations is exacerbated for larger financial groups that often have multiple regulators in multiple jurisdictions. In managing differences in AML/CFT requirements between home and host countries of financial groups, FATF global standards direct such groups to apply the laws of the jurisdiction with the stronger requirements. To support this outcome, or any outcome with consistency, supervisors across jurisdictions and across sectors must have a system for coordinating their efforts. The initiatives of the AML Task Force may help illuminate ways of standardizing and strengthening these efforts.

Supervisory AML/CFT models for sectors that lack a functional financial regulator present yet another systemic supervisory challenge to financial accountability. In the United States, as in most other financial centers, MSBs and certain other non-banking or non-financial sectors covered under existing AML/CFT preventive measures lack a federal functional regulator. This raises substantial challenges of resources and expertise needed to oversee effective implementation of AML/CFT preventive measures in these sectors.

To address these challenges, the United States and many other countries delegate national AML/CFT examination authority for these sectors to national or federal tax authorities. While there continue to be reasonable arguments defending this position, it is becoming increasingly clear that additional examination and/or supervisory support may be needed to adequately oversee effective AML/CFT implementation in these sectors.

The United States continues to develop and explore initiatives to strengthen oversight and examination of these sectors through the Financial Crimes Enforcement Network (FinCEN). FinCEN is a Treasury bureau that functions as the U.S. financial intelligence unit and additionally has authority delegated from Treasury to issue and enforce AML/CFT preventive measures across the U.S. financial system in accordance with the Bank Secrecy Act (BSA).

In particular, FinCEN has coordinated with and leveraged MSB licensing and examination authorities in most states. FinCEN also continues to coordinate with Treasury's Internal Revenue Service in pursuing a principal-agency model for MSB examination. This model consolidates AML/CFT responsibility for MSB agent networks with their principals, including Western Union, MoneyGram, Sigue and other primary money transmitters.

It is unclear the extent to which other countries are developing or exploring these or other models for strengthening regulatory examination and oversight of AML/CFT preventive measures in sectors that lack a functional regulator. It is also not clear whether further steps may be needed to bring additional AML/CFT supervisory resources and expertise to these sectors.

What is clear is that MSBs and other sectors covered by AML/CFT regulation but lacking a federal functional regular – including insurance companies, casinos, and dealers in precious metals and stones in the United States – may present substantial risks of illicit finance. While the relative scale of these risks may appear small when compared to the overwhelmingly disproportionate size of the banking sector and capital markets, the high risk nature of the services offered by some of these sectors can make them disproportionately prone to illicit financing risks.

The recent emergence of virtual currency providers underscores this point. Virtual currencies and the administrators and exchangers that provide them have emerged as a potentially promising new form of money transmission. Yet this relatively new industry understandably lacks familiarity or experience with AML/CFT risk management. When these illicit financing risks are compounded by limited oversight and supervision, they can appear prohibitive to the banks that virtual currency providers, other MSBs and other AML/CFT covered industries ultimately rely upon for convertibility, settlement, clearance and other services. This can frustrate efforts to obtain banking services and in some instances may provide an additional impetus for banks to exit accounts with such industries.

Pursuing and Disrupting Illicit Financing Networks

Beyond ensuring compliance with AML/CFT preventive measures necessary to achieve financial transparency, financial accountability requires countries to effectively pursue and disrupt illicit financing networks. It is these networks, and the criminal interests they support, that ultimately undermine the integrity of the financial system.

There are a number of systemic challenges that the United States and all countries face in pursuing and disrupting illicit financing networks. As in the case of achieving financial transparency, these challenges primarily stem from gaps in implementing FATF global standards. Such standards broadly include requirements to facilitate effective analysis and investigation, prosecution and confiscation, and targeted financial sanctions against illicit financing activities, actors and assets. They also include a number of measures to facilitate cross-border cooperation in these actions.

The systemic challenges to pursuing and disrupting illicit financing networks presented by gaps in implementing FATF global standards are numerous and require additional time and consideration beyond the immediate scope of this hearing. However, it is important to recognize that the work of the FATF is now focused on assessing the effectiveness of jurisdictions in implementing AML/CFT and financial sanctions requirements pursuant to revised and strengthened global standards. This work, facilitated by the leadership of the United States and other financial centers, will greatly assist countries in identifying and closing gaps in implementing the FATF global standards, including those required to pursue and disrupt illicit financing networks.

Today, I would like to briefly highlight two critical developments that appear to have emerged from systemic challenges in pursuing and disrupting illicit financing networks.

The first development concerns the growing difficulty of systematically pursuing complex, cross-border criminal investigations of sophisticated illicit financing networks. The expertise and investment of time and resources required to systematically pursue such financial investigations is often prohibitive for all but the most advanced, well-resourced and protected teams of criminal investigators and financial analysts. The United States is consistently more effective in overcoming these challenges than any other country in the world. Nonetheless, these challenges are becoming more daunting as the complexity and globalization of the financial system and illicit financing networks have grown.

To keep pace with these challenges, the United States has increasingly turned to national security authorities to combat illicit financing and the transnational criminal organizations that often perpetrate and benefit from such activity. This is the second development that has emerged from the systemic challenges to pursuing and disrupting illicit financing networks. Just as terrorism and other national security threats have converged with criminal interests, so has our response.

To address the growing challenges that law enforcement faces in pursuing and disrupting illicit financing networks, the United States has developed effective complementary outcomes to criminal prosecution and forfeiture. These outcomes increasingly offer options for law enforcement, in collaboration with financial authorities, to effectively disrupt and deter sophisticated transnational organized crime through the application of targeted financial measures. These measures include targeted financial sanctions most often issued by Treasury under the International Economic Emergency Powers Act

(IEEPA) and preventive measures issued by Treasury pursuant to Section 311 of the USA PATRIOT Act.

The success of these authorities in assisting law enforcement pursue and disrupt an expanding range of transnational criminal activity illicit financing can be seen in the expansion of financial sanctions over the past several years. Such sanctions, originally applied against Columbian drug cartels and eventually global drug trafficking organizations, have expanded to target criminal conduct ranging from terrorist financing, proliferation financing, foreign corruption in context of certain sanctioned government regimes, and most recently, cybercrime.

The increasing application of targeted financial measures to disrupt an expanding range of criminal activity can also be seen in increased use of Section 311 to target primary money laundering concerns. These concerns include those presented by rogue digital currency providers, as well as money transmitters and banks that become infiltrated or exploited by organized crime and terrorist organizations.

Far from precluding more traditional outcomes of criminal prosecution and forfeiture, these actions can often facilitate such outcomes, as several cases have shown.

These developments underscore the importance of targeted financial measures to strengthen our financial integrity in combating the criminal and national security threats we face. They also underscore the acute need for ongoing U.S. leadership in continuing to advance the global commitment to financial integrity, including through the application of targeted financial sanctions and measures.

Recommendations to Address Systemic Challenges to Financial Integrity

Addressing the systemic challenges to financial integrity discussed above will require the clear support of this Committee. The following recommendations outline specific steps that this Committee can take to lead Congressional action, including with respect to new legislation, support for further executive action by the Administration, and targeted investments specifically directed to protect and strengthen our financial integrity against the full range of threats to our national and collective security.

New Legislation

Since the issuance of the USA PATRIOT Act in October 2001, the Congress has generally provided unwavering and essential bipartisan support and leadership on a wide range of issues to protect the integrity of the U.S. and international financial system. This is particularly true with respect to Congressional legislation. The following additional legislative action will further these interests by addressing systemic challenges to our financial integrity:

(i) <u>Adopt legislation expanding the purposes of the Bank Secrecy Act (BSA) to explicitly include protecting the integrity of the financial system.</u> Such

legislation is required to underscore the importance of financial integrity and the full partnership that is required between industry and authorities to achieve it. Section 5311 of Title 31 of the United States Code declares 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 purpose is more important than ever, it is also incomplete. Protecting the integrity of the financial system is an essential objective in its own right.

Expanding the purpose of the BSA to reflect this will elevate the role of financial institutions and underscore the importance of government partnership with them. In addition to law enforcement and other investigative and analytic authorities, financial institutions – together with the customers and economy they service – are direct beneficiaries of financial integrity. They are also 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. And they must be full partners with governing authorities in implementing the BSA to advance this purpose.

Amending the purpose of the BSA will assist all stakeholders in recognizing these truths. It may also facilitate a stronger commitment to a risk-based approach by industry and authorities. Protecting the integrity of the financial system, beyond filing reports or maintaining records, clearly requires such an approach. This will further augment the importance of collaboration between industry and governing authorities to facilitate a shared understanding of illicit financing risk and effective risk management programs.

(ii) Adopt legislation to require the disclosure and maintenance of meaningful beneficial ownership information in company formation processes. Such legislation is required to address the systemic challenges posed by the chronic abuse of legal entities to mask the identities and illicit financing activities of the full scope of criminal and illicit actors. For several years and through at least three 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.

The current Administration has developed a proposal that is reasonable and effective, leveraging current IRS reporting requirements to obtain beneficial ownership information from companies created under the authority of the states. This Committee should work with the Congress, the Administration and state

authorities to support this approach, including through legislation required to ensure adequate availability of beneficial ownership information to the full range of US authorities investigating illicit finance.

(iii) Consider legislation strengthening the information-sharing provisions of Section 314 of the USA PATRIOT Act. Such action may assist in addressing the systemic challenges to financial integrity posed by information-sharing constraints. Such legislation could strengthen information-sharing by clearly extending Section 314(b)'s safe harbor provisions to the widest range of counter-illicit financing information sharing by financial institutions. This should include enabling compliance teams from different financial institutions to share information while working in common groups for purposes of mapping illicit financing networks. Such work could be facilitated by FinCEN and other investigative authorities, whose participation may require amending Section 314(a). This Committee should work with FinCEN to explore whether additional legislative authority is needed to advance these ideas and others to facilitate more effective information sharing by financial institutions in uncovering illicit financing networks.

Support Treasury Rulemaking under the BSA

(i) Support the issuance of Treasury's Proposed Rule on Customer Due Diligence (CDD), consistent with FATF global standards. Such action is required to address the systemic challenges posed by CDD practices that fall below global standards, particularly with respect to beneficial ownership. Treasury's proposed rule clarifying and strengthening CDD has incorporated and benefitted from exhaustive stakeholder comments collected through an outreach campaign unprecedented in the history of BSA rulemakings. Congressional support for Treasury's proposed rule may facilitate action by the Administration to finalize this rulemaking.

(ii) Support Treasury's consideration to extend AML/CFT preventive measures to investment advisers, consistent with FATF global standards. 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 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 financial transparency in our capital markets. This gap also puts broker-dealers and other covered capital market sectors in the unfair and difficult position of trying to manage illicit financing risks of the investment adviser sector they service.

Congressional support for Treasury's consideration to extend AML/CFT preventive measures to this sector may facilitate such action by the Administration.

(iii) Support Treasury's consideration to extend AML/CFT preventive measures to real estate agents, consistent with FATF global standards. Such action is required to help address the systemic challenges created by gaps in vulnerable industries that are not covered by AML/CFT preventive measures. 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 real estate agents. Several recent cases and investigative reporting by the media have indicated that this vulnerability continues to be exploited in the United States, perhaps most prominently in New York City and Miami. Treasury has long considered extending AML/CFT preventive measures to this industry. Congressional support may facilitate such action by the Administration.

(iv) Support Treasury's consideration of lowering the recordkeeping and travel rule thresholds for funds transfers from $3000 to $1000, consistent with FATF 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 triple the costs and risks for illicit financing networks engaged in such structuring. Maintaining a threshold of $1000 would preserve a reasonable threshold well above the average value of cross-border remittances, thereby avoiding any potential collateral and exclusionary impact on remittance flows. Congressional support for Treasury's consideration to lower this threshold may facilitate such action by the Administration.

Provide Additional Resources Targeting Strategic Investments to Strengthen Financial Integrity

Despite the clear and growing importance of financial integrity to our CFT campaign, national and collective security, and economic stability, US authorities responsible for protecting and advancing our financial integrity are severely stretched. These authorities are literally the best in the world at what they do, and their success has led to the welcome expansion of the counter-illicit financing mission and the continued protection of the expanding financial system. To maintain our unparalleled success, our counter-illicit financing authorities require the resources needed to match this expanding mission.

The critical importance of financial transparency and the proven impact of targeted financial measures represent a compelling investment opportunity for Congress to achieve a high return with relatively marginal costs. The recommendations below target specific investments that could significantly enhance our financial integrity and expand

the ability of the United States to combat national security threats through financial action.

(i) Provide protected resources for Treasury to enhance examination and supervision of BSA-covered industries lacking a federal functional regulator. Such action is needed to address the systemic challenges posed by AML/CFT regulatory coverage of high risk or vulnerable sectors that lack a federal functional regulator. Through the creative efforts of FinCEN and the IRS described above, Treasury has strengthened oversight and supervision of the MSB sector. These efforts would be further strengthened by additional resources that could be used to support a targeted supervisory and examination function managed by FinCEN, in continued coordination with the IRS. Such additional resources would also strengthen FinCEN's ability to oversee and enforce implementation of AML/CFT preventive measures in other industries lacking a federal functional regulator – including insurance companies, dealers in precious metals and stones, and casinos. Finally, such additional resources will be further needed if Treasury extends AML/CFT preventive measures to real estate agents, as recommended above.

(ii) Provide protected resources for Treasury's IRS and the Asset Forfeiture and Money Laundering Section of the Department of Justice to enhance financial investigations of illicit financing networks. Such action is needed to strengthen the systematic pursuit of illicit financing networks by the criminal investigative and prosecutorial authorities that are best suited and trained to support this mission. Such dedicated resources should be protected from competing interests of tax investigations in the case of the IRS and forfeiture actions by AFMLS. Such interests are obviously central to the respective missions of the IRS and AFMLS and critical to the broader financial integrity mission. Nonetheless, these interests should not preclude strengthening the parallel and sustained development of units dedicated to pursuing or supporting criminal investigations of the most sophisticated and dangerous illicit financing networks.

(iii) Provide protected resources for Treasury to enhance targeting of primary money laundering concerns under Section 311 of the USA PATRIOT Act and targeting of illicit financing networks under IEEPA. Such action is needed to give Treasury the resources it requires to continue applying targeted financial measures against a growing range of criminal and national security threats. The clearly disruptive impact of these actions and the increased demand for additional action justify additional resources that match the Treasury's expanding role in combating threats to our financial integrity and national security.

(iv) Provide protected resources for Treasury to develop foreign capacity in critical allies to support the effective implementation of AML/CFT measures and the application of targeted financial measures. Such action is required to strengthen

the global commitment to financial integrity and the impact of Treasury's targeted financial measures against those who threaten our collective security and the integrity of the global financial system.

Other Steps

(v) Task the Congressional Research Service to conduct a study of cross-border information-sharing requirements and prohibitions that our financial institutions must meet. Such action is needed to better understand the information-sharing challenges that our financial institutions face in identifying and managing transnational illicit financing risks. Armed with a better understanding, Congress can work with the Administration to develop solutions that assist our financial institutions in sharing the information they need to protect the integrity of our financial system.

(vi) Support the work of the AML Task Force in coordinating and strengthening examination, supervision and enforcement of AML/CFT preventive measures and financial sanctions. Such support may be needed to underscore the importance of collaboration across Treasury, law enforcement and the regulatory community to harmonize expectations for industry in implementing an effective risk-based approach to managing illicit financing risks. Such support may also encourage the development of new ideas and mechanisms to strengthen the integrity of the financial system, including through possible amendments to existing authorities to better align AML/CFT preventive measures to the risks facing our financial system. The 2015 National Money Laundering and Terrorist Financing Risk Assessments provide an excellent opportunity to reinvigorate this work.

Conclusion

Once again, I am honored and humbled to testify before you today in support of those across our government and financial services industries who fight every day to protect our financial integrity. They are the best in the world in advancing this mission. Their continued success will require your ongoing support.

I would be happy to answer any questions you may have.