

Senate Judiciary Committee

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# S.1241: Modernizing AML Laws to Combat Money Laundering and Terrorist Financing

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Chairman Grassley, Ranking Member Feinstein, and members of the Senate Committee on the Judiciary, thank you for the opportunity to testify today. It is an honor for me to be here.

“Anti-money laundering legislation is the least effective of any anti-crime measure, anywhere.”<sup>1</sup>

Why does Ron Pol, a respected anti-money laundering researcher, make such a stunning statement? Because the bottom-line metrics suggest that money-laundering enforcement fails 99.9 percent of the time. Or as longtime financial crime expert Raymond Baker notes, “Total failure is just a decimal point away.”<sup>2</sup>

This failure to successfully combat money laundering has dramatic impact. Outside crimes of passion – for example, murder committed in a jealous rage – criminals, criminal organizations, kleptocrats, and some businesses and corporations are typically motivated by *greed*. In today’s increasingly interconnected world, the manifestations of unfettered avarice impact all of us – politically, socially, economically, and culturally. Around the world, people see it in their communities. In the United States and elsewhere, the opioid, methamphetamine, and cocaine epidemics are devastating. Gang violence, financial fraud, government contracting fraud, corruption, internet scams and ransom-ware attacks, identity theft, and other crimes affect our daily lives.

We intrinsically know that the global range and magnitude of organized criminal activity that generates illicit proceeds is increasing. Intellectual property rights violations, human trafficking, wildlife trafficking, and environmental and natural resource degradation and exploitation are all unfortunate manifestations of greed facilitated by our increasingly interconnected and borderless world. There is also entrenched criminality that is resistant to enforcement. The trade in illicit tobacco, for example, has existed for generations. It affects every country in the world. So does customs fraud.

Financial crimes and abusive tax evasion contribute to the deterioration of social compacts. Worldwide, distrust in the privileged class has seemingly reached epidemic proportions, coupled with (if not driven by) a corresponding absence of “accountability.” Corruption is the great facilitator and is also fueled by tainted money.

Terror finance – a corollary of money laundering – and sanctions busting threaten national security.

Law enforcement, policy makers, and the media can get so distracted with the immediacy of the criminal behavior. It is easy to forget the aim of these criminal activities is not the crime itself, but the *proceeds of crime*. Many have questioned the efficacy of the “War on Drugs.” But why do we not acknowledge that our inability to stop the laundering and seize the proceeds fuels the greed behind the drug trade and perpetuates the narcotics trafficking we are trying to eradicate?

In other words, many of the ills we face “come back to money.” And money laundering is the essential component of transnational crime. It is part of the greed equation because it turns criminal proceeds into seemingly clean money that can be freely spent.

## Magnitude of the Global Problem

How much money is being laundered? Unfortunately, the estimates are all over the map. The Financial Action Task Force (FATF), the international anti-money laundering/combating the financing of terrorism (AML/CFT) policy-making body, stated, “Due to the illegal nature of the transactions, precise statistics are not available and it is therefore impossible to produce a definitive estimate of the amount of money that is globally laundered every year.”<sup>3</sup> With that caveat in mind, the International Monetary Fund (IMF) has estimated that money laundering comprises approximately 2 to 5 percent of the world’s gross domestic product (GDP) each year, or approximately \$1.5 trillion to \$3.7 trillion in 2015 – nearly the size of the U.S. federal budget.<sup>4</sup> Similarly, the United Nations Office on Drugs and Crime (UNODC) conducted a study to determine the magnitude of illicit funds. According to the UNODC, criminal proceeds in 2009 amounted to 3.6 percent of global GDP, roughly \$2.7 trillion.<sup>5</sup>

The actual magnitude of international money laundering is probably much higher depending upon what is included in the count. For example, there is an international movement to recognize tax evasion as a predicate offense to charge money laundering.<sup>6</sup> A study by Tax Justice Network estimated that in 2010, between \$21 and \$32 trillion was hiding in more than 80 international tax havens. The study also found that privileged elites in 139 lower- and middle-income countries had \$7.3 to \$9.3 trillion in unrecorded offshore wealth while at the same time, most of the governments of the countries involved were borrowing themselves into bankruptcy and other economic dangers.<sup>7</sup>

The 2016 release of the “Panama Papers” offers additional evidence of the scope of the problem, showing how one Panamanian law firm created a network of over 200,000 non-transparent entities, allowing criminals, corrupt government officials, taxpayers, and others to hide their income and wealth. Similar outrages were reported with the recent release of the “Paradise Papers.” The leaks provide a glimpse into the opaque practices of business formation and the placement and layering and integration of funds that facilitate a myriad of financial crimes, tax evasion, and avoiding of sanctions.

Global Financial Integrity estimates that the developing world loses over \$1 trillion in illicit outflows every year, largely through abusive trade misinvoicing. This practice is a form of trade-based money laundering and a common denominator in both customs fraud and tax evasion.<sup>8</sup>

Further complicating reliable estimates on the magnitude of international money laundering is the enormity of “black” and “grey” markets around the world. Underground, informal, “parallel,” cash-based economies can comprise a substantial portion of a country’s GDP. For example, in the economies of countries as diverse as India and Mexico, the underground or informal economies are estimated at approximately 30 percent of GDP. Much economic activity in the developing world takes place in the informal sector, with many transactions, even those of legitimate businesses, carried out in cash (often in U.S. dollars). International grey markets often include barter trade and forms of cyber payments – two common money-laundering methodologies on opposite ends of the tech spectrum – that are generally impervious to financial transparency reporting requirements, taxes, and law enforcement countermeasures.

There are an estimated 232 million migrant workers around the world.<sup>9</sup> Globalization, demographic shifts, regional conflicts, income disparities, and the instinctive search for a better life continue to encourage ever more workers to cross borders in search of jobs and security. Many countries are dependent on remittances as an economic lifeline. Although estimates vary, according to the World Bank, global remittances may have reached approximately \$575 billion in 2016.<sup>10</sup> These estimates cover what is officially remitted. Unofficially, nobody knows. However, the International Monetary Fund believes, “Unrecorded flows through informal channels are believed to be at least 50 percent larger than recorded flows.”<sup>11</sup> So, using the above World Bank and IMF estimates, unofficial remittances are enormous, approaching nearly \$1 trillion annually.

Opaque informal remittance systems are sometimes referred to as “alternative remittance systems,” “parallel banking,” “underground banking” and “informal value transfer systems.” While these systems are for the most part used by hard-working migrant workers to send money home to support their loved ones, the funds transfers and the networks used to make them are practically impervious to the tax man. Their lack of transparency and avoidance of financial reporting requirements also make them attractive to criminal elements and terrorists. Law enforcement and intelligence agencies have had little success in monitoring these networks in this country and around the world.<sup>12</sup>

## **Bottom-Line Metrics**

Out of the trillions of dollars that are laundered every year, how much of the proceeds of crime are actually seized and forfeited? According to the UNODC, the answer is less than one percent.<sup>13</sup>

In addition to the magnitude of money laundering, the other bottom-line metric that matters is the number of successful investigations, prosecutions, and convictions. While statistics of this nature vary markedly from country to country, are open to question, and sometimes do not include the money-laundering activities of criminals convicted on other charges, the sobering fact is that for a money launderer to be caught and convicted today, he or she has to be either very stupid or very unlucky.

The number of money-laundering cases filed worldwide is miniscule. For example, the Philippines has a large economy and is increasingly recognized as an important regional financial center. According to 2016 data, only 49 anti-money laundering cases have been filed since 2001. There has not been a single successful prosecution or conviction.<sup>14</sup>

The British Virgin Islands is advertised as the world’s leading offshore center, with more offshore companies than any other country. In 2014, there was one prosecution for money laundering.<sup>15</sup>

According to the Angolan Central Bank, approximately \$17 billion has been siphoned from the Angolan economy in the last five years alone – several orders of magnitude above foreign direct investment into the country. The origin of this money is unclear. Additional value is transferred

out of the country through abusive trade misinvoicing. Widespread corruption in government and commerce facilitates money laundering. In 2015, there were no prosecutions or convictions for money laundering.<sup>16</sup>

In Japan, the numbers of investigations, prosecutions, and convictions for money laundering are so low that they are not even publicly released.<sup>17</sup>

The list goes on and on. The annual State Department International Narcotics Control Strategy Report, which tracks countries' anti-money laundering efforts around the world, reinforces this conclusion. While there have been many positive developments, a comprehensive and objective reading of the report's statistics on prosecutions and convictions is sobering and does not inspire confidence in the effectiveness of the current AML program.

Money laundering is international in scope. Criminals and criminal organizations are attracted to the weak link. The lack of AML/CFT enforcement in one country can affect many others.

While tremendous work has been done to enact AML/CFT regimes around the world that on paper adhere to the FATF 40 AML/CFT recommendations, the results as measured by illicit money seized and money launderers convicted can only be accurately described as abysmal. That is the primary reason why FATF revamped its evaluation procedures in 2012 to place more emphasis on enforcement results.

## **Situation in the United States**

The total amount of money laundered in the United States is conservatively estimated in the hundreds of billions of dollars every year. According to the Internal Revenue Service, tax evasion is also skyrocketing, and the IRS believes that "money laundering is in effect tax evasion in progress."<sup>18</sup> While tax evasion is not yet considered to be a predicate offense for money laundering in the U.S., related crimes are. For example, identity theft connected to tax fraud is rampant.

While the magnitude of money laundering in the United States is difficult to measure, we do have some statistics regarding how much illicit money is seized.

In 2014, the U.S. "confiscated" approximately \$4.4 billion.<sup>19</sup> While this sounds like an impressive total, it is not certain what percentage was actually forfeited instead of ultimately released. Let us approximate \$3 billion. The UNODC estimated proceeds from all forms of financial crime in the U.S., excluding tax evasion, was \$300 billion in 2010 (about 2 percent of the U.S. economy).<sup>20</sup> If we use the UNODC estimate (I believe a more accurate estimate is at least double that amount), that means we are actually recovering less than 1 percent of the illicit money generated by criminal activity every year!

We can drill down even further for specific examples. While estimates of U.S. narcotics sales vary widely, a 2010 White House study pegged the number at \$109 billion annually.<sup>21</sup> Studies conducted by the U.S. government suggest that as much as \$18 to \$39 billion of those illicit proceeds are smuggled annually across our southern border in the form of bulk cash.<sup>22</sup>

So how have we done? A variety of law enforcement agencies play a role in detecting and intercepting bulk cash smuggling, particularly Immigration and Customs Enforcement (ICE) and Customs and Border Protection (CBP). From 2005 to 2016, CBP officers reportedly seized a total of \$211 million at the southern border.<sup>23</sup> According to a 2011 GAO study, we are seizing less than 1 percent of the multi-billion in drug-trafficking proceeds smuggled across the border.<sup>24</sup> Another study suggests that \$99.75 of every \$100 the cartels ship south is getting through.<sup>25</sup> Putting these numbers in perspective adds clarity – think of it this way: We seize only a George Washington quarter out of a \$100 Benjamin Franklin paper bill!

The long-term consequences of our failure to effectively combat money laundering are far worse than the above estimates thanks to the “miracle of compounding.” We often forget about the money made on the money that is successfully laundered. According to a domain practitioner’s 2011 assessment<sup>26</sup> looking at compound interest, assuming the \$39 billion is accurate and the cartels simply invest the illicit proceeds at a 5 percent annualized rate of return, after 20 years just that one year has mushroomed into a \$1.7 trillion problem!

This is a simplistic example, but compound interest works not only in IRAs and 401ks, but in the cartels’ favor as well. And that is just one example of AML failure, representing just the southwest border, for one year, and for just one comparatively straight-forward asset class.

### **The Largest Money Laundering Methodology (and most ignored)**

Trade misinvoicing is most commonly a method of moving value illicitly across borders that involves deliberately misrepresenting the value of a commercial transaction on an invoice by fraudulently misreporting the quantity, quality, price per unit, and/or description of a good that results in the shipment being over or under-invoiced. Trade-based money laundering (TBML) is used to launder money, transfer value, and avoid paying the requisite tax on goods. It is also often used in countries which have capital controls as a means of getting money or value out.

I believe trade-based money laundering around the world and specifically in the United States is grossly underestimated. If we want to better understand the true scale of the problem facing the United States, we should systematically examine TBML and value transfer. The U.S. government has not done this.

TBML can be used either to move value out of the U.S. to other countries or out of other countries into the U.S. Value is moved out of the U.S. by under-valuing exports and over-valuing imports. The opposite trade transactions – over-valued exports and under-valued imports – are used to move money into the U.S.

Dr. John Zdanowicz, an academic and early pioneer in the field of TBML, studied 2013 U.S. trade data obtained from the U.S. Census Bureau. By examining under-valued exports (\$124 billion) and over-valued imports (\$94 billion), Dr. Zdanowicz found that \$218 billion was illicitly moved out of the United States in the form of value transfer. That figure represents 5.7 percent of U.S. trade.

Examining over-valued exports (\$68 billion) and under-valued imports (\$273 billion), Dr. Zdanowicz calculates that \$341 billion was moved illegally into the United States – representing 8.9 percent of U.S. trade in 2013.<sup>27</sup> Almost all of this trade fraud has escaped both detection and enforcement. Customs fraud is the primary predicate offense of TBML. The loss of revenue to the United States is staggering.

I believe the United States has the most professional and vigorous customs enforcement service in the world. So if almost 6 to 9 percent of our trade is tainted by customs fraud and perhaps trade-based money laundering, what does that imply for the extent of those practices in the rest of the world, in particular countries with weak governance and high corruption?

By examining other forms of TBML, the magnitude of the problem increases further. In addition to customs fraud and capital flight, trade misrepresentation is also involved with tax evasion, export incentive fraud, value-added tax (VAT) fraud, evading capital controls, barter trade, and underground financial systems such as *hawala* and the *fei-chien* – the Chinese “flying money” system – the black market peso exchange (BMPE), abuses with the Afghan Transit Trade, and commercial trade-based money laundering such as trade diversion, transfer pricing, and abusive trade-misinvoicing. Some of these methodologies are also used by terrorist financiers.<sup>28</sup>

In 2016, I wrote a book entitled *Trade-Based Money Laundering: The Next Frontier in International Money Laundering Enforcement* (Wiley). In the book, I make the argument that if all its various forms are included, TBML is the largest money-laundering methodology in the world. It is also the least known, least understood, and least enforced.

## **Threats on the Horizon**

In 2008, I wrote an essay published by the Department of State entitled “Mobile Payments – a Growing Threat.”<sup>29</sup> Today the threat has materialized.

There are now over 400 million mobile money accounts in the world, with approximately 270 mobile money services operating in approximately 100 countries. More than one billion mobile money transactions were processed in December, 2015. By 2019, approximately 1.6 billion people will make person-to-person mobile money transfers.<sup>30</sup>

From one perspective, we should cheer these developments. The G-20 included “financial inclusion” on its priority agenda to help over two billion adults around the world who today have limited access to financial institutions.

Easy access to mobile payments, or M-payments, via the ubiquitous cell phone is transforming lives by providing a much-needed link to financial services at a reasonable price. Users are not required to have a bank account or credit card. Countries without modern financial infrastructure are able to “leapfrog” directly into cutting edge networks. However, this wonderful development is going to have some dangerous side effects.

As I discussed in my 2016 testimony<sup>31</sup> before the Task Force to Investigate Terrorism Financing of the House Financial Services Committee, M-payments are used in the placement, layering, and even integration stages of money laundering.

There are currently few documented cases of money laundering and terror finance related to M-payments. In large part, this is because the countries where M-payments are growing exponentially also have very poor AML/CFT detection and enforcement.

Up to this point, we have generally waited for a crisis to occur before we react. It would be so much better to recognize the inherent danger in M-payments and move quickly now to engineer new forms of data collection and analytic tools into M-payment systems to provide a foundation for effective regulatory and enforcement countermeasures that will certainly be required to prevent usage of these new payment facilities for illicit purposes.

Another money laundering threat on the horizon is related to services. Service-based money laundering (SBML) is exactly what the name implies. Instead of laundering money or transferring value through trade goods, services are used. Similar to TBML, SBML typically uses some form of invoice fraud and manipulation. Fraudulent invoice techniques such as over- and under-invoicing, multiple invoicing, and false description are also applied to services. Common service-based laundering methods can include accounting, legal, marketing, natural resource exploration fees, software coding, etc.

During a visit to Belgrade, authorities told me about a case in which organized crime used fraudulent invoices generated for “music concert promotion” services as a technique to send illicit funds to Cyprus.

According to the U.S. Department of Treasury’s 2015 National Money Laundering Risk Assessment, “Fraud encompasses a number of distinct crimes, which together generate the largest volume of illicit proceeds in the United States”<sup>32</sup> Although most of this service-based fraud is perpetrated against federal government programs such as claims for tax refunds, Medicare and Medicaid reimbursement, food and nutrition subsidies, etc., fraud in all its varied forms is a growing cause of alarm. In fact, Treasury estimates that fraud generates perhaps twice the volume of illicit proceeds earned from drug trafficking.

From an investigative standpoint, SBML is extremely challenging. For example, in TBML, authorities can often track an item or a commodity. They can follow a physical trail. A product is manufactured and sent from country A to country B, perhaps transshipped through country C. Import and export data exists. Through analytics, we can discover anomalies that might be indicative of customs fraud and follow the value trail. In service-based laundering, an invoice is presented for payment. What evidence is available that would enable authorities to judge its validity? Who knows if the service was actually completed or if the invoice was inflated or understated? Where is the data? The invoice and other paperwork justify payment and perhaps the laundering of tainted money. And in international transactions, there are difficulties surrounding competence, jurisdiction, and venue. And, of course, much service-based fraud is related to tax evasion.



## Time to Shift the Paradigm

The Bank Secrecy Act was enacted almost fifty years ago. The original AML model developed to fight the “War on Drugs” was created in an era with threats much different than the ones we face today. In the intervening years, we have had major AML legislation, enhanced by rules and regulations, which have improved the ability of law enforcement to “follow the money.” We have had some enforcement success. There is no doubt we have also disrupted and deterred some criminal activity. But if we acknowledge the true scale of international money laundering and the enforcement actions that matter – forfeitures and convictions – the current AML paradigm with individual institutions, especially financial institutions (FIs), operating as the designated illicit activity detection agents is having negligible impact on all of this illicit-financing activity; the current paradigm is simply not working.

The main limitation is that the detection agents are expected to identify illicit-financing activity by analyzing just their own transaction data. Illicit financiers know that if their financing activity spans multiple FIs using a variety of transaction types, there is only a very small chance that their transactions will be identified as illicit, especially if their control of the variety of account-holding entities remains hidden.

In 1970, the Bank Secrecy Act (BSA) initiated the collection of financial intelligence by regulated financial institutions. At the time, the financial transactions environment was slow, cumbersome, paper driven, and expensive. Real-time transaction processing was barely feasible. As a consequence, individual FIs, as the only entities with access to the transaction records, were the only possible choice to be the illicit activity detection agents. Over the years, financial intelligence reporting requirements have dramatically increased and now include many more types of entities, such as money-service businesses and designated businesses and professionals as detection agents. What has not changed is that each designated detection agent is still expected to identify suspected illicit activity primarily from analyzing just its own data.

AML/CFT compliance costs in the United States alone are estimated to be approximately \$8 billion per year.<sup>33</sup> If I was in industry, I imagine the costs would be more palatable if I was assured that the data was at least being fully exploited. It is not. To make matters worse, the regulated industry that reports financial intelligence is so afraid of fines for non-compliance that it “defensively” files garbage reports cluttering the system with almost useless data, making it increasingly difficult to identify real and timely suspicious activity. FinCEN analyzes and maintains some 200 million BSA records involving more than 80,000 financial institutions.<sup>34</sup> Approximately 18 million pieces of financial intelligence are filed annually with FinCEN.

I was at Treasury’s FinCEN when Suspicious Activity Reports (SARs) were first introduced. SARs were designed to create a “haystack full of needles.”<sup>35</sup> Twenty years later, there is so much unusable information that we are back to trying to find the “needle in the haystack.”

The nearly 50 years of monumental effort and expense that has been devoted to get the individual FI-based implementation of the current AML/CFT paradigm to produce acceptable results is the reason for this hearing. Einstein reportedly defined “insanity” as “doing the same thing over and over again expecting a different result.” The evolution of financial transaction

processing now enables implementation of a new AML/CFT paradigm that would have been impossible up until fairly recently.

Over the last few years, there has been an explosion in processing speed, efficiency, digitalized data, and advanced analytics. Paper records have been replaced by digital records. Transaction processing is done by computers now connected by networks that enable transactions to be completed in a few seconds almost anywhere. Sophisticated software-based analytical capabilities can access virtually limitless processing capacity to quickly analyze vast amounts of data. Almost instantaneous financial transparency and corresponding alerts are achievable.

The only thing that has not yet been changed is the current AML/CFT paradigm. We need an illicit activity detection capability based on a new AML intelligence collection, analysis, and dissemination paradigm. A new paradigm enables pursuit of two important objectives. First, it will enable adding the objective of preventing illicit access to the financial system in addition to the objectives of detecting and punishment. Second, it will enable a method of accessing multi-FI transaction data that does not require exposure of any private data in detection processing.

Many observers have talked about a public-private “partnership” in the financial intelligence (FININT) world, but nothing of substance has ever materialized. Under the current AML/CFT paradigm, the public/private relationship has become essentially adversarial. I believe the time is now right for government and industry representatives to work together and design and implement a modern, robust, efficient, effective, and near real-time AML detection system that incorporates the necessary privacy safeguards and oversight.

Technology exists to allow participating institutions to act together in a type of consortium, a new type of detection agent operating on behalf of the individual FIs, to get the collective benefit of analyzing an extract of multi-FI, multi-transaction-type data without any private data being exposed in the detection process. Automated analytics would be applied against transactions to screen sanctioned and suspect parties. Anomaly detection and alerts could be red-flagged on a real-time basis and illicit transaction execution prevented. Cautionary warnings would be provided to participating institutions, relevant authorities, and public and private financial intelligence units (FIUs). The transaction data extract provided for detection processing could be anonymized to protect customer privacy, while transactions and reports to relevant parties would be provided in real time.

Such a consortium facility would also change the nature of the relationships among the key stakeholders in the struggle to combat illicit financing. The necessarily slow current process of issuing new regulations in response to the discovery of new illicit financing methods would be replaced. There would be no more requirements for FIs to produce a huge volume of financial intelligence or for law enforcement to laboriously shift through those reports to assemble the information and evidence required to support filing cases. Instead, the stakeholders would be positioned to cooperate effectively in combatting illicit financing activity. With access to extracts of comprehensive multi-FI, multi-transaction-type data, the consortium working with its stakeholder partners will be able to uncover new illicit-financing methods, implement the required detection capabilities, and begin limiting the effectiveness of the new illicit method in short order.

This model could be applied on different platforms and involve different parties. A completely revamped FinCEN or other Treasury entity could be at the center of the network, or perhaps a private sector consortium could act as the trusted clearinghouse.<sup>36</sup>

At the financial intelligence consortium, I would like to see law enforcement representatives sit side-by-side with the reporting industry representatives. Law enforcement could continuously tweak the reporting parameters, provide feedback industry so desperately wants, and directly alert their colleagues in the field with near real-time speed regarding suspicious activity, which is much more useful in thwarting potential criminal activity than it is to react after the fact.

## **Change the Incentives for Law Enforcement**

Our AML efforts currently all come down to enforcement. The United States has the best and most robust law enforcement in the world. Yet dated information suggests that, in the United States, money launderers face a less than 5-percent risk of conviction (some plead to lesser charges). Currently, there are about 1,200 money-laundering convictions a year at the federal level.<sup>37</sup> That seems like a large number, but – divided into the amount of criminal activity and factoring in the hundreds of billions of illicit proceeds generated – it is not.

Under the current AML/CFT paradigm, it often takes two years or more for law enforcement to put together a long-term complex money-laundering case. They are costly and resource intensive. Many ultimately fail. Law enforcement personnel at the federal, state, and local levels are rated and promoted, in large part, by the number of cases they make. Management of a given field office or police department is also rated in part by case statistics. Thus, it is only natural for law enforcement officers and their managers to prioritize shorter-term investigations. In other words, although not part of official policy, often times emphasis is put on comparatively simple cases and quick arrests that look good statistically but that do not have much of an impact on the entrenched criminal enterprises that are motivated by greed. A common refrain in law enforcement is “big cases mean big problems.”

Priorities should be changed. Instead of our primary emphasis on intercepting narcotics or seizing stolen vehicles or stopping containers of counterfeit goods, we should also change the enforcement paradigm. The new emphasis should be on following the money trail to the criminal hierarchy and taking away the ill-gotten gains. The new AML/CFT paradigm implementation with access to multi-FI and multi-transaction-type data can automate much of the follow-the-money task by identifying the pattern of transactions spanning multiple accounts, transaction types, and geographies. The most important discoveries will be the accounts in which the illicit kingpins hold their ill-gotten funds. Whereas the case building and prosecution effort required to bring such kingpins to justice is time consuming and expensive, processes exist to allow quick seizure of illicit assets once the evidence is available on the accounts holding those assets. We must learn to better target the profits of transnational crime, not just the people and products.

## **Additional Recommendations**

*Develop an Updated Anti-Money Laundering Strategy*

Following the completion of the U.S. Money Laundering Threat Assessment in 2005, the U.S. government produced an inter-departmental National Anti-Money Laundering (AML) Strategy report. Ten years later, the U.S. government completed a new money laundering risk assessment in 2015.<sup>38</sup> It should follow that threat assessment with an updated strategy to strengthen U.S. anti-money laundering enforcement efforts to counter threats to the financial system. Action items should be included in the report, and Congress should hold the agencies, departments, and bureaus responsible if they fail to implement them. *There was no accountability* in the failure to implement action items in our last (2007) Anti-Money Laundering Strategy report.<sup>39</sup> Reading the 2007 report ten years later is eye opening.

### *Make All Felonies Predicate Offences for Money Laundering*

The United States is one of only a small number of industrialized countries that enumerates a list of predicate offenses for money laundering, rather than referencing *all serious crimes*, as recommended by FATF. Most industrialized countries instead use a “threshold” approach to predicate offenses, where all crimes that carry a certain minimum sentence or fine are considered predicate offenses. In the United States, the equivalent would be to amend the money-laundering statutes to make all felonies predicate offenses for money laundering. One of the significant loopholes that this would fix would be to make tax evasion a predicate offense for money laundering, bringing us in line with the international anti-money laundering standards set by FATF in 2012, which state that countries should ensure that “tax crimes” are predicate offenses.<sup>40</sup>

### *A FATF Recommendation on Trade-Based Money Laundering (TBML)*

FATF, a collection of more than 30 governments which sets international anti-money laundering standards, recognizes that TBML is an enormous concern. In fact, FATF believes it is one of the three major global money-laundering methodologies. I am convinced that if we consider all its forms, TBML is the largest. However, in 2012, when the current FATF recommendations were reviewed, updated, and promulgated, TBML was not specifically addressed. The U.S. Department of the Treasury, which leads the U.S. FATF delegation, should introduce a resolution calling for members to promote trade transparency in order to combat trade-based money laundering and value transfer.

### *Establish a Global Network of Trade Transparency Units (TTUs)*

One key countermeasure for TBML is to establish trade-transparency units (TTUs). TTUs are most effective when trading partners agree to exchange transaction-level trade data between individuals or trading companies of the two countries in order to identify irregularities and detect and combat wrongdoing. For the vast majority of global trade, government authorities are only able to see one side of cross-border trade transactions. Importers and exporters are subject to reporting in the jurisdiction where they operate, but not in the jurisdictions where their counterparties operate. This practice means that parties on either side of a cross-border transaction are able to report different information to their respective authorities, without the authorities of either jurisdiction being aware of the discrepancies.

The concept behind TTUs is simple. By providing government authorities access to information reported on both sides of a trade transaction, anomalies can be spotted. The anomalies, like the misinvoicing of price, value, quantity, or quality of goods, could be indicative of simple customs fraud, TBML, or even underground financial systems. TTUs can provide additional value in TBML analysis by adding law enforcement data, financial intelligence, and commercial information. The creation of these additional data sources is key to identifying more sophisticated schemes, where false information is reported identically on both sides of a transaction.

The United States pioneered the concept of TTUs. I envision a global TTU network somewhat analogous to the Egmont Group of Financial Intelligence Units (FIUs). Today, approximately 16 TTUs exist around the world, loosely cooperating under a U.S.-sponsored TTU umbrella. Most are in Latin America. Many other countries are interested in creating TTUs. Not only is trade transparency a proven countermeasure to TBML, but, by cracking down on customs fraud, it enhances revenue collection. TTUs have only been in existence a few years, but the network has already recovered well over \$1 billion.<sup>41</sup>

Specific line-item funding should be provided to the U.S. TTU so as to enhance its analytic capabilities and augment the personnel necessary to foster trade transparency in the United States and to expand the international TTU network.

### *Beneficial Ownership Transparency*

Congress should move legislation to end the abuse of anonymous shell companies by requiring beneficial ownership transparency.

Anonymous U.S. shell companies are one of the top tools used by criminals, kleptocrats, and tax evaders looking to conceal funds from law enforcement. A simple fix – requiring the real owner of a U.S. company to be named during the incorporation process – will cut down, in dramatic fashion, the ability of criminals to finance their crimes. This information should also be updated with authorities whenever beneficial ownership information changes.

### *Initiate a New Money Services Business (MSBs) Registration Effort*

In the late 1990s, a study sponsored by FinCEN estimated that there were over 200,000 money services businesses (MSBs) in the United States. MSBs include businesses that cash checks, issue money orders, and execute wire transfers. After the September 11th attack and passage of the 2001 USA PATRIOT Act, MSBs were required to register with FinCEN and obtain licenses in the states in which they do business. However, according to the government's own data, the federal registration program has not been successful, with only about one-quarter of the estimated number of MSBs having registered with FinCEN.<sup>42</sup> Moreover, not all states require licensing for companies which do not maintain a physical location in the state, and few states have made MSB licensing a priority. The resulting multiple gaps in federal and state registration and licensing data is of increasing concern because approximately one-half of all suspicious activity reports (SARs) filed with FinCEN every year originate via MSBs. The tens of thousands

of MSBs absent from the federal registration and state licensing processes include *hawalas*, *casas de cambio*, and a myriad of informal money-transfer services exploited by money launderers. The diversity and accessibility of the MSB sector also presents ongoing, grave challenges for effective oversight.

It is a federal offense to fail to register with FinCEN, to operate a money transmitting business in contravention of any applicable state licensing requirements, or to transport or transmit funds that are known to have been derived from a criminal offense or intended to be used to promote or support unlawful activity. The IRS is responsible for ensuring that MSBs register with FinCEN and for conducting AML/CFT compliance examinations, but it has neither the personnel nor the resources to fulfill those responsibilities.

The IRS should be given additional resources to carry out its MSB duties or it should delegate those duties to FinCEN, which should initiate a new, intensive MSB registration and oversight effort over the next two years. FinCEN should undertake an aggressive effort to identify unregistered or unlicensed MSBs and ensure they fulfill their registration and licensing requirements. FinCEN should also consider preempting state MSB licensing requirements by issuing a rule establishing uniform licensing requirements applicable to every MSB/money transmitter operating in the United States. Creating uniform, nationwide licensing standards and procedures would reduce the accumulative regulatory burden for interstate MSBs while also providing a more uniform and efficient set of laws for money transmitters to follow.

### *Promote Usage of the Legal Entity Identifier (LEI)*

The LEI is a unique 20-character code that identifies distinct legal entities that engage in financial transactions. The LEI is a global, non-proprietary identification system and freely accessible. Over 435,000 legal entities from more than 195 countries have now been issued LEIs. The LEI will be a linchpin for financial data – the first global and unique entity identifier enabling risk managers and regulators to identify parties to financial transactions instantly and precisely. And, as LEI is adopted, subsequent iterations of the program will begin linking beneficial ownership data to these unique identifiers, thus helping create transparency not only around company structures but around ownership structures as well. The widespread use of LEI will help provide financial transparency, accountability, and assist investigators in following the money trail. Currently, an international collaborative effort between public and private entities is developing the LEI, with the support of the Financial Stability Board (FSB) and the endorsement of the G-20. Legislation should be passed that requires U.S. companies that engage in financial transactions to obtain an LEI.<sup>43</sup>

### *Close Gatekeeper Loopholes*

FinCEN should close loopholes related to the gatekeepers of the financial system (also known as designated non-financial businesses and professions, or DNFBPs) that enable corrupt individuals and criminals to launder money through the U.S. financial system. DNFBPs include attorneys, accountants, and real estate agents. All appropriate AML/CFT obligations should be applied to these professions as is urged in the 2016 FATF Mutual Evaluation Report of the United States.<sup>44</sup>

## Conclusion

The need to convert “dirty” cash into clean, untraceable funds is central to the success or failure of criminal enterprises. As detailed above, we have not kept pace with the innovations in money laundering practices nor adopted updated strategies to effectively identify and catch the beneficiaries of illegal activity. As a result, we are, as has been stated, a decimal point away from complete failure.

At the same time, the amounts of money lost are staggeringly high and growing, fueled by secrecy and misaligned incentives. The cost of inaction is already too high.

I want to emphasize my respect for my law enforcement colleagues that work tirelessly and at times great personal risk to follow hidden money trails. Likewise, I greatly admire the dedication and professionalism of anti-money laundering compliance officers in financial institutions and money service businesses. While they might not all agree with portions of my testimony, I’m quite confident that all recognize that what we are doing now is not working and that our present efforts can be dramatically improved.

The above steps will challenge the status quo. They provide a roadmap for much needed change. If we are serious about the safety and security of our communities and our nation, the integrity of our financial system and the resulting impact on the broader economy, then it is time to admit the failures of our past efforts and consider new and better approaches to combat illicit finance.

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Note: Much of the information in this testimony was taken from an August 2017 paper by the author entitled “Countering International Money Laundering: Total Failure is Only a Decimal Point Away.” The paper was edited and published by the Financial Accountability & Corporate Transparency / FACT Coalition ([www.thefactcoalition.org](http://www.thefactcoalition.org)).

The original report is available at: <https://thefactcoalition.org/wp-content/uploads/2017/08/Countering-International-Money-Laundering-Report-August-2017-FINAL.pdf>

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