



# Countering International Money Laundering

*Total Failure is 'Only a Decimal Point Away'*

By John A. Cassara

August 2017



**FACTCOALITION**

Financial Accountability & Corporate Transparency



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## Executive Summary

Worldwide anti-money laundering efforts are currently just a decimal point away from total failure. Failure would have a dramatic impact on U.S. law enforcement and financial systems. Why? Because outside of crimes of passion, criminals, kleptocrats, and unscrupulous companies are typically motivated by *greed*.

In today's interconnected world, the manifestations of unfettered avarice impact us all. We see it in our communities: the opioid, methamphetamine, and cocaine epidemics are devastating. Financial fraud, fraud in government contracting, identity theft, and worse endanger individuals and our communities and waste taxpayer dollars. Terror finance and sanctions busting threaten national security.

Law enforcement, policymakers, and the media can get so distracted with the immediacy of the criminal behavior it is easy to forget that the aim of criminal activity isn't the crime itself—but the *proceeds* of the crime. Advocates, scholars and researchers have all questioned the efficacy of the “War on Drugs.”<sup>1</sup> But why don't we acknowledge that our inability to stop the laundering and seize the proceeds fuels the greed behind the drug trade?

How much money is being laundered? Estimates are difficult without better data, but the International Monetary Fund (IMF) and United Nations Office on Drugs and Crime (UNODC) estimate the scale of global money laundering falls somewhere around two to five percent of global gross domestic product — approximately \$1.5 trillion to \$3.7 trillion in 2015. The IRS observes: “money laundering is tax evasion in progress.” If tax evasion here and abroad is included in the count, the magnitude of international money laundering is staggering.

### “Total Failure Is Just a Decimal Point Away”

How well are we doing in fighting the problem? The data we do have presents a bleak picture. Here are a few sobering numbers:

- According to the UNODC, less than one percent of global illicit financial flows are seized and forfeited.
- Raymond Baker, a longtime financial crime expert, notes that the numbers show enforcement fails 99.9 percent of the time. “In other words, total failure is just a decimal point away.”
- Dated information suggests money launderers face a less than five percent risk of conviction in the United States. The situation in most areas of the world is even worse.

### What Can Be Done?

This report advances a number of “steps-forward” on how to more effectively combat money laundering.

#### Congress

- Congress should move legislation to end the abuse of anonymous shell companies by requiring beneficial ownership transparency.
- Congress should make all felonies predicate offences for money laundering.
- Congress should provide specific line item funding to the U.S. Trade Transparency Units (TTUs) so as to enhance their analytic capabilities and augment the personnel necessary to foster trade transparency in the United States and to expand the international TTU network.
- Congress should pass legislation which requires U.S. companies that engage in financial transactions to obtain a Legal Entity Identifier (LEI).

- Congress should pass legislation requiring transactional lawyers, and anyone else who forms legal entities, to carry out anti-money laundering due diligence.

#### *Inter-Agency*

- The U.S. should develop an updated anti-money laundering strategy to address new and continuing threats to the financial system.
- The U.S. should convene an inter-agency task force to adapt crime-fighting strategies to cover the use of mobile payment systems.
- The administration should require bidders for federal contracts and grants to publicly disclose their beneficial ownership information.
- The administration should adopt the Legal Entity Identifier (LEI), or a similar, non-proprietary and open system, that makes the hierarchy of entity ownership transparent, as the standard identifier in the federal procurement process.

#### *Treasury Department and the Financial Crimes Enforcement Network (FinCEN)*

- The Department of the Treasury, which leads the U.S. Financial Action Task Force (FATF) delegation, should introduce a resolution calling for members to promote trade transparency in order to combat trade-based money laundering and value transfer.
- Treasury should instigate a new rule-making process to strengthen due diligence requirements for financial institutions.
- FinCEN should be tasked with aggressive outreach to communities that rely on informal Money Service Businesses (MSBs). FinCEN should pre-empt state MSB licensing requirements and establish uniform licensing requirements that would be applicable to any company designated as an MSB/money transmitter in the United States.
- FinCEN should finalize the proposed rule to impose anti-money laundering (AML) and suspicious activity reporting requirements on registered investment advisers.
- FinCEN should re-examine each of the temporary AML exemptions to determine whether these exemptions are still warranted.

#### *Department of Justice*

- The Department of Justice should ensure that the top decision-makers at financial institutions, accounting firms, and law firms are held personally accountable for the actions of their organizations.
- Justice should change the incentives for law enforcement to encourage them to pursue complex financial crimes cases.
- Justice should provide specific funds for anti-money laundering/counter-terrorist finance (AML/CFT) training to the 93 U.S. Attorneys' offices.

The following report details the near failure of current efforts to combat money laundering and the rationale for comprehensive reform. These specific recommendations form the basis of a new approach to addressing money laundering and the dangerous threats to our safety and security from the crimes funded through illicit finance.

## I. Introduction

The worldwide failure to successfully combat money laundering has dramatic impact. Outside of 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, fraud in government contracting, corruption, a plethora of internet scams and ransomware attacks, identity theft, and other crimes affect our daily lives. Terror finance and sanctions busting threaten national security.

Law enforcement, policymakers, and the media can get so distracted with the immediacy of the criminal behavior that it is easy to forget the aim of these criminal activities is not the crime itself — but the *proceeds* of crime. Advocates, scholars and researchers have all questioned the efficacy of the “War on Drugs.”<sup>2</sup> But why don't we acknowledge that our inability to stop the laundering and seize the proceeds fuels the greed behind the drug trade?

Financial crimes and abusive tax evasion practiced by the elites contribute to the deterioration of social compacts. Worldwide, distrust in the privileged class has seemingly reached epidemic proportions<sup>3</sup> coupled with (if not driven by) a corresponding absence of accountability.<sup>4</sup> Anger and inequality are common themes in both the developed and developing world.

In other words, many of the ills we face come back to *money*. As detailed in this report, money laundering is the great enabler because it turns criminal proceeds into seemingly clean money that can be freely spent. And yet, our efforts to combat international money laundering are almost a complete failure. This report, some of which is adapted from a recent article I wrote for *The Hill*,<sup>5</sup> will explain the shortcomings of our current approach to combating financial crime, and it will outline a number of recommendations for improving those efforts.



## II. Background

### Definition

Once criminals and criminal organizations accumulate money from their illicit activities, they must try to hide it or disguise it so authorities cannot determine from where the dirty money comes. A working definition of money laundering is “the hiding or disguising of the proceeds of any form of criminal activity.” The key word in that definition is *any*. In the United States, we limit the definition to stated “predicate offenses” — or specified unlawful activities — that generate the illicit money upon which money laundering charges can be brought when criminals seek to hide or disguise those illicit proceeds, such as narcotics trafficking, fraud, smuggling, selling child pornography, etc. The international norm to charge money laundering is broader and includes “all serious crimes.”<sup>6</sup>

### Magnitude

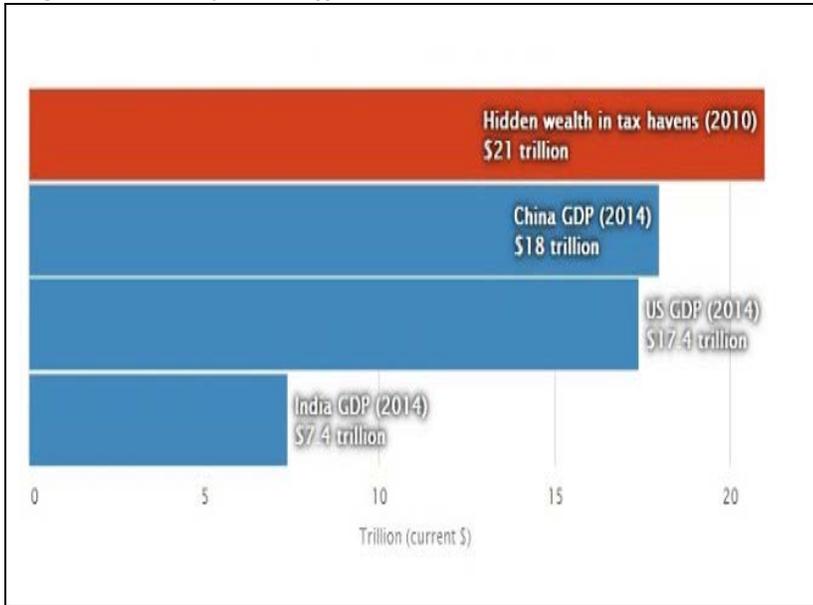
How much money is being laundered? Unfortunately, the estimates are all over the map. The Financial Action Task Force (FATF), an international anti-money laundering/counter-terrorist finance (AML/CFT) policymaking body, has stated that, “Due to the illegal nature of the transactions, precise statistics are not available and it is therefore impossible to produce a definitive estimate of the amount of money that is globally laundered every year.” 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>7</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, in 2009, criminal proceeds amounted to 3.6 percent of global GDP (See Table 1).<sup>8</sup>

Table 1: The International Monetary Fund (IMF) Estimates of Money-Laundering as a Percent of Global GDP<sup>9</sup>

Table 1: FATF estimate of money-laundering (1988)			
Amounts estimated to have been laundered (1988)	As a percentage of global GDP		
US\$0.34 trillion	2.0%		
Source: International Monetary Fund, Financial System Abuse, <i>Financial Crime and Money Laundering- Background Paper</i> , February 12, 2001.			
Table 2: IMF estimates of money laundered (1998)			
	Minimum	Maximum	Mid-point
IMF estimates of money laundered as a percentage of global GDP	2%	5%	3.5%
Estimate for 1996 in trillion US\$	0.6	1.5	1.1
Estimate for 2005 in trillion US\$	0.9	2.3	1.5
<b>Estimate for 2009 in trillion US\$</b>	<b>1.2</b>	<b>2.9</b>	<b>2.0</b>

Source: United Nations Office on Drugs and Crime, October 2011

Figure 1: Money Held Offshore in Tax Havens<sup>10</sup>



Source: Youth Voice, April 2016

**The magnitude of international money laundering is probably much higher depending upon what is included in the count.**

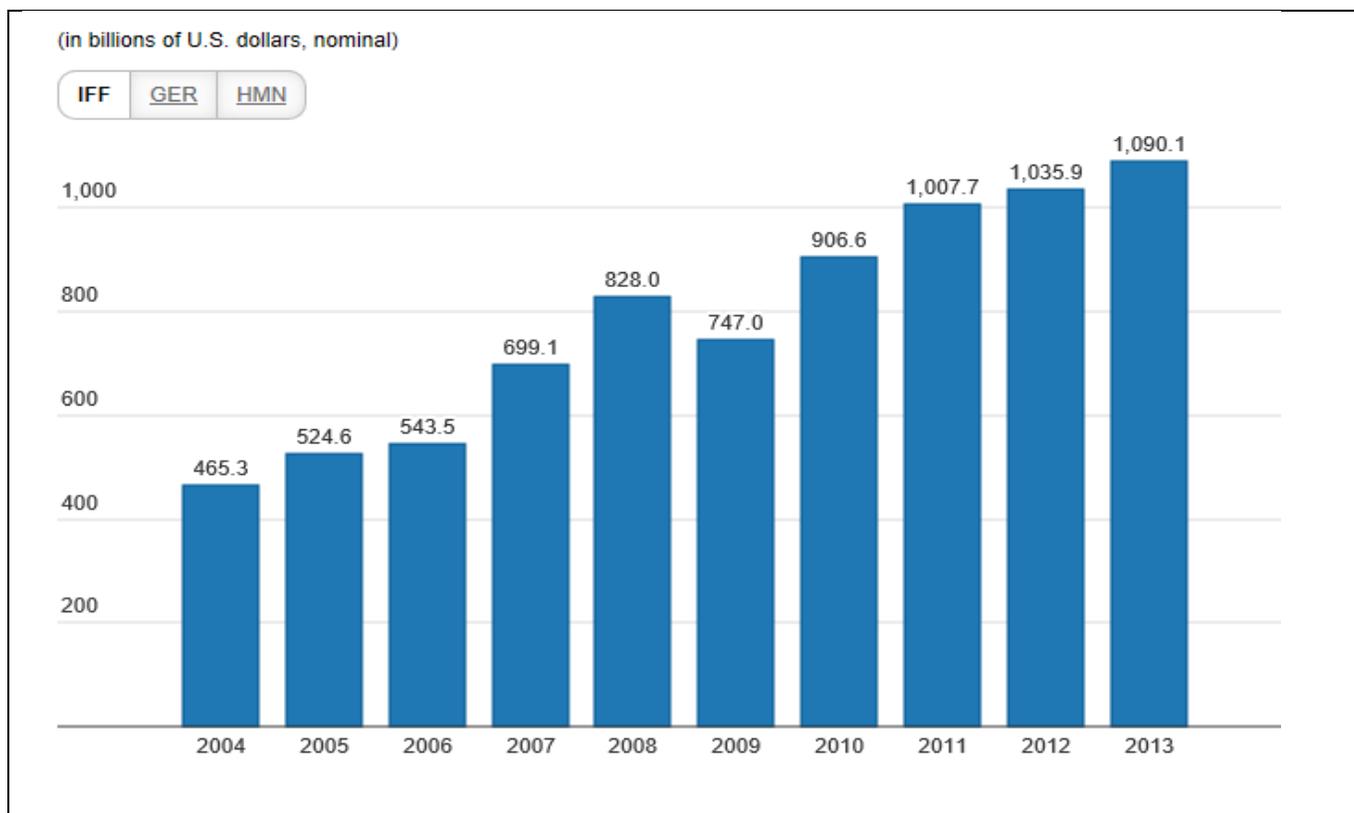
For example, there is an international movement to recognize tax evasion as a predicate offense to charge money laundering.<sup>11</sup> A study by the Tax Justice Network estimated that, in 2010, between \$21 trillion and \$32 trillion was hiding in more than 80 international tax havens. The study also found that privileged elites in 139 lower and middle-income countries had \$7.3 trillion 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 (See Figure 1).<sup>12</sup>

The 2016 release of the “Panama Papers” offers additional proof 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.

Global Financial Integrity estimates that the developing world lost \$1.1 trillion in illicit outflows in 2013 alone, 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 (See Figure 2).<sup>13</sup>

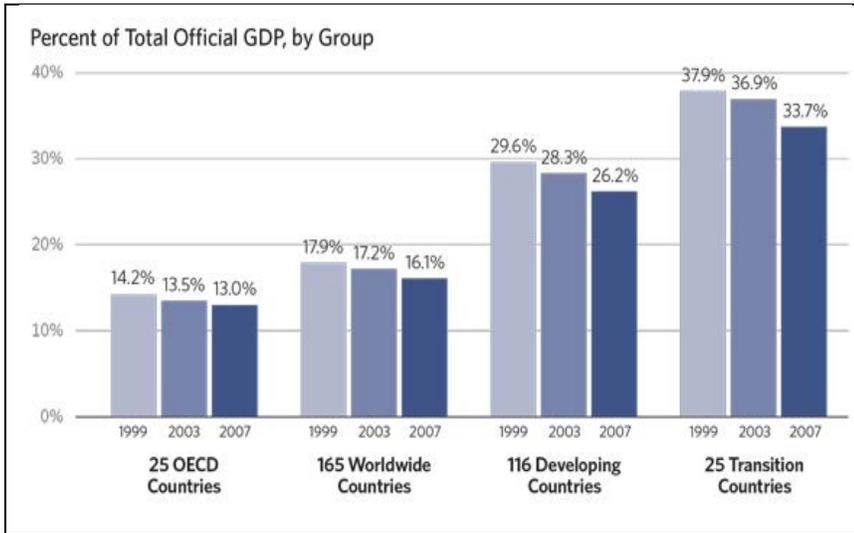
Figure 2: Illicit Financial Flows from Developing Countries: 2004-2013<sup>14</sup>



Source: Spanjers, Joseph, and Dev Kar. *Global Financial Integrity*, December 2015

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 black market is estimated at 30 percent or more of GDP.<sup>15</sup> In Egypt, the estimates reach 40 percent.<sup>16</sup> Most economic activity in the Democratic Republic of the Congo takes place in the informal sector, estimated to be up to ten times the size of the formal sector, with many transactions, even those of legitimate businesses, carried out in cash (often in U.S. dollars).<sup>17</sup> 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 (See Figure 3).

Figure 3: Size and Development of the Shadow Economy<sup>18</sup>

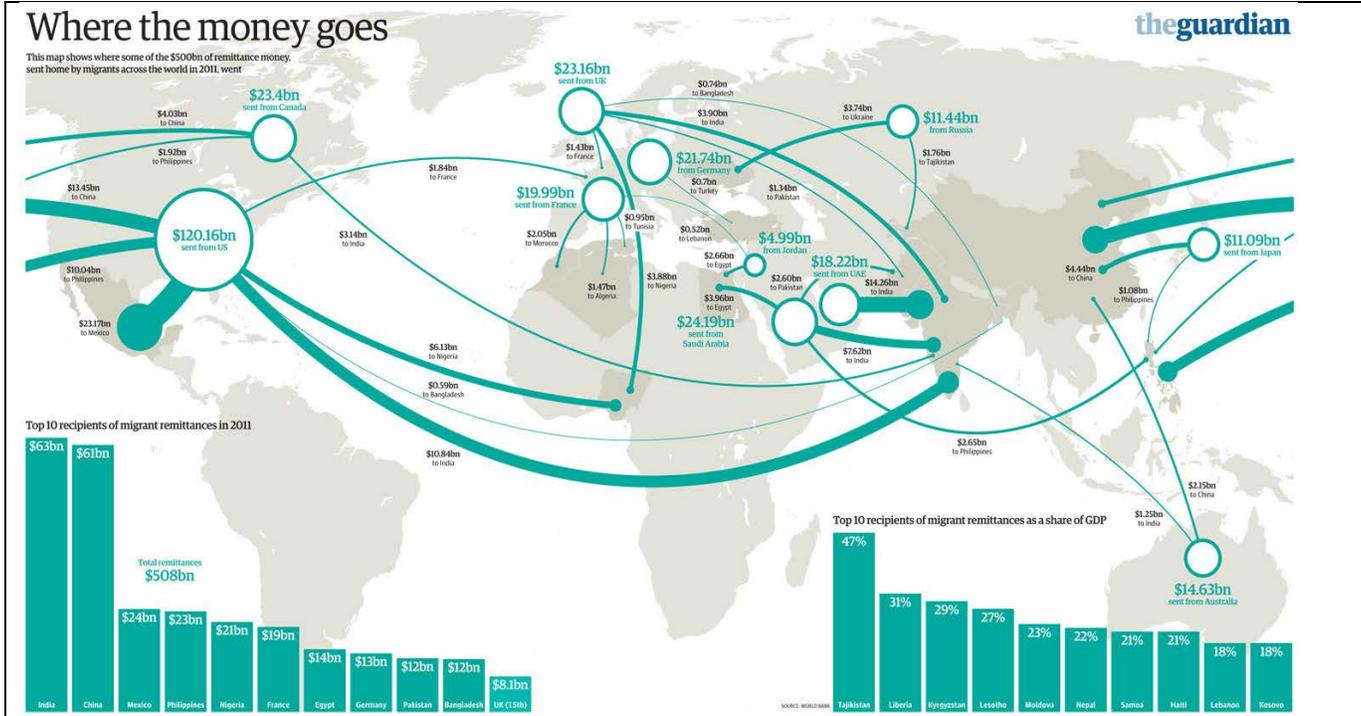


Source: The Heritage Foundation, 2010

There are an estimated 232 million migrant workers around the world.<sup>19</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.<sup>20</sup> Many countries are dependent on remittances as an economic lifeline. The World Bank estimated that global remittances reached \$707 billion in 2016.<sup>21</sup> These estimates cover what was 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>22</sup> So, using the above World Bank and IMF estimates, unofficial remittances are enormous. The funds are almost entirely underground and the networks practically impervious to the tax man and law enforcement (See Figure 4).

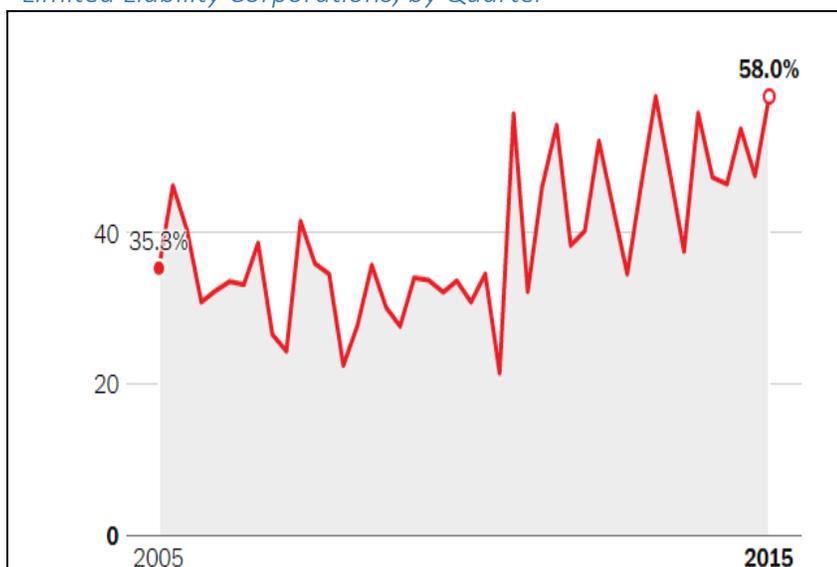
Figure 4: Estimates of the Underground Remittance System Known as Hawala<sup>23</sup>



Source: The Guardian

Using just one example, economists believe that the underground remittance system known as hawala is a \$100 billion industry worldwide. No government should prevent hard working immigrants that wish to send a portion of their income back to their home countries to support their loved ones. However, because of the opaque and underground nature of the financial system, hawala is also a money laundering mechanism. As such, it is abused by criminals and terrorists, endangering national and international security.<sup>24</sup>

*Figure 5: Percent of U.S. Properties over \$3 Million Bought by Limited Liability Corporations, by Quarter<sup>25</sup>*



Source: Ana Swanson, *Washington Post*, April 2016

The purchase of expensive real estate is another example where there are rising concerns of international money laundering. For example, last year the Chinese spent almost \$30 billion on residential property in the United States. The Chinese are also purchasing properties in major western cities such as London, Sydney, Vancouver, Toronto, and Auckland. Most of the purchases are made in cash. The flight of private wealth and tainted money leaving China appears to be due to worries about the economic outlook and the clampdown on corruption. As one former ambassador to China said, the country could very well be “the number one exporter of hot money in the world.” Yet China has strict capital controls that limit its citizens to only transferring the equivalent of approximately \$50,000 a year out of the country. Despite the restrictions, the torrent of money continues.<sup>26</sup> Anonymous shell companies are a prime method for evading these safeguards, and their use in real estate transactions are widespread and rising (See Figure 5).

The purchase of expensive real estate is another example where there are rising concerns of international money laundering. For example, last year the Chinese spent almost \$30 billion on residential property in the United States. The Chinese are also purchasing properties in major western cities such as London, Sydney, Vancouver, Toronto, and Auckland. Most of the purchases are made in cash. The flight of private wealth and tainted money leaving China appears to be due to worries about the economic outlook and the clampdown on corruption. As one former ambassador to China said, the country could very well be “the number one exporter of hot money in the world.” Yet China has strict capital



### III. Situation in the United States

While the anti-money laundering regime is generally better in the United States than in other countries, there remain serious gaps in the U.S. framework — particularly regarding beneficial ownership, trade-based money laundering, and the treatment of the gatekeepers of the financial system (also known as designated non-financial businesses and professions, or DNFBPs).

The total amount of money laundered in the United States is conservatively estimated in the hundreds of billions of dollars every year.<sup>27</sup> 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>28</sup> While tax evasion is not yet considered to be a predicate offense for U.S. money laundering, related crimes are. For example, identity theft connected to tax fraud is rampant, which correlates to a 2015 Treasury Department paper<sup>29</sup> that states fraud is the largest predicate offense for money laundering in the United States — surprisingly, not the proceeds of narcotics trafficking.

Furthermore, money laundering 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 study trade-based money laundering (TBML) and value transfer. Dr. John Zdanowicz, an academic and early pioneer in the field of TBML, examined 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 5.69 percent of U.S. trade.<sup>31</sup>

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 8.87 percent of U.S. trade in 2013 (See Table 2). Almost all of this trade-fraud has escaped both detection and enforcement. Customs fraud is the primary predicate offense of TBML, and the loss of revenue to the United States is staggering. Because TBML often masks underground financial systems, there are concurrent threats to our national security. In just one example, U.S. officials have estimated that the black-market peso exchange — one of the most pernicious trade-based money laundering systems used by narcotics traffickers — is also one of the “largest money laundering methodologies in the Western hemisphere.”<sup>32</sup> But the Department of the Treasury appears reluctant to even estimate the magnitude of the scope of the TBML problem.<sup>33</sup>

*Table 2: Trade Based Money-Laundering Estimates<sup>30</sup>*

<b>Money Illicitly Moved Into The U.S.</b>	
<b>Under-Valued Imports</b>	\$272,753,571,621
<b>Over-Valued Exports</b>	\$68,332,594,940
<b>Total</b>	\$341,086,166,561
<b>As a Percent of Total U.S. Trade</b>	8.87%
<b>Money Illicity Moved Out of the U.S.</b>	
<b>Over-Valued Imports</b>	\$94,796,135,280 over valued
<b>Under-Valued Exports</b>	\$124,116,420,714 under valued
<b>Total</b>	\$218,912,555,994
<b>As a Percent of Total U.S. Trade</b>	5.69%

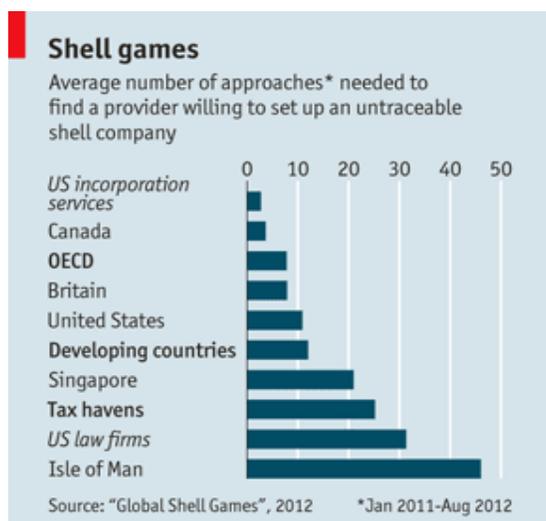
*Source: Zdanowicz, June 2015*

Of course, laundered money has an exponential effect. A few years ago, the GAO released a report estimating that the amount of drug dollars smuggled across the border from the United States into Mexico primarily to facilitate “placement” into foreign financial institutions approached approximately \$39 billion. Of that \$39 billion, GAO found that U.S. and Mexican law enforcement and customs officials combined had intercepted only pennies on every dollar smuggled.<sup>34</sup> Those numbers are extremely troubling, because intercepting bulk cash is a comparatively straight-forward anti-money laundering enforcement effort. Performing poorly in intercepting bulk cash does not bode well for the more complex efforts to combat money laundering, including through cyber smuggling, trade-based money laundering, and layering illicit proceeds through a labyrinth of anonymous shell corporations.

The long-term economic consequences of our failure to effectively combat money laundering are far worse than the simple estimates listed above suggest, thanks to the “miracle of compounding.” Per an analysis of J.R. Helming, assume narcotics cartels receive a 5% return on the above \$39 billion. After 20 years, that \$39 billion mushrooms into a \$1.7 trillion problem.<sup>35</sup> And that is just one year of enforcement failure, representing just the southwest border, and for just one comparatively straight-forward asset class.

U.S. anti-money laundering investigations are stifled, in part, by the lack of transparency regarding beneficial ownership of legal entities formed in America. According to one study, the United States is one of the easiest places in the world for terrorists, human traffickers, and corrupt foreign politicians to open anonymous companies to launder illicit money with impunity.<sup>37</sup> When investigating the most heinous crimes, it is commonplace for law enforcement to hit a dead-end when encountering a shell company (See Figure 7).

*Figure 7: Average Number of Approaches Needed to Find a Provider Willing to set up an Untraceable Shell Company<sup>36</sup>*



Source: *The Economist*, April 2012

“Anonymous shell companies... are one of the primary tools used by bad guys to openly acquire and access nefarious funds,” wrote Dennis Lormel, the FBI’s former anti-terror finance chief, in 2013. “These dubious dealings are not limited to... ‘offshore’ tropical islands. The United States is among the most egregious offenders with its woeful lack of regulations requiring the true ownership of companies to be identified.”<sup>38</sup>

In April 2016, Patrick Fallon, head of the FBI’s financial crimes section, noted: “While we [in the U.S. talk] about offshore accounts in other countries, I think we have a lot of room for improvement here to promote transparency... It is a significant impediment to our investigations when we can’t determine who the true owner is of a company.”<sup>39</sup>

Furthermore, the Financial Action Task Force sharply criticized the U.S. for its beneficial ownership problems — as well as for shortcomings with regards to U.S. treatment of investment

advisers, lawyers, accountants, and real estate agents — in its latest mutual evaluation report published in December 2016.<sup>40</sup>

## V. Bottom Line Results

Reliable statistics on money laundering enforcement are hard to find and sometimes dated. Yet the data that do exist present a bleak picture. It is important to remember that in anti-money laundering efforts, the bottom-line *measurables* (a term used frequently within the U.S. government) are neither the number of financial intelligence reports filed nor the politically popular but vague term of *disruption*. Rather, the metrics that matter are the number of arrests, convictions, and illicit money identified, seized, and forfeited. In other words, divide the trillions upon trillions that are being laundered by effective enforcement actions.

Despite periodic, positive, public pronouncements from the Department of the Treasury and various administrations, here are a few sobering numbers:

- According to the United Nations Office on Drugs and Crime (UNODC), less than 1 percent of global illicit financial flows are currently being seized and forfeited.<sup>41</sup>
- According to Raymond Baker, a longtime authority on financial crimes, using statistics provided by U.S. Treasury officials concerning the amount of dirty money coming into the United States and the portion caught by anti-money laundering enforcement efforts, the numbers show enforcement is successful 0.1 percent of the time and fails 99.9 percent of the time. “In other words, total failure is just a decimal point away,” notes Mr. Baker.<sup>42</sup>
- 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 700 money laundering convictions a year. That seems like a large number, but — divided into the amount of criminal activity — it is paltry. Besides, many convictions simply reflect additional counts added on against people charged with other crimes.<sup>43</sup>
- According to the U.S. State Department, the situation in most areas of the world is even worse.<sup>44</sup>

The Philippines has a large economy and is increasingly recognized as an important regional financial center. Since 2001, only 49 anti-money laundering cases have been filed. So far, of those 49 cases, there has not been a single successful prosecution or conviction.<sup>45</sup>

The British Virgin Islands is advertised as the world’s leading offshore center<sup>46</sup> with more offshore companies than any other country. In 2014, there was one prosecution for money laundering.<sup>47</sup>

According to the Angolan Central Bank, approximately \$17 billion has left 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 not any prosecutions or convictions for money laundering.<sup>48</sup>

In Japan, the numbers of investigations, prosecutions, and convictions for money laundering are so low that they are not even publicly released.<sup>49</sup>

The list goes on and on. In fact, the State Department’s 2016 International Narcotics Control Strategy Report<sup>50</sup>, which tracks countries’ anti-money laundering efforts around the world, reinforces this conclusion. While there are many positive developments, a comprehensive and objective reading of the report’s statistics on prosecutions

and convictions is sobering. Ron Pol, a researcher on anti-money laundering measures, writes: “[Existing] anti-money laundering legislation is perhaps the least effective of any anti-crime measure, anywhere.”<sup>51</sup>

If our current anti-money laundering countermeasures are “a decimal point away from total failure,” isn’t it time to introduce a new strategy and tactics?

## VII. Policy Recommendations

We can do better. Here are a number of measures that could significantly improve U.S. anti-money laundering enforcement.

### *Congress*

#### [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, terrorists, 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.

#### [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 the Financial Action Task Force (FATF), a collection of more than 30 governments which sets international anti-money laundering (AML) standards. Worse yet, the United States uses one list for crimes committed in the U.S. and another list for crimes committed abroad. 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>52</sup> Legislation to make all felonies predicate offenses for money laundering has been introduced by both Sen. Charles Grassley (R-IA) and Rep. Maxine Waters (D-CA) in previous Congressional sessions but has not yet been adopted.

#### [Establish a Global Network of Trade Transparency Units \(TTUs\)](#)

One key countermeasure for TBML is to establish trade-transparency units (TTUs) between affected countries. TTUs are formed when two countries agree to exchange transaction-level trade data on trade between individuals or trading companies of the two countries to 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, trade-based money laundering (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. Today, approximately 16 TTUs exist around the world, loosely cooperating under a U.S.-sponsored TTU umbrella. Most are in Latin America. Other countries around the world are interested in 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>53</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.

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

The Legal Entity Identifier (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>54</sup>

### Expand Due Diligence Obligations to Transactional Lawyers and Formation Agents

In December 2016, the Financial Action Task Force came out with its latest mutual evaluation report on the progress of the United States in meeting the FATF anti-money laundering and counter-terrorism financing standards. While the report gave the United States strong marks overall, it highlighted two key deficiencies. First, it stated that the lack of timely access to adequate, accurate, and current beneficial ownership information remained one of the fundamental gaps in the U.S. AML regime. Second, it noted that lawyers, accountants, real estate agents and other significant professional service providers operating in the United States were still largely exempt from the AML requirements levied on financial institutions under the Bank Secrecy Act, and that this exemption presented a real vulnerability given the propensity for abuse in this area.

Congress should pass legislation requiring persons who form legal entities, including transactional lawyers, to carry out AML due diligence. Specifically, the legislation should require formation agents to conduct a risk-based due diligence review before accepting a client; to identify higher risk clients; to conduct risk-based monitoring of client funds and activities; and to report suspicious transactions to law enforcement. These AML obligations have long been part of the international AML standards set by FATF, and the United States should take the steps necessary to meet its FATF commitments.

## *Inter-Agency Recommendations*

### Develop an Updated Anti-Money Laundering Strategy

Following the completion of the U.S. Money Laundering Threat Assessment in 2005,<sup>55</sup> the U.S. government produced an inter-departmental National Anti-Money Laundering (AML) Strategy Report.<sup>56</sup> Ten years later, the U.S. government completed a new money laundering risk assessment in 2015.<sup>57</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.

### Adapt Crime Fighting Strategies to Cover Mobile Payments

Fewer criminals are carrying suitcases full of cash. And, while most still use traditional banks, increasingly, mobile payment systems are the money laundering vehicle of choice. These new and emerging financial structures have fewer rules, less transparency and greater flexibility to route and hide illicit funds.

The U.S. should convene an inter-agency anti-money laundering task force to develop specific recommendations on how to best address this growing threat to undermining enforcement of anti-money laundering laws.<sup>58</sup>

### Require Beneficial Ownership Information from Government Contractors

The administration should require bidders for federal contracts and grants to publicly disclose their beneficial ownership information, as a means to ensure that fraudsters, criminals, and sanctioned individuals are not recipients of taxpayer money. This information should be publicly available for free in a machine-readable format, such as the Open Contracting Data Standards and operable across government-led initiatives on federal spending transparency.

### Legal Entity Identifier in Procurement

In February 2016, the General Services Administration (GSA) issued a request for information to assess and replace the current identifier used to track and verify entities that receive federal funds. The administration has the authority to assign a unique entity identifier without any action from Congress. At a minimum, the administration should adopt the Legal Entity Identifier (LEI) — or a similar, non-proprietary and open system, that makes the hierarchy of entity ownership transparent — as a standard identifier in the procurement process by requiring bidders for federal contracts and grants to disclose both their LEI identification number and a list of their beneficial owners. A company's LEI should be included as a mandatory field in the GSA database for companies seeking to bid on federal contracts.

## *Treasury Department and the Financial Crimes Enforcement Network (FinCEN)*

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

The international Financial Action Task Force recognizes that trade-based money laundering (TBML) is an enormous concern. In fact, FATF believes it is one of the three major global money laundering methodologies. 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.

### Strengthen Due Diligence Requirements for Financial Institutions

FinCEN published a rule in May 2016 that requires U.S. financial institutions to collect what the rule describes as "beneficial ownership" information for legal entities opening new accounts. Unfortunately, the rule's definition of 'beneficial owner' does not comport with internationally recognized definitions, due to multiple loopholes and poor drafting. While the rule does require information to be provided about the people who directly or ultimately (through another level or more of corporate ownership) own shares in the corporate client, it only requires this information if someone owns a 25 percent or greater interest. If nobody owns that much of the company, then the bank does not need to identify any of the ultimate shareholders. In that case, the only person a bank has to list as a 'beneficial owner' is a senior manager of the corporate client, and a manager is simply not a beneficial owner as the term is otherwise internationally understood. The rule also allows a trustee to be named as the "beneficial owner" of a trust, even though trustees typically are not the true owner of the trust's assets. The result is that the rule's current definition of beneficial owner — and therefore the information a bank needs to collect about who owns or controls their corporate clients — is insufficient, not in compliance with international standards, and allows a bank to skirt 'know your customer' checks.

In addition, the bank does not have to incorporate the beneficial ownership information into its electronic records, it does not have to keep copies of information provided as verification that the people listed as beneficial owners exist, and the bank is permitted to legally rely on the information provided by the person from the company filling out the beneficial ownership form, even though the form only requires that they provide information "to the best of their knowledge," which may be very little or entirely inaccurate. The Treasury Department should instigate a new rule-making process to close these loopholes and improve the rule.

### 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., including businesses that cash checks, issue money orders, and execute wire transfers. After the September 11<sup>th</sup> 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. 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 hawaladars, 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 Internal

Revenue Service (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 pre-empting 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 inter-state MSBs while also providing a more uniform and efficient set of laws for money transmitters to follow.

### Close Gatekeeper Loopholes

The following are recommendations for actions that FinCEN should take to close U.S. 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.

#### Finalize AML Requirements for Registered Investment Advisers

In 2015, FinCEN proposed a rule to require registered investment advisers to comply with anti-money laundering (AML) and suspicious activity reporting (SAR) requirements. FinCEN should finalize the proposed rule to impose anti-money laundering and suspicious activity reporting requirements on registered investment advisers.<sup>59</sup> The rule would apply to investment professionals for some of the largest financial players in the United States today, including hedge funds, private equity funds, trusts, foundations, and other pooled investment vehicles which collectively determine whether billions of dollars will enter the U.S. financial system, including offshore dollars from a variety of sources. While many U.S. investment advisers have voluntary AML and SAR reporting programs, none are currently subject to mandatory AML and SAR program requirements, despite their ongoing money laundering vulnerabilities. The absence of any legal obligation on the part of registered investment advisers to detect and prevent money laundering stands in stark contrast to the AML and SAR obligations of banks, securities firms, mutual funds, insurance companies, and other financial institutions operating in the United States.

Today, many investment advisers can accept funds from shell corporations and partnerships with hidden owners, conduct suspicious transactions with no questions asked, and witness highly suspect transactions with no obligation to report the activity to law enforcement. FinCEN should undertake to finalize the rule as soon as possible in order to close the current, glaring gap in AML protections safeguarding the U.S. financial system from abuse by terrorists, money launderers, and other criminals.

#### Re-Examine All Temporary AML Exemptions

FinCEN should also examine each of the temporary anti-money laundering (AML) exemptions now in existence, including for “seller[s] of vehicles, including automobiles, airplanes, and boats”, persons involved with real estate closings, and “private bankers.” to determine whether these exemptions are still warranted.

## *Department of Justice*

### Hold Individuals Accountable for Corporate Wrongdoing

U.S. law enforcement agencies should ensure that the top decision-makers at financial institutions, accounting firms, and law firms are held personally accountable for the actions of their organizations. In September 2015, the U.S. Department of Justice published a memorandum outlining steps it was taking to ensure that where corporate misconduct was identified, individuals responsible for the wrongdoing were also held accountable.<sup>60</sup> This important policy should be reaffirmed by the Attorney General and solidified by nominating to key posts in the Justice Department, such as the Deputy Attorney General, Assistant Attorney General (Criminal Division), Assistant Attorney General (Tax Division), and U.S. Attorney Offices, officials committed to bringing cases against individuals for white collar crime and strongly enforcing anti-money laundering and tax laws. Beyond criminal prosecution, regulators can also take action against individuals by requiring personnel changes, suspending or debarring them from regulated industries, or suspending or revoking their licenses to engage in certain types of business. Deterring corporate misconduct starts with individual accountability.

### Change the Incentives for Law Enforcement

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. Cases and publicity also influence budgets. 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 the 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.

The incentives should be changed. Financial crimes investigators require specialized expertise and should be rewarded for it. Recognition (in many forms) should be given to those law enforcement officers that pursue the proceeds of crime — not the oftentimes straightforward predicate offense used to charge money laundering. Law enforcement personnel involved with complex financial crimes cases often cannot fairly compete via promotion boards against colleagues with good statistics covering straightforward criminal activity. This is an important reason why “impact cases” or headline grabbing financial crimes investigations that drive reforms have almost disappeared. Each department and agency has its own internal policies that govern promotion, but thought should be given to incentivizing meaningful financial crimes investigations.

### Enhance AML/CFT Training

Criminal activity takes place at the local level. Yet, it is precisely at the state and local levels where law enforcement professionals have the least knowledge of money laundering and terror finance and their countermeasures. Many are unaware of common money laundering methodologies and investigative tools that are available. Local analysts and investigators cannot recognize suspicious financial and value transfer activities, if they do not recognize telltale indicators. The Department of Justice should provide specific funds for anti-money laundering/counter terror finance (AML/CFT) training to the 93 U.S. Attorneys’ offices. Excellent training is also provided by the Bureau of Justice Assistance grants to the State and Local Ant-Terrorist Training (SLATT) initiative.

## VII. Conclusion

Financial crimes are about the money. 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.

The above reforms provide a roadmap for change and challenge the status quo. 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.



## About the Author

### *John A. Cassara*

John A. Cassara is a former U.S. intelligence officer and Treasury Special Agent. Mr. Cassara retired after a 26-year career in the federal government intelligence and law enforcement communities. He is considered an expert in anti-money laundering and counter-terrorist financing, with particular expertise in the areas of money laundering in the Middle East and the growing threat of alternative remittance systems and forms of trade-based money laundering and value transfer. He invented the concept of international “Trade Transparency Units,” an innovative countermeasure to entrenched forms of trade-based money laundering and terrorist financing. A large part of his career was spent overseas. He is one of the very few to have been both a clandestine operations officer in the U.S. intelligence community and a Special Agent for the Department of the Treasury.

His last position was as a Special Agent detailee to the Department of the Treasury’s Office of Terrorism Finance and Financial Intelligence (TFI). His parent Treasury agency was the Financial Crimes Enforcement Network (FinCEN), the U.S. Financial Intelligence Unit (FIU). He worked at FinCEN from 1996–2002. From 2002–2004, Mr. Cassara was detailed to the U.S. Department of State’s Bureau of International Narcotics and Law Enforcement Affairs (INL) Anti-Money Laundering Section to help coordinate U.S. inter-agency, international, anti-terrorist finance training and technical assistance efforts

During his law enforcement investigative career, Mr. Cassara conducted a large number of money laundering, fraud, intellectual property rights, smuggling, and diversion of weapons and high technology investigations in Africa, the Middle East, and Europe for a variety of federal agencies. While assigned to the Office of the Customs Attaché in Rome, Italy, he directed the first truly international anti-money laundering task force, called Operation Primo Passo, (“First Step”). The innovative operation combated Italian/American organized crime by examining the movement of money between the two countries and represented an early use of financial intelligence to proactively initiate investigations. During his customs career, he also served two years as an undercover arms dealer. He began his career with Treasury as a Special Agent assigned to the Washington Field Office of the U.S. Secret Service.

Since his retirement, he has lectured in the United States and around the world on a variety transnational crime issues. He is a consultant for government and industry. Mr. Cassara has authored or co-authored several articles and books, including *Hide and Seek, Intelligence, Law Enforcement and the Stalled War on Terrorist Finance* (2006 Potomac Books) and *On the Trail of Terror Finance - What Intelligence and Law Enforcement Officers Need to Know* (2010 Red Cell IG). In 2013, his first novel was released - *Demons of Gadara. Trade-Based Money Laundering: The Next Frontier in International Money Laundering* (Wiley) was released in November, 2015.

Further information – including specific recommendations on how to improve AML/CFT enforcement – is available at [www.JohnCassara.com](http://www.JohnCassara.com).



## About the FACT Coalition

### *Who We Are*

Founded in April 2011, the Financial Accountability and Corporate Transparency Coalition (FACT Coalition) is a non-partisan alliance of more than 100 state, national, and international organizations working toward a fair tax system that addresses the challenges of a global economy and promoting policies to combat the harmful impacts of corrupt financial practices.<sup>61</sup>

### *Our Goals*

- End the use of anonymous shell companies as vehicles for illicit activity;
- Strengthen, standardize, and enforce anti-money laundering laws;
- Require greater transparency from multinational corporations to promote informed tax policy;
- Ensure that the U.S. constructively engages in global financial transparency initiatives; and
- Eliminate loopholes that allow corporations and individuals to offshore income and avoid paying their fair share of taxes.

### *Why It Matters*

There is untold wealth hidden in secrecy jurisdictions around the globe. The wealth-stripping from corrupt practices and regimes, illegal activity, and legal-but-ethically-bankrupt tax avoidance schemes is larger than most can possibly imagine. Because of the secret nature of the financial flows, it is impossible to know precisely the amount of money, but economist Gabriel Zucman estimates at least \$7.6 trillion is in tax havens and secrecy jurisdictions.<sup>62</sup> The Boston Consulting Group estimates \$11 trillion.<sup>63</sup> And the Tax Justice Network estimates between \$21 and \$32 trillion dollars.<sup>64</sup>

Roughly \$2.5 trillion is currently stashed offshore by the 500 largest U.S. companies, costing American taxpayers more than \$700 billion in unpaid taxes.<sup>65</sup> Indeed, the annual cost of offshore tax avoidance by *multinational companies* is \$94 billion to \$135 billion,<sup>66</sup> while overseas tax evasion by *individuals* drains an additional \$40 billion to \$70 billion each year from the American public.<sup>67</sup>

We seek a larger conversation about how specifically certain interests are manipulating the tax system and undermining our ability to act collectively to solve problems. The secrecy, in particular, allows certain entities to play by a different set of rules than the rest of us. Internationally, the secrecy facilitates corruption and impoverishes developing countries. In the U.S., we are complicit in the draining of wealth of other nations and fueling the austerity movement in our own.

### *Learn More*

Interested in learning more about the FACT Coalition or becoming a member? Visit our website at [thefactcoalition.org](http://thefactcoalition.org) or contact Jacob Wills at [jwills@thefactcoalition.org](mailto:jwills@thefactcoalition.org) or +1 (202) 827-6401.



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