



**Testimony of Greg Baer
President
The Clearing House Association**

**Before the House Financial Services Subcommittee on
Financial Institutions and Consumer Credit**

***Implementation of FinCEN's Customer Due Diligence Rule –
Financial Institution Perspective***

April 27, 2018

Chairman Luetkemeyer, Ranking Member Clay, and members of the Subcommittee, my name is Greg Baer and I am the President of the Clearing House Association and General Counsel of the Clearing House Payments Company. Established in 1853 and owned by 25 large commercial banks, we are the oldest banking payments company in the United States, and our Association is a nonpartisan advocacy organization dedicated to contributing quality research, analysis and data to the public policy debate.

Thank you for the opportunity to testify today on FinCEN’s customer due diligence (“CDD”) rule and efforts financial institutions have made over the last two years to comply with it. In sum, the CDD rule will be used to identify the beneficial owners of companies, which will potentially assist law enforcement in identifying businesses that are used for money laundering and other illicit activities. However, TCH does have concerns about recent guidance issued by FinCEN, which detracts from the clarity and predictability of the CDD rule, and the process by which the rule will be implemented—as the guidance was not subject to notice and comment and was in some instances based on prior guidance, also released without notice and comment, by the federal banking agencies and other regulators. We are also concerned that the banking agencies, perhaps with endorsement from FinCEN, may reinterpret the rules going forward.

Background

FinCEN and the federal banking agencies have long imposed customer due diligence expectations on financial institutions, and the banking agencies have expanded those requirements through their *FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual*.¹

On May 11, 2016, FinCEN adopted its *Customer Due Diligence Requirements for Financial Institutions* rule after a multi-year rulemaking process. The rule states that a financial institution’s CDD program should encompass the following elements: “(i) customer identification and verification; (ii) beneficial ownership identification and verification; (iii) understanding the nature and purpose of customer relationships to develop a customer risk profile; and (iv) ongoing monitoring for reporting suspicious transactions and, on a risk-basis, maintaining and updating customer information.”² The first element, a customer identification and verification program, is already an AML requirement known as the Customer Identification Program, or CIP, rule;³ the second is a new regulatory requirement; and the third and fourth are already expected parts of financial institution’s suspicious activity reporting program, now formally codified by this regulation.

¹ See FFIEC Bank Secrecy Act/Anti-Money Laundering Examination Manual, 2014, “Customer Due Diligence—Overview,” p. 56.

² See 81 Fed. Reg. at 29,398.

³ See Customer Identification Programs for Banks, Savings Associations, Credit Unions and Certain Non-Federally Regulated Banks (“CIP rule”), 12 CFR Part 21 (Office of the Comptroller of the Currency)(“OCC”); 12 CFR Parts 208 and 211 (Board of Governors of the Federal Reserve System)(“Federal Reserve”); 12 CFR Part 326 (Federal Deposit Insurance Corporation)(“FDIC”); 12 CFR Part 748 (National Credit Union Administration)(“NCUA”); and 31 CFR Part 1020.220 (FinCEN).

The new beneficial ownership requirement mandates that covered financial institutions identify and verify beneficial ownership information for certain legal entity customers each time a new account is opened or when a triggering event occurs. In particular, institutions are generally required to collect and certify information on two ownership prongs for a given legal entity: (i) an equity prong that requires the identification of individuals who directly or indirectly own 25 percent or more; and (ii) a control prong that requires the identification of an individual with “significant responsibility to control” the legal entity. The 61-page rule also includes other technical provisions, exemptions, and exclusions.

Overview

TCH believes that the CDD rule and its beneficial ownership information collection requirement will potentially provide law enforcement with useful information, primarily as they use ownership information to learn more about suspect companies or entities. We particularly appreciate FinCEN’s efforts to give financial institutions some flexibility in how they collect and certify beneficial ownership information, which was the product of a commendable notice and comment process. Furthermore, FinCEN appropriately decided not to apply the beneficial ownership requirement retroactively.

We understand that FinCEN and the FFIEC have been working to update the BSA/AML examination manual to provide additional technical guidance to examiners about the CDD rule’s requirements.⁴ While we support publication of a revised manual so that examiners and institutions can have a shared interpretation of the rule, we do not believe that the manual should make substantive changes to the underlying rule unless published for public comment as required under the Administrative Procedure Act.⁵ Since adoption of the CDD rule in 2016, financial institutions have invested millions of dollars and rebuilt their internal systems to implement the rule’s provisions ahead of the May 11, 2018 compliance deadline. In particular, the new beneficial ownership information collection requirement has obliged them to make substantial changes to the onboarding of new accounts and employee training practices as well as significant technological investments to incorporate the requirements of the final rule.

⁴ On April 24, POLITICO reported that banking regulators indicated that the revised manual would be “released soon” and that “[f]or upcoming exams, regulators will be looking at what banks have been doing to prepare and then providing ‘beginning guidance as opposed to looking at strict compliance,’ said Doreen Eberley, the FDIC’s director of risk management supervision.” See Victoria Guida, “ICBA asks FinCEN to delay beneficial ownership rule by 1 year,” (April 24, 2018).

⁵ More generally, TCH believes that Treasury should urge the FFIEC to update and revise the BSA/AML Examination Manual. Since its initial publication in 2005, the manual has frequently been expanded but never substantially edited and revised; such revisions are long overdue. For example, many of the suspicious activity “red flags” included in the manual are anachronistic to today’s financial system and make it difficult for banks to efficiently and effectively fulfill their reporting obligations. As the document that effectively serves as the methodology for the regulators’ BSA/AML risk assessments, and therefore the regulatory requirements for an institution’s BSA/AML program, the manual should be critically reviewed and revised much more frequently and subject to notice and comment under the Administrative Procedure Act.

Financial Institution CDD Implementation Concerns

TCH recognizes the importance of robust CDD processes and agrees with FinCEN's stated position that "[e]xpressly stating the [CDD] requirements facilitates the goal that financial institutions, regulators, and law enforcement all operate under the same set of clearly articulated principles."⁶ However, we do have two concerns with the CDD rule: first, the rule requires financial institutions to identify beneficial owners on a per-account basis and not a per-customer basis; and second, its preamble does not explicitly affirm FinCEN's sole ultimate authority to determine CDD standards, and rather appears to leave the door open for further *ad hoc* interpretations by examiners.⁷ Additional guidance released by FinCEN earlier this month has exacerbated these concerns.

The CDD rule requires covered financial institutions to reconfirm the beneficial owners of an existing customer each time that same customer opens an additional account. This requirement is extremely burdensome to the point of being unworkable for institutions that routinely open multiple accounts on the same day, or within a short period of time, for customers. For example, title or escrow customers can open multiple accounts daily to assist in closing real estate transactions. Furthermore, large corporations can open multiple accounts in a day or within a few days to assist with business related needs including general checking, lines of credit for business operations, lending, and to facilitate investment strategies.

The cost of reconfirming ownership with each new account does not appear to come with any corresponding benefit. There is no reason to believe that the opening of a new account, in and of itself, is an indication that the beneficial ownership of the customer has changed. Customers with the same ownership frequently open new accounts; customers may change beneficial ownership and not open a new account. Thus, a financial institution should be able to determine, consistent with a risk-based approach, whether re-identification and re-certification is necessary based on whether it has a reasonable belief that it has identified the customer's current beneficial owners by ownership criteria at least as stringent as those required by the final rule. We note that this approach is also consistent with the approach taken by FinCEN and the federal banking agencies in the final CIP rule.

The "new account" requirement is complicated further by guidance released by FinCEN on April 3, 2018, in the form of 37 FAQs.⁸ TCH appreciates FinCEN's efforts to provide additional guidance to the industry on implementing the CDD rule. FinCEN's April 3 FAQs provided useful clarity on various aspects of the final rule, including (i) clarifying that when

⁶ See 81 Fed. Reg. at 29, 449.

⁷ See TCH-FSR Comment Letter to Treasury on its "Review of Regulations" (July 31, 2017) for more information on our concerns, available at www.theclearinghouse.org/-/media/tch/documents/tch-weekly/2017/20170731_joint_trades_comment_letter_to_treasury_on-review_of_regulations.pdf. See also The Clearing House Letter to FinCEN, Re: Notice of Proposed Rulemaking—Customer Due Diligence Requirements for Financial Institutions (RIN 1506-AB-25), (October 3, 2014), available at <https://www.theclearinghouse.org/-/media/files/association%20related%20documents/20141003%20tch%20comments%20to%20fincen%20on%20cdd.pdf>.

⁸ See FIN-2018-G001, "Frequently Asked Questions Regarding Customer Due Diligence Requirements for Financial Institutions," ("FinCEN April 3 FAQs") (April 3, 2018), available at www.fincen.gov/sites/default/files/2018-04/FinCEN_Guidance_CDD_FAQ_FINAL_508_2.pdf.

financial institutions create accounts for administrative or operational purposes, and not at a customer's request, the CDD rule's beneficial ownership information collection requirement does not apply; (ii) indicating that the CDD rule's beneficial ownership collection exclusion for foreign financial institutions, where the foreign regulator collects and maintains beneficial ownership for that institution, is not dependent on whether the beneficial ownership requirements applied by such institution's foreign regulator match the U.S. requirements; and (iii) making clear that a certification can be obtained in various forms and methods, such as by oral confirmation, among other things.

However, the guidance raises other issues. In some cases, the FAQs appear to add requirements that go beyond the parameters of the final rule. For example, the guidance includes statements that institutions are required to "certify" (in addition to collecting and verifying) beneficial ownership information at a triggering event, which is contrary to the plain language of the final rule, including statements in the preamble, that require institutions to certify such information only when a new account is opened. The guidance also provides that in cases where a trust directly or indirectly owns 25% or more of a legal entity customer, for the purposes of the equity prong, the trustee should be identified "regardless of whether the trustee is a natural person or a legal entity," even though the rule clearly states that beneficial owners are "natural persons who own or control legal entities."⁹

Most significantly, FinCEN's FAQ 12 in the guidance states that institutions are required to obtain beneficial ownership information from legal entities when a financial product, like a certificate of deposit or loan, renews or rolls over for the first time following May 11. Therefore, to implement FAQ 12 as written, financial institutions would need to restructure, or "break," their origination systems in order to put products covered by this FAQ into a holding process to allow for customer outreach to reconfirm beneficial owner information, as such products do not require the institution to interact with the customer in order to initiate an automatic renewal. Again, there is no reason to believe that an auto-renewal is evidence that a change in beneficial ownership might have occurred. The FAQ 12 guidance is further complicated by the fact that these products include contractual provisions requiring the financial institution to auto renew them without interruption. Therefore, on May 11, financial institutions will be in the untenable situation of either not being in compliance with the FAQs to the CDD rule or breaching their contracts with customers. For example, a small business may not be able to pay its employees or vendors because its line of credit would be put into default until a financial institution can obtain beneficial ownership information from the business; as that default would be the result of a contractual breach by its bank, it could sue for damages.

We note that FinCEN in its FAQs has recognized and attempted to resolve this issue by providing that, during the initial certification of beneficial ownership information, if the customer also agrees to notify the institution of any change in ownership, then future renewals are covered.¹⁰ However, there likely remain millions of outstanding accounts that require

⁹ See 81 Fed. Reg. 29, 398.

¹⁰ FAQ 12 states that "[i]n the case of a loan renewal or CD rollover... if at the time the customer certifies its beneficial ownership information, it also agrees to notify the financial institution of any change in such information, such agreement can be considered the certification or confirmation from the customer and should be documented and maintained as such, so long as the loan or CD is outstanding." See FinCEN April 3 FAQs, *supra* n. 8.

grandfathering. We believe that the costs of requiring amendments to all those accounts would dwarf any potential AML benefits.¹¹

We note that the FAQs issued by FinCEN were not subject to notice and comment, so any attempt to apply or treat them as binding in nature would violate the Administrative Procedure Act.¹² Therefore, legally, the incompatibility between guidance and contract described above should be resolved by institutions adhering to their contracts, as future contracts would eventually bring them into compliance with the guidance, and we would hope that FinCEN would agree to such a common sense approach. However, we are concerned that financial institutions could be forced by examiners to treat FinCEN's guidance as a binding regulation. Bank compliance officers cannot afford either institutionally or personally to risk examiner sanction, whether in the form of a Matter Requiring Attention in the examination process or a formal enforcement action. Also, given that a firm could be examined by multiple agencies, there is potential for variation in interpretation.

In order to provide covered institutions and FinCEN with additional time to resolve or provide clarity and comfort, we would encourage FinCEN to grant exceptive relief on various aspects of the rule, like the guidance provided in FAQ 12 and complex aspects of the "new account" requirement, until such matters can be further discussed, or as a way to provide institutions with additional time to calibrate their programs to implement aspects of the FAQs that provided further clarity on the regulation, but did not create additional requirements. The BSA grants the Treasury Secretary with the authority to "prescribe an appropriate exemption from a requirement" implemented under it.¹³ Along with other authorities, the Secretary of the Treasury has delegated this responsibility to FinCEN.¹⁴ FinCEN has utilized this tool

¹¹ It is worth noting that FinCEN's FAQ 12 guidance is derived from joint agency guidance released in 2005—also without notice and comment or Congressional review—which included a statement that "[f]or the purposes of the CIP rule, each time a loan is renewed or a certificate of deposit is rolled over, the bank establishes another formal banking relationship and a new account is established." See "Interagency Interpretive Guidance on Customer Identification Program Requirements under Section 326 of the USA PATRIOT Act, FAQs: Final CIP Rule," p. 8 (April 28, 2005). That guidance was inconsequential at the time, as it was intended to clarify that the customer whose account is renewed is *not* subject to CIP again, but now has substantial ramifications as the "new account" focus of the CDD rule leads to an illogical conclusion. So, while FinCEN acknowledges in FAQ 12 that the "risk of money laundering is very low," a combination of agency guidance, FinCEN guidance, and a zero-tolerance examination culture is likely to set financial institutions on a path to devoting extraordinary resources towards those products—resources that could better be used elsewhere. We need a regime that deploys financial institution resources to combating financial crime, not checking boxes that were created by guidance issued in 2005.

¹² See U.S. Government Accountability Office "Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation--Applicability of the Congressional Review Act to Interagency Guidance on Leveraged Lending," (October, 19, 2017), available at www.gao.gov/assets/690/687879.pdf. See also U.S. Government Accountability Office "Bureau of Consumer Financial Protection: Applicability of the Congressional Review Act to Bulletin on Indirect Auto Lending and Compliance with the Equal Credit Opportunity Act," (December 5, 2017), available at www.gao.gov/assets/690/688763.pdf.

¹³ See 31 U.S.C. 5318(a)(7).

¹⁴ See Treasury Order 108-01 (July 1, 2014).

infrequently, but it could prove particularly useful in providing some regulatory comfort while institutions seek further clarity and direction from FinCEN.¹⁵

CDD Rule's Triggering Event Requirement

We were pleased that FinCEN declined to impose its beneficial ownership information collection requirement retroactively, or to all covered legal entity customer accounts at a financial institution, and instead took the prudent approach of applying it from the compliance date of the rule. FinCEN's approach strikes the right balance, as banks typically use the initial information obtained under the CIP rule and through KYC processes to do a risk assessment of the customer. Customers that the bank views as higher risk will normally be subjected to additional levels of due diligence, which may already involve obtaining beneficial owner information. Moreover, banks may seek to refresh information about accountholders when certain events trigger a review. Therefore, the final rule's requirement that a financial institution need acquire beneficial ownership information for a current account on the occurrence of a triggering event is more appropriate than a broad, retroactive requirement.

Beneficial Ownership Legislation

Furthermore, as financial institutions test their CDD implementation systems, they are discovering that meeting the final rule's requirements with respect to current customers on the occurrence of a triggering event takes a substantial period of time, as banks must request beneficial ownership information from clients, verify it, then perform additional due diligence as needed, including screening the names provided against both internal and external bank OFAC lists.¹⁶ There is also a client friction, as clients want to know why their bank (and no other company with which they conduct business) must investigate their ownership. As TCH has previously testified, the government should collect this information and allow access to it by law enforcement and financial institutions legally obligated to determine ownership in the exercise of their BSA/AML obligations. We strongly support Congressional efforts in this regard, including those in the draft "Counter Terrorism and Illicit Finance Act."

¹⁵ See 31 CFR 1010.970 which states that "[t]he Secretary, in his sole discretion, may by written order or authorization make exceptions to or grant exemptions from the requirements of this chapter. Such exceptions or exemptions may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to particular transactions or classes of transactions. They shall, however, be applicable only as expressly stated in the order of authorization, and they shall be revocable in the sole discretion of the Secretary."

¹⁶ While not the subject of this hearing, TCH also recommends that Treasury increase the efficiency and effectiveness of sanctions compliance, and further recognize a risk-based approach to such compliance. OFAC sanctions programs are a vital tool to U.S. foreign policy and therefore it is essential that compliance expectations are risk-based and communicated consistently in order to avoid inconsistent application of program requirements. For example, Treasury should clarify that (i) financial institutions are expected to apply sanctions to a subsidiary of a person listed on a relevant OFAC list when there is a reason to know that the entity is a majority-owned subsidiary of a listed person, such as when the subsidiary is a customer of the financial institution or is listed as a subsidiary on an OFAC list; (ii) publish the names of all known sanctioned parties on OFAC-published lists to allow financial institutions to properly screen for and interdict prohibited transactions; and (iii) standardize the information in the various sanctions lists published by OFAC.

Of course, there are other benefits to that legislation, including a bar on forming anonymous companies. Many criminals avoid the banking system and launder money by forming LLCs and using them to hold real estate, art, jewelry or other valuables—all without having to touch the banking system. The CDD rule does nothing to prevent this behavior, but beneficial ownership legislation could be of valuable assistance to law enforcement in determining who owns what.

With respect to implementation, the CDD rule’s preamble states that the federal functional regulators have authority to “establish AML program requirements in addition to those established by FinCEN that they determine are necessary and appropriate to address risk or vulnerabilities specific to the financial institutions they regulate.”¹⁷ As TCH has previously testified before this Subcommittee, BSA compliance examinations should be conducted under standards clearly set by FinCEN and not subject to interpretive discretion by the federal functional regulators.¹⁸ Congress vested exclusive authority to implement the BSA in Treasury, not other agencies,¹⁹ and as previously discussed, the Secretary has delegated that authority to FinCEN.²⁰ Congress also did not exempt this area of law from the Administrative Procedure Act or the Congressional Review Act. Therefore, financial institutions have the same right to know the rules to which the government is subjecting them as any other company or individual, under any other statutory regime.

In particular, public reports indicate that the federal banking agencies have considered directing institutions to collect beneficial ownership at a 10% equity threshold in “high risk” cases, a practice that we understand has been informally enforced for years, even prior to the release of FinCEN’s CDD rule.²¹ However, FinCEN was very clear in its rule that financial institutions should, on a risk basis, determine when to collect information at a lower equity threshold. Therefore, any effort by federal banking agency examiners to impose such a requirement, or to act in a similar manner with regard to a different provision of the CDD rule, is not only unsupported by law but also an unwise use of financial institution resources.²²

¹⁷ See 81 Fed. Reg. 29,403-29,404.

¹⁸ See Testimony of Greg Baer before the House Financial Services Subcommittee on Financial Institutions and Consumer Credit, “Examining the BSA/AML Regulatory Compliance Regime,” (June 28, 2017), available at <https://financialservices.house.gov/uploadedfiles/hhrg-115-ba15-wstate-gbaer-20170628.pdf>.

¹⁹ 31 U.S.C. 5318(a)(2) and (h)(2). We note that other potential AML-related sources of statutory authority do not apply here. For example, section 8(s) of the FDI Act only grants the agencies with authority to “prescrib[e] regulations requiring [banks] to establish and maintain procedures reasonably designed to assure and monitor the compliance of such depository institutions with the [BSA]”; while regulations thereunder may establish procedural expectations for compliance with the BSA, they cannot interpret the BSA itself.

²⁰ See Treasury Order 108-01 (July 1, 2014).

²¹ See The Clearing House, “Appropriate Implementation of FinCEN’s Customer Due Diligence Rule,” (December 14, 2017), available at www.theclearinghouse.org/-/media/new/tch/documents/advocacy/20171214_tch_letter_cdd_rule_implementation.pdf.

²² *Id.*

More broadly, this situation illustrates why the Treasury Department should take a more prominent role in coordinating AML/CFT policy across the government to set priorities for the AML/CFT regime. This leadership role should extend to establishing definitive CDD standards to be enforced by FinCEN and, if necessary, examined for compliance by the banking agencies.

Domestically, banks of all sizes report that current CDD requirements have increased the cost of opening new accounts, and may represent a majority of those costs. Of course, disproportionate and heightened account opening requirements make low-dollar accounts for low- to moderate-income people much more difficult to offer and price. While the connection is not immediately apparent, AML/CFT expense is clearly an obstacle to banking the unbanked, and a reason that check cashers and other forms of high-cost, unregulated finance continue to prosper. The problem, of course, is that bank examiners do not internalize those costs. And those in the government who do internalize those costs play no role in examining the performance of financial institutions.

On April 24, Joint Economic Committee Democrats highlighted data showing that “one in four American households are unbanked or underbanked, representing nearly 34 million families.”²³ They go on to note that such individuals rely on alternative financial services like payday, or auto title loans, and this results in their being charged additional fees (e.g. for an income of \$22,000 an unbanked household can pay more than \$1,000 each year in extra fees). In many cases, these people are making a rational decision, in part related to the topic of today’s hearing. Low and moderate income people often do not receive regular paychecks, and therefore frequently make cash deposits. Banks are required to flag frequent deposits as high risk for money laundering, and investigate the source of the funds—in effect, investigate the depositor. LMI customers understandably react badly to being challenged by their bank, and often prefer to retain cash and use a check casher to deposit any checks they receive. Furthermore, if customers fail to respond to such an inquiry, the bank is expected to file a SAR, which could lead to the closing of an individual’s account. Of course, these closings become known and further the reputation of banks as a bad place for LMI customers to do business.

Thus, it is easy to understand why LMI families might prefer to remain unbanked—to keep that cash at home, to take the odd check to a check casher rather than a bank, and when there is need for emergency funds—having no existing deposit relationship with a bank—to turn to a payday lender. Therefore, we should not assume that choices to remain unbanked are the product of ignorance, but rather investigate their causes and seek to remove impediments to those people entering the banking system.

One could argue that some of these cash transactions are illicit finance—for example, income that may not be reported to the IRS. However, a thoughtful cost-benefit analysis might conclude that the law enforcement benefits of this regime as applied to low dollar accounts—where prosecution is extraordinarily unlikely—are vastly outweighed by the societal costs of

²³ See Joint Economic Committee Democrats, “Financial Access Still Out of Reach for Millions,” (April 24, 2018), available at <https://www.jec.senate.gov/public/index.cfm/democrats/blog?ID=D5B2E636-5782-4608-B1D4-B7C40E49CE50>.

pushing large numbers of people out of the banking system. The one thing that is certain is that the current regime does not allow bank examiners to undertake such a cost-benefit analysis.

For that to occur, the Department of the Treasury would have to exercise serious leadership in this area.

Treasury is uniquely positioned to balance and prioritize the sometimes conflicting interests relating to national security, the transparency and efficacy of the global financial system, the provision of highly valuable information to regulatory, tax and law enforcement authorities, financial privacy, financial inclusion, and international development concerns and there is a clear precedent for such a process.²⁴

More broadly, and beyond the scope of this hearing, in order to strengthen the effectiveness of the regime in catching criminals, a technological revolution is required. Such a revolution could allow financial institutions to assist law enforcement and national security agencies far more effectively. For that revolution to occur, however, the Treasury Department and FinCEN must begin to analyze raw data and establish incentives to encourage innovation. The existing system, where priorities are not clearly established and examinations are compliance focused, with zero tolerance across all types of activity, including the adoption of innovative technology, cannot produce this revolution.

Furthermore, we believe that FinCEN should reclaim examination authority for large, internationally active banks that file a majority of the reports required under the BSA and present almost all of the most difficult policy questions with respect to de-risking. As TCH has noted in previous testimony, of the roughly one million SARs filed annually by depository institutions (banks and credit unions), *approximately half are filed by only four banks*. Certainly, reform is warranted for smaller firms, where the cost of filing that handful of SARs is wildly disproportionate to its benefit. But if the goal is to catch dangerous criminals, identify terrorist activity, and reduce collateral damage to U.S. interests abroad, FinCEN need focus its examination energy on only a very few firms.

We estimate that an examination team of only 25-30 people at FinCEN could replicate the existing work of the federal banking agencies and the IRS (for the largest MSBs) at the largest, most internationally active institutions. More importantly, a dedicated FinCEN exam team for this small subset of large institutions could receive appropriate security clearances, meet regularly with end users and other affected parties, receive training in big data and work with other experts in government. They in turn would be supervised by Treasury officials with law enforcement, national security, and diplomatic perspectives on what is needed from an AML/CFT program—not bank examiners with no experience in any of those disciplines. And when FinCEN turned to writing rules in this area, like the CDD rule, it would do so informed by its experience in the field. It would see the whole battlefield, and promote innovative and imaginative conduct that advanced law enforcement and national security interests, rather than auditable processes and box checking.

²⁴ The production of the National Security Strategy and the National Intelligence Priorities Framework both use interagency processes to establish priorities.

Importantly, the benefits of a FinCEN examination function would extend well beyond the handful of banks it examined. Priorities set and knowledge learned could be transferred to regulators for the remaining financial institutions. And innovation started at the largest firms, with encouragement from FinCEN, would inevitably benefit smaller firms. The result of FinCEN assuming some supervisory authority would be a massive *cultural* change, as the focus shifted to the real-world effectiveness of each institution's AML/CFT program, rather than the number of SARs filed or number of beneficial ownership certifications financial institutions have on file. That change would start with those banks under sole FinCEN supervision, but would eventually spread to all institutions.

In addition, we believe that Treasury should conduct a broad review of current BSA requirements and guidance, de-prioritize the investigation and reporting of activity of limited law enforcement or national security consequence and create opportunities for the law enforcement and national security communities to provide general feedback on financial institution filings.²⁵ Banks receive inquiries from law enforcement for follow-up information in less than 10% of cases, and for some categories of SARs, close to 0%. The apparent inutility of the reports that are currently filed is a direct result of the outdated nature and misaligned incentive structure of the current framework. Critically evaluating, updating and streamlining the requirements would not only improve the utility of SARs and CTRs in particular, but also make more resources available to other higher value AML/CFT efforts, such as more proactively identifying and developing techniques to combat emerging trends in illicit activity, investing more heavily in innovation generally (including with respect to machine learning), and engaging in more proactive intelligence-led investigations. Allowing firms to redeploy their resources in this way would substantially increase the law enforcement and national security value of information provided by the financial sector.

Furthermore, one of the most pressing needs related to our national AML/CFT regime is to enable financial institutions to innovate their anti-money laundering programs. Financial institutions need to be able to innovate alone or in concert with their peers as new technologies emerge that allow for both efficiency gains and improved threat assessments. Advances in technology have the potential to truly change the way in which institutions approach illicit finance threats, which can only enhance our nation's AML/CFT regime. It is important for the government to encourage this innovation and provide responsible yet sufficient leeway to test and utilize these new systems and processes. Similarly, it is important that any reform should be flexible enough to address emerging technologies, like crypto currencies, that pose illicit finance risks that are currently being investigated.²⁶

²⁵ See The Clearing House letter to FinCEN on its "Request for Comments Regarding Suspicious Activity Report and Currency Transaction Report Requirements," (April 10, 2018), *available at* www.theclearinghouse.org/advocacy/articles/2018/04/20180410-tch-comments-to-fincen-on-sar-and-ctrs/

²⁶ We note that in 2013, FinCEN issued guidance stating that "an administrator or exchanger [of a virtual currency] is an MSB under FinCEN's regulations, specifically, a money transmitter, unless a limitation to or exemption from the definition applies to the person." See FIN-2013-G001, "Application of FinCEN's Regulations to Persons Administering, Exchanging, or Using Virtual Currencies," (March 18, 2013), *available at* www.fincen.gov/resources/statutes-regulations/guidance/application-fincens-regulations-persons-administering.

The draft “Counter Terrorism and Illicit Finance Act” would further many of these goals, and we encourage Congress to enact it. AML/CFT reform is needed in order to make the system more efficient and effective—the CDD rule is simply a symptom of the larger issue with the system. I look forward to your questions.