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VIA EMAIL (fatfconsultation@fatf-gafi.org)

Mr. Luis Urrutia
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The Financial Action Task Force
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Dear Mr. Urrutia:

This purpose of this letter is to respond to the Financial Action Task Force’s (FATF) consultation paper developed in preparation for the Fourth Round of Mutual Evaluations concerning the 40+9 Recommendations on money laundering and terrorist financing. These comments are intended to assist FATF in improving the 40+9 Recommendations to strengthen global efforts to combat money laundering, terrorist financing, and foreign corruption.

Need for Strong Global Standards. The United States has long supported the development of strong international standards to protect the global financial system against money laundering, terrorist financing, and foreign corruption. The U.S. Senate Permanent Subcommittee on Investigations, which I chair, has contributed to that effort by conducting investigations exposing how money launderers, corrupt officials, tax evaders, and others have utilized U.S. professionals and financial institutions to conceal, transfer, and spend suspect funds.1 The Subcommittee’s investigations have provided detailed case histories and concrete evidence of the need for transparency in financial transactions and holdings to stop abuses that are fueling crime and undermining tax fairness. Its work has also contributed to strengthening U.S. anti-money laundering and anti-corruption laws.

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In 1999, for example, the Subcommittee released a report and held a hearing on four case histories of heads of states or their relatives who used Citibank Private Bank to deposit at least $100 million each in suspect funds. In 2001, the Subcommittee examined how correspondent banking has been used by criminals to commit money laundering, drug trafficking, financial fraud, and other crimes. In 2004, the Subcommittee exposed how embassy accounts at Riggs Bank in Washington, D.C., were being used by foreign officials, their relatives, and close associates to conceal and transfer suspect funds. In 2006, the Subcommittee released a report and held a hearing on six case histories showing how U.S. residents were using tax havens to hide assets, evade taxes, and engage in other misconduct. In several hearings in 2006 and 2009, the Subcommittee looked at deficiencies in U.S. systems for identifying the beneficial owners of U.S. corporations. In 2008, the Subcommittee exposed how two tax haven banks were helping U.S. taxpayers evade U.S. taxes. Most recently, in 2010, the Subcommittee held a hearing and issued a report which examined how U.S. attorneys, real estate and escrow agents, lobbyists, and others have helped politically powerful foreign officials, their relatives, and associates gain access to the U.S. financial system.

**FATF Consultation Paper.** Since its creation, FATF has focused on exposing money laundering and terrorist financing threats, and conducting peer reviews to encourage compliance with its standards. Over 180 jurisdictions have pledged to comply with FATF standards. In 2003, FATF strengthened its longstanding 40 Recommendations to combat money laundering, by adding 9 Special Recommendations to combat terrorist financing. The 40+9 Recommendations now provide the leading global anti-money laundering (AML) and counter-terrorist financing (CTF) standards and also contribute important measures to counter corruption.

FATF has requested comment on its proposal to strengthen the 40+9 Recommendations' incorporation of a Risk Based Approach (RBA) to money laundering and terrorist financing threats as well as proposals addressing a number of other AML/CTF issues. This letter addresses six of those issues: (1) application of the RBA; (2) customer due diligence and beneficial owners; (3) politically exposed persons (PEPs); (4) third party reliance; (5) making tax crimes a predicate offense for money laundering; and (6) cross-border wire transfers.

**Risk Based Approach.** The FATF consultation paper indicates that, in 2003, when the 40 Recommendations were last revised, the intention was to introduce appropriate risk-based flexibility into the Recommendations in a manner that would allow resources devoted to AML activities to be efficiently allocated to address the most serious money laundering and terrorist financing risks. A Risk-Based Approach (RBA) means focusing AML resources where the greatest risks lie, as an alternative to a more prescriptive approach in which AML requirements are applied in a similar fashion irrespective of a customer's risk profile. FATF has proposed adding a comprehensive RBA statement to the Recommendations, clarifying aspects of the RBA, and ensuring a more consistent treatment of RBA issues throughout the Recommendations.

The FATF Recommendations would be strengthened by the inclusion of a comprehensive statement endorsing an RBA to AML/CTF programs. An RBA affords financial institutions of
all types the flexibility to establish an efficient and cost-effective means to target their AML/CTF resources. An RBA also allows financial institutions to consider risk variables that may increase or decrease the potential risk of each customer, resulting in a corresponding change in the level of customer due diligence. A higher risk customer would require an institution to take enhanced measures to mitigate risks. Conversely, a lower risk customer would require a lower level of attention. Under the RBA, all institutions should be required to perform a careful analysis of the AML/CTF risks posed by its customers, using information in within the institution’s control as well as publicly available information, and to use such information to design appropriate procedures to mitigate AML/CTF risks involving the higher risk customers.

To be effective, the RBA should require that every customer be subject to a risk assessment. No customer or class of customers should be exempt from monitoring by the financial institution. In addition, the RBA should prohibit the exemption of any class of financial institutions from a country’s AML/CTF obligations. The establishment of exempt institutions – financial institutions engaging in retail banking, for example – or exempt classes of customers would inevitably result in high risk customers attempting to fit within the exempt class or deposit their funds in the exempt financial institutions in order to evade AML/CTF safeguards.

A comprehensive statement of the RBA, which requires financial institutions to undertake a careful risk assessment of each customer and, based on an informed judgment regarding the risk posed by each customer, target its AML/CTF resources where their highest risks lie, would contribute to the development of efficient and cost effective means to combat money laundering, terrorist financing, and corruption.

Beneficial Ownership. A key issue in developing an effective RBA involves the inclusion of clear policies regarding the obligations of financial institutions to identify and verify the identity of their customers. Know-your-customer or KYC has become an international signal that a financial institution is carrying out its AML/CTF obligations. Effective risk assessments depend upon accurate and meaningful KYC information that looks beyond the nominal owner of a financial account or real estate sales document to ascertain the true beneficial owner of the account or asset. An RBA recognizes that AML/CTF risks vary with each customer and that a “one-size-fits-all” approach is not necessary or appropriate. For certain customers, minimal due diligence measures are sufficient at the acceptance stage, while others require enhanced due diligence to ascertain and verify the customer’s identity. The same is true when it comes to the ongoing monitoring of transactions. Obligations should also vary depending upon whether the customer is a natural person, corporation, trust, foundation, or other entity.

The RBA being developed for the FATF Recommendations should make it clear that financial institutions conducting risk assessments must first engage in KYC efforts that identify both the nominal and beneficial owners of the accounts, relationships, or assets being reviewed. Without a list of the beneficial as well as the nominal owners, an institution’s assessment of its customers’ risk profiles will be incomplete and inadequate, in particular because the highest risk customers are likely to be concealed behind nominees. Adding the concepts of “nominal” and
"beneficial" owners to the Recommendations and RBA would help provide, not only terms that are easy to understand, but also a construct that makes the meaning of each term clearer by way of contrast.

FATF is to be commended for refining its approach to customer due diligence and beneficial ownership to provide additional guidance on what steps a financial institution should take to ascertain the true identity of its customers and assess the AML/CTF risks they pose. Key to this effort is a useful definition of beneficial ownership that provides a standard broad enough to encompass a wide variety of schemes used to conceal ownership, but also specific enough to help laypersons understand who qualifies as a beneficial owner. One approach that may be helpful is a definition developed in connection with our ongoing legislative efforts to require U.S. States to obtain the names of the beneficial owners of the corporations and limited liability companies (LLCs) formed under U.S. laws, which is supported by the U.S. Treasury, Justice, and Homeland Security Departments. This definition applies only to beneficial owners of corporations or LLCs:

(1) **BENEFICIAL OWNER**

(A) **In General.** Except as provided in subparagraph (B), the term “beneficial owner” means a natural person who, directly or indirectly –

(i) exercises substantial control over a corporation or limited liability company; or

(ii) has a substantial interest in or receives substantial economic benefits from the assets of the corporation or limited liability company.

(B) **Exceptions.** The term “beneficial owner” does not include –

(i) a minor child;

(ii) a person acting as a nominee, intermediary, custodian, or agent on behalf of another person;

(iii) a person acting solely as an employee of a corporation or limited liability company, and whose control over or economic benefits from the corporation or limited liability company derive solely from the employment status of the individual;

(iv) a person whose only interest in the corporation or limited liability company is through a right of inheritance, unless the individual also meets the requirements of subparagraph (A); or
(v) a creditor of a corporation or limited liability company, unless the individual also meets the requirements of subparagraph (A).

The strengths of this definition are that it provides a general legal standard flexible enough to apply to a number of situations, as well as a checklist of limited exceptions to help laypersons understand who qualifies as a beneficial owner.

This definition, like that in the current FATF standards, makes it clear that beneficial ownership is determined, not by ownership alone, but also by who controls an entity. In offshore jurisdictions, ownership of a legal entity is routinely assigned to nominees who then take direction from the concealed beneficial owners. One confusing part of the FATF consultation paper is its proposal that financial institutions identify the persons who exercise the “mind and management” of an entity. This phrase is worrisome, because it potentially confuses the concept of beneficial ownership with concept of management. The managers of a legal entity may or may not be its beneficial owners. FATF should be careful not to confuse the two or water down the beneficial ownership concept which, after many hard years of work by FATF and others, has become an internationally accepted term of art. Rather than explain the concept of “control” in terms of discerning an entity’s “mind and management,” the RBA should simply clarify the reasonable steps that a financial institution should take to identify the beneficial owners of a customer. Where a financial institution, after making a reasonable effort, is unable to ascertain the beneficial owners, Recommendation 5 already provides that it should not open an account for the customer and terminate the relationship.

The FATF consultation paper also proposes adding the concept of ownership interests that are “so diversified that there are no natural persons (whether acting alone or together) that exercise “effective control” of an entity, and then excusing financial institutions from having to identify those owners. Since all entities are controlled and managed by natural persons, this approach is troublesome and raises the specter of unscrupulous persons creating legal entities with numerous owners simply to evade ownership disclosures. A better approach would be for the RBA to relieve financial institutions of the obligation to obtain the names of the natural persons who own highly regulated entities — such as publicly traded corporations, banks, insurance companies, and utilities — not because their ownership is dispersed, but because the owners are already known to and monitored by regulatory authorities. This approach excuses financial institutions from having to obtain the owners’ names because those names are already known, rather than because no one really knows who owns or controls a particular entity.

Politically Exposed Persons. The FATF consultation paper also proposes to amend its Recommendations in response to a request from the G20 leaders to help deter and detect

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2 The FATF Glossary states: “Beneficial owner” refers to the natural person(s) who ultimately owns or controls a customer and/or the person on whose behalf a transaction is being conducted. It also incorporates those persons who exercise ultimate effective control over a legal person or arrangement.”
corruption and the laundering of corruption proceeds. Senior officials engaged in large-scale corruption can have a disproportionate impact on a country, a region, even a generation of citizens victimized by a corrupt society. They can export problems by spreading corruption internationally, undermining the rule of law, encouraging crime, and even opening the door to terrorism. To strengthen its anti-corruption provisions, FATF proposes to amend Recommendation 35 to include a reference to the 2003 UN Convention Against Corruption (UNCAC). Presumably this reference would recommend that FATF members sign and ratify the convention. Inclusion of an UNCAC reference in Recommendation 35 would also impact Recommendation 6, which directs FATF member countries to require financial institutions to screen clients to identify politically exposed persons (PEPs), conduct enhanced due diligence into the source of their wealth and funds, and conduct enhanced ongoing monitoring of PEP business relationships. UNCAC defines PEPs as “individuals who are, or have been, entrusted with prominent public functions and their family members and close associates,” a definition which is similar but not identical to the FATF definition.

The anti-corruption provisions of the 40+9 Recommendations do need to be strengthened, and requiring members to sign and ratify UNCAC would not only accomplish that objective, but also bring the two sets of international anti-corruption standards into alignment. UNCAC, which has been signed by 140 countries, requires signatories to criminalize a wide range of corrupt acts, including bribery, embezzlement, influence peddling, and money laundering. It also directs signatories to require their banks to verify the identity of their customers, take reasonable steps to identify the beneficial ownership of funds deposited into high-value accounts, and conduct enhanced scrutiny of accounts sought or maintained by PEPs. In addition, it requires signatories to provide mutual legal assistance to extradite and prosecute offenders. UNCAC was further strengthened at a recent conference in DOHA, when the signatories agreed to undergo a peer review process to evaluate their compliance with its provisions. Including UNCAC within the FATF Recommendations would enable FATF to take advantage of the international consensus and compliance mechanisms that have been developed for that convention.

Tying the FATF Recommendations to UNCAC would also require Recommendation 6 to be modified to apply to both domestic and foreign PEPs. UNCAC is designed to combat both types of corruption, and FATF, which currently targets only foreign corruption, should take a consistent approach. The result would be to require financial institutions, when conducting their risk-based due diligence and assessments, to apply enhanced due diligence to all PEPs, whether foreign or domestic. That approach is supported by a recent World Bank Report documenting financial abuses and corruption by PEPs. The World Bank estimates that $1 trillion is paid each year in bribes, and the proceeds of corruption stolen from developing countries ranges from $20 billion to $40 billion per year. The sheer magnitude of such “grand corruption” by PEPs and the use of banks to launder such illicit proceeds, supports strengthening FATF standards to apply to both domestic and foreign PEPs. As the World Bank report points out, all PEPs are exposed

to the opportunity to misuse their position for personal gain, and distinguishing foreign from domestic PEPs omits an important risk factor for banks. Commercial databases are also already available addressing both groups of PEPs, minimizing any extra compliance costs. To further increase consistency between the two sets of anti-corruption standards, FATF should also consider altering its PEP definition to bring it into alignment with the UNCAC definition.

A third key issue involves a FATF proposal which appears to suggest relieving financial institutions of the obligation to apply enhanced due diligence to PEP family members and close associates, an ill-advised change that would not only weaken FATF’s anti-corruption safeguards, but also create a significant difference with UNCAC. The FATF proposal appears to be that, instead of requiring financial institutions to determine whether a customer is a family member or close associate of a PEP, its focus could be limited to situations where a family member or close associate already has a business relationship with a financial institution and determine whether a PEP is the beneficial owner of the funds involved in that relationship. The Subcommittee’s anti-corruption work has established that the laundering of suspect funds occurs, not only when a PEP handles those funds, but also when the PEP distributes illicit money to family members and associates. In addition, some honest PEPs may have relatives or associates who attempt to use the PEP’s status to engage in corrupt practices of their own. Because of the potential for such corruption, family members and close associates should be treated as PEPs in their own right, presenting a corruption-based money laundering risk that warrants its own risk assessment using enhanced due diligence.

A few examples from past Subcommittee investigations illustrate the elevated risks associated with PEP relatives and close associates. In a 1999 Subcommittee investigation, evidence was presented that, from 1994 to 1997, Citibank maintained three private bank accounts in Switzerland and a consumer account in Dubai for three corporations under the control of the husband of the Prime Minister of Pakistan. Some of those accounts accepted suspect funds that may have been associated with $10 million in kickbacks for a gold importing contract in Pakistan. The 2004 Subcommittee investigation of Riggs Bank disclosed that, from 1995 until 2004, Riggs opened personal accounts for the wife of the President of Equatorial Guinea and several corporate accounts for businesses controlled by his son, all of which accepted multiple large deposits of suspect funds. The bank failed for years to designate any of those accounts as high risk or to subject them to enhanced monitoring. In the Subcommittee’s 2010 investigation, evidence was presented that the daughter-in-law of the President of Equatorial Guinea formed a U.S. trust, opened bank accounts in the name of that trust, and then used those bank accounts to transfer substantial sums into and out of the United States. In another instance, the daughter of the President of Gabon accepted $1 million in cash from her father, who had brought the funds into the United States in a diplomatic pouch, and she then used those funds to purchase real estate in New York City. These and other troubling case histories demonstrate that PEP relatives and close associates present an elevated risk of involvement with corruption proceeds, and that a RBA should require them to be subject to enhanced due diligence and scrutiny. Exempting these individuals from automatic, enhanced due diligence would dramatically weaken existing FATF standards and open up a breach with UNCAC.
To combat the corruption threat posed by PEPs, the FATF Recommendations should be further strengthened by spelling out the enhanced due diligence procedures that should be used for PEPs, using in part the recent World Bank recommendations for PEP controls. The FATF Recommendations could make it clear, for example, that financial institutions should use reliable PEP databases to screen clients; use account beneficial ownership forms that ask for PEP information; obtain copies of any government financial declaration forms; accept substantial funds from a high risk senior political figure only where due diligence has identified a legitimate source for the funds; establish, using a risk based approach, value and volume thresholds for PEP transactions; and conduct annual reviews of PEP accounts. Spelling out enhanced due diligence procedures for PEPs would create a welcome set of international benchmarks to combat PEP corruption.

One last PEP issue involves PEP databases. The recent World Bank study, as well as the Subcommittee's own investigations, show that financial institutions today regularly consult electronic databases to identify PEPs, including relatives and close associates of senior political figures. But the quality of those databases varies and is often poor. To assist financial institutions in identifying PEPs, FATF should consider undertaking the creation of or working with other international organizations to create and maintain a comprehensive and reliable PEP database. In addition, FATF standards should require financial institutions to consult PEP databases as part of their due diligence efforts and direct government regulators to audit the reliability of the PEP databases used by their financial institutions.

**Third-Party Reliance.** The FATF consultation paper also raises several issues with Recommendation 9 involving third-party reliance. The first issue involves when banks can rely on customer due diligence performed by an outside third party. Currently, under Recommendation 9, countries have discretion to allow a financial institution to rely on a third party to perform due diligence, subject to certain conditions including that the third party is itself subject to AML obligations. FATF proposes to leave that approach unchanged.

The Subcommittee's work confirms the importance of ensuring that the third party performing customer due diligence are, by law, subject to AML obligations. The Subcommittee's investigations have determined that wrongdoers have been able to bring millions of dollars in suspect funds into the United States by acting through third parties, including attorneys, escrow agents, real estate agents, and offshore trustees.

Many of those U.S. professionals are under no obligation to take AML precautions when dealing with clients. For example, they have no obligation to know their clients, evaluate the source of their client's funds, or report suspect activity to law enforcement. In the United States, attorneys and real estate and escrow agents routinely handle large sums, but are currently exempt from U.S. requirements to establish AML controls to detect or prevent money laundering. These facts indicate that FATF should retain its current approach of allowing third party reliance only where the third party relied upon is subject to AML obligations of its own. Absent such a requirement, third party reliance is an invitation to evasion of AML/CTF safeguards.
A second issue involves reliance on intra-group customer due diligence efforts. FATF is considering allowing one part of a financial group to rely on the customer due diligence performed by another member of the same group. The problem, here, is the existence of bank secrecy laws and practices that prevent disclosures across international lines. The Subcommittee’s 2004 investigation involving Riggs Bank accounts for Equatorial Guinea illustrates the problem. An important issue exposed in the Riggs investigation was the inability of U.S. financial institutions with foreign affiliates to obtain key due diligence information about accounts opened and managed by those foreign affiliates. After questions arose about $35 million in wire transfers from a Equatorial Guinea government account, Riggs sent letters under Section 314 of the Patriot Act to two U.S. banks asking them voluntarily to share information about the beneficial owners of certain accounts to which the funds had been directed. Both banks declined to provide the requested information, because the funds had been deposited into accounts at their foreign affiliates in Luxembourg and Spain, and bank secrecy laws in those jurisdictions barred disclosure of client information, not only to third parties, but to personnel within the same bank if located outside the host country. In other words, bank secrecy laws prevented banks operating in the United States from obtaining client-specific information from their own foreign affiliates.

This bar on disclosure across international lines, even within the same bank, presents an obstacle to effective AML/CTF due diligence within multinational banks, as well as an impediment to international efforts to combat money laundering. FATF should promote procedures to enable financial institutions with foreign affiliates to exchange client information across international lines to safeguard against money laundering and terrorist financing. One place to start would be to allow intra-group reliance only where countries agree to waive bank and corporate secrecy for intra-group financial entities, and the financial institutions agree to share information freely between and among entities in the same corporate group, across international lines for AML/CTF purposes.

**Tax Crimes.** FATF is considering including in its standards a directive that countries make tax crimes a predicate offense for money laundering. Over the last decade, the Subcommittee has conducted multiple investigations into offshore tax abuse, exposing ways in which some financial institutions and professionals help U.S. taxpayers hide taxable income and evade their U.S. tax obligations. In 2008 and 2009, for example, the Subcommittee released a report and held hearings showing how two banks, UBS AG in Switzerland and LGT Bank in Liechtenstein, assisted tens of thousands of U.S. clients open foreign financial accounts without reporting the accounts, assets, or investment income to the IRS.⁴

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In 2008, the Subcommittee also released a report and held a hearing showing how some financial institutions were helping non-U.S. hedge funds and other foreign financial institutions avoid payment of U.S. taxes on U.S. stock dividends by conducting transactions and moving funds through foreign jurisdictions. In 2006, the Subcommittee released a report and held hearings on six case studies showing how U.S. financial professionals, including bankers, lawyers, accountants, investment advisors, and others were using tax havens to help U.S. taxpayers dodge payment of U.S. taxes. In 2003 and 2005, the Subcommittee released reports and held hearings showing how leading accounting firms, such as KPMG, were designing, marketing, and implementing abusive tax shelters which, in some instances, made use of offshore financial accounts and transactions to help U.S. taxpayers dodge their tax obligations. The Subcommittee has estimated that offshore tax abuse costs the U.S. Treasury $100 billion in lost revenues each year.

While some jurisdictions already treat tax evasion as a predicate offense for money laundering, the United States does not. Some opponents claim that making tax crime a money laundering offense would expand the use of criminal procedures in tax matters, and confuse criminal and tax laws that have long been treated as separate subjects in U.S. courts. In contrast, proponents claim that countries that have designated tax crimes as money laundering offenses have continued to treat tax cases as primarily civil matters, reserving money laundering prosecutions for a few, particularly egregious tax cases that deserve them. They also point out that many tax evaders are involved in crime and use the same offshore financial institutions and tax haven tricks as money launderers, warranting the same treatment. In the United States, the U.S. Senate has already passed legislation making tax evasion a predicate offense for money laundering; while that provision was not enacted into law, there is no reason to believe that the Senate would not support the same measure if given the opportunity.

If FATF were to proceed with this proposal, the term "tax crime" should be broadly defined to encompass all types of crimes involving the unlawful intent to evade payment of taxes. No distinction should be made between "tax fraud" and "tax evasion," or between "misdemeanor" and "serious" tax crimes. Nor should a distinction be made between conduct that qualifies as a tax crime in one jurisdiction but not another; instead the FATF standard should take a similar approach to that taken in many tax treaties, and provide that a tax crime exists if any jurisdiction in which the taxpayer conduct is defined as a crime.

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8 S. 386, Fraud Enforcement and Recovery Act of 2009 (FERA), section 2(g).
Cross-Border Wire Transfers. A final issue involves cross-border wire transfers. FATF is considering proposals to amend Special Recommendation VII to enhance the transparency of international wire transfers by requiring financial institutions to provide additional information in wire transfer documentation. This proposal is a good one, since complete originator and beneficiary information on wire transfers provides critical information in assessing the risk associated with a wire transfer, and the effectiveness of global AML/CTF efforts is often predicated on the ability to identify who is behind particular money transfers. Requiring financial institutions to obtain key information and retain records of wire transfers also provides law enforcement with critical information and evidence. To make this proposal effective, however, the FATF standard should be clear that financial institutions receiving wire transfers without complete originator and beneficiary information should not accept, forward, or execute those transfers.

FATF is also considering requiring financial institutions to screen cross-border wire transfers against UN Security Council sanctions lists. This proposal holds great promise as a deterrent of international money laundering and other crimes, and should also be adopted. A comparable screening process has been successfully implemented in the United States which requires financial institutions to screen wire transfers against lists maintained by the Office of Financial Assets Control (OFAC) of the U.S. Treasury Department. Wire transfer screening technology provides a powerful tool to enable banks to monitor suspicious wire transfers at minimal cost and prevent wrongdoers from corruptly using international wire transfer systems. FATF should promote use of wire screening technology by its member countries.

Improvements to the proposed FATF 40+9 Recommendations can serve as a powerful incentive for member countries to strengthen their anti-money laundering, counter-terrorist financing, and anti-corruption efforts. Thank you for the opportunity to comment.

Sincerely,

Carl Levin
Chairman
Permanent Subcommittee on Investigations