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WEST COAST AML FORUM

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Good morning. It is a pleasure to be joining you to kick off this year's conference. This event always provides a tremendous opportunity to spend some time with our many partners on the West Coast. This morning, I will use the opportunity to update you on some of the work FinCEN is doing and, hopefully in the process, demonstrate how valuable your partnership is to all that we do. In particular, I would like to discuss a few areas where FinCEN has been harnessing its authorities to ensure we have an appropriate level of transparency in our financial system.

Virtual Currency Efforts

First and perhaps most timely, is our ongoing work in the virtual currency space. Yesterday, FinCEN announced its first civil enforcement action against a virtual currency business, Ripple Labs. The action relates to Ripple's failures to register with FinCEN as a money services business, and to implement an adequate anti-money laundering (AML) program. Then, after Ripple created and registered a subsidiary, that entity – XRP II – failed to have an effective AML program and failed to report suspicious financial transactions.

Virtual currency exchangers – like all members of regulated industry – must bring products to market that comply with our anti-money laundering laws. Innovation is laudable but only as long as it does not unreasonably expose our financial system to tech-smart criminals eager to abuse the latest and most complex products.

The regulatory framework for money services businesses, which include virtual currency exchangers and administrators, has been in existence for years. To clarify these regulatory requirements, FinCEN issued guidance just over two years ago, noting that virtual currency exchangers and administrators are “money transmitters” under the Bank Secrecy Act (BSA) and its implementing regulations. As such, they are required to register with FinCEN as a money services business and institute certain recordkeeping, reporting, and AML program measures.

Since issuing the guidance, FinCEN has regularly engaged with the virtual currency industry through administrative rulings and outreach efforts to further clarify our regulatory coverage. We are extremely fortunate to have a team of experts who work very hard to keep pace with the quickly evolving technology in this area. They share what they have learned through extensive training efforts with law enforcement, regulators, and prosecutors domestically and globally. These are the people who are on the front lines of investigating illegal use of emerging payment systems. They also share their experiences with industry so that companies will be able to avoid being compromised by unlawful actors, and being used as a vehicle for illicit finance.

Working closely with our delegated BSA examiners at the Internal Revenue Service (IRS), FinCEN recently launched a series of supervisory examinations of businesses in the virtual currency industry. As with our BSA supervision of other parts of the financial services industry, these exams will help FinCEN determine whether virtual currency exchangers and administrators are meeting their compliance obligations under the applicable rules. Where we identify problems, we will use our supervisory and enforcement authorities to appropriately penalize non-compliance and drive compliance improvements.

FinCEN coordinated the Ripple action with the United States Attorney’s Office for the Northern District of California, with whom we have a strong partnership. Under the terms of the agreement, Ripple and its subsidiary, XRP II, consented to FinCEN’s $700,000 penalty, with credit for $450,000 in criminal forfeiture to be paid to the U.S. Attorney’s Office. They also admitted to FinCEN’s detailed statement of facts and admitted that their conduct constituted willful violations of the Bank Secrecy Act.

As a part of their consent agreement, Ripple and XRP II agreed to undertake steps to ensure future compliance with their anti-money laundering obligations under the Bank Secrecy Act, a prerequisite for all such businesses seeking to become a legitimate member of regulated industry. For example, they will transact XRP and “Ripple Trade” activity through a money services business registered with FinCEN. This new MSB and XRP II will take all necessary steps to implement and maintain an effective AML program, with required internal controls, training programs, risk assessments, and other requirements that such programs entail. And, finally, they will comply with the Funds Transfer and Funds Travel Rules, which were issued to ensure that essential information can be made available to law enforcement to trace the flow of dirty money.

Ripple and XRP II also agreed to undertake certain enhanced remedial measures that should prove helpful to their continued development as a regulated member of industry. They will conduct a three-year "look-back" review of their records to identify and provide overdue reports of suspicious activity. This new MSB and XRP II will retain external independent auditors to review their compliance every two years, up to and including 2020. In addition to the companies themselves, the auditors' reports will be provided to FinCEN and the U.S. Attorney's Office. Finally, Ripple Labs will also undertake certain enhancements to the Ripple Protocol to appropriately monitor all future transactions.

<u>Money Laundering through Real Estate</u>

Another area where we need to ensure transparency is the area of real estate. In February of this year, *The New York Times* published a series of articles entitled "Towers of Secrecy" on the use of shell companies to purchase high-value real estate at the Time Warner Center in New York City. The series has spurred discussion in the AML community about the use of real estate to launder money. So today I thought it might be worth spending some time talking about this issue.

This is not a new issue for me, or I dare say any of us in this room. In fact, it has been a reoccurring theme throughout my professional career. I have spent nearly 18 years in public service, the first 15 years as a prosecutor in a variety of roles at the U.S. Department of Justice. For a large part of that time, I worked as an organized crime prosecutor focusing on transnational organized crime, and Russian organized crime in particular. A prominent part of my practice involved investigating and prosecuting cases where members of criminal organizations based outside of the United States were nonetheless laundering their funds in the United States. Often, this involved the suspected purchase of personal residences with criminal proceeds. And, of course, the mere purchase of real estate worth more than $10,000 with criminal proceeds is often sufficient to constitute a violation of U.S. anti-money laundering laws without any further aggravating conduct.

Because I was working in the Criminal Division rather than a particular United States Attorney's Office during this timeframe, I had nationwide program responsibilities that provided me with insight into organized crime cases that were being investigated by my law enforcement colleagues throughout the United States. So, in addition to my own cases, I would receive information about a variety of ongoing investigations in various cities across the country. I recall during that timeframe of the late 1990s and early 2000s a real concern among many of my law enforcement colleagues who were seeing what they believed to be members of transnational criminal organizations purchasing personal residences in large cities throughout the United States in the names of a shell company or a nominee. In some areas, my colleagues relayed that the residences remained vacant and that there were entire areas where these residences remained completely vacant - lights off.

Of course, this phenomenon was not new in the United States. All we had to do was consult our colleagues who had investigated and prosecuted narcotics cases in South Florida during the wild, narcotics-fueled days of the 1980s and seen first-hand the endemic use of narcotics proceeds to fund the purchase of luxury real estate in Miami.

By 2010, I had become the Chief of the Asset Forfeiture and Money Laundering Section at the Justice Department, which added to my perspective on the issue. From this new vantage point, I could see not only our own Section's forfeiture cases, but also the forfeiture cases being brought across the country to seize, forfeit, and ultimately liquidate real properties that had been purchased with criminal proceeds. At the Justice Department, we were only responsible for a portion of the forfeitures occurring in this country but certain Justice Department statistics still provide some insight into the scale of the problem. For instance, according to publicly available statistics, in fiscal year 2014, our colleagues at the Justice Department sold more than 450 forfeited or seized properties for more than $92 million.

But where this issue really came to the forefront for me was through the Attorney General's Kleptocracy Asset Recovery Initiative. This initiative, started in 2010 at the Justice Department, focuses on the recovery of corruption proceeds of foreign high-level officials so that corrupt leaders cannot seek safe haven for their stolen wealth in the United States, and that stolen assets are recovered and returned to those victimized by corruption. This initiative is run by a group of talented and dedicated prosecutors in the Asset Forfeiture and Money Laundering Section. Observing their work during my time as Chief of the Section, it again became apparent that the laundering of funds through real estate was a mainstay.

Finally, we fast forward to the present, or at least the last three years since I have had the honor as serving as the Director of FinCEN. My current position has provided me with yet another vantage point to observe the same problems.

Through our analysis of BSA reporting and other information, FinCEN continues to see the use of shell companies by international corrupt politicians, drug traffickers, and other criminals to purchase luxury residential real estate in cash. A shell company is an entity that is formed for the purpose of holding property or funds and does not itself engage in any significant business activities. Our information shows funds transfers in the form of wire transfers originating from banks in offshore havens at which accounts have been established in the name of the shell companies. The criminals will direct an individual involved in the settlement and the closing in the United States to put the deed to the property in the name of the shell company. Thus, the identity of the owner of the property is obfuscated.

The Bank Secrecy Act established anti-money laundering obligations for financial institutions, including institutions involved in real estate transactions. By including these businesses in the BSA's definition of financial institution, Congress acknowledged the potential money laundering and financial crime risks in the real estate industry. In the 2001 USA PATRIOT Act, Congress mandated that FinCEN issue regulations requiring financial institutions to adopt AML programs with minimum requirements or establish exemptions, as appropriate. Since then, FinCEN has implemented AML requirements for certain real estate businesses or established exemptions for others consistent with the BSA.

In the real estate finance area, FinCEN regulatory initiatives established AML requirements for non-bank lenders and originators as well as the government-sponsored entities that issue mortgage-backed securities. We have not issued rules for the broader category of "persons involved in real estate closings and settlements." As a result, real estate purchases that do not involve a mortgage issued by a bank or non-bank lender are not subject to BSA requirements, although such transactions may be covered by criminal money laundering statutes.

FinCEN has considered whether to issue rules for persons involved in real estate closings and settlements. In April 2003, FinCEN issued an advance notice of proposed rulemaking for the category of financial institution to solicit public comment on appropriate AML requirements and who they should cover. The advance notice stated that any rules likely would cover settlement and closing attorneys and agents, appraisers, title search and insurance companies, escrow companies, and possibly mortgage servicers and corporate service providers. Based on comments from the advance notice, FinCEN decided not to move forward until we better identified the money laundering risks and activities involved.

So, even today, FinCEN's task remains: to define the money laundering risks associated with certain persons involved in real estate closings and settlements, and consider appropriate initiatives to address these risks. Outreach and engagement with our regulatory, law enforcement, and real estate industry partners will be an important component of our efforts as we determine if additional AML requirements are needed.

In the meantime, an area of particular focus for FinCEN, Treasury, and the Administration, continues to be our ongoing efforts to seek greater transparency in the area of beneficial ownership of corporate entities. I will discuss this issue in a bit more detail in a few moments and then leave it to our colleagues on the upcoming panel to delve into greater detail. But in short, greater transparency of beneficial ownership information would make it more difficult for criminals to hide their purchases of luxury real estate through the use of shell companies.

Third Party Money Launderers

I also want to share with you today how we are working to address another priority target that threatens the transparency of our financial system: Third party money launderers, which I will refer to as "3PMLs." Some criminal organizations use the services of a complicit third party to obtain access to financial institutions. These 3PMLs, which can include professional gatekeepers such as attorneys, and accountants, knowingly provide financial services to criminals. In addition to providing access to the financial system, these 3PMLs add an aura of legitimacy to criminals using the service.

As FinCEN's recent 311 action regarding Banca Privada d'Andorra (BPA) illustrates, FinCEN will pursue financial institutions that we believe facilitate third-party money laundering activity. We cannot permit institutions and their associated 3PMLs to act as gateways to the U.S. financial system for criminal and other bad actors.

3PMLs use a wide variety of schemes and methods to infiltrate financial institutions. These schemes and methods include using illicit shell and shelf corporations, layering financial transactions, creating and using false documentation, and exerting improper influence on employees in financial institutions or on government officials. Earlier, I described what I meant by a *shell* company. A *shelf* corporation is an entity that is formed and then placed aside for years. The length of time that a shelf corporation has been in existence adds legitimacy to the entity and makes it a prime vehicle for money laundering.

In the case of BPA, FinCEN found that reasonable grounds exist for concluding that several officials of BPA's high-level management in Andorra facilitated financial transactions on behalf of 3PMLs that were providing services to individuals and organizations involved in organized crime, corruption, smuggling, and fraud. In March of this year, FinCEN found that BPA is a foreign financial institution of primary money laundering concern, and issued a companion Notice of Proposed Rulemaking (NPRM). If the NPRM is adopted as a final rule, covered U.S. financial institutions would be prohibited from opening or maintaining correspondent or payable-through accounts for BPA, as well as other foreign banks used to process transactions involving BPA.

Beneficial Ownership

As I conclude today, I wanted to briefly touch on the issue of beneficial ownership as I know it will be discussed further by the next panel. Beneficial ownership information is so important to our efforts to enhance financial transparency, particularly as it relates to the issues we have discussed this morning surrounding money laundering through real estate and third party money launderers.

I have been in government 18 years now, but this is the first policy issue that I have been involved with from start to what I hope is now the finish – from the grassroots level through the near final stages of a rulemaking process. As far back as 10 years ago when I was working as a prosecutor, so many of my very own investigations were stalled by an inability to follow the money. And inevitably shell companies were involved. So when people ask "why beneficial ownership" and "why now?" what I really want to say is "why not 10 years ago?"

We all benefit from a level-playing field that requires all financial institutions to employ reasonable efforts to enhance the integrity of their institutions and the financial system as a whole. As most of you know, in July 2014, FinCEN working closely with its partners in Treasury issued an NPRM to amend existing BSA regulations to help prevent the use of shell and shelf companies to engage in or launder the proceeds of illegal activity in the U.S. financial sector.

As proposed, the rule would clarify and strengthen customer due diligence obligations of banks and other financial institutions, including brokers or dealers in securities, mutual funds, futures commission merchants, and introducing brokers in commodities. The proposed amendments would add a new requirement that these entities know and verify the identities of the real people who own, control, and profit from the companies they service.

So where are we now? The comment period on the CDD NPRM closed in October 2014. We received 126 comments, illustrating the high level of interest in the proposal. Commenters included trade associations, law firms, consulting firms, research institutes, banks, other financial institutions within the scope of the rule and otherwise substantially impacted, federal regulatory agencies, and several concerned individuals.

Some commenters requested greater clarification on questions of scope and key definitions, while others proposed more significant revisions to the rule. Many commenters nonetheless expressed broad thematic support for the rulemaking's underlying purposes. We are now in the process of thoughtfully reviewing, discussing, and considering the issues that were raised by those that commented. This is why there is an NPRM process, so we can gather feedback and consider change. We want to get this right.

Conclusion

Thank you again for allowing me to be a part of your conference for another year. These types of events combining law enforcement, regulators, and industry, are truly my favorite. When we discuss these issues together, and have frank and open dialogue, we all benefit. And while our perspectives may all be a bit different, we all share a common goal and have a collective impact when we are all pulling in the same direction.

And although we still have much to do, collectively we have come a long way. We are motivated in what we do because it's more than just good business; it's more than doing what's best for the bottom line. It is about doing what's right. It's about doing each of our parts to keep illicit actors out of the financial system. When government and industry take on this challenge together, we can and do make a difference.

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