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THE FINANCIAL WAR ON TERRORISM AND THE ADMINISTRATION'S IMPLEMENTATION OF TITLE III OF THE USA PATRIOT ACT

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

SECOND SESSION

ON

THE ADMINISTRATION'S IMPLEMENTATION OF THE ANTI-MONEY LAUNDERING PROVISIONS (TITLE III) OF THE USA PATRIOT ACT (PUBLIC LAW 107–56), AND ITS EFFORTS TO DISRUPT TERRORIST FINANCING ACTIVITIES

JANUARY 29, 2002

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C O N T E N T S

TUESDAY, JANUARY 29, 2002

WITNESSES

ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD

THE FINANCIAL WAR ON TERRORISM AND THE ADMINISTRATION'S IMPLEMENTATION OF TITLE III OF THE USA PATRIOT ACT

TUESDAY, JANUARY 29, 2002

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:10 a.m. in room SD–538 of the Dirksen Senate Office Building, Senator Paul S. Sarbanes (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN PAUL S. SARBANES

Chairman SARBANES. Let me call this hearing to order.

We would ask people in the audience to tighten up a bit. We have a lot of people outside who want to get in. We will try to accommodate as many of them as possible.

The Committee meets today to hear testimony about the financial aspects of the ongoing war on terrorism and about the Administration's implementation of the anti-money laundering provisions of Title III of the USA PATRIOT Act, which was signed into law by the President last October.

We are first going to turn to our Congressional colleagues. Senator Levin is meeting with President Karzai of Afghanistan, who is here with us today on the Hill. We are also going to hear from Senator Grassley, Chairman Oxley, and if he is able to join us, Congressman LaFalce. These colleagues of ours, along with Senator Kerry, made a very forceful and persuasive case for tougher anti-money laundering rules and enforcement over a sustained period of time. I was pleased to work with Chairman Oxley as we put the legislation together last October.

After our Congressional colleagues, we will then hear from a panel from the Administration and I will refrain from introducing them until they come to the table.

The United States and many other countries have been engaged for the last 5 months in what must surely be the most intensive financial investigations that have taken place. To date, the United States has seized or frozen more than $34 million in terrorist-related assets. In, addition, our allies have frozen almost $46 million more. More than 165 persons have been identified as involved in the financing of terrorist activities and the Administration witnesses, in fact, may have more up-to-date figures than the ones I am using, and if so, we urge them to bring them forward. Although the details of the investigations and their methods are classified,

each of the witnesses that we will be hearing from can describe to the Committee how specific approaches or resources have been coordinated and targeted—using the expanded information access which was provided by our legislation, and how our experience thus far will contribute to shaping our continued effort to end money laundering.

A broad strategy for this effort is essential. The United States must lead both by example and by promoting concerted international action. Our goal must be not only to apprehend particular individuals, but also to cut off the pathways in the international financial system, along which terrorists and other criminal elements move money. We must act to make it impossible to create the chains of obscure corporations or partnerships so tangled that not even experienced and dedicated investigators can figure out with certainty who owns what, or where the money trail begins and ends. This effort depends crucially on concerted international action. Even as we build stronger, more effective anti-money laundering programs at home, we must press for comparable programs and for an end to unreasonable "bank secrecy" around the world, offering technical assistance wherever possible, but employing stronger influence where necessary.

Title III of the USA PATRIOT Act constitutes the most extensive updating of our civil anti-money laundering laws since 1970. It means little if it is not promptly and effectively implemented, a formidable task. Under the new law, the Treasury Department, working with the Federal financial regulators and the Department of Justice, must issue a number of new Bank Secrecy Act rules, in many cases, by April of this year. It must also submit important reports to Congress about issues that were deferred last year. These include application of the Bank Secrecy Act to investment companies, especially hedge funds, a subject which was raised by Senators Dodd and Corzine, and its application to underground banking systems, a subject on which Senator Bayh has already held a Subcommittee hearing. At the same time, the agencies must establish the operating programs for training, audit, intelligence analysis, and enforcement, the programs that turn words into realities. Even as a broader strategy is put into place, attention must be focused on such matters as budgets, training, interagency coordination, and allocation of investigative resources. I note that Deputy Secretary Dam announced last week a $3.3 million budget increase for the Financial Crimes Enforcement Network, and we are looking forward today to learning more generally about how the agencies are marshaling the resources to get the job done.

I want to close with a brief comment on the regulatory guidance to be issued by Treasury under Title III. That guidance obviously needs to be carefully drawn to carry through the intent of Congress. I commend Treasury for timeliness in issuing its first set of proposed rules. But I remain concerned about a couple of aspects of those draft rules relating to the ban on U.S. correspondent accounts for foreign shell banks. This rule would still allow a U.S. bank to rely without any due diligence solely on a certification by its foreign customers, even if the bank has reason to doubt the certification. I am frank to say I do not think this is consistent with the statutory language. Also, a provision which was intended to be

a limited exception to the Act could become a broad loophole when, as the rule proposes, a shell bank is permissible so long as a regulated bank owns as little as 25 percent of the shell bank's shares. We hope that Treasury will revisit these issues and the Deputy Secretary may wish to comment on them in his testimony.

With that, I am pleased to turn to the Ranking Member on the Republican side, Senator Gramm, and yield to him for a statement.

STATEMENT OF SENATOR PHIL GRAMM

Senator GRAMM. Mr. Chairman, let me thank you for this hearing. I want to thank our colleagues who are with us today. I want to thank them for their contribution to what I believe is a good bill, one that I am proud of. But, Mr. Chairman, this is your bill and I want to especially thank you.

In the environment that we were in after September 11, the plain truth is that you could have passed any bill you wanted to pass. And that puts you in a position where you had to make a decision as to whether you were going to listen to a broad range of concerns, or whether you were just going to pass a bill.

I want to personally thank you for working with me and with others to be sure that we built in some safeguards for due process into this bill. This is a very good bill. I am proud to have supported it. We have two things in here that are very important, three things if you want to begin with the power of the bill itself.

This bill gives the Treasury Department massive new powers to go in and freeze assets and to begin the process of seizing assets, to do it unilaterally, to do it with no advanced notice because timing is important. Secrecy and action is important in seizing assets. If people know that you are about to seize their assets, they tend to try to move them. But we also require that once they have acted, once they have achieved the goal of the bill, freezing the assets and initiating seizure, that they then have to follow the Administrative Procedures Act in publishing a notice as to why they took the action they did.

This is very important from the point of view of due process because, then, you have a rebuttable presumption out there, so that if people feel that they were treated unjustly, if they feel a mistake was made, then they have the opportunity to go into court where they know why the Treasury took the action it did. And if they can rebut that, they have a basis to counter the Treasury's claim. I think that is vitally important. This bill would have certainly passed without that provision in it and I want to personally thank you for putting it in there. I think it is important.

The second thing that we did which is also very important is that we did not put ourselves in the position of committing ourselves to enforce other countries' currency laws. A great concern I have is that in many countries around the world with oppressive governments, they try to prevent people from getting their assets out of the country. I do not ever want us to be in a position where we could have a situation like we did in Nazi Germany in the 1930's where we could literally, in our efforts to fight terrorism, be in a position of seizing people's money that they are trying to get out of a repressive country.

I think that we have a well-balanced bill here and I do not think anybody can be critical that the bill is not strong enough. This bill is powerful medicine, it also is a bill that tries to be sure that in giving power to law enforcement, we preserve the right for any innocent party that may have been caught up in this process or erroneously targeted, to come back after the fact and have their day in court and have justice. And I think that is very important.

This is a good bill and I am very proud of it. I think it is very important that we monitor the bill and that we follow its enforcement. If in the future there are changes that need to be made, then I think that those are changes that we can look at and make.

Again, I want to thank and to congratulate you.

Chairman SARBANES. Thank you very much, Senator Gramm.

Senator Reed.

COMMENTS OF SENATOR JACK REED

Senator REED. Thank you very much, Mr. Chairman, for holding this hearing. I am eager to hear my colleagues and the witnesses. I will defer any opening statement. I do want to recognize Representatives Oxley and LaFalce. Nice to see you, and of course, Senator Grassley.

Thank you, Mr. Chairman.

Chairman SARBANES. Senator Enzi.

COMMENTS OF SENATOR MICHAEL B. ENZI

Senator ENZI. I look forward to the testimony of the witnesses, Mr. Chairman. I have no statement.

Chairman SARBANES. Senator Stabenow.

STATEMENT OF SENATOR DEBBIE STABENOW

Senator STABENOW. Mr. Chairman, I have a full statement for the record, but I want to make a couple of comments.

I want to welcome my colleagues and former colleagues from the House. It is wonderful to see you. We came together in a bipartisan way and did something historic last year and it shows what can happen when people of goodwill in times like this are willing to work together. I think everyone, rightly so, deserves to be proud.

I want to speak for a moment about an issue that we addressed in the bill. And that is the issue of the concentration accounts loophole. We need to continue to encourage Treasury to do more. I was pleased to offer the amendments that were accepted, strengthening due diligence and making it clear that the Treasury can issue regulations to crack down on the concentration accounts loophole. I remain concerned that we have, in fact, actions moving ahead. We need to make sure that the Treasury is addressing this issue.

Concentration accounts are internal, administrative accounts that financial institutions operate to temporarily aggregate incoming money so that money comes into a pool until those funds can be properly identified and credited to the appropriate account. In the past, there is evidence that some institutions have allowed concentration accounts to serve as a secret conduit for drug monies.

Even as long as 4 years ago, the Federal Reserve raised a red flag about lax concentration accounts protocols in its Sound Practices for Private Banking. However, the Fed issued only guidance

and its warning does not have the impact of a regulation. That is why I hope this will be addressed as we move forward on regulations. Recently, my colleagues, Senator Levin, Senator Grassley, and I, joined together in writing to Treasury Secretary Paul O'Neill urging him to quickly act on this new explicit authority.

I would like to enter that letter into the record, Mr. Chairman, and indicate again, congratulations to everyone who has worked on this bill. I hope that the concentration account issue will be addressed in a forthright manner through regulation by the Treasury Department and hope as we hear from the Secretary, we will hear about his actions in that regard.

Thank you.

Chairman SARBANES. Thank you very much, Senator Stabenow.

And we very much appreciate the way you are continuing to stay very close to this issue. We got a lot done, but that is not to say that there aren't some other things that still need to be addressed, and of course, that is one of the purposes of this hearing.

Senator John Kerry, who has been involved with Senators Levin and Grassley in earlier times on this issue, is chairing another hearing this morning and unable to be with us, but he has submitted a statement for the record and it will be included in the record.

I am now pleased to turn to our colleagues. Senator Grassley, why don't we hear from you first and then we will go to our House colleagues.

STATEMENT OF CHARLES E. GRASSLEY
A U.S. SENATOR FROM THE STATE OF IOWA

Senator GRASSLEY. Well, it is appropriate to thank you for your leadership on getting this very important legislation passed. But I am even happier to hear the strong statement you make about oversight and watching the regulations being written and the strategy being put in place because that follow-through is as important as the legislation itself. And your strong statement should signal to everybody involved in this legislation, particularly those in the private sector, what you intend to do to continue your leadership.

I think people already know that, or you wouldn't have that long line of people waiting to get in here. I thought maybe I was going to the wrong hearing when I came up to this door.

[Laughter.]

But I am glad that there is that kind of interest.

This legislation and what we are doing today is all about going after the bad guys and put out of business now and forever those willfully evil people who are targeting Americans, whether they are terrorists or not. Originally, when we had money laundering legislation, it was to go after the drug traffickers. Now it is traffickers and terrorists. We intend to say to all these evil people, no more holidays, no more free rides.

I understand the Administration, the Congress, the public, and the business community, as well as other countries are committed to helping us shut down Terrorism Incorporated.

I make an admonition that I made in the comments in support of the legislation last fall to the banking community, and I hope it is not unfair to separate them out. Only I do it in a respectful way.

I do it to add to what Senator Gramm said about this being very powerful medicine. But it can even be more powerful medicine.

The extent to which you cannot with our English language put everything down in a perfect way to get everything done that we want done, and even some things that are unanticipated in order to win the war against this very sophisticated people that we call terrorists, I call upon the banking community once again because they are a very closely knit business and profession, although I know they are very competitive.

They understand each other and they know where the problem is and they know how to get at it. I just ask them to go above and beyond the spirit of the law to help us win this war on terrorism, particularly the money laundering that is the war industry, let us say, of terrorism. I hope I will see that spirit as we get into this legislation as we saw it last fall as it was passed. And I think that we will prevail.

I applaud those efforts and commend those engaged on behalf of the good in this fight. There is no easy or royal road that lies before us. Much is expected and much is required of all of us. And I mean all of us, not just bankers when I say that. Our history speaks of our willingness and ability to rise to the challenge. We have our work cut out for us, and I think that we are up to it.

While it is a bit early to expect much in the way of specific implementation of the measures, it is not too soon to check on how things are going, so I have these observations.

The first of these concerns the need for a fully integrated national money laundering strategy. I felt strongly enough about this issue to have worked to pass legislation in the 106th Congress to establish a requirement that our money laundering efforts be coherent, coordinated, and integrated. That was an important goal before September 11, and, in my view, is now more than ever important. That is a law of some standing, and we are now getting ready to see the third strategy required under the law.

I am concerned, then, in this regard, that in the rush to do the many important things that must be done to combat terrorism and drug-trafficking, we are missing something. That something is the integrated, coherent, sustained, strategic thinking and coordinated responses that must be an essential part of what we are about. We expect what we do in the end to make a difference. And in my humble opinion, part of that is the need to be doing strong thinking in this regard. This does not mean some paper exercise in which we publish a strategy and then forget the need for strategic thinking and coordinated responses. I intend to pay close attention to this, to where things stand in regard to the need for such integrated strategic thinking, and I hope that this Committee will also join me to ensure that this is the case.

I have a five-page letter that I am going to send to the Administration on this point, but I do not want to put it in the record because I think they should read it first. But I am following up my remarks with that.

As we go ahead, I also think that it is important to pay attention to a couple of ongoing issues. In particular, I think we need to do some creative thinking on how we and others can address the problem of informal banking networks. Systems such as the hawala and

the Black Market Peso Exchange activities. I also think we need a more sustained look at precious metals markets and the role that they play in money laundering. And we need to improve our efforts in a broader range of financial services, including money orders, stocks and bonds, and money exchange houses.

In conclusion, I say that we also need to look at tax haven regulations and to some extent, we need to look at tax shelters as we deal with other problems facing this Congress as well. And that is under the jurisdiction of our Senate Finance Committee that will be looking into it. I know we need to remain competitive internationally, but we cannot permit money launderers the opportunity to shelter their money at the same time.

Thank you.

Chairman SARBANES. Thank you very much for the statement and even more for the continuing interest that you have indicated.

I saw the Administration people catch their breath when you mentioned the five-page letter.

[Laughter.]

We welcome that contribution to this effort.

Chairman Oxley. And again, let me stress the very close working relationship we had as we harmonized the House and Senate bills in the course of bringing the legislation to a conclusion. We are pleased to have you here today.

Senator GRASSLEY. Mr. Chairman, you will not make me mad if you do not have questions, but if you have questions, I will stay. If you do not, we have the economic stimulus bill on the floor.

Chairman SARBANES. Yes, that is a good point, Chuck. I am glad you mentioned it.

Do any of my colleagues have any questions of Senator Grassley?

[No response.]

Senator GRASSLEY. Thank you very much.

Chairman SARBANES. Thank you for coming.

STATEMENT OF MICHAEL G. OXLEY
A U.S. REPRESENTATIVE IN CONGRESS
FROM THE STATE OF OHIO

Representative OXLEY. Thank you, Mr. Chairman. Let me say, first of all, what a pleasure it was working with you and Senator Gramm on this important legislation. It is really a model of bipartisanship and bicameral legislation that perhaps can set a template for future activities in this area.

I want to particularly thank you for your hospitality during a very difficult time on both sides of the Capitol, where we were unable to use our offices and were able to use your, not particularly spacious, Capitol office. But it worked very well and I think everyone got to know each other very well as a result.

[Laughter.]

Chairman SARBANES. At close quarters.

Representative OXLEY. At close quarters.

[Laughter.]

But the product turned out to be very successful and we are most appreciative. I know I speak for my friend from New York as well in saying that we enjoyed the hospitality there at that critical time.

In the 3 months since we were together in the East Room of the White House to watch President Bush sign the USA PATRIOT Act into law, we have seen a number of successes in the financial war on terrorism. The Bush Administration has pursued an aggressive strategy of blocking and freezing suspected terrorist funds, including closing down hawalas in cities across the country.

I might point out, parenthetically, Mr. Chairman, that the first list that came out of some of these hawala operations, I was surprised and perhaps a little bit stunned to find that two of those operations were in Columbus, Ohio. It did not surprise me that the news came from New York and Chicago and other major cities, but Columbus, Ohio was quite a surprise.

The Administration has also been active on the international front, working with Interpol and other governments to hammer out agreements and protocols that will facilitate greater cooperation on terrorist financing issues.

The Treasury Department and other financial regulators are off to an impressive start in writing the rules to implement the new law. As you know, Mr. Chairman, one of our primary goals in the USA PATRIOT Act was to extend the anti-money laundering regime to segments of the financial services industry that had not previously been fully enlisted in that effort. I was pleased that among the first regulations rolled out by the regulators were rules to apply Suspicious Activity Reporting requirements to securities broker-dealers and so-called "money services businesses." By standardizing regulation and leveling the playing field among different industry groups, we also close possible loopholes that terrorists and other criminals are only too happy to exploit.

I also want to compliment the Administration for its announcement last week that the President's 2003 budget will contain increased funding for the Financial Crimes Enforcement Network—FinCEN—which the USA PATRIOT Act elevated from agency to bureau status, and which has a critical role to play in supporting law enforcement efforts to track and seize terrorist assets.

The financial services industry has been asked to do a lot in the wake of September 11, including responding to a blizzard of requests for information from law enforcement authorities and making significant, and costly, adjustments to internal operating procedures. The industry will be asked to do a lot more as regulatory implementation of the new anti-money laundering provisions gathers speed. This could be one of the financial service industry's finest hours as it rises to the challenge of shutting down the channels used by terrorists. As proud as we are of our legislative achievement, none of us has any illusions that Title III of the USA PATRIOT Act is the last word, or that we can afford to rest on our laurels in the fight against terrorism. The one thing that we can least afford is complacency.

This hearing is the first of what I am sure will be many efforts in both the House and the Senate to exercise rigorous oversight of regulatory implementation of the USA PATRIOT Act to ensure that deadlines are met and Congressional intent is closely followed. We need to know from Treasury what parts of the new law are working well, and what parts are not. And indeed, I am glad to have the Treasury people in the next panel. As ongoing investigations

proceed and additional intelligence is gathered in al Qaeda's former haunts in Afghanistan and elsewhere, we will undoubtedly learn things about the methods that terrorists use to move money through the international financial system that could serve as the basis for future legislative efforts.

Previous investigations suggest that one of the techniques favored by terrorists in financing their operations is credit card fraud. This underscores the importance of the work that Senator Levin and others are doing to determine the potential money laundering vulnerabilities associated with credit cards, which we know are used extensively in Internet gambling and to transact business through unregulated offshore secrecy havens. At a minimum, credit card associations should be required to implement anti-money laundering programs, as mandated for all financial institutions in the USA PATRIOT Act.

Finally, I will be paying particular attention—as I know industry is—to regulatory implementation of the provision in the USA PATRIOT Act requiring financial institutions to verify the identity of those who attempt to open accounts with them. The provision imposes legal obligations not only on financial institutions to verify the identity of account holders, but also on customers to supply institutions with accurate and truthful information.

Let me close by thanking you once again, Chairman Sarbanes, for allowing me to appear this morning. I look forward to working with you and the other Members of this Committee, as well as our Committee, as we rededicate ourselves to the absolutely essential task of starving the terrorists of the funds needed to commit their acts of evil.

Thank you, Mr. Chairman.

Chairman SARBANES. Thank you very much, Chairman Oxley.

Are there any questions for Chairman Oxley before I turn to Congressman LaFalce?

[No response.]

We would be happy to have you stay, Mike, if you want.

Representative OXLEY. I would be glad to stay and listen to my good friend from New York.

Chairman SARBANES. All right. Congressman LaFalce, we are very pleased to have you here and thank you again for all your efforts last fall as we enacted this legislation.

STATEMENT OF JOHN J. LAFALCE
A U.S. REPRESENTATIVE IN CONGRESS
FROM THE STATE OF NEW YORK

Representative LAFALCE. Thank you very much, Chairman Sarbanes, Senators Bayh and Enzi, and former colleagues, some now Senators. Former colleague of the House is an even higher title.

[Laughter.]

It is a pleasure to be before you.

Prior to enactment of the USA PATRIOT Act, successive Treasury Secretaries were limited in their ability to take proactive action on money laundering matters. The Secretary could either issue nonbinding informational advisories to U.S. financial institutions, or take the extreme approach of invoking sweeping and often disruptive economic sanctions. And because both approaches were

impractical, and largely ineffective, neither was invoked with any regularity.

To address this challenge, in the last Congress, I worked closely with the Treasury Department, most especially Stu Eizenstadt, and also with the then-Chairman of the Banking Committee, Jim Leach. We crafted an anti-money laundering bill that would grant the Secretary new, very practical authorities. And our Banking Committee passed bill H.R. 3886, 31 to 1. Congressman Paul opposed it. But it was never allowed to advance to the floor of the House for full House consideration. It was just stopped. We could not even get it to the Rules Committee. To my knowledge, there was no similar bill that was allowed to advance in the Senate. In the beginning of 2001, Senator John Kerry and I introduced a similar bill, hopefully to do more in the 107th Congress. Our legislation created a range of new measures that the Secretary could employ with precision against specific money laundering threats.

We were not able to move it until September 11. And after those very tragic events, the need for stronger, more effective measures became quite clear. As a result of the USA PATRIOT Act, which includes many things, including our legislation, the Treasury Secretary's new, more flexible anti-money laundering powers will enable law enforcement to tackle with much more effectiveness abuses of our financial system by criminals and terrorists.

The Secretary can identify a region, a particular institution, and even a foreign jurisdiction as an area of primary money laundering concern and impose a series of special measures. The Secretary can prohibit certain transactions with certain countries or regions, or require the collection of certain information. This information could be enormously useful in tracking the financial dealings of terrorists, or in blocking the opening of accounts in the United States by banks and other financial institutions from such jurisdictions.

To date, to my knowledge, the Administration has not used those provisions of the new law to declare any parts of the world, through which terrorists funnel their cash, as areas of primary money laundering concern. Now the Administration has stated its success in seizing U.S. assets of terrorist organizations, which we are told now amounts to about $80 million. But it is clear that the more we learn about terrorists' financial networks, and the various countries through which their money passed, the more compelling it becomes for the new measures to be invoked. But according to the information given me from Treasury, the Secretary has not yet imposed a single special measure against those jurisdictions.

In terms of adopting one or all of the special measures under the USA PATRIOT Act, it seems to me that there are many candidates. Reports have surfaced that countries such as Saudi Arabia, Sudan, Egypt, and others have served as conduits and sources for terrorist funds. We must not forget that countries such as Lebanon, Russia, Israel, Guatemala, the Philippines, Hungary, and others have been named by the Financial Action Task Force as noncooperative jurisdictions in the fight against money laundering. The United Arab Emirates, another candidate, recently adopted a good anti-money laundering law, but it remains to be seen whether it is going to be implemented effectively. Clearly, whether it is to fight terrorism, organized crime, or drug trafficking, there are many opportunities

for the Treasury to invoke even the mildest measures under the USA PATRIOT Act.

I am very sensitive to the need to respect U.S. diplomatic prerogatives. I also understand that the Bush Administration may be reluctant to threaten special sanctions against a country that is cooperating with our current efforts to disrupt the financing of al Qaeda and our investigation of the September 11 attacks. However, if countries that are linked to terrorist funding do not adopt permanent reforms now to strengthen their anti-money laundering regimes, and vigorously enforce these laws, then these countries will once again become the terrorists' portal into the global financial system. I hope the Bush Administration proceeds more aggressively in that regard.

Now while the special measure provisions became fully operative October 26, when we were all at the White House with President Bush, Treasury still has to undertake rulemaking in two areas. Section 311 requires the Treasury Secretary to issue two sets of regulations. The first set defining beneficial ownership. And that is needed to implement recordkeeping requirements that are designed to help law enforcement ferret out who owns and controls the funds transferred to U.S. banks and other U.S. financial institutions—not just banks—from jurisdictions with weak financial controls.

The other set of regulations is intended to define the term, correspondent account, for nonbanks. And without this definition, any special measure ordered by the Treasury Secretary would have gaping holes. It would almost apply only to banks, and not other financial institutions, such as broker-dealers and money transmitters. These definitions are needed to fully implement another important section of the USA PATRIOT Act, namely, the Heightened Due Diligence Requirements of Section 312.

I understand that Treasury has been engaged in informal discussions with industry about the regulations. Congress intended that they do exactly that, that they seek the input of industry in crafting these regulations. However, let me issue a caveat. I think this should be a more public and transparent process. I have been in tune with many negotiations with the financial services industry in the past when they have had an agenda that, in my judgment, has not always been in the public interest.

Prior to September 11, they were not the most enthusiastic supporter of the bills that I had advanced. Immediately subsequent to September 11, I noticed a discernible change in attitude. It was a very forthcoming, very cooperative approach. But, as time elapses, I am just concerned about the possibility that they could lapse back to a pre-September 11 attitude. And that is something that Treasury and we, in particular, should be mindful of.

Something else, too. We tend to focus in on banks, but there is a wide range of financial institutions. And I just want to mention one thing in particular. Gambling, and within the context of gambling, Internet gambling. I think this is growing astronomically. We need to have a much better handle on it. The Justice Department is here today. We have an Act dealing with wires that needs better definition. It needs beefing up. It needs much better enforcement. And if we do not deal with that issue, we are going to have

unbelievable money laundering taking place globally via the Internet and Internet gambling sites.

Mr. Chairman, let me just ask unanimous consent to revise and extend my remarks and include the entirety of my testimony at this point.

Chairman SARBANES. We will include the full testimony in the record. Thank you very much, Congressman LaFalce.

We have been joined by Senator Levin, whose hearings a number of years ago on this issue were of immense assistance and also his legislative proposal when we came to deal with this issue. And we are glad he was able to come and be with us.

Are there any questions of Congressman LaFalce, because the House Members may want to excuse themselves?

[No response.]

If not, thank you all very much.

Carl, we will be happy to hear from you.

STATEMENT OF CARL LEVIN
A U.S. SENATOR FROM THE STATE OF MICHIGAN

Senator LEVIN. Thank you, Mr. Chairman, and Members of the Committee.

A great deal of progress has been made in the war on terrorism, and one of the weapons that we now have in our arsenal is some very strong anti-money laundering legislation. Getting money out of the hands of terrorist groups is critically important, just as destroying their training camps, their leadership and destroying al Qaeda and their command structure, taking away the money laundering capabilities that they have had and their sources of revenue, is also critically important.

I want to take my hat off to this Committee, to you, Mr. Chairman, to you, Senator Gramm, and to all the Members of the Committee who really acted with great speed in passing this legislation. If I can pay a special debt of gratitude to Senator Stabenow, my colleague from Michigan, for the special role she played on this Committee. The staff of this Committee also, working under very difficult constraints because of the fact our buildings were closed, were able, through literally night session after night session, to put together a very strong piece of legislation. Indeed, the strongest, toughest new anti-money laundering legislation that we have had in the last 15 years. And I know that Senator Grassley would join me in giving you our special thanks for adopting such a significant portion of the Levin–Grassley legislation, which we had worked on for many months and years, indeed. I just want to focus on one aspect of the bill this morning, and that has to do with its application to the securities industry.

As Congressman LaFalce mentioned, this is not just banks we are talking about. It is financial institutions that are covered by the anti-money laundering legislation.

The focus of our legislation, of course, is on the foreign financial institutions, which carry higher money laundering risks just by the nature of their business. They handle the money of their clients, transfer third-party funds through U.S. securities accounts.

U.S. securities firms have very limited information about these accounts. Businesses and offshore jurisdictions that have corporate

and bank secrecy laws that issue offshore licenses and businesses and jurisdictions that have been designated as noncooperative with international anti-money laundering efforts have even greater risks for us. So that is what the focus of our recent investigation has been. It is the offshore jurisdictions. It is the jurisdictions that have bank secrecy laws, the ones that issue offshore licenses, and it is businesses and jurisdictions that have been designated as noncooperative with international anti-money laundering risks and efforts. What we have done is taken a survey. We have asked 22 securities firms in this country, for information about their accounts.

The preliminary survey information that we have indicates the existence of significant money laundering risks in the securities field. We need the Treasury Department to continue to move very quickly to address these risks and to continue to include the securities industries as well as banks. This is the estimate we have received in the last few months in partial response to our surveys.

Twenty-two firms were sent these surveys. We have asked them for information about their numerous offshore clients. Of the 22 firms, 10 have given us complete responses to their surveys. None of those 10 had less than 300 offshore entities as clients. One of the 10 firms had 16,000 offshore entities as clients. And together, the 10 firms had 45,000 offshore entities as clients.

Now offshore entities, as we know, are these entities which are licensed by governments, usually in the Caribbean, that are not allowed to do business in those jurisdictions that are licensed to only act offshore. And they have a special risk for us for many reasons, money laundering being one, tax haven being another. But our focus has been on the money laundering aspect.

We have just 10 securities firms that have gotten offshore clients, information showing the total of over 45,000 offshore entities as their clients. One of them has 16,000 offshore entities alone. The bottom line is that tens of thousands of offshore entities which are highly vulnerable to money laundering, have accounts at U.S. securities firms.

This survey, also gives us some estimates, about how much money these offshore clients are putting into those securities accounts. Those 45,000 offshore entities at the 10 firms altogether have about $140 billion in assets in those U.S. securities accounts, most of that coming from offshore corporations and trusts, a small amount coming from offshore banks and from offshore insurance companies, but about 95 percent comes from offshore corporations and trusts.

What this preliminary information demonstrates is that the securities industry, like the banking industry, has clear money laundering risks that need to be addressed. The good news is that, as a whole, these high-risk accounts represent only about 2 percent of all accounts. And that means that there is a small enough number of accounts that a focused anti-money laundering effort should be able to monitor the transactions to identity suspicious activity and to alert law enforcement in order that we can put out of business the terrorists or other criminals that are attempting to use our securities accounts to carry out their illegal activities.

That is the preliminary findings of our Subcommittee, Chairman Sarbanes. It shows that the decision of the Congress to include the

securities industry in our legislation was very much on target. We hope the Treasury Department will continue to move promptly. They seem to have been meeting their deadlines to be publishing regulations which look to be appropriate and apt. We hope they continue on that timeline so that we can move as quickly as we believe the terrorists move.

We have to keep ahead of them and that means our anti-money laundering legislation needs to be strictly and promptly enforced. Again, this Committee will have a very critical role in seeing to it that that is done.

Chairman SARBANES. Thank you very much, Senator Levin, and thank you for that very helpful report on the survey which the Subcommittee you Chair and the Committee on Government Affairs has undertaken.

Are there any questions from my colleagues?

[No response.]

Senator LEVIN. I would just ask that the entire statement be made a part of the record.

Chairman SARBANES. The full statement will be included in the record. And we very much appreciate you taking the time to come and be with us this morning.

Senator LEVIN. Thank you.

Chairman SARBANES. Thank you very much.

If the panel would now come forward, we are going to hear from: Kenneth Dam, the Deputy Secretary of the Treasury; Michael Chertoff, the Assistant Attorney General in charge of the Criminal Division of the Department of Justice; Richard Spillenkothen, the Director of the Division of Banking Supervision and Regulation at the Federal Reserve; and Annette Nazareth, who is Director of the Division of Market Regulation of the U.S. Securities and Exchange Commission.

We are running a little behind schedule so I am going to bring everyone to the table. Secretary Dam, I know you have to leave, so we are going to hear from you first, and perhaps Mr. Chertoff, and direct questions to you. And then, I know you have to make an engagement at the White House at noon if I am not mistaken.

We have been joined by Senator Bayh and Senator Miller. I will yield to them for any opening statement they might want to make.

COMMENTS OF SENATOR EVAN BAYH

Senator BAYH. I have no opening statement, Mr. Chairman. But I would like to thank you for what I understand were very positive remarks about the hearing we had on hawala.

Chairman SARBANES. Thank you. It was a very good hearing.

Senator Miller.

COMMENT OF SENATOR ZELL MILLER

Senator MILLER. I have no opening statement.

Chairman SARBANES. All right. Thank you very much.

Secretary Dam, we are very pleased you are here today. We know the important responsibilities that the Treasury has in this matter. We regard it as a good sign that the number-two person at Treasury is here with us this morning.

We would be happy to hear from you.

STATEMENT OF KENNETH W. DAM, DEPUTY SECRETARY
ACCOMPANIED BY: JIMMY GURULÉ
UNDER SECRETARY FOR ENFORCEMENT
U.S. DEPARTMENT OF THE TREASURY

Mr. DAM. Thank you, Chairman Sarbanes, and distinguished Members of this Committee. I have a rather lengthy statement in writing which I would like to submit for the record.

Chairman SARBANES. The full statement will be included in the record.

Mr. DAM. Thank you very much for inviting me to testify about our efforts to disrupt terrorist financing, in particular, the steps we are taking to implement the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. I have asked Under Secretary for Enforcement Jimmy Gurulé to join me here today, perhaps to answer any specific questions which I am not able to answer fully.

On September 24 of this past year, President Bush said that, "We will starve the terrorists of funding." The Treasury Department is determined to help make good on that promise. And I am here today to tell you about the progress that we have made and some of the complexities that we face.

Now, we well recognize that much of our progress is attributable to the efforts of this Committee. After all, you helped give us the Act that we are here to talk about today. That Act and the USA PATRIOT Act, which is now part, have been indispensable to our efforts.

Let me just cite one example which has already been mentioned, and that is the Act requires all financial institutions to have an anti-money laundering program in effect by April. And although many broker-dealers, already had such programs in place, the Act assures that all soon will.

I thank this Committee and I also want to thank the other Federal agencies which have had an important role in implementing the Act and in the financial war on terrorism, more generally. They are the Departments of State, Defense, and Justice, the FBI, and the intelligence community. And also, the National Security Council has been focused on the entire question.

There is the Working-Level Interagency Committee that handles the designations of foreign terrorist organizations and of foreign intermediaries that finance terrorism. We also have a new high-level NSC commission chaired by Treasury which is focusing on the strategy for the future.

There was some talk earlier about the necessity to have a strategic approach and we are trying to follow that advice. There are also other interagency committees that are concerned with the regulations that we have to issue under various provisions of the Act.

Let me talk first about the financial war on terrorism and give you a bit of a status report. Let me make it clear that our priority is to help prevent terrorist attacks by disrupting terrorist finances. Where there is a conflict between preventing terrorist attacks and say the prosecution of criminal cases against terrorists, preventing the attacks comes first. And we are also interested in preventing the attacks not just blocking and seizing money, important as that may be as a tool, but it is only one tool.

In many ways, the financial strategy closely tracks our strategy in what I will call the physical war. We remain focused on finishing off al Qaeda, not just in the Afghanistan area, but throughout the world. We are focusing on not only the al Qaeda operatives, but also on those intermediaries and others who support them financially. We are beginning to focus more and more on other terrorist groups of global reach. And in addition, we are making important efforts to make sure that this is not a U.S.-only unilateral program, unilateral financial war, but it is not just led by the United States, but it is actually a multilateral effort led by a number of nations around the world, and I will talk about that later.

One important question, and I think that this will become more important as we go along, is how should we measure our success? By its very nature, this is the first of a kind, and so we are focusing on making sure that we are making progress. Mr. Chairman, you mentioned blocked assets. That is very important. I have the same numbers you have, although I think we will be increasing those numbers from what I know is going on. But since September 11, the United States and other countries have frozen more than $80 million in terrorist-related assets.

We also have what I would call somewhat qualitative measure, and that is, how well are we doing in the effort to have international cooperation? After all, without cooperation, we really cannot do this. It is a little different from the war on the ground. After all, we cannot bomb a foreign bank account. We absolutely need the assistance of other countries. Foreign governments, as you mentioned, have blocked a good deal of money, over $46 million, which is over half the total of $80 million. That is not surprising because I do not think the al Qaeda, for example, are going to be keeping much money in the United States given our efforts, and 147 countries and jurisdictions around the world have blocking orders in place.

We also have success in multilateral fora, such as the United Nation, which has its own list, the G–7, and the G–20, which have adopted programs, and of course, the Financial Action Task Force, which has been mentioned earlier. As a matter of fact, in October, the United States hosted an extraordinary FATF hearing here in Washington which added to the money laundering program, the 40 recommendations. Also the recommendations in the area of terrorist financing.

Another measure that we are working on is the flow of funds disrupted because that is really what we are getting at. Getting some money is important, but breaking down the flow is what is most important to disruption. And let me just give you one example. We shut down the al Barakaat hawala network, as someone mentioned earlier, and in so doing, we seized $1.9 million in assets. But we disrupted the flow of much more. Our analysts believe that al Barakaat's worldwide network channeled as much as $15 to $20 million to al Qaeda on an annual basis. It is important, therefore, to keep an eye on the flow of funds—how much money moved through a pipeline that we froze—as well as how much money was in the pipeline the day we froze it.

Also, we collect what might be termed as "anecdotal evidence of success" because sometimes it is very revealing. We know from our

intelligence reports that al Qaeda was suffering financially in the Afghanistan battle. We are beginning to see evidence that potential donors are being more cautious about giving money to organizations where the money might end up in the hands of the terrorists because the donors don't want to be tagged with this responsibility.

Obviously, this is closely related to money laundering. And this Committee, of course, is very familiar with the money laundering problem. There are some differences, however. Stopping terrorist financing is perhaps a little more nuanced in some ways than money laundering because you can characterize terrorist financing as "reverse money laundering." In money laundering, the proceeds of crime are laundered for legitimate use or for use in perpetrating more crimes. If you find evidence of the original crime, that may lead you to more other kinds of money laundering. In terrorist finance, in one sense, it is the other way around. Proceeds of legitimate economic activity in that case are used for illicit purposes and the money can come from almost anywhere.

I am going to talk about, for example, charities a bit later. Now just a progress report on some institutional issues of interest to this Committee. We have the Foreign Terrorist Asset Tracking Center, the FTAT, up and running. It is under the direction of the Office of Foreign Assets Control. FTAT was funded by a Congressional appropriation for 2001, and it was being organized and staffed when the attacks occurred. When it is fully operational, which I hope to be quite soon, it will serve as an analytical and strategic center for attacking the problem of terrorist financing. Since September, it has been acting. It has been functioning. It just does not have all of the facilities it needs yet, but will soon. Since September, it has served not only to provide essential analysis of particular targets and networks, but also as an information hub where intelligence and law enforcement agencies can share and analyze information for a common purpose. This kind of interagency concentration on hunting the sources of terrorist financing is unprecedented at the U.S. Government. So while FTAT is still in its infancy, I believe it is making a significant impact and it will make more of an impact in the future.

We also have something called Operation Green Quest, organized to use all of the resources of the Treasury, including the Secret Service, the IRS, forensic accountants, the customs union, which is used to investigating complicated financing schemes to run around our customs efforts. And it is working with the FBI and with other agencies.

Thus far, in the short time it has been up and running, it has accounted for 11 arrests, three indictments, the seizure of nearly $4 million, and bulk cash seizures of over $8.5 million. So it is a promising beginning and I expect important results from it in the future.

We have worked closely with the FBI as well. We, for example, immediately after September 11, put Treasury's people with the FBI's Financial Review Group in order to offer our technical assistance, our special competence, to the FBI, and I am proud of that.

We have a lot more work to do. We want to encourage other countries to independently identify foreign terrorist financing organizations. At the end of September, the European Union did so.

And we need them to work on other terrorist organizations. We want more countries to be involved in this process.

We have to do much more with the documents that we found in Afghanistan, the e-mail, the hard drives and so forth, and that is a big job. That is quite interesting, but we need to make big efforts in that area.

We also have to redouble our efforts in the area of intelligence with other countries to get at the hawala dealers and informal systems, for example, that was mentioned.

Let me just say that some have said that the financial war on terrorism is an impossible task, and I understand why some people say that. Money is fungible and illegal money tends to flow to the country that is most hospitable. So it is not necessary to have a few key financial centers clean. We have to clean up the financial environment throughout the world. And that it is difficult does not mean it is impossible. It is an unconventional war where there are no boundaries, where civilians are the targets and where the people, the so-called martyrs, are themselves the weapons. We also have a situation in which we have electronic money transfers. We have electronic messaging, e-mails, and so forth. They are, in a sense, the logistics of the war against us. We have to recognize that in addition to disrupting the money, there is one other important thing that we can do here. That is that if we can identify the flows of money, we can identify through that the footprint of sleeper cells and disable them and perhaps prevent the next attack.

That is my status report on the financial war on terrorism. Now, I want to come to the other question about the implementation of the Act. We are committed, and I want to assure you, to an aggressive and thorough implementation of the statute.

First, we have been, and will continue to work closely with our sister agencies, with the private sector, which is very important in this case, and with Congress. We have made some progress.

We have issued interim guidance and regulations covering four statutory provisions. And two of those sets of regulations took effect already in December. One is a prohibition against certain U.S. financial institutions maintaining correspondent accounts for foreign shell banks that are indirectly providing services to them, which is Section 313. And the other is the requirement that U.S. financial institutions obtain ownership and registered agent information from foreign banks for which they maintain correspondent accounts, Section 319(b). And then, in addition, on November 20—that was within a month of the passage of the Act—we issued interim guidance, as we call it, explaining the provisions of some other parts of the Act, identifying their scope and providing financial institutions with a form of certification. That is something that we can come back to if you wish, Mr. Chairman, because you mentioned it, that can be utilized to comply with the provisions. We have issued in December some interim guidance on regulatory standards, and—this is 4 months ahead of statutory deadline—we have issued a regulation implementing Section 365 of the Act, which effectively gives FinCEN access to reports filed by nonfinancial trades or businesses when they receive $10,000 or more in cash or currency. Now, we also issued a proposed rule on securities brokers which has been discussed previously. And by the way,

although it did not require the Act, we have also made effective a regulation on money services businesses which includes the hawalas, and there are a number in the United States, but also other organizations that sell money orders and travelers checks and so forth. And you have already mentioned the $3.3 million increase in FinCEN's budget. That is because we are going to have a lot more suspicious activity reports, for example, coming in from all of these new kinds of financial institutions, new in the sense that they newly have to file these SAR's. We have a Suspicious Activity Reporting Hotline which I am very proud of because we do not have to wait around for the paper to come in through the mail, or a fax to come in. We can get it over the hotline from financial institutions, where they see it either cheaper or more convenient to use the hotline or where they recognize that this is something that we should know about right away.

Also, we tried to set for ourselves a series of principles that we want to use in interpreting the statute, drafting the regulations, and generally conducting our end of this war.

First of all, we want to prevent unnecessary regulatory arbitrage. The principle should be that people should not be able to shift from one type of financial institution to another in order to avoid a regulatory scheme or to avoid money laundering controls.

The second principle is that we need to enhance coordination and the information flow, and that is within the Administration, with financial institutions, and from financial institutions. And of course, with the Congress.

The third is that we need to respect important privacy rights. We need to make sure that the reporting that we are requiring is the kind that we need for action, and not just for satisfying our curiosity, if I might characterize it that way.

The fourth principle is that we also need to use this legislation to protect our financial system.

In addition to principles, we have set some priorities. We need over the next 3 months because of the need to implement by April, which has been mentioned, to have implementation provisions addressing Section 314 on information sharing among financial institutions, law enforcement, regulatory authorities, of enhancing due diligence provisions under Section 312. Methods for identifying and confirming the identity of foreign nations under 326. Minimum requirements for anti-money laundering compliance programs, provisions on the role of the IRS in the Administration of the Bank Secrecy Act, which is Section 357. Methods for improving compliance with the obligation to report foreign bank accounts, which is Section 361. And some more, Section 313, 319–B, 365.

There are some other provisions that do not have an April deadline, but we are working on them now and will be addressing them more formally. The authority of the Secretary to designate primary money laundering concerns, I think that was mentioned earlier and impose special measures. That is Section 311. Also, the concentration account issue which is Section 325. Account opening procedures under Section 326. Suspicious activity reporting for futures commission merchants and others in the commodity field under Section 356. We also want to look at the exemptions. Some of those exemptions need to be broadened, not narrowed, because they are

possibly broadened. We are going to look at that because they are burdensome, but they are done by organizations which are not a terrorist threat, and I may be able to say a few words about that later if you are interested.

Then there are some other areas that I needn't address now.

In short, just to summarize, Mr. Chairman, this is a long-term battle against abuse of our financial systems and by many other kinds of criminal organizations. But the new focus has to be on terrorist financing.

Treasury welcomes the ability to lead and we will continue to lead on the financial front of this war, and we are going to work closely with other agencies. And I want to assure you that, although we had to learn a little bit to get along with people we had not dealt with all that much in the past, the cooperation has really improving.

We need to broaden and deepen our international cooperation with other countries, with supernational and international organizations. And of course, we have to move ahead on implementation of the Act. So, we are ready for this effort and we really appreciate your support. The foundation that the statute gives us to do what we need to do.

That concludes my formal testimony.

Chairman SARBANES. Thank you very much.

I say to my colleagues, I think what we are going to do here now, if Mr. Chertoff can stay on, Mr. Dam is going to have to go. We are going to have a vote scheduled at 11:30 a.m., if they stick to the schedule. So, I intend that we should now question Mr. Dam.

Mr. Chertoff, are you able to stay on?

Mr. CHERTOFF. I am, Mr. Chairman.

Chairman SARBANES. So that is not a problem. Why don't we do that? Each of us can ask Mr. Dam a question or two and try at least to have that opportunity before the vote interferes. I do not know whether Mr. Gurulé will be able to stay behind after Mr. Dam leaves.

Mr. GURULÉ. If you would like, I would be happy to stay, Chairman Sarbanes.

Chairman SARBANES. You can clean up the scene if it is necessary.

[Laughter.]

When do you think you will have the whole regulatory framework into place? I know you are now required under the statute to have some by April. Others you said you are working on. Under the best circumstances, when will we have the whole regulatory framework into place?

Mr. DAM. Well, I certainly think by the end of the year, but I hope we can do it before that because it is very important.

Some of the provisions require extensive consultation, not only with other departments, but also with industry, so we can learn a little bit more about the industry practice and make sure we are asking things that we can get straight answers to.

There are also, as Senator Gramm has suggested, some issues which raise problems about overburdening people. In fact, perhaps they verge on the area of civil liberties. But we are going to be very

careful what we do because we want to do it right. So it is a top priority for us.

Chairman SARBANES. All right. Obviously, it is a matter we intend to follow very closely, both to get it into place as quickly as possible, and then to review its workings once it is in place.

Are you considering using the authorities Congress granted to the Treasury to invoke special measures against jurisdictions of primary money laundering concern?

Mr. DAM. Yes, sir, we are. And that is one of the areas where we need to do some work because some of the provisions, some of the terms, for example, do not have definitions. That is not a complaint, because you had to work very quickly. But we want to make sure that the definitions are broad enough to do the job and not so broad that they bring in the information and impose burdens that are not necessary.

Chairman SARBANES. Of course, if those jurisdictions move to, in effect, put into place their own statutory arrangements, as some countries have done, and then implement them, they no longer would be a prospective target as a possible jurisdiction of primary money laundering concern. Is that correct?

Mr. DAM. Mr. Gurulé, I believe, can give a better answer to that.

Mr. GURULÉ. I think, Mr. Chairman, that you are referring to the FATF list of the noncooperative countries and territories. And certainly with respect to the special measures provision, we are looking at that provision and applying it, considering using it with respect to, whether it would be appropriate to use it, these 19 countries that are on that list.

The ultimate goal and objective, however, with respect to the FATF process, is to ensure that these countries are cooperating, that they are in compliance with the recommendations that FATF has made for establishing a strong anti-money laundering regime.

If we can accomplish that through the FATF process, we intend to do so. If special measures will assist us in accomplishing that objective, we are certainly open to using 311 for that purpose.

Mr. DAM. Excuse me, Mr. Chairman.

Chairman SARBANES. Go ahead.

Mr. DAM. When it gets to terrorist money, we are not held back by any of the dates that are in the FATF process. We can act immediately and we have acted against at least one country that I can think of, for accounts in their country, even though they are going through the FATF process and are not getting compliance.

Chairman SARBANES. Senator Gramm.

Senator GRAMM. Thank you, Mr. Chairman.

Ken, let me just ask a couple of questions and then make a couple of points.

First, in looking at the bill, and you have had it long enough to look at it, if not to implement, do you believe in this bill you have the powers you need to do the job you need to do?

Mr. DAM. Yes, sir, I do. But if we find we do not have sufficient power, we will certainly be back to you. Moreover, if something has to be brought, and it probably would be in that area, and we would like a little broader authority, possibly. But at this point, we do not have anything to propose.

Senator GRAMM. Well, let me just emphasize two points. First of all, I think promoting a multilateral approach is vitally important.

When we get into these things, it is always easy to assume that actions have tremendous benefits and no cost. But at the margin, you want to push these things to the point where the benefits and the costs are equal. The more countries we have participating, the more uniform in the developed world especially that you have standards, the less likely you are to move investment accounts and bank accounts based on differential regulatory costs, and I think that is important.

The final point I would like to make is that it seems to me that judgment is going to be very important here. And that is, making a judgment as to where strict enforcement is going to yield the high return. And it gets back to costs and benefits.

In listening to Carl talk about accounts at security firms, if a French insurance company has an account with Merrill Lynch that it does trading with, and it does not want to be known for doing the trading—perhaps it is concerned that one of its competitors in France will say, they are collecting French insurance premiums and they are investing in the United States. And don't we want people investing here? Or maybe some politician might make a crusade in saying that, this company is not investing in France. We could be creating jobs here.

We have to exercise some judgment in looking at these things and deciding the areas where you are never going to have a strong enough law and you are never going to have enough money to proctor each and every account and each and every transaction.

The question is going to be figuring out where you put in your efforts. Like duck hunting. You go the Eastern Shore of Maryland, you do not go to the desert. It is not that there are no ducks in the desert. It is just that there are very few of them. Hunting them there is not productive.

[Laughter.]

And what I want to be sure in implementing this law is that you use the parts intensively that help you get the job done, that you do not feel like you have to use resources in areas that you do not feel are productive. I hope you will work with us, keep us informed, and try to put the focus where it yields a return. I think that is vitally important.

Mr. DAM. I certainly agree with that philosophy. We have to keep our eye on the ball. And it is urgent, in the terrorist area, particularly, that we move because the consequences affect us whether terrorist attacks occur or not. It is one of the reasons that we need to work with the industry.

For example, I have heard, and I do not have any direct knowledge of this, but there is some question of what exactly is a correspondent account in the securities area. And that is something that we want to get right, not just make the definition as broad as possible to cover up our lack of understanding of some of these arrangements. We want to work with industry to be sure we understand what their practices are and that we are attacking the important things.

Chairman SARBANES. Senator Reed.

Senator REED. Thank you, Mr. Chairman. And thank you, Mr. Secretary, for your testimony. I agree with the point you made and the point that Senator Gramm just emphasized, the need for international cooperation.

I would suspect that our strongest leverage is on American financial institutions. And one of the responsibilities is to know their customers much better. In that regard, could you give us some sense of how you feel that process is going, whether our institutions are being more careful about who they deal with?

And second, do you think there is adequate, both legal and regulatory, incentives to report suspicions promptly to authorities if there is some suspicion about a customer dealing with an American institution?

Mr. DAM. There are a number of provisions in the Act which deal with the question of some kinds of customers. Obviously, the prohibitions with regard to shell companies. There are the special due diligence requirements, Section 312, and the regulations are due in April on those.

There is Section 326 on customer identification requirement. If you would like, we could perhaps give you a more coherent answer to that in writing than I am able to come up with on the spur of the moment.

Senator REED. That is entirely fair, Mr. Secretary.

Well, if this system works as we hope it does, that our financial institutions are looking closely at people who they deal with overseas and they discover, at least they have suspicions, do we have the adequate incentives and regulatory structure so that those suspicions will be translated quickly to the authorities?

Mr. DAM. Right. Well, in your first question, as you originally stated, would have to do with the suspicious activity reports. In some areas, organizations, even before they are required to, before the regulations become final, have been sending in the suspicious activity reports.

But for those who are reluctant, the fact is that the reports are mandatory. This is quite important, I would think, to a regulated financial institution to not go too close to the cliff in interpreting that mandatory requirement because there are legal consequences.

Senator REED. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman SARBANES. Senator Bayh.

Senator BAYH. Thank you, Mr. Chairman. I would like to thank all of our panelists for being here today.

Mr. Dam, I have three brief items. I am not going to ask you about them, but if I could ask your staff to follow up with my staff on, I would be interested in the responses. Two have to do with the money service businesses. I will just refer to them as hawala, which I think you know, I have a special interest in.

The Act that we passed require that the money service businesses begin to register by December 31 of last year and that they begin to file suspicious activity reports no later than the spring.

I am just interested in how that is progressing. In fact, there has been a pretty good rate of compliance with regard to the December 31 date, and how are we doing on making progress toward them filing suspicious activity reports?

Related to that, since a lot of these are, for lack of a better term, "mom-and-pop" type of operations, what kind of outreach have we engaged in to try and spread the word so they know about the provisions of the Act, that they need to register and begin to file it?

If your staff can follow up with my office, I would be interested in that. Also, in the final point of interest, and I will get to my question, the report Treasury was supposed to put together on hawala, what other steps might be necessary? I would be interested in the status report of that and just when we could expect to maybe see some drafts or that kind of thing.

My two brief questions, Mr. Secretary, relate to the use of—and you alluded to it in your remarks and I think you have spoken to it at greater length in your prepared testimony—charities or development institutions and through them, nongovernmental organizations, as possible conduits for funds to terrorist organizations.

If I had to look out beyond the horizon, I would anticipate that this might be an area of growing interest. I am just curious, and if you could just elaborate a little bit in terms of what the scope of this problem has been, what we are doing about it, where you would anticipate going from here?

Mr. DAM. I am delighted to be able to talk about that. By the way, on the money service businesses with the hawalas, we must have done something to get the word out because in the first 2 weeks, 8,500 registered. But who knows how big the universe is? But we will be back to you on that.

Senator BAYH. Yes.

Mr. DAM. With regard to charities, we are talking largely now about charities in Islamic countries or that involve charitable work in those countries. Of course, the same thing is true of other kinds of charities in the sense that it has been my observation even in the United States that some charities are not closely looked after by their boards and sometimes the staff has their own private agenda.

Generally speaking, this is not a situation that is special to terrorism. But in the terrorism area, it is serious. Many of these Middle Eastern charities, for example, do great charitable work, no question about it. I know that from my prior experience in the State Department that much of the support for the Palestinian community comes from Islamic charities. They support hospitals and they support orphanages and so forth.

Senator BAYH. Forgive me for interrupting, but there were a couple of them that you identified that were providing some assistance to Hammas, I believe, or attempting to.

Mr. DAM. Absolutely. We have moved against several charities, including their offices in the United States.

Now the problem is that, in many cases, the staff also has another operation, a clandestine operation, out the back door, so to speak, supporting terrorism. And that is why we have to work on this and we have to work on it with the host countries.

We have to be sure that the donors are aware of this problem because, in many cases, the donors really do not know. In some cases they do, or maybe some of them do not want to know because they are accustomed to paying what I would call protection money.

We think that the directors who just volunteered their names may want to take a look more carefully now, and we also think in many cases, the governments do not want those kinds of organizations in their country and are taking steps to clean them up.

So it is our strategy to work on all of those angles, as well as just designating the charity.

Senator BAYH. Thank you, Mr. Secretary. I appreciate that. This is an interest of mine and I am going to continue to correspond with you about it. I appreciate your good work and I would like to thank the rest of the panel.

Chairman SARBANES. Senator Miller.

Senator MILLER. I will be quick. I know we have a vote going on. This is a follow-up to what Senator Gramm asked you about the law being adequate. I wanted to ask you, do you think that the personnel are adequate? I am not talking about their ability but about the number. For example, you talked about the SAR's coming in on the hotline. Do you have enough analysts to give the proper amount of analysis that they need?

Mr. DAM. We certainly have gone through a budget process and I think the new budget is our best judgment about how to trade off the desire everyone has for more. And I am not just talking now about FinCEN, the Financial Crimes Enforcement Network, which receives the SAR's, but all of the entire apparatus that we have devoted to this problem.

And we try to bring other groups in under the existing budget. I mentioned the Secret Service, the IRS, the Customs Bureau, to work on the kinds of problems that we have that utilize the SAR's.

With regard to FinCEN itself there were substantial increases in the past. So while some people might not think that 6 percent is all that much, you have to remember, it is on a basis of an increase of some 26 percent in the past couple of years in FinCEN. It is our judgment that should be adequate. But if it is not, we would certainly consider it a priority and we will put it in the next budget if we need to.

Senator MILLER. When a country gets put on the FATF, how hard do they work to get off of it?

Mr. DAM. My impression is that they make very strenuous efforts. In many cases, it is not so easy to get off because they need the right kind of statute. They need the right kinds of regulations, and their people need the right kind of training.

Some of these countries are quite small. We are talking about countries with less than 100,000 in population. And even some of the larger ones are only 4 to 5 million. They do not have an enormous number of financially experienced regulatory personnel. We are working on those problems, and for such problems provide technical assistance. We have several organizations in the U.S. Government that are providing technical assistance and we are putting more focus on how to coordinate that and in getting our embassies involved in the coordination process.

That is a very brief status report.

Senator MILLER. Thank you, sir.

Thank you, Mr. Chairman.

Chairman SARBANES. Good. We have tiny countries and tens of billions of dollars moving through those countries. That is going to be a focus of attention for a long time now.

Senator Corzine, there is enough time for you to go ahead and do a questioning period.

COMMENTS OF SENATOR JON S. CORZINE

Senator CORZINE. I will be very quick. One of the sub-elements of the USA PATRIOT Act was investment company activity and more specifically, hedge funds. If we ever needed an example of how money can be moved without people fully understanding who the owner is or what it is, or its intent, I think we have a visible example on the front pages of the papers for the last few weeks, really reflecting private partnership that move money. I hope Treasury will work with the other appropriate agencies with regard to looking at how foreign transfers of money can be utilizing an unregulated element.

You speak about the SAR's among securities brokers and banks. I think this is one of those places, not where I want to paint the industry with a broad brush, but if you were looking for means of moving money in an unregulated arena, not unlike the hawalas that Senator Bayh talked about. This is certainly one of those areas where large chunks of cash can be moved around. Could you just give me a quick posting? And I would be happy to sit down with your people.

Mr. DAM. We welcome your interest in this, Senator Corzine. I know you are very interested in this. As a matter of fact, you have the attention of the industry because in at least one case, we heard from somebody very knowledgeable about the industry.

Under Section 356, we are required to file a report, and we are working on that. It is not due until October 26, but perhaps, we certainly can work with you before the report is finished to tell you what we know.

We also have been meeting with other kinds of financial organizations besides hedge funds because there are other kinds of investment companies. Mutual funds, for example, are involved in 356 and venture capital funds as well.

And also, under Section 326, which is a customer identification section, it is possible that we can address the hedge fund issue under the existing legislation. But this is an area that I mentioned before when I was asked, do we need more authority?

Because they are not regulated financial institutions, we have to learn a lot. And we do not want to try to regulate every financial institution in the world just because they are out there, but we want to know what we are doing and we are giving a lot of attention to the question of investment companies.

Senator CORZINE. There might be other reasons for excess leverage or heavy leverage and its implication on the financial system apart from the element of the ability to use them as a vehicle that is outside the regulatory net for most purposes, and can be significant as we have seen, through citings in the mid-1970's to 1998 to maybe even recently.

Mr. DAM. One of the things we are doing, and it is related to some of these organizations—I would not say hedge funds in par-

ticular—is we are working aggressively to increase the number of agreements that we have with countries in the tax information exchange agreements.

And we have just signed agreements with the Cayman Islands. You have heard of them in this context. The Bahamas, Antigua and Barbados, and there are more in the pipeline.

Senator CORZINE. Is there progress in the Gulf States?

Mr. DAM. I can speak to that, but I would like to give you some information in writing on that, if I may. There has been great progress with the Gulf States in the terrorist financing area. But in this particular area, I am not able to address that out of my own personal knowledge.

I view this as a question of cleaning up the financial environment so that we do not have jurisdictions which create a climate that lends itself to terrorist financing in particular.

Senator CORZINE. I totally agree. Thank you.

Chairman SARBANES. We are going to have to adjourn because we have a vote. We will excuse you, Secretary Dam, so you can stick to your schedule, and I will return.

Mr. Gurulé, I think if you could stay on, that would be helpful.

Mr. GURULÉ. I am happy to do so, Mr. Chairman.

Chairman SARBANES. Secretary Dam, as you are departing, let me underscore how closely we intend to monitor this situation. I have a concern about the agreements with the Cayman Islands and the Bahamas because they give, I think it is 3 or 4 years, like a grace period in there, and a lot of mischief can happen during that period of time.

The others I hope you would take back with you and look again at these concerns that I read in my opening statement, about the U.S. correspondent accounts for foreign shell banks, and that we are not in a posture of relying solely on the certification by the foreign customers without undertaking a due diligence process. I think that is extremely important.

And the other is the 25 percent ownership of shell bank shares in terms of a regulated bank being permissible. It seems to me to be very low and open up again opportunities for a lot of mischief.

But we will interact with you and Treasury over these issues in the coming days. Thank you very much for coming. We appreciate your testimony, and we look forward to continuing to work closely with Treasury as you move ahead.

We will return very shortly and resume the hearing.

Mr. DAM. Thank you, Mr. Chairman.

Chairman SARBANES. The hearing stands in recess.

[Recess.]

Chairman SARBANES. The hearing will resume.

Mr. Chertoff, we would be happy to hear from you.

STATEMENT OF MICHAEL CHERTOFF
ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION
U.S. DEPARTMENT OF JUSTICE

Mr. CHERTOFF. Thank you, Mr. Chairman.

It is a pleasure to appear before the Committee to address our progress on the financial front of the ongoing war on terrorism. I have a longer statement which I would request be included.

Chairman SARBANES. We will include the full statement in the record.

Mr. CHERTOFF. I will just give you a summary of that statement now and, of course, I will be happy to answer questions.

What I would like to focus on is our efforts to fight the financial front of the war on terrorism, as well as what we have been doing to implement the authorities set forth in the USA PATRIOT Act, Title III, relating to money laundering.

At the outset, I would like to thank the Members of the Committee and Congress for their prompt response to the terrorist threat posed to the United States. The USA PATRIOT Act provided those of us whose mission it is to protect the people of the United States with a wide array of new measures that will enhance our ability to deal with both financial and other dimensions of terrorism. We welcome the new authority granted by the Act, thank this Committee, and look forward to using our new powers in a vigorous but responsible manner.

Mr. Chairman, let me turn first to the issue of the financial aspects of our anti-terrorism initiative. And while, of course, I am not at liberty to get into information that is protected by grand jury or other elements of confidentiality that govern criminal investigations, I can nevertheless provide a list of areas in which the Department of Justice, working with other agencies, and with our partners abroad, has been making headway in dealing with the issue of terrorist financing.

Within a matter of days after September 11, the Department and the FBI established what we call the Financial Review Group, which is an interagency task force including many components of the Treasury, the intelligence community, as well as the FBI itself, investigating terrorist financing and operating out of FBI headquarters. And the idea here was simply to gather, to vacuum in all kinds of financial information—transactions, travel data, telephone records—and bring them into a centralized database that would allow us to manipulate and analyze the information to develop leads and begin to put together investigative cases.

By collecting the information in one central depository, we now have and are accumulating a central focus for forensic analysis. At the same time that we established the Financial Review Group, the Department also created a Terrorist Financing Task Force which is composed of prosecutors who are dedicated to working with the FRG specifically to develop terrorist financing cases, particularly with an emphasis on nongovernment organizations and charities that may be providing financial aid for terrorist activity.

And again, the point of the task force was this. The financial trail is important in doing all of our terrorist cases. But we wanted to make sure that we had people who were specifically focused on the issue of terrorist financing and who would be looking to make cases against nongovernmental organizations or charities that are providing some of the money that aids and abets terrorism.

Finally, the another piece of our effort here is to link the Terrorist Financing Task Force and the FRG with the individual U.S. Attorney's offices in the 94 districts, each of which have been mandated to set up anti-terrorism task forces which network in State

and local law enforcement officials, as well as the various Federal agencies in the field.

So, we have all of this network to bring together. And I am pleased to say that we have made some very substantial progress in tracing financing as it relates not only to the September 11 attacks, but also more broadly, to the al Qaeda and other terrorist organizations.

Through financial information, for example, we have established how the hijackers of September 11 received their money, how and where they were trained, where they lived, and perhaps most significantly, the names and whereabouts of persons with whom they worked and with whom they came into contact.

The efforts of the FRG, the Terrorist Financing Task Force, and the ATTF's, have resulted in targeted law enforcement actions that are at the heart of the Administration's assault on terrorism. For example, my most recent information tells me that we have, through the FRG, put together a centralized terrorist financial database which includes transaction details from over 90,000 documents, that we have coordinated and assisted in the financial investigations of over 250 individuals and groups who are suspects of FBI terrorist investigations. The group has catalogued and reviewed approximately 271,000 financial documents and has analyzed over 61,000 financial transactions from over 90 foreign banks. So, we have this tremendous pool of information which is growing and which we are now able to make use of.

To get into a couple of specific cases, on November 7, 2001, the Attorney General announced a nationwide enforcement action in conjunction with Treasury against the al Barakaat money-transfer network, which included coordinated arrests and the execution of search warrants in Massachusetts, Virginia, and Ohio. And of course, these actions were teamed up with Treasury's execution of blocking actions against al Barakaat-related entities in Georgia, Minnesota, and Washington State.

In addition to this coordinated shutdown, we are currently prosecuting the principals of al Barakaat's Boston branch for operating an unlicensed money transmitting business that caused the transfer of over $3 million to banks in the United Arab Emirates. On November 14, 2001, both Liban Hussein, President of al Barakaat, and his brother, Mohamed Hussein, were indicted for violations of Title 18, U.S.C. § 1960, arising out of this unlawful operation.

More recently, on December 4, 2001, the President, along with the Attorney General and the Secretary of the Treasury, announced the designation and blocking action against the Texas-based charity known as the Holy Land Foundation, which was alleged to be a North American front for the terrorist organization, Hamas. This, of course, emphasizes that our fight against terrorist financing extends beyond al Qaeda to other organizations as well.

There is another aspect of what we are doing in terrorist financing that I think is promising. We are using computers to analyze information that we are gathering through this effort to uncover patterns of behavior that, before the advent of this new kind of technology, we might not have been able to reconstruct. And I am told that they call this data mining and predictive technology. Through this technology, which uses algorithms and other kinds of

analytical techniques, we seek to identify patterns that could lead us to locate other potential terrorists and terrorism networks. This is a technology which I gather has been previously used by the business community probably to telemarket and things of that sort. But it comes in very handy here.

For example, we have reason to believe that terrorists have long utilized identity theft and Social Security number fraud to help them obtain employment and access to secure locations. They have used these documents to obtain driver's licenses, hazardous material licenses, bank and credit accounts through which terrorism financing flows.

The Utah ATTF, under the leadership of the U.S. attorney out there, recently undertook a computerized data verification operation using data mining that uncovered fraud committed by some 60 persons who were employed in sensitive locations throughout the Salt Lake City International Airport. And of course, locating these people and focusing on them and removing them is an important part of the Attorney General's stated goal of using law enforcement techniques to prevent potential threats to our national security. So that is something which we are going to continue to do.

Chairman SARBANES. And those are people who obtained Social Security numbers and used them in a fraudulent manner. Is that correct?

Mr. CHERTOFF. Correct.

Chairman SARBANES. And then they built everything else off of that. Is that correct?

Mr. CHERTOFF. That is correct. And though we are not accusing them of being terrorists, what we have been able to do, using the predictive technology, is identify them as lawbreakers, recognize they are in sensitive locations, and then prosecute them for the violations of law.

Chairman SARBANES. Well, I commend you on that. And it sends a very powerful message that people can engage in this deceit and deception. In the end, they get documents that appear to be legitimate. But they are all based off of a phony premise. Correct?

Mr. CHERTOFF. That is absolutely correct. And of course, we saw that with respect to the driver's licenses, which played a role in the September 11 episode.

Chairman SARBANES. Right.

Mr. CHERTOFF. So, we are going to be continuing in this data mining and predictive effort. We are also working closely with Treasury and international agencies as well.

Let me now just turn very briefly to our use of the new USA PATRIOT Act authorities. We have already started to deploy some of these new legal weapons. For example, the new civil forfeiture authority provided in the USA PATRIOT Act, which is codified at 18 U.S.C. 981(a)(1)(G), was used in November by the U.S. Attorney's Office for the District in New Jersey, to obtain nine seizure warrants for bank accounts that had been used by some of the terrorists who were involved in September 11. And of course, this was something that we could not have done under the old law. Notice of the proposed forfeiture of these accounts has been made and, not surprisingly, no one has stepped forward to claim an interest in the money in those accounts.

We also have used Section 319 of the USA PATRIOT Act, which allows us to forfeit monies held in a correspondent account of a foreign bank where the person against whom we seek the forfeiture has deposited money in the foreign branch of that bank. We recently used Section 319 of the USA PATRIOT Act to recover almost $1.7 million in funds from the perpetrator of a fraud scheme, which we can use to compensate his victims. As you know, Mr. Chairman, Section 319 gave us a tool that we had not previously had to reach those who take their ill-gotten gains and deposit them abroad out of the reach of U.S. justice.

Because there was money in the correspondent bank account of the bank which held the deposits, we used the new tool to regain money for the victims. And this will be important not only for fraud, but also for terrorism as well.

We are, of course, working on how to implement the other authorities. Congress granted us a very important tool in the ability to use subpoena power against correspondent bank accounts of foreign banks. We are working now to delegate the authority to use that tool and I am anticipating that we will be using it in our terrorist cases going forward.

I would like to conclude, Mr. Chairman, by again expressing the appreciation of the Department for your support and the support of the Committee in our anti-money laundering and anti-terrorist financing initiatives.

I appreciate the opportunity to appear and I am happy to answer questions.

Chairman SARBANES. We are very pleased to have you. I would be remiss if I did not also once again state for the record the tremendous help that you were as we tried to formulate the legislation and move it through, and we appreciated your strong support. And, indeed, Mr. Gurulé, your efforts in that regard as well.

I am going to go ahead and take the testimony of the other two witnesses, and then I may have just a few questions.

Mr. Spillenkothen, we would be happy to hear from you.

STATEMENT OF RICHARD SPILLENKOTHEN, DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. SPILLENKOTHEN. Thank you, Mr. Chairman. We submitted an extended statement, but I will make some summary comments.

Chairman SARBANES. If you get that microphone a little closer to you, I think it will work a little better.

Mr. SPILLENKOTHEN. I am extremely pleased to be here to discuss the Federal Reserve's work in implementing the USA PATRIOT Act and our efforts to help law enforcement track terrorist financing activities.

Last November 26, the Board issued a supervisory letter concerning the USA PATRIOT Act to all domestic and foreign banking organizations under its supervision. The letter described the provisions of the Act, highlighted those that should receive the banks' and supervisors' immediate attention, and described new rules that would be issued under the Act.

As you all are aware, and as has been discussed here today, the primary responsibility for issuing these regulations rests with

Treasury. However, at the request of Treasury staff and consistent with statutory requirements for consultation, the Federal Reserve has been actively assisting the Treasury Department. Treasury has established 20 working groups for different regulatory projects required by the USA PATRIOT Act and the Federal Reserve is involved in 15 of these groups.

As the USA PATRIOT Act effective dates have approached and proposed rules have been issued, the Federal Reserve is making certain that banking organizations are aware of the new requirements and that they are taking reasonable steps to comply. We are doing this through the bank examination process, the process that is going to be significantly revised and enhanced in the Federal Reserve System as a result of the USA PATRIOT Act.

The Federal Reserve believes that banking organizations and their employees are the first and strongest line of defense against financial crimes and, in particular, money laundering.

With respect to terrorism, we are working with law enforcement, as discussed today, and the industry to see whether there are any specific indicators, red flags, of terrorist money laundering that may be distinguishable from money laundering from corruption and drugs. This effort will be crucial not only for law enforcement to identify suspects, but also for supervisors to determine if there is a way in the future for potential suspicious activity related to terrorism to be detected proactively.

Shortly after September 11, the FBI sought our assistance in circulating to banks a list of suspected terrorists. Within 24 hours of that request, the Federal Reserve and the other Federal banking agencies disseminated the list to virtually every banking organization in the country.

Beginning in the middle of September and running through October of last year, the proliferation of various requests continued as banks received increasingly longer lists from a variety of law enforcement sources, both domestically and abroad. To alleviate the burden of searching for names on these multiple lists, many of which were duplicative, the FBI and the other law enforcement agencies prepared a unified Control List to supersede the other lists. To ensure that the broadest number of financial institutions received this Control List, it was agreed that e-mail would be the most efficient and expeditious method of distribution. The Federal Reserve and the other Federal banking supervisors issued a joint agency request explaining this system to almost 20,000 financial institutions and then proceeded to circulate the list.

The Federal Reserve has also provided the Control List to the Basel Committee for circulation among its member countries, primarily the G–10 countries. In addition, we provided the Control List to over a dozen other central banks around the world.

Finally, I can report that starting on September 17 of last year, the New York Reserve Bank, at the request of law enforcement and pursuant to subpoenas, began searching the records of Fedwire, the Federal Reserve's large dollar electronic payment system, for any information related to the terrorist acts. Search results have been provided to various law enforcement agencies, which have reported to us that the information we provided has been useful to their ongoing law enforcement investigations.

In addition, multiagency teams led by various U.S. Government agencies have been deployed to foreign countries to analyze bank and other financial records. On several of these occasions, senior Reserve Bank examiners have traveled abroad and worked with these teams.

So in the wake of the terrorist attacks, the FBI, as mentioned previously, formed the Financial Review Group, a multiagency law enforcement task force to trace transactions and assist in seizing assets of terrorists and their supporters here and abroad. Recognizing the particular expertise that bank supervisors can bring to these investigations, and regulators' and supervisors' facility with bank records, representatives from the Federal Reserve participated in these efforts. Our staff regularly participates in the Financial Review Group's efforts.

All of the actions I have described underscores the Federal Reserve's strong commitment to the bank regulatory community's anti-money laundering and anti-terrorism mission. We will continue our cooperative efforts with Congress, the banking industry, the other bank supervisors and securities industry supervisors, and the international community to develop and implement effective programs addressing the ever-changing strategies of terrorists and other criminals who attempt to launder funds through banking organizations both here and abroad.

The Federal Reserve will also continue to lend our expertise to the U.S. law enforcement community anywhere in the world when it seeks to track or intercept terrorist funds.

Thank you.

Chairman SARBANES. Thank you very much.

Ms. Nazareth is the Director of the Division of Market Regulation for the Securities and Exchange Commission. We would be happy to hear from you.

STATEMENT OF ANNETTE L. NAZARETH
DIRECTOR, DIVISION OF MARKET REGULATION
U.S. SECURITIES AND EXCHANGE COMMISSION

Ms. NAZARETH. Thank you, Chairman Sarbanes.

I am pleased to appear before you today to testify on behalf of the Securities and Exchange Commission concerning the steps the Commission has taken to assist in the financial aspects of U.S. anti-terrorism initiatives, and the implementation of the USA PATRIOT Act.

My appearance before you today comes during a period of close intergovernmental cooperation to implement the USA PATRIOT Act's new mandates in the fight against money laundering and terrorism. Chairman Pitt has made clear the Commission's full partnership in these efforts. Within hours of the September 11 attacks, the Commission and its staff began the process of identifying and executing the steps we could effectively take in this collaborative effort. The enactment of the USA PATRIOT Act further strengthened this process.

I will first address the SEC's contributions to the financial aspects of the Government's anti-terrorism efforts that respond most directly to questions raised by the attacks. There are two key components to this work.

First, on September 12, 2001, the staff of the Division of Enforcement commenced a review of certain trading activity preceding the terrorist attacks of September 11. Working with the surveillance staff of the U.S. securities self-regulatory organizations, Commission staff reviewed trading activity in over 125 individual securities and index products. The results of this inquiry have been, and continue to be, shared with criminal law enforcement authorities.

Second, we have supported the effective use of the Control List of individuals or entities identified by the Federal Bureau of Investigation and other law enforcement agencies. At the request of the Department of Justice, the Commission issued a release to enlist the voluntary review by securities-related entities of the Control List to identify name matches with accounts at each institution. To date, nearly 1,800 entities have agreed to conduct such reviews.

The Commission is an active participant in working groups, led by the Department of the Treasury, that were established to help implement the USA PATRIOT Act. Regulatory implementation of the USA PATRIOT Act is proceeding in a timely fashion. New regulations, either proposed or soon-to-be proposed, should provide appropriate tools to deny money launderers and terrorists the use of the Nation's financial institutions to launder the proceeds of crime for profit, or for the furtherance of their criminal activities, including terrorism.

One important tool is the proposed suspicious activity reporting rule for broker-dealers. Treasury proposed this rule on December 20, after close consultation with Commission staff. This proposal will require broker-dealers to file with the Government reports of suspected illegal activity through their firms.

The proposed rule focuses broker-dealers on the money laundering risks stemming from their client-base and on the types of business in which they engage. This risk-based approach to identifying and to reporting suspicious transactions should empower broker-dealers to focus their SAR detection and reporting resources appropriately.

As the Committee knows, broker-dealers affiliated with banks have already long been subject to the bank regulators' SAR rules. Other broker-dealers have filed SAR's on a voluntary basis. We believe that this rulemaking proposal completes the process of assuring that all broker-dealers report possible money laundering.

We are also working with the other members of the working groups, including the bank regulators, the Commodity Futures Trading Commission, the Department of Justice, and the Internal Revenue Service to move forward with the full complement of rules called for under the USA PATRIOT Act.

For example, on December 19, Treasury issued a proposed rule to implement the USA PATRIOT Act's new prohibition against providing correspondent accounts to foreign shell banks that are not affiliated with a supervised bank.

Other forthcoming rulemaking projects should complement the shell bank proposal. In particular, interagency discussions are underway concerning the identification of customers at account opening and due diligence policies for correspondent and private banking accounts.

The USA PATRIOT Act also requires financial institutions to establish anti-money laundering programs by April 24, 2002. In order to implement this provision effectively, the NASDR and the New York Stock Exchange developed a rule that was fully vetted through the Section 352 interagency working group. We expect the NASDR to file this proposed rule for Commission consideration shortly. A companion rule is scheduled to be considered by the New York Stock Exchange Board in February. These proposals will, when completed, enable frontline examiners for broker-dealers, as part of their ongoing responsibilities, to examine and enforce this key provision of the USA PATRIOT Act.

The Commission is continuing in other ways to focus its attention, and the securities industry's attention, on money laundering. The Bank Secrecy Act provisions that are applicable to broker-dealers have been included in our examination program for decades. Also, we have long had an open dialogue with the Securities Industry Association-affiliated group of senior broker-dealer compliance officials who meet to share anti-money laundering approaches with one another, and with the Government.

A current, broader Commission examination initiative was announced in May 2001. Commission staff, along with the staff from the New York Stock Exchange and the NASD, began conducting a series of comprehensive risk-based anti-money laundering examinations to assess industry practices for anti-money laundering compliance. The ongoing examinations are helping to shape our understanding of existing practices at all types of firms, and of how they should be strengthened.

The SEC staff also has been working with Treasury and the private sector to address the application of the Bank Secrecy Act and anti-money laundering programs to investment companies registered with the Commission under the Investment Company Act of 1940.

I am heartened to be able to provide the Committee with so many examples of action taken since the adoption of the USA PATRIOT Act. Together, the regulators and the industry have made substantial progress on some difficult issues in a short period of time. On behalf of the Commission, I appreciate the opportunity to participate in this hearing. We look forward to continuing to share our views with this Committee, the Treasury, and other participants in the implementation of the USA PATRIOT Act.

Thank you.

Chairman SARBANES. Thank you all very much. They have called another vote, so I will ask some questions very quickly before I draw the hearing to a close.

First of all, is the SEC cooperating with other national securities regulators in the money laundering fight? You talked about, I think you said, intragovernmental cooperation and you have all spoken about within our own Government. What is the SEC doing with relationship to comparable agencies in other countries?

Ms. NAZARETH. The SEC is active in a number of international initiatives, including through IOSCO. We participate in a lot of the FATF initiatives. I personally am a member of the Financial Stability Forum that has taken an active interest in international

money laundering and the problems with offshore centers. So, we have had our focus on the international arena as well.

Chairman SARBANES. And I take it that is true of the Federal Reserve coordinating with other central banks as well. Is that right?

Mr. SPILLENKOTHEN. Yes, sir, that is true.

Chairman SARBANES. Now this formulation of these regulations, how is that being done? Is there a standing interagency group that is putting together the regulations?

Mr. GURULÉ. Yes, Mr. Chairman. In fact, at the Treasury Department, right after the USA PATRIOT Act was signed into law, the general counsel took charge of the implementation process, working closely with staff from the Treasury's enforcement office. And several working groups were established with respect to each provision, so that we would have a team of experts.

Chairman SARBANES. Is the Justice Department part of that process?

Mr. GURULÉ. Justice has been involved in the process as well. We have been working very closely with Justice.

Mr. CHERTOFF. That is correct.

Chairman SARBANES. Now, we want the consultation. Does the consultation noticeably slow up getting the regulations into place?

Mr. GURULÉ. I do not think that it does. We have been on a very short timeline with respect to action items and deadlines to accomplish these action items.

The cooperation that we have received from the Department of Justice has been excellent. I believe that is the reason that we are on track with respect to the implemention of regulations for these provisions.

Chairman SARBANES. One of the provisions in that legislation was about sharing information about specific individuals, the financial institutions, where there was reason for concern.

I gather from what is being said here today, that there have been quite extensive lists that have been developed by law enforcement and then have been moved along by the financial regulators to institutions. Is that correct?

Mr. GURULÉ. Again, it is my understanding that the cooperation is going well, that we are on the right track in terms of the timeline to get this implemented, and good progress is being made.

I am very pleased and encouraged by the progress to date. I do not see any major issues to implementing these regulations in a timely fashion.

Chairman SARBANES. You are the ones who send the lists on to the private institutions?

Mr. SPILLENKOTHEN. Right. Our experience has been that the information was in the hands of the private-sector banks in a very timely way and that they have run these lists to see if they have transactions or relationships with these individuals, and have informed law enforcement when they have found information to suggest that they have.

Chairman SARBANES. Ms. Nazareth.

Ms. NAZARETH. Our experience was equally positive. In fact, when the requests first went out to the brokerage firms, as you all know, a number of the brokerage firms were themselves very adversely affected by the events of September 11, and notwith-

standing that the requests were going to compliance people in firms who had themselves been affected and were not able to operate out of their offices, they nevertheless undertook extensive efforts in a very timely fashion to check the control lists and to report back on any activity that they thought should be reported.

Chairman SARBANES. Do you think that a correspondent account for foreign shell banks, that a U.S. bank should be able to rely simply on the certification by its foreign customers or that it should exercise some due diligence in that regard?

Mr. GURULÉ. I think with respect to the Section 313, that it is important that Section be read in conjunction with Section 312. As you know, Section 312 is a provision that requires due diligence. For example, where the particular correspondent account involves a foreign bank, and the license has been issued by a country that is on the noncooperative countries and territories list.

I think that, in such a case, there would be a requirement of filing additional reports under these due diligence requirements. If it turned out that information uncovered that perhaps the bank had not been accurate or forthcoming in identifying its status as a shell bank, then that information could ultimately lead to Section 311 special measures taken under that provision. I think that it is important that we look at Section 313 and read it in conjunction with Sections 312 and 311.

Chairman SARBANES. We intend to monitor this very closely. We want to be very careful that the regulations as they are put in place do not contain in them some opening that is then exploited and, in effect, results in undermining the whole system. That is why I am worried also about the 25 percent on the shell bank shares. But we will come back to that.

I am going to yield now to Senator Corzine because I know he has been here for a while. Let me just make this point.

We do not think that the statute is the be-all and end-all. We understand that there may be further statutory adjustments that need to be made. Are you all looking at that as well, as you seek to put the statute into place, whether, as you go through this process, whether you see something and say, you know, if we really could have a modification or an addition here, it would really help us in this effort?

Mr. CHERTOFF. We are, Mr. Chairman. And I have to agree with what Secretary Dam said just before the adjournment.

One of the things we want to be careful about is, as we run it out into practice, to make sure that we do not have unintended asymmetries where, by moving from one regulatory scheme to another, you can get a lesser degree of coverage. I think we are all mindful of that as we deploy these new powers.

Chairman SARBANES. Well, we will be in constant touch with you. But to the extent that you can identify additional changes that need to be made in the fine-tuning of the law, we are very anxious to get those recommendations from you.

Senator Corzine.

Senator CORZINE. Thank you, Mr. Chairman. Just two quick questions, one general and one specific.

Implementation sounds as if it is moving in a positive direction and cooperation is in place. Once you implement, there is a collection of an unbelievable amount of data, I suspect.

Practically speaking, are the means in place to be able to use the data? Sometimes we take false comfort from rules and regulations without the ability to implement. That is the first question.

The second is more toward Ms. Nazareth. Without revealing any specifics, are there indications that some of the insider trading, the manipulative trading, or advanced trading that was talked about in the press prior to September 11, are there indications that that was a reality, without trying to get at any kind of specifics.

Thank you. First, if any of you could comment on it, but I am concerned about those that have to use that data.

Mr. GURULÉ. Well, certainly with respect to resources, we feel that we have sufficient resources at this point in time to implement the provisions of the USA PATRIOT Act.

FinCEN's budget, as Secretary Dam indicated, was increased for 2003, since 2001 was increased approximately 25 percent. So in that area, we feel confident that we can get the job done. Having said that, certainly, if we find in the process of implementing these provisions that we need additional resources, manpower, so to speak, to get the job done——

Senator CORZINE. Do you feel confident that, with all the suspicious activity reports, you will be able to look at those and draw the kinds of conclusions that are necessary to protect the public?

Mr. GURULÉ. At this point, yes. But, again, I reserve the right that if we find that we need additional resources, we are certainly prepared to come back and request the support that we need to get the job done. The key here is to get the job done and we are committed to doing that.

Mr. CHERTOFF. Senator, I basically can echo that. We received enhanced resources in the most recent budget. As you know, the FBI is in the process now again of redeploying some of its resources and we anticipate that will give us what we need. Of course, if that turns out to be incorrect, we will not be bashful.

But I also think it is important that we are trying to use some of the new technologies in terms of interpreting and analyzing the data. These technologies include data mining and some of the algorithms in use in the private practice, which enable firms to combine and recombine data to connect and find patterns that might not be discernible to the human eye.

We are starting to take advantage of these techniques. My hope is that by using these computerized techniques, we can actually multiply our ability to make use of the information that we are collecting.

Mr. SPILLENKOTHEN. At the Federal Reserve, we are galvanizing our existing resources and also expanding the people we have to provide oversight to the reserve banks and the implementation effort of the USA PATRIOT Act.

As a routine part of our examination process, we have long had instructions to our examiners to review SAR's filed by individual institutions before we conduct on-site examinations.

We have a procedure for doing that. And we also are going to be expanding our resources to develop and draft regulations and new

guidelines, exam procedures, and training for the new requirements under the USA PATRIOT Act.

Senator CORZINE. Ms. Nazareth, can you comment on the second question?

Ms. NAZARETH. The Commission has not publicly stated what the results of its examination were, so I do not feel prepared to do that at this time.

We did share all of the information that we had with the criminal authorities and obviously, they have a much larger picture of all the activities, so it is really for them to take the information and determine how it all fits together.

Senator CORZINE. Thank you.

Chairman SARBANES. We want to thank the panel very much. You have been enormously helpful. And we look forward to staying in close touch with you as we continue to work on this matter.

The hearing stands adjourned.

[Whereupon, at 12:40 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied for the record follow:]

PREPARED STATEMENT OF SENATOR PAUL S. SARBANES

The Committee meets today in its oversight capacity. It will hear testimony about the financial aspects of the ongoing war on terrorism and about the Administration's implementation of the anti-money laundering provisions of Title III of the USA PATRIOT Act, which was signed into law by the President on October 26, 2001.

I am especially pleased to turn first to Senators Levin and Grassley. Along with Senator Kerry, they were the first witnesses to appear before this Committee, two weeks after the September 11 tragedy, to make the case forcefully and persuasively for tougher anti-money laundering rules and enforcement. Senator Kerry is chairing another hearing this morning, but he has submitted a statement for the record. I am also pleased to welcome Chairman Oxley and Ranking Member LaFalce of the House Financial Services Committee, who led the effort in the House last October; we worked closely together to craft the final version of Title III.

After our Congressional colleagues, our witnesses are Kenneth W. Dam, the Deputy Secretary of the Treasury; Michael Chertoff, the Assistant Attorney General of the Criminal Division of the Department of Justice; Richard Spillenkothen, Director of the Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve Board; and Annette L. Nazareth, Director of the Division of Market Regulation of the U.S. Securities and Exchange Commission.

The United States and many other countries have been engaged for the last 5 months in what must surely be the most intensive financial investigations in history. To date, the United States has seized or has frozen more than $34 million in terrorist-related assets, and our allies have frozen almost $46 million more. More than 165 persons have been identified as involved in the financing of terrorist activities. Although the details of the investigations and their methods are classified, each of the witnesses can describe to the Committee how specific approaches or resources have been coordinated and targeted—using the expanded information access granted by the USA PATRIOT Act, and how our experience thus far will contribute to shaping our continuing effort to end money laundering.

A broad strategy for this effort is essential. The United States must lead both by example and by promoting concerted international action. Our goal must be not only to apprehend particular individuals, but also to cut off the pathways in the international financial system along which terrorist and other criminal money moves. We must act to make it impossible to create the chains of obscure corporations, trusts, or partnerships so tangled that not even experienced and dedicated investigators can figure out with certainty who owns what, or where the money trail begins and ends. This effort depends crucially on concerted international action. Even as we build stronger, more effective anti-money laundering programs at home, we must press for comparable programs and for an end to unreasonable "bank secrecy" around the world, offering technical assistance wherever possible, but employing stronger measures where necessary.

Title III of the USA PATRIOT Act constitutes the most extensive updating of our civil anti-money laundering laws since 1970. But it means little if it is not promptly and effectively implemented, and implementation is a formidable task. Under the new law the Treasury Department, working with the Federal financial regulators and the Department of Justice, must issue a number of new Bank Secrecy Act rules, in many cases by April 2002. It must also submit several important reports to Congress about issues that were deferred last year. These include application of the Bank Secrecy Act to investment companies, especially hedge funds, a subject raised by Senators Dodd and Corzine, and its application to underground banking systems, a subject on which Senator Bayh has already held a Subcommittee hearing. At the same time the agencies must establish the operating programs—for training, audit, intelligence analysis, and enforcement—that turn words into realities. Even as the broader strategy is put in place, attention must be focused on such matters as budgets, training, interagency coordination, and allocation of investigative resources. I note that Deputy Secretary Dam announced last week a $3.3 million budget increase for the Financial Crimes Enforcement Network, and we are looking forward to learning today more generally about how the agencies are marshaling their resources to get the job done.

I want to close with a brief comment on the regulatory guidance to be issued by Treasury under Title III. That guidance must be carefully drawn to reflect accurately the intent of Congress. While I commend Treasury for timeliness in issuing its first sets of proposed rules, I remain concerned about the draft rules relating to the ban on U.S. correspondent accounts for foreign shell banks. This rule would permit a U.S. bank to rely without any due diligence solely on a certification by its foreign customers, even if the bank has reason to doubt the certification, which in my view is not consistent with the statutory language, with other BSA rules, or

with general guidance for banks provided by the Basel Committee on Banking Supervision. In addition, what was intended in my opinion to be a limited exception in the USA PATRIOT Act becomes a broad loophole when, as the rule proposes, a shell bank is permissible so long as a regulated bank owns as little as 25 percent of the shell bank's shares. I would hope that Treasury will revisit these issues.

I look forward to hearing from our witnesses.

PREPARED STATEMENT OF SENATOR DEBBIE STABENOW

Thank you, Mr. Chairman. I am glad that you have called this hearing.

The legislation that this Committee considered shortly after the September 11 attacks and that was ultimately incorporated into the USA PATRIOT Act of 2001 was profoundly important and truly historic.

As you have noted, it brings a new level of scrutiny to money laundering activities. And, we should acknowledge the hard work of so many of our colleagues. We are fortunate today to be joined by a few key leaders on the subject.

I would like to welcome the senior Senator from my home State, Senator Carl Levin, whose thorough investigations on this subject are well-known by all of us here and are deeply appreciated. I would also like to welcome Senator Grassley and the leaders of the House Financial Services Committee: Chairman Oxley and Ranking Member LaFalce.

The final legislation that we reported out of this Committee is a demonstration of what is possible when we join together in a spirit of cooperation in the best interests of the country.

I am happy that we were able to incorporate important amendments that I offered to the bill. In particular, I am glad that we have enacted strong "due diligence" requirements and that we have clarified the ability of the Treasury to issue regulations to crack down on the "concentration accounts loophole." The concentration accounts loophole is a serious concern of mine and I want to take a moment to highlight the subject. As all of us know, concentration accounts are internal, administrative accounts that financial institutions operate to temporarily aggregate incoming monies until those funds can be properly identified and credited to an appropriate account. In the past, there is evidence that some institutions have allowed concentration accounts to serve as a secret conduit for drug monies. This has been such a problem that, over 4 years ago, the Federal Reserve raised a red flag about lax concentration account protocols in its Sound Practices for Private Banking. However, the Fed issued only guidance and its warning does not have the impact of a regulation. That is why I felt it was so important for us to address this loophole with a regulation.

Recently, my colleagues, Senators Levin and Grassley, joined me in writing to Treasury Secretary Paul O'Neill. We urged him to act quickly on his new explicit authority.

In the aftermath of September 11, Senators Levin, Grassley, and I remain concerned about drug money laundering, but also are newly concerned that terrorists might seek to use the concentration accounts loophole to hide transfers of money among terrorist operatives around the world.

I hope that our witnesses appearing before us today from Treasury will be able to update us on the preparation that the Department is doing so that they may proceed with a proposed concentration accounts rule.

I think it would be very unfortunate for the Administration not to move forward with their new explicit authority. We all realize that the war against terrorism is going to be a prolonged struggle. The decisive steps that this Committee, the entire Congress, and the Administration have taken show that we are completely committed to stopping the flow of terrorist money, eradicating terrorism, and protecting our families both abroad and on our own soil.

I look forward to hearing from our witnesses today about how the new law is being implemented. Thank you, Mr. Chairman.

PREPARED STATEMENT OF SENATOR EVAN BAYH

Chairman Sarbanes, thank you for holding today's oversight hearing on our recently enacted International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001. It is important to hold such a hearing early in the implementation process, so that we can ensure that any regulatory actions taken accurately

reflect the legislation that we passed. I would also like to welcome today's witnesses, and thank them for their efforts in this financial war on terrorism.

In the past, consultation and coordination among the agencies charged with fighting the financial war on terrorist organizations was not effective. The 2001 Act addressed that problem and provided the Administration with the weapons it needs to successfully fight the war. In fact, the legislation has resulted in the United States seizing more than $34 million in terrorist related assets, and our allies seizing $46 million more. That fact is very important, because no criminal syndicate—whether it is organized crime, a drug cartel, or terrorist cells—can survive without extensive financing.

Nor can a war be fought and won without adequate resources. For that reason, I was pleased to hear Deputy Secretary Dam's announcement last week that the Administration will be requesting a $3.3 million increase for FinCEN's budget to $52.3 million. This is of special interest to me because the Deputy Secretary indicated that the budget increase would specifically go toward implementation and enforcement of the money service business regulations—which include hawala. I look forward to your testimony, Deputy Secretary, and to hearing an update on the implementation of the money service business regulations.

As I have discussed with Chairman Sarbanes, I intend to hold a hearing in my Subcommittee—the International Trade and Finance Subcommittee—on another terrorist financing mechanism. That mechanism is the link between al Qaeda and certain charities and nongovernmental organizations.

Just last December, Green Quest announced action to block the assets of three entities that provide financial and material support to the terrorist organization HAMAS—including the Holy Land Foundation for Relief and Development, which raises millions of dollars annually that is used by HAMAS. Holy Land supports HAMAS activities through direct fund transfers to its offices in the West Bank and Gaza that are affiliated with HAMAS and transfers of funds to Islamic charity committees and other charitable organizations that are part of HAMAS or controlled by HAMAS members. Holy Land Foundation funds are used by HAMAS to support schools that serve HAMAS ends by encouraging children to become suicide bombers and to recruit suicide bombers by offering support to their families.

We must continue to aggressively seek out every angle that terrorists use to finance their operations, and make sure that every cent of U.S. aid or charity is going to the people who need it the most in developing countries and not to terrorist groups for training and arms. I hope that you will comment of this issue Deputy Secretary Dam.

Thank you, Chairman Sarbanes, for holding this important hearing, and I look forward to the witnesses' testimony.

PREPARED STATEMENT OF SENATOR JON S. CORZINE

Thank you, Mr. Chairman, for holding this important hearing.

I also want to welcome Senators Kerry, Levin, and Grassley, Chairman Oxley and Congressman LaFalce and the other witnesses who have joined us to testify before the Committee this morning.

Mr. Chairman, I would be remiss if I did not applaud your stewardship in the process that resulted in the passage of the Title III money laundering provisions that were included in the USA PATRIOT Act.

As the President has said on more than one occasion, we must leave no stone unturned in attempting to root out terrorism and the source of terrorist financing. The new authorities granted under this legislation to the Treasury and Justice departments and to other financial regulators and law enforcement communities will do just that.

In light of the September 11 attacks, there is no doubt that the new enemy that we face is not only highly trained and sophisticated in the ways of terrorism—but also very well-financed. We must root out the financial sources of terrorism, including those linked to money laundering and the drug trade, and eliminate them.

Mr. Chairman, while we applauding this effort, we should not consider our work done. What we have seen with Enron is an example of how secrecy and deceit can undermine an entire financial structure. Imagine what that type of offshore anonymity can provide to the terrorist seeking to undermine our democracy. We must ensure that our laws, in protecting our citizens, are not used to protect the identities of those who would see us harmed.

The veil of offshore secrecy that Enron utilized is analogous to the types of financial activities that Senator Dodd and I sought to have looked at by the Treasury,

the SEC, and the Fed with regards to hedge funds and other unregulated money managers.

The report language included in Section 356 of Title III requires our Federal agencies to study the extent to which unregulated financial entities like hedge funds could be used to launder money or finance terrorism. The very nature of these funds, and the anonymity that many of their investors enjoy, necessitate they undergo this scrutiny.

With demand for these types of funds growing, I find it very troubling that we currently lack the ability to ascertain the who, what, and where of many of the individuals who invest in these funds offshore, which is done primarily through private banks and trusts.

The inability to obtain access to beneficial owner information for these types of entities leaves a glaring hole in the security of our financial system, and potentially in our homeland security. That is something that we must not allow to happen.

Thank you, Mr. Chairman.

PREPARED STATEMENT OF CHARLES E. GRASSLEY

A U.S. SENATOR FROM THE STATE OF IOWA

Mr. Chairman, Members of the Committee, I want to thank you for the opportunity to speak this morning on an interest that we all share. This Committee and this Congress passed important legislation last year to deal with terrorist money laundering. Our interest now is about getting down to brass tacks. It is about finding the means and employing those means to go after bad guys. To put out of business now and forever those willfully evil men who have targeted the United States and its citizens. Whether they are terrorists or drug traffickers, what we intend is to ensure no more holidays, no free rides.

I understand that the Administration, this Congress, the public, the business community, and other countries are committed to doing what must be done in shutting down Terrorism Incorporated. It is gratifying to see the spirit, here and abroad, that prevails in this regard. I want to applaud those efforts and to commend those engaged on behalf of good in this fight. There is no easy or royal road that lies before us. Much is expected and much is required of us. Our history speaks of our willingness and ability to rise to challenge. We have our work cut out for us, but we are up to it.

While it is a bit early to expect much in the way of specific implementation of the measures that we passed in the USA PATRIOT Act, it is not too soon to check on how things are going. In this regard, I have a few observations.

The first of these concerns the need for a fully integrated national money laundering strategy. I felt strongly enough about this issue to have worked to pass legislation in the 106th Congress to establish a requirement that our money laundering efforts be coherent, coordinated, and integrated. That was an important goal before September 11, and, in my view, is now more important that ever. That is a law of some standing and we are now getting ready to see the third strategy required under the law.

I am concerned, however, that in the rush to do the many important things that must be done to combat terrorism and drug trafficking, we are missing something. That something is the integrated, coherent, sustained strategic thinking and coordinated responses that must be an essential component of what we are about. We expect what we do to make a difference. And in my humble opinion, part of what we need to be doing is thinking. This does not mean a paper exercise in which we publish a strategy and then forget the need for strategic thinking and coordinated responses. I intend to pay close attention to where things stand in regard to the need for such integrated strategic thinking, and I hope that this Committee will also join me to ensure that this is the case.

As we look ahead, I also think that it is important to pay attention to a couple of on-going issues. In particular, we need to do some creative thinking on how we and others can address the problem of informal banking networks. Systems such as the hawala system and Black Market Peso Exchange activities. I also think we need a more sustained look at precious metals markets and the role that they play in money laundering. And we need to improve our efforts in the broader range of financial services, including money orders, stocks and bonds, and money exchange houses.

We need to think about tax haven regulations to ensure that we remain competitive internationally but do not permit money launderers the opportunity to shelter their money at the same time. These efforts that I have noted will require us to

be diligent and prudent. We need to be sure that we do not regulate ourselves out of our rights; and to ensure our rights do not become the means to take us for a ride. Government and the financial sector need to explore more and better means to cooperate. We need a spirit of cooperation and reasonableness. The challenges ahead have no easy solutions. They inevitably will involve frustration. They require our best thinking, our honest efforts, and a spirit of working to common purpose.

PREPARED STATEMENT OF MICHAEL G. OXLEY

A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF OHIO

Thank you, Chairman Sarbanes, for the invitation to testify this morning, and for holding this important hearing. The anti-money laundering provisions of the USA PATRIOT Act that were enacted last October were a model of bipartisan and bicameral cooperation. I salute you, Mr. Chairman, Senator Gramm, your colleagues on the Committee, and my fellow panelists for a job well done.

In the 3 months since we were together in the East Room of the White House to watch President Bush sign the USA PATRIOT Act into law, we have seen a number of successes in the financial war on terrorism. The Bush Administration has pursued an aggressive strategy of blocking and freezing suspected terrorist funds, including closing down "hawalas" in cities across the country. The Administration has also been active on the international front, working with Interpol and other governments to hammer out agreements and protocols that will facilitate greater cooperation on terrorist financing issues.

The Treasury Department and other financial regulators are off to an impressive start in writing the rules to implement the new law. As you know, Mr. Chairman, one of our primary goals in the USA PATRIOT Act was to extend the anti-money laundering regime to segments of the financial services industry that had not previously been fully enlisted in the effort. I was pleased that among the first regulations rolled out by the regulators were rules to apply Suspicious Activity Reporting requirements to securities broker-dealers and so-called money service businesses. By standardizing regulation and leveling the playing field among different industry groups, we also close possible loopholes that terrorists and other criminals are only too happy to exploit.

I also want to commend the Administration for its announcement last week that the President's 2003 budget will contain increased funding for the Financial Crimes Enforcement Network (FinCEN), which the USA PATRIOT Act has elevated from agency to bureau status, and which has a critical role to play in supporting law enforcement efforts to track and seize terrorist assets.

The financial services industry has been asked to do a lot in the wake of September 11, including responding to a blizzard of requests for information from law enforcement authorities and making significant (and costly) adjustments to internal operating procedures. The industry will be asked to do a lot more as regulatory implementation of the new anti-money laundering provisions gathers speed. This could be one of the financial services industry's finest hours, as it rises to the challenge of shutting down the channels used by terrorists.

As proud as we are of our legislative achievement, none of us has any illusions that Title III of the USA PATRIOT Act is the last word, or that we can afford to rest on our laurels in the fight against terrorism. The one thing we can least afford is complacency.

This hearing is the first of what I am sure will be many efforts in both the House and Senate to exercise rigorous oversight of regulatory implementation of the USA PATRIOT Act, to ensure that deadlines are met and Congressional intent is followed. We need to know from Treasury what parts of the new law are working well, and what parts are not. As ongoing investigations proceed and additional intelligence is gathered in al Qaeda's former haunts in Afghanistan and elsewhere, we will undoubtedly learn things about the methods that terrorists use to move money through the international financial system that could serve as the basis for future legislative efforts.

Previous investigations suggest that one of the techniques favored by terrorists in financing their operations is credit card fraud. This underscores the importance of the work that Senator Levin and others are doing to determine the potential money laundering vulnerabilities associated with credit cards, which we know are used extensively in Internet gambling and to transact business through unregulated offshore secrecy havens. At a minimum, credit card associations should be required to implement anti-money laundering programs, as mandated for all financial institutions in the USA PATRIOT Act.

Finally, I will be paying particular attention—as I know industry is—to regulatory implementation of the provision in the USA PATRIOT Act requiring financial institutions to verify the identity of those who attempt to open accounts with them. The provision imposes legal obligations not only on financial institutions to verify the identity of accountholders, but also on customers to supply institutions with accurate, truthful information.

Let me close by thanking you once again, Chairman Sarbanes, for allowing me to appear this morning. I look forward to working with you and the other Members of this Committee as we rededicate ourselves to the absolutely essential task of starving the terrorists of the funds needed to commit their acts of evil.

PREPARED STATEMENT OF JOHN J. LAFALCE

A U.S. REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Chairman Sarbanes, Senator Gramm, and Members of the Committee, I appreciate the opportunity to appear before the Committee today to discuss the Administration's approach to the financial war on terrorism, as well as the progress made in implementing the financial provisions of the USA PATRIOT Act.

I am pleased to be at the witness table in the company of Senators Levin, Grassley, and Chairman Mike Oxley of the House Financial Services Committee, on which I serve as Ranking Member. All of us came together last year at a crucial time in our Nation's history, and in the wake of the most egregious acts of terrorism ever on U.S. soil, to enact far-reaching and meaningful anti-money laundering laws. Today, we examine the progress made thus far in implementing the new powers granted to the law enforcement and intelligence agencies under the USA PATRIOT Act. My testimony today will address the following:

- First, the Bush Administration's efforts to capitalize on provisions in the USA PATRIOT Act that help the United States identify and target areas of primary money laundering concern around the world; these special measures are designed to strengthen anti-money laundering controls in jurisdictions with inadequate or nonexistent anti-money laundering regimes.
- Second, the need to strengthen international cooperation to root out terrorists' infiltration of offshore secrecy havens, and the world's financial system.
- Third, the Treasury Department's progress in issuing regulations that will have the effect of preventing U.S. financial institutions from doing business with terrorists, terrorist organizations, and their fronts.

Strengthening Global Regulation

Prior to enactment of the USA PATRIOT Act, successive Treasury Secretaries were limited in their ability to take proactive action on money laundering matters. The Secretary could either issue nonbinding informational advisories to U.S. financial institutions, or take the extreme approach of invoking sweeping, and often disruptive, economic sanctions. Because both approaches were impractical—and largely ineffective—neither was invoked with any regularity.

To address this challenge, the Clinton Administration's Treasury and I crafted legislation in the 106th Congress to grant the Secretary new, more practical authorities. The House Banking Committee passed this bill, H.R. 3886, on a vote of 31 to 1, but it was never allowed to advance to full House consideration. In March 2001, Senator Kerry and I both introduced a similar bill to accomplish this in the 107th Congress. Our legislation created a range of new measures the Secretary could employ with precision against specific money laundering threats.

After the tragic events of September 11, the need for stronger, more effective measures became quite clear. As a result of the USA PATRIOT Act, which includes our legislation, the Treasury Secretary's new, more flexible anti-money laundering powers will enable law enforcement to tackle with much more effectiveness abuses of our financial system by terrorists and criminals.

Under the USA PATRIOT Act, the Secretary can identify a region, a particular institution, and even a foreign jurisdiction as an area of primary money laundering concern and impose a series of special measures. The Secretary can prohibit certain transactions with certain countries or regions, or require the collection of certain information. This information could be enormously useful in tracking the financial dealings of terrorists, or in blocking the opening of accounts in the United States by banks and other financial institutions from such jurisdictions.

To date, the Administration has not used the new law, to my knowledge, to declare any parts of the world, through which terrorists funneled their cash, as areas of primary money laundering concern. To be sure, the Administration has touted its

success in seizing the U.S. assets of terrorist organizations, which we are told now amount to nearly $80 million. But it is clear that the more we learn about terrorists' financial networks, and the various countries through which their money passed, the more compelling it becomes for the new measures to be invoked. But according to the Treasury Department, the Secretary has not yet imposed a single special measure against these jurisdictions. Not one.

In terms of adopting a special measure under the USA PATRIOT Act, it seems to me that many candidates exist. Reports have surfaced that countries such as Saudi Arabia, Sudan, Egypt, and others have served as conduits and sources for terrorist funds. And we must not forget that countries such as Lebanon, Russia, Israel, Guatemala, the Philippines, Hungary, and others have been named by the Financial Action Task Force as noncooperative jurisdictions in the fight against money laundering. The United Arab Emirates, which has been linked to al Qaeda funding, recently adopted anti-money laundering laws, but it remains to be seen whether it will be enforced effectively. Clearly, whether it is to fight terrorism, organized crime, or drug trafficking, there are many opportunities for the Treasury to invoke even the mildest measures under the USA PATRIOT Act.

I am very sensitive to the need to respect U.S. diplomatic prerogatives. I also understand that the Bush Administration may be reluctant to threaten special sanctions against a country that is cooperating with our current efforts to disrupt the financing of al Qaeda and our investigation of the September 11 attacks. However, if countries that are linked to terrorist funding do not adopt permanent reforms now to strengthen their anti-money laundering regimes, and vigorously enforce these laws, then these countries will once again become the terrorists' portal into the global financial system. By failing to impose, or even to threaten to impose, special measures, I fear that the Bush Administration is missing an opportunity to seek permanent changes in these countries.

Regulations Under the USA PATRIOT Act

While the special measure provisions became fully operative on October 26, 2001, if the U.S. Government is to fully utilize those provisions, the Treasury must undertake rulemaking in two areas. Section 311 of the USA PATRIOT Act requires the Treasury Secretary to issue two sets of regulations. The first set, defining "beneficial ownership," is needed to implement recordkeeping requirements that are designed to help law enforcement ferret out who owns and controls the funds transferred to U.S. banks and other U.S. financial institutions from jurisdictions with weak financial controls.

The other set of regulations is intended to define the term "correspondent account" for nonbanks. Without this definition, any special measure ordered by the Treasury Secretary would have gaping holes. It would almost of necessity apply only to banks, and not other financial institutions, such as broker-dealers and money transmitters. These definitions are also needed to fully implement another important section of the USA PATRIOT Act, namely, the heightened due diligence requirements of Section 312.

I understand that the Treasury has been engaged in informal discussions with industry about the regulations. Congress intended that Treasury would seek the input of industry in crafting these regulations. However, that process should be a public and a transparent process. In this way the Congress and the people can judge whether the regulations were crafted without inappropriate accommodations to industry.

I understand that the Treasury Department has been given many additional responsibilities under the new legislation, and I appreciate the work that has been done to date. However, if the Bush Administration is serious about implementing these new anti-money laundering provisions, it should proceed as soon as possible to complete the regulatory work in an open and transparent process.

Prior to September 11, the Bush Administration showed little interest in the enactment of new anti-money laundering laws. In fact, to the contrary, in August 2001 the Treasury and Justice Departments completed a National Money Laundering Strategy in August 2001 (which was actually release after September 11) that was grossly deficient. The Congress and the American people need assurances from the Administration that it is committed to fully implementing the new anti-money laundering laws, and that its support for these laws will not fade after the current crisis has ended.

Internet Gambling

The FBI has identified Internet gambling as a very serious money laundering threat. We must address this threat through legislation that clarifies that the Federal Wire Act already prohibits Internet gambling and adds a new prohibition

against the use of credit cards and other payment methods to pay for wagers over the Internet. Congress must adopt a strong anti-Internet gambling bill this year.

Voluntary Efforts Are No Substitute for Compliance

I have also become aware of what have been characterized as voluntary efforts regarding terrorist funding by some in the financial services industry to coordinate and share information with Federal law enforcement agencies. There is no question that financial institutions are the first line of defense against money launderers.

However, while I believe that these voluntary arrangements are laudable, and contribute to the overall fight against money laundering, I welcome these efforts with a certain amount of caution. The Federal Government must ultimately be in charge of this effort, and there must be public accountability for the voluntary program, if we are to insure that is designed to further the Federal Government's public policy interests.

Moreover, such voluntary efforts cannot serve as a substitute for compliance with the USA PATRIOT Act and other laws. The current arrangement cannot be a substitute for the law, which is why it is so vital for the success of this legislation that the Administration issue the USA PATRIOT Act regulations—and issue them now.

Looking to the Future

All of us have contributed in meaningful ways to the enactment of the USA PATRIOT Act this past year, and all of us are hopeful that, by destroying terrorism's international financial networks, it will help the American people regain the confidence and sense of security that is the hallmark of our great Nation. Chairman Sarbanes, I commend your leadership in holding this hearing, and appreciate the opportunity to present my views on these very important matters. Thank you.

PREPARED STATEMENT OF CARL LEVIN

A U.S. SENATOR FROM THE STATE OF MICHIGAN

Progress is being made in the war on terrorism, and one powerful weapon in our arsenal has been the worldwide effort by the United States and other countries to locate and dismantle terrorist financing. We are told that about $80 million in suspected terrorist funds have been frozen worldwide since September 11. In addition, terrorist profit centers have been disrupted, from wire transfer activities at U.S. banks to sales of honey to hawalas and other enterprises still under investigation. Eighty million dollars is a lot of money—many times over what it cost al Quaeda to bring down the World Trade Center—and taking this money out of terrorist hands and depriving them of new income is as important as destroying their training camps, taking apart their command structure, and eliminating their military weaponry.

I would like to discuss two topics this morning. First, I would like to make some observations about the ongoing implementation of the new anti-money laundering law and, second, I would like to give you a preview of some of the latest anti-money laundering work that the Permanent Subcommittee on Investigations is doing.

Last year, Congress enacted the toughest new anti-money laundering law in 15 years. My hat is off to this Committee for the key role it played. Congratulations are due, in particular, to Chairman Sarbanes who, not only committed the Committee to drafting a bill in record time and won unanimous bipartisan support for the Committee draft, but also, after the anthrax scare closed three Senate office buildings, hosted about 50 Congressional staffers in his Capitol Hill office in all night sessions until the bill was done. I also want to thank him, Senator Stabenow, Senator Gramm, and the other Committee Members for their careful consideration of the anti-money laundering work done by my Subcommittee, for including my staff every step of the way, and for including so much of the Levin–Grassley bill in the final legislation.

This year, 2002, is key to the effectiveness of the new law. We all know that regulations can strengthen, weaken, or alter the intent of enacted legislation, and dozens of implementing regulations are due throughout the calendar year. So far, the Treasury Department has done a good job meeting the deadlines and writing proposed regulations on shell banks, foreign bank ownership, and suspicious activity reporting by securities firms. Particularly important has been the Department's willingness to meet head on the requirement in the law to extend anti-money laundering obligations to all U.S. financial institutions, not just banks. It hasn't shied from that requirement and, equally important, the proposed regulations have been careful not to start down the road of making exceptions or special rules for various

players in the financial community. Instead, everyone has been made subject to essentially the same anti-money laundering requirements. Also important was the signal sent by the Department's prompt and straightforward implementation of the December deadline for closing shell bank accounts.

So at this stage I have had few complaints about how the Treasury Department has been implementing the new anti-money laundering law. That is not the same as saying I have no concerns. One issue that has come up repeatedly, for example, are provisions that appear to postpone compliance with the law's requirements. We must hold to the dates set in the law. We do not have the luxury of time. Osama bin Laden and al Quaeda have not quit; there is plenty of evidence that they still may strike; and, if they do, they will again try to use our financial institutions against us. That is why it is more important than ever that we seal the cracks in our anti-money laundering defenses as quickly and as completely as possible, and why we need to continue to push U.S. financial institutions to get their anti-money laundering programs up and running now. I urge the Committee to hold the Department's feet to the fire on the compliance deadlines.

Some of the biggest implementation challenges are looming as, over the course of the next 6 months, the Department will issue regulatory guidance on the law's requirements for money laundering programs, enhanced due diligence reviews, customer verification, and identification of beneficial owners. How these complex issues are addressed will determine whether the new anti-money laundering law lives up to its potential. A good start has been made, and this oversight hearing sends the right message about how important these issues are and how many people are watching to make sure they are handled the right way.

One of the biggest changes wrought by the new law has been to extend the anti-money laundering obligations to all U.S. financial institutions, not just banks. One of the key financial sectors affected by these new obligations is the securities industry, which is also the recent focus of my Subcommittee's anti-money laundering efforts.

Last year, a GAO report I requested identified a number of gaps and inadequacies in the anti-money laundering efforts in the U.S. securities field. The study showed that thousands of U.S. securities firms do not have even basic anti-money laundering controls in place. It also indicated that, while some large securities firms have voluntarily established sophisticated anti-money laundering programs, those programs are the exception rather than the rule in the industry. The intent of the GAO report was to help the securities industry evaluate what needs to be done next to strengthen their anti-money laundering controls.

This year, to get a better sense of the foreign financial institutions and offshore businesses that have U.S. securities accounts, the Subcommittee is surveying 22 large and small U.S. securities firms with a variety of clients and services.

Foreign financial institutions carry higher money laundering risks because, by the nature of their business, they handle the money of their clients and transfer these third-party funds through their U.S. securities accounts. U.S. securities firms often have limited information about these third parties. Businesses in offshore jurisdictions that have corporate and bank secrecy laws and issue offshore licenses, and businesses in jurisdictions that have been designated as noncooperative with international anti-money laundering efforts, pose even greater risks. These offshore and noncooperative jurisdictions are identified and discussed in the State Department's key anti-money laundering publication, the *International Narcotics Control Strategy Report,* which expresses concern at the growing use of these jurisdictions for criminal purposes, from terrorism to narcotics trafficking to tax evasion. That is why the new anti-money laundering law requires U.S. financial institutions to conduct enhanced due diligence reviews of foreign financial institutions in offshore or noncooperative jurisdictions to ensure that the foreign financial institutions they do business with are legitimate enterprises and not conduits for terrorists or other criminals.

All of the firms contacted by the Subcommittee immediately agreed to respond to the survey and have cooperated in this effort, although many that gave us initial survey responses have agreed to refine or revise certain aspects of the data they submitted to make the data more comparable and detailed. To date, 10 of the survey responses are entirely complete.

This preliminary survey information indicates the existence of significant money laundering risks in the securities field that need to be addressed. The first indication of the extent of the problem came to us right after the survey went out. All but a few firms called back and indicated that they would be unable to provide an accurate count of their offshore clients, because their data systems did not identify offshore entities, despite the higher money laundering risks involved. The surveyed firms agreed to undertake an analysis of their client information and provide the

best estimates they could to enable us to develop overall estimates of the U.S. securities accounts held by offshore entities. Over the last 2 months, firms provided us with the following good faith estimates. All 22 of the firms indicated that they have numerous offshore clients. Of the 10 firms with completed survey responses, none had less than 300, and one firm had more than 16,000 offshore entities as clients. Altogether, those firms show a total of over 45,000 offshore entities as clients, consisting of over 38,000 offshore corporations and trusts, 4,400 offshore banks, 2,160 offshore securities firms, and 670 offshore insurance companies. While the data reflects the fact that offshore entities may open accounts at more than one securities firm, the bottom line is that tens of thousands of offshore entities, which are highly vulnerable to money laundering, now have accounts at U.S. securities firms.

The survey responses also give some estimates about how much money offshore clients are putting into their U.S. securities accounts. The data indicates that the 45,000 offshore entities at the 10 firms have, altogether, about $140 billion in assets in their U.S. securities accounts, with most of that, about $137 billion, coming from offshore corporations and trusts. The next biggest category is offshore banks with about $2 billion in their U.S. securities accounts. Offshore insurance companies have about $280 million, and offshore securities firms have about $235 million. Looking at the individual survey responses shows that the smallest amount of these assets at any one firm is about $90 million, while the most is $67 billion.

The survey has identified only four foreign shell bank accounts at U.S. securities firms, all four of which are required to have been closed by the end of the year under the new law. Foreign shell banks are those banks that have no physical presence in any jurisdiction and which carry the highest money laundering risks in the banking world. Another category of interest is foreign banks in countries that have been designated by the Financial Action Task Force or FATF as noncooperative with international anti-money laundering efforts. The data shows that five firms have accounts for about 400 of these high-risk foreign banks, with the number ranging from a low of about 50 to a high of about 140 at any one securities firm. These 400 foreign banks have about $375 million in assets in their U.S. securities accounts, with two-thirds of that total, about $255 million, at just two of the U.S. securities firms.

Another category of interest is money service businesses outside of the United States, such as foreign money exchange houses that deal in foreign currencies, cash checks, and wire funds. This category includes, for example, the Dubai money houses that transmitted funds for the 19 al Quaeda terrorists. The preliminary survey information indicates that only three firms have money service business clients.

The preliminary information collected by the Subcommittee demonstrates that the securities industry, like the banking industry, has clear money laundering risks that need to be addressed. These risks include tens of thousands of high-risk clients and hundreds of billions of dollars in high-risk funds. The good news is that, as a whole, these high-risk accounts represent only about 2 percent of all accounts. That means that they represent a small enough number of accounts that a focused anti-money laundering effort should be able to monitor their transactions, identify suspicious activity, and alert law enforcement in order to possible terrorists or other criminals attempting to use U.S. securities accounts to carry out their illegal activities.

The Subcommittee data also indicates that the U.S. Treasury Department is on the right track in its decision to apply the same anti-money laundering rules to U.S. securities firms as apply to U.S. banks. I also applaud the Department's decision to apply the rules to U.S. insurance companies that are registered as broker-dealers and sell annuities. While many insurance products present low risks for money laundering, some products such as annuities sold to offshore shell corporations present very different risks that require appropriate controls.

Which brings me to a final point—the need to focus our anti-money laundering efforts on the highest risks. It is important to realize that this principle is embedded in the new law, which is designed to focus scarce resources on the worst problems—such as shell banks, offshore jurisdictions, and noncooperative countries. With respect to the provisions that will be applied across the board to all U.S. financial institutions—the requirements for anti-money laundering programs and client verification—the law does not require a one-size-fits-all approach. For example, it permits, and I hope the regulators will include in the regulations, a direction to all U.S. financial institutions to engage first in a money laundering analysis to identify their risk areas and then to design programs that focus on those risks.

Congratulations again on holding this very important oversight hearing on this landmark legislation.

PREPARED STATEMENT OF JOHN F. KERRY

A U.S. SENATOR FROM THE STATE OF MASSACHUSETTS

Mr. Chairman, I would first like to thank you for the opportunity to testify on the implementation of the anti-money laundering provisions included in the USA PATRIOT Act that were enacted into law last year. I know that these anti-money laundering provisions would not have been included in the law without your hard work and dedication. I would also like to thank your staff along with the other Members of the Senate Banking Committee, Senator Daschle, Senator Levin, Senator Grassley, and Congressman LaFalce, for their hard work and assistance in developing and enacting this important law. However, I believe that there is still much work that remains to be done to appropriately implement the anti-money laundering provisions of the new law and to renew our efforts to work with our allies to stop the flow of tainted money into the United States.

This important new law greatly expands the ability of the Federal Government to take actions to combat international money laundering. I look forward to working with Treasury Secretary O'Neill and others to ensure that the new law is implemented to prevent laundered money from slipping undetected into the U.S. financial system and, as a result, to increase the pressure on foreign money laundering and tax havens to bring their laws and practices into line with international anti-money laundering standards. I appreciate the efforts of the Treasury Department to implement the complicated provisions of this new law. As the regulatory process continues, I will specifically be interested in the final definition of both the beneficial owner of an account and the definition of correspondent banking. These definitions will be crucial to ensuring that the new anti-money laundering provisions are implemented fully. I plan to work closely with Chairman Sarbanes, Senator Levin, and Congressman LaFalce to ensure they are acceptable.

The USA PATRIOT Act provides a clear warning to those who have assisted or unwittingly assisted those involved in the al Qaeda network or other terrorist organizations in laundering money that the United States will take whatever actions are necessary, including denying foreign banks and jurisdictions access to the United States economy, to stop terrorists and international criminal networks from laundering money into the United States through the international financial system.

The new law includes legislation which I sponsored, that provides the tools the United States needs to crack down on international money laundering havens and protect the integrity of the U.S. financial system from the influx of tainted money. The United States has the largest and most accessible economic marketplace in the world. Foreign financial institutions and jurisdictions must have unfettered access to markets to effectively work within the international economic system. It will give the Treasury Secretary, in conjunction with our allies in the European Union and the Financial Action Task Force, the authority to leverage the power of our markets to force countries or financial institutions with lax money laundering laws or standards to reform them. If they refuse, the Treasury Secretary will have the authority to deny foreign financial institutions or jurisdictions access to the U.S. marketplace. This will help stop international criminals from laundering the proceeds of their crimes into the U.S. financial system or using the proceeds to commit terrorist acts.

The USA PATRIOT Act also includes a number of important provisions that have begun to seal the cracks in existing law and provide new tools to law enforcement to stop money laundering. First, the law requires U.S. financial institutions to use appropriate caution and diligence when opening and managing accounts for foreign financial institutions. It prohibits foreign shell banks, who have no physical location in any country, from opening accounts in the United States and requires our financial institutions to take reasonable steps to ensure that foreign banks are not allowing shell banks to use their U.S. accounts to gain access to the U.S. financial system. It expands the list of money laundering crimes and assists our law enforcement efforts by making it easier to prosecute those crimes. It requires financial institutions to develop appropriate anti-money laundering programs. It prohibits the use of concentration accounts that allow foreign banks to transfer large amounts of cash into the United States without including appropriate information on the beneficial owner of the funds.

The events of September 11 and other more recent events have also shown the need for additional efforts by the United States and its allies to limit the ability of international terrorists and others to use tax havens to hide the proceeds of their crimes.

I remain very concerned about the Bush Administration's policy to take a unilateral approach to the issue of tax havens and to step away from the bilateral efforts of the European Union and the Organization of Economic Cooperation and Development (OECD) to place appropriate limits on tax havens. Tax havens assist terrorists

and international criminal organizations looking to hide money derived from the sale of drugs, weapons, and other criminal enterprises. In many cases, the funds that criminals hide in countries who are considered "tax havens" have already been laundered in the international financial system. Contrary to what some claim, the OECD approach does not punish countries just for having low tax rates or seek a harmonization of tax policy. Instead, the OECD attempts to reduce the number of countries whose tax systems have a lack of transparency, a lack of effective exchange of information and those that have different tax rules for foreign customers than for its own citizens.

The OECD has currently targeted 36 jurisdictions that it believes participate in unfair tax competition and undermine other nations' tax bases. I strongly believe that international terrorists and others should not be allowed to hide the proceeds of their illegal acts by simply claiming to be evading what they consider unfair taxes. I believe the Bush Administration approach will make it more difficult for the international community to track and freeze the assets international terrorists like Osama bin Laden and expand upon the recent progress in fighting financial crimes we have achieved.

Working together, we have achieved a great deal to crack down on international money laundering havens and protect the integrity of the U.S. financial system from the influx of tainted money. I look forward to working with Chairman Sarbanes and others to insure that the new law is properly implemented to stop international criminal and terrorist networks from laundering the financial proceeds of their crimes and to stop the use of the international financial system to develop terrorist networks.

PREPARED STATEMENT OF KENNETH W. DAM

DEPUTY SECRETARY, U.S. DEPARTMENT OF THE TREASURY

JANUARY 29, 2002

Chairman Sarbanes and the distinguished Members of the Senate Banking Committee, thank you for inviting me to testify about the Treasury Department's efforts to disrupt terrorist financing and, in particular, the steps that we are taking to implement the provisions of the International Money Laundering Abatement and Financial Anti-Terrorist Financing Act of 2001. I have asked Under Secretary for Enforcement Jimmy Gurulé to join me today.

On September 24, 2001, President Bush stated, "We will direct every resource at our command to win the war against terrorists, every means of diplomacy, every tool of intelligence, every instrument of law enforcement, every financial influence. We will starve the terrorists of funding." The Treasury Department is determined to help make good on this promise. I am here today to tell you about the progress we have made and some of the complexities we still face.

Much of our progress is directly attributable to the Congress and this Committee. The swift passage of the USA PATRIOT Act and, in particular, Title III of that Act—the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001, have given us important new tools in the financial front of the war on terrorism. To highlight just two aspects of the Act:

- The Act requires financial institutions to terminate correspondent accounts maintained for foreign shell banks and to take reasonable steps to ensure that they do not indirectly provide banking services to foreign shell banks. Treasury provided immediate, interim guidance to financial institutions, suggesting that they obtain certification from all foreign banks with correspondent accounts that they were not shells and that the foreign banks did not themselves maintain correspondent accounts for shell banks.
- The Act requires all financial institutions to have an anti-money laundering program in place by April. Although many broker-dealers already had anti-money laundering programs in place, the Act ensures that all will.

This Committee played an important role in securing the passage of these and other provisions. On behalf of the Treasury Department—including our 25,000 law enforcement officers—I thank you.

I also wish to thank the many Federal agencies that have worked with Treasury. This is a team effort. We have worked closely with the State Department, the Defense Department, the Department of Justice, the Federal Bureau of Investigation, the intelligence community, and many other parts of the Federal Government. We coordinate daily at all levels and, I think, have done a good job of setting aside some of our historical rivalries. To cite just one of many examples of this coordination,

the Administration recently created a new high-level strategies and priorities committee that I chair. This committee brings together senior officials from across the Government to chart our strategy for pursuing terrorist finances over the coming months and years.

Summary of Developments in Financial Aspects of U.S. Anti-Terrorism Initiatives

Our priority is to help prevent terrorist attacks by disrupting terrorist finances. As the President has said, we seek to "starve the terrorists of funding." Our goal is to deprive terrorists of one of the raw ingredients in terrorism: Money for arms, explosives, plane tickets, and even the day-to-day sustenance of operatives. I will tell you candidly that where there is a conflict between preventing terrorist attacks and the prosecution of criminal cases against terrorists, preventing terrorist attacks comes first.

The strategy for the financial front of the war on terrorism closely tracks our strategy in the rest of the war. We remain focused on finishing off al Qaeda. We are targeting not only al Qaeda operatives, but also their financial intermediaries and others that support them. Increasingly, we are also focussing on other terrorist groups of global reach. In addition, we are striving to ensure that fight on the financial front is not a unilateral effort or even a U.S.-led effort, but, like the rest of the war, a multilateral effort led by nations around the world.

We use several tactics on the financial front of the war on terrorism. Some of our tactics are public—like the public designation of terrorist organizations and the civil blocking of terrorist assets. Other tactics are private—for example, we work with foreign governments to enable them to designate and block terrorist assets on their own behalf. I would be pleased to tell you more about our private efforts in a closed session.

One thing that is different about the financial front from the rest of the war is that it is perhaps harder to measure success in the financial effort. To address this, we measure success in many ways. For example, we track the total amount of terrorist assets blocked. Since September 11, the United States and other countries have frozen more than $80 million in terrorist-related assets. We expect the amount of blocked assets to continue to grow—although we also expect to release some of the money. For example, assets once controlled by the Taliban regime of Afghanistan will be returned to the legitimate government of Afghanistan.

The amount of assets blocked underscores the importance of another measure—the amount of international cooperation in the financial front of the war. I cannot emphasize enough how vitally important international cooperation is. After all, we cannot bomb foreign bank accounts. We need the cooperation of foreign governments to investigate and block them. So far, we have received a remarkable degree of cooperation. Foreign governments have blocked more than $46 million—over half of the total of $80 million. One hundred forty-seven countries and jurisdictions around the world have blocking orders in place. We work with these countries daily to get more information about their efforts and to ensure that the cooperation is as deep as it is broad. For example, we are providing technical assistance to a number of countries to help them develop the legal and enforcement infrastructure they need to find and freeze terrorist assets.

We have also had success pursuing international cooperation through multilateral fora including the UN, the G–7, the G–20, the Financial Action Task Force (FATF), and the international financial institutions to combat terrorist financing on a global scale. A good example of Treasury leadership on this issue is in the role of the United States in the FATF on Money Laundering, a 31 member organization. In late October 2001, the United States hosted an Extraordinary FATF Plenary session, at which FATF members established eight Special Recommendations on Terrorist Financing. These recommendations quickly became the international standard on steps that countries can take to protect their financial systems from abuse by terrorist financiers. Our delegation is at a meeting in Hong Kong as I speak establishing a process by which all countries will engage in a self-assessment of compliance with these recommendations.

Still another measure is the flow of funds disrupted. For example, when we shut down the al Barakaat hawala network, we seized $1.9 million in assets. But we disrupted the flow of much more. Our analysts believe that al Barakaat's worldwide network channeled as much as $15 to $20 million to al Qaeda a year. It is important, therefore, to keep an eye on the flow of funds—how much money moved through a pipeline that we froze—as well as how much money happened to be in the pipeline when we froze it.

Finally, we do not ignore nonquantified measures of success. I would be willing to elaborate upon these measures in a closed session. I can tell you in open session,

however, that we believe from our intelligence channels that al Qaeda and other terrorist organizations are suffering financially as a result of our actions. We also believe that potential donors are being more cautious about giving money to organizations where they fear that the money might wind up in the hands of terrorists.

Having discussed some of our successes, I wish to spend a moment on some of the complexities we face. This Committee is intimately familiar with the challenges facing our anti-money laundering efforts. Stopping terrorist financing is perhaps more nuanced than money laundering because terrorist financing could be described as "reverse money laundering." In money laundering, the proceeds of crime are laundered for legitimate use or for use in perpetrating more crimes. If you find evidence of the original crime, you are likely to be placed on the trail of some money laundering. In terrorist finance, it is often the other way around. Proceeds of legitimate economic activity are used for illicit purposes. The money can come from almost anywhere.

A particular form of this problem is presented by the case of illicit charities. Illicit charities are organizations that exploit their charitable status to funnel money to terrorists. Such organizations are, in my view, particularly deplorable. But at the same time, it cannot be doubted that some of them do perform some charitable acts and that many donors believe that their donations are paying for charitable works. To solve this problem, we are developing a comprehensive, coordinated, interagency strategy to clean up illicit charities while still providing vehicles for legitimate charitable works.

I would like to highlight a few additional steps that we have taken. First, we got the Foreign Terrorist Asset Tracking Center (FTAT) up and running under the direction of the Office of Foreign Assets Control (OFAC). FTAT was funded by Congress in the fiscal year 2001 Appropriations Bill and was being organized and staffed when the attacks occurred. When fully operational, FTAT will serve as an analytical and strategic center for attacking the problem of terrorist financing. Since September, FTAT has served not only to provide analysis of particular targets and networks, but also as an information hub where intelligence and law enforcement agencies can share and analyze information for a common purpose. Thus far, the Department of Defense, the Department of Justice, and the intelligence community have made vital contributions to this interagency effort to hunt down the sources of terrorist financing. Though FTAT is still in its infancy, it is making a significant impact on this cooperative and concentrated interagency venture.

Second, on October 25, 2001, Treasury created Operation Green Quest (Green Quest), a new multiagency financial enforcement initiative intended "to augment existing counter-terrorist efforts by bringing the full scope of the Government's financial expertise to bear against systems, individuals, and organizations that serve as sources of terrorist funding." Green Quest is made up of investigators and analysts from the U.S. Customs Service, the IRS–Criminal Investigation Division, the Financial Crimes Enforcement Network (FinCEN), OFAC, the Secret Service, and the FBI with support from the Department of Justice. These agencies have brought their world-renowned financial expertise to bear on terrorist financing and have seen remarkable results in the 3 months FTAT has been in existence.

Green Quest has complemented the work of FTAT in identifying terrorist networks at home and abroad, and it has served as an investigative arm in aid of blocking actions. Green Quest's work, in cooperation with the Department of Justice, has led to 11 arrests, 3 indictments, the seizure of nearly $4 million, and bulk cash seizures of over $8.5 million. Green Quest agents, along with the FBI and other Government agencies, have traveled abroad to follow leads, exploit documents recovered, and to provide assistance to foreign governments. The work of these financial experts is just starting but they have already opened well over two hundred terrorist financing investigations and are following new leads on a daily basis.

Third, we have worked closely with the FBI-led investigation into the September 11 attacks. Immediately after the attacks, Treasury deployed personnel to the FBI's Financial Review Group, bringing additional financial investigative capabilities, contacts in the financial sector, and expertise to the FBI's group. Treasury has also deployed people to serve on various Joint Terrorism Task Forces (JTTF's) headed by the FBI. Since then, those committed to this mission have made real significant contributions, in the Group and in the field, to tracking the perpetrators of those heinous acts.

The November 7, 2001, designation of al Barakaat as a terrorist-related financial entity is an example of how Treasury efforts, along with the fine work of our interagency partners, can lead to results in this war on terrorist financing. Al Barakaat

is a Somali-based hawaladar [1] operation, with locations in the United States and in 40 countries, that was used to finance and support terrorists around the world.[2] FTAT analysis identified al Barakaat as a major financial operation that supported terrorist organizations and was providing material, financial, and logistical support to Osama bin Laden, al Qaeda, and other terrorist groups.

Treasury coordinated efforts to block assets and to assist other law enforcement agencies to take actions against al Barakaat. On November 7, 2001, Federal agents executed search warrants in three cities across the country (Boston, Columbus, and Alexandria) and shut down eight al Barakaat offices across the United States, including locations in the following cities:

- Boston, Massachusetts;
- Columbus, Ohio;
- Alexandria, Virginia;
- Seattle, Washington; and
- Minneapolis, Minnesota.

As part of that action, OFAC was able to freeze $1,900,000 domestically in al Barakaat-related funds on November 7, 2001. Treasury also worked closely with key officials in the Middle East to facilitate blocking of al Barakaat's assets at its financial center of operations. Disruptions to al Barakaat's worldwide cashflows could be as high as $300 to $400 million per year, according to our analysts. Of that, our experts and experts in other agencies estimate that $15 to $20 million per year would have gone to terrorist organizations. The al Barakaat investigation exemplifies the importance of the flow of funds disruption measure that we are attempting to use more broadly. In addition, the combined work of FTAT and law enforcement led to additional leads in the al Barakaat investigation.

This is an example of what our combined efforts can do when we join our resources and our expertise to fight the scourge of terrorist financing. Although we have made much progress, we still have much work to do.

First, we must encourage more independent identification of terrorist groups by other countries. The EU designation at the end of December is a step in the right direction, but we need more countries to initiate more designations.

Second, we have to ensure that more countries issue blocking orders for more of the entities identified, by the United States, other countries, and the international community, as being part of terrorist financial networks. We must also do a better job of following up with the countries to make sure that their orders, once issued, are fully implemented and obeyed.

Third, we must do a better job of exploiting the "industrial quantity" of documents captured in Afghanistan and increasingly elsewhere. Hard drives and e-mails must be exploited as well. This is a massive task. To do it, we must bring documents together from all over the world, translate them, cross-reference them, and thereby build a complete picture. No one document can tell us that much.

Fourth, we must redouble efforts by United States and allied intelligence services against such financial intermediaries as hawala dealers and other informal systems.

To conclude this portion of my testimony, I believe that we have had several important successes on the financial front of the war on terrorism. We have marshaled the considerable expertise of our Treasury law enforcement personnel to execute the President's mission to detect, disrupt, and dismantle the financial infrastructure of terrorist financing. We have worked closely with other agencies of the Federal Government and, I believe, have obtained an unprecedented level of cooperation and coordination. We have worked extensively with foreign governments to ensure that terrorist money has nowhere to hide.

Some have said that the financial war on terrorism is an impossible task. After all, money is fungible and illegal money tends to flow to the most hospitable country. I disagree. That the task is difficult does not mean that it is impossible. This is an unconventional war where there are no boundaries, where civilians are the targets, where people (or so-called "martyrs") are the weapons, and where electronic money transfers and messaging are the fuel and the logistics train. Among other things, identifying the flow of money helps us find the footprint of sleeper cells, disable them, and perhaps prevent the next attack.

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[1] Hawala is a type of alternative remittance system that is common in many parts of the world, including the Middle East and Far East. A hawaladar is an entity that engages in hawala transactions.

[2] Some individuals may have used al Barakaat as a legitimate means to transfer value between individuals in different countries without passing through the formal international banking system.

Implementation of the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001

The Treasury Department is committed to the aggressive and thorough implementation of the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. In the aftermath of September 11, efforts to enhance the Federal Government's ability to combat international money laundering, which had already begun before September 11, were given a whole new level of priority by Congress and the Administration. The Government and the financial community were forced to rethink assumptions, to reevaluate risks of money laundering and abuse in connection with terrorist financing, and, ultimately, to take the steps necessary to protect the country's financial system. The results of this reassessment were dramatic. Through the Act, which is also known as Title III of the USA PATRIOT Act, Congress took up the challenge of eliminating vulnerabilities within our anti-money laundering regime. Now, we at Treasury will continue this initiative through implementing regulations.

The Act is ambitious not only in scope, but also in its aggressive implementation schedule. The inclusion of numerous key provisions demonstrates remarkable resolve by Congress following the September attacks. Perhaps the most striking aspect of the Act is that in one legislative package, Congress addressed many deficiencies identified in our counter-money laundering regime. Treasury must address a wide array of challenging issues and promulgate regulations with far-reaching consequences—all on an accelerated schedule.

TREASURY'S IMPLEMENTATION PLAN

Our plan for implementation relies heavily on tapping the existing resources and expertise found in the Government to develop creative solutions to complex issues. Once the Act became law, we formed interagency working groups to handle each of the statutory provisions requiring implementation or reports. After identifying the appropriate Treasury personnel to chair these working groups, we solicited interagency participation. This system offers two distinct advantages: (1) it brings the collective knowledge and expertise of the various Governmental agencies and departments together; and (2) it facilitates the consultation requirements found in many provisions of the Act. I am pleased to say that the results thus far have been remarkable. Other agencies and departments stepped forward immediately, committing personnel and resources. For example, less than 1 month after the Act was signed by the President, Treasury issued interim guidance on two key provisions that were set to take effect on December 26, 2001. When Treasury requested consultation, the other agencies and departments responded quickly, assisting with our analysis of the issues and the completion of the guidance in time for the affected financial institutions to use it. And the cooperation continues. Working groups and subgroups meet almost daily. Drafts are being circulated and comments are received when requested. We are grateful for the assistance.

Another encouraging result of this process has been the response of the private sector and industry groups. With respect to several key provisions, we have received not only positive comments about the legislation, but also helpful insight into implementation issues. Others have contributed by simply taking the time to educate us on their particular industry and existing practices and procedures. Regulations cannot be conceived and drafted in a vacuum. Creative and constructive suggestions from those who will be affected by the regulations allow us to identify issues early and then find solutions early.

As I have noted, our implementation plan has met with some early success. Since October of last year, we have issued interim guidance and regulations covering four statutory provisions. The two provisions that took effect in December were the prohibition against certain U.S. financial institutions maintaining correspondent accounts for foreign shell banks or indirectly providing services to them (Section 313) and the requirement that U.S. financial institutions obtain ownership and registered agent information from foreign banks for which they maintain correspondent accounts (Section 319(b)). On November 20, less than 1 month after the passage of the Act, Treasury issued interim guidance that explained the provisions, identified their scope, and provided financial institutions with a certification that could be utilized to comply with the provisions. Treasury subsequently issued a formal proposed rule in December that codified the Interim Guidance as a regulatory standard. On a separate front, 4 months ahead of the statutory deadline, Treasury issued in December a regulation implementing Section 365 of the Act, which effectively gives FinCEN access to reports filed by nonfinancial trades or businesses when they receive $10,000 or more in coins or currency. Finally, as required by Section 356 of the Act, Treasury issued in December a proposed rule that would require securities brokers and dealers to file suspicious activity reports. In support of FinCEN's in-

creased responsibilities under the Act, the President's fiscal year 2003 budget calls for a $3.3 million increase in FinCEN's budget to help FinCEN expand suspicious activity reporting to a number of new industries and maintain the Suspicious Activity Reporting Hotline, begun this fall, to expedite the investigation of suspicious financial activities.

We have many additional regulations to promulgate and reports to file with Congress. We are determined to promulgate these regulations and prepare the reports expeditiously. We are always cognizant of the urgency of our task. At the same time, we are also working closely with other agencies, the private sector, and, of course, the Congress to ensure that we do our job not just fast, but well.

TREASURY'S IMPLEMENTATION PRINCIPLES

As we implement the Act, we are guided not only by the express statutory language, but also by certain core principles that reflect our vision of what this legislation should accomplish and the manner in which it should be implemented. This legislation addresses broad issues and relies heavily on implementing regulations to define the scope of the provisions. Through the regulatory process, we will take the general and make it specific, exercising our discretion where appropriate. In this role, it is essential that we remain true to our core principles, which are as follows:

Prevent Regulatory Arbitrage

The Act takes aim at those areas of our financial and regulatory system that present opportunities for exploitation. Treasury embraces this goal, and, through the regulatory process, will adhere to the principle that people should not be able to shift from one type of financial institution to another in order to avoid a regulatory scheme or anti-money laundering controls. The test is a very functional one, namely, can a similar financial transaction be accomplished through another financial institution with less regulation. The justification for this principle is two-fold: First, our financial system is only as secure as its most vulnerable point; and second, a regulatory scheme must not create a competitive advantage for one type of financial institution over another when they perform the same or similar functions.

Our proposed regulation for Section 319(b) illustrates the point. Section 319(b) provides the Secretary of the Treasury and the Attorney General with administrative subpoena authority to compel the production of documents from foreign banks with correspondent accounts in the United States. The Section also requires "covered" U.S. financial institutions that maintain a correspondent account on behalf of a foreign bank to maintain records identifying the owners of the foreign bank as well as its registered agent. But Section 319(b) does not define "financial institution" for purposes of the Section. Based on the notion that similar activity should be regulated similarly, instead of limiting the application to depository institutions—such as banks, thrifts, credit unions—Treasury proposed to extend the rule to securities brokers and dealers who also maintain correspondent accounts for foreign banks. In this way, the rule does not create the opportunity to shift from a bank to a securities broker or dealer in order to avoid regulation.

The provision of the Act requiring Treasury to issue a rule requiring securities brokers and dealers to file suspicious activity reports embodies this same principle. Banks and other depository institutions must file suspicious activity reports because such reports are important to the fight against money laundering. Because the potential for money laundering exists in the securities industry, a similar rule will soon apply. Section 356 of the Act also directs us to recommend whether and how to bring investment companies under the Bank Secrecy Act. For this as well we will analyze the functional activities of such entities, compare them with the activities of regulated entities, and identify the money laundering risks presented. With this information, Treasury will be able to proffer methods for applying the BSA to such entities.

Honor a Central Purpose of the Act: To Enhance Coordination and Information Flow

An overarching goal of this legislation, and an important lesson we are learning as we continue our work to disrupt the financial underpinnings of terrorism, is that appropriate information must be made available to enable law enforcement, the intelligence community, and the regulators to protect our financial system. The financial institutions themselves have a critical role in sharing and reporting information. The Act facilitates information sharing on a number of levels: (1) among law enforcement and financial institutions; (2) among regulators, law enforcement, and the intelligence community; and (3) among financial institutions themselves. We will fulfill this goal of enhancing the ability to use and share information to combat terrorism and money laundering.

Treasury, through FinCEN, is well positioned to continue to expand its role as the lynchpin for information sharing and coordination between the Government and the financial sector. Indeed, Section 361 of the Act, among other things, requires FinCEN to establish a high-speed network for access to its extensive BSA data and information. Similarly, Section 362 requires Treasury to establish a highly secure network through which financial institutions can make Bank Secrecy Act filings and receive alerts regarding suspicious activities or persons requiring immediate attention. Treasury is charged with establishing a highly secure network through which financial institutions can make Bank Secrecy Act filings and receive alerts regarding suspicious activities or persons requiring immediate attention. I am pleased to report that FinCEN is on schedule to have a working prototype for initial testing by mid-April.

Additionally, Section 314 of the Act contemplates an expanded role for Treasury in the sharing of information regarding terrorism and money laundering not only among law enforcement and financial institutions, but also among financial institutions themselves. Treasury is completing work on a regulation that will be issued by the February deadline that, in part, first sets up the procedures by which financial institutions may share information among themselves regarding suspected terrorist financing, including money laundering, after providing notice to Treasury.

Respect Important Privacy Rights

The significant anti-money laundering provisions of the Act also serve to highlight the tension between the need to share information and the legitimate need for financial privacy. We acknowledge, as we must, that now more than ever law enforcement and the intelligence community must have the ability to obtain and share financial information. However, that need must always be balanced against our fundamental notions of privacy. Striking that balance is the challenge for Treasury as we implement this legislation.

Require Only the Degree of Reporting That Results in Action by the Government

The potential new reporting obligations created by the Act mean that we must be even more vigilant in ensuring that the information reported is useful and, in fact, will be used effectively by the Government. One consequence of an aggressive regulatory scheme is increased reporting obligations. But additional reporting requirements in and of themselves cannot serve as proxies for an effective anti-money laundering regime. If the information is not going to be used, it should not be requested. This principle guided our approach to implementing Section 365. That Section requires that nonfinancial trades or business file a report when they receive over $10,000 in coins or currency—a requirement that is virtually identical to the requirement placed on the very same businesses to file a report with the IRS under Section 6050I of the Internal Revenue Code. Although the purpose of Section 365 was unquestionably to provide law enforcement and regulatory authorities with access to the same information currently received by the IRS—information that could not be easily shared because of the IRS confidentiality statute—as written, Section 365 seemed to impose a new reporting requirement. Thus, we crafted a rule that permits businesses to file a single cash reporting form that will go to both FinCEN and the IRS, thus satisfying both reporting requirements with a single report.

Protect Our Financial System

The Bank Secrecy Act exists to protect our financial system. The Act provides Treasury with additional authority to systematically eliminate known risks to the financial system, as well as to act in response to a specific threat that may arise. Proven high-risk accounts, such as correspondent accounts maintained on behalf of foreign shell banks, will no longer be permitted access to our system. In Section 311, you have also given us a powerful weapon with which we can apply graduated, proportionate measures when specific money laundering risks involving foreign jurisdictions and individuals arise. This new authority makes it clear that the Secretary, in consultation with other agencies, can impose an array of special measures that are tailored to the particular risk presented. Treasury is conducting active training and outreach to educate law enforcement agencies about this new tool.

TREASURY'S IMPLEMENTATION PRIORITIES

Within the framework of the principles I have outlined above, the first priority for Treasury is to take all reasonable steps to meet the deadlines imposed by the Act. We have devoted considerable resources to this task, redirecting our policy objectives to accommodate this effort. I will not sit here today and assure this Committee that, without fail, we will meet each deadline. The issues presented are complex and, as we proceed, new ones continue to arise. I can assure you, however, that

we are working and will continue to work diligently on implementation, while taking the time that may be necessary to resolve difficult legal and policy questions.

Beyond the deadlines imposed in the Act, we have identified various provisions which, for a variety of reasons, we seek to pursue at the outset. These are provisions that, in our view, should be addressed on an expedited basis if possible. Finally, certain provisions with no immediate deadlines will inevitably have to be implemented after the more immediate priorities.

The First Tranche—To be Implemented by April

Over the next 3 months, we are striving to implement statutory provisions addressing: (1) information sharing among financial institutions, law enforcement and regulatory authorities (Section 314); (2) enhanced due diligence provisions applicable to financial institutions that maintain either private bank accounts or correspondent accounts for non-U.S. persons (Section 312); (3) methods for identifying and for confirming the identity of foreign nationals (Section 326); (4) the minimum requirements for anti-money laundering compliance programs for financial institutions; (5) the role of the IRS in the administration of the Bank Secrecy Act (Section 357); and (6) methods for improving compliance with the obligation to report foreign bank accounts (Section 361). Additionally, we will be issuing final regulations covering the foreign shell bank correspondent account prohibition (Section 313), the record-keeping provision under Section 319(b), and the cash reporting requirements (Section 365).

The Second Tranche—To Be Implemented as Expeditiously as Possible

Treasury is moving forward now to implement the following provisions addressing: (1) the authority of the Secretary, in consultation with other agencies, to designate primary money laundering concerns and impose special measures against them (Section 311); (2) concentration accounts (Section 325); (3) account opening procedures (Section 326); (4) suspicious activity reporting for futures commission merchants, commodity trading advisors, and commodity pool operators (Section 356); and (5) the efficient use of exemptions for currency transaction reports (Section 366). We intend to issue regulations further defining terms contained in Section 311 at the same time we issue regulations implementing the due diligence provisions of Section 312. Also, Treasury and the regulators are aggressively moving forward to draft regulations setting forth customer identification procedures for financial institutions.

Immediate Results

Although we have much to do to fully implement the provisions of the Act, I wish to emphasize that the Act has helped us generate immediate results in the financial front of the war on terrorism. I alluded to two of those results at the beginning of my testimony.

Information Sharing

The amendments to the Bank Secrecy Act clarify the authority of the Secretary to share BSA information with the Intelligence Community for intelligence or counterintelligence activities related to domestic or international terrorism, regardless of whether the BSA information is related to law enforcement. The amendments to the Right to Financial Privacy Act (RFPA) further enhance the ability of Government to obtain and share relevant financial records with another agency or department, such as FinCEN and OFAC, involved in intelligence or counterintelligence activities related to international terrorism without notifying the targets. The amendment to the Fair Credit Reporting Act facilitates Government access to information contained in suspected terrorists' credit reports when the inquiry relates to international terrorism. This amendment allows those investigating suspected terrorists prompt access to credit histories that may reveal key information about the terrorists' plan or source of funding—without notifying the targets.

The Act also allows for greater information sharing with the private sector and self-regulatory organizations. Under the Act, for example, financial institutions that submit voluntary disclosures of information relating to terrorism and money laundering are immunized from liability, and Bank Secrecy Act reports can now be made available to securities and commodities self-regulatory organizations.

IEEPA Amendments That Have Helped in Our Freezing Efforts

This Committee was also largely responsible for amendments to the International Emergency Economic Powers Act (IEEPA) that clarified the authority of the President and the Treasury Department to target and block terrorist assets successfully and efficiently. On December 14, 2001, OFAC utilized this authority to block suspect assets and records during the pendency of an investigation in the case of Global Re-

lief Foundation and Benevolence International Foundation, two charities with locations in the United States.

In addition, it has become easier to share and use intelligence information for freezing assets since the USA PATRIOT Act authorized courts to consider classified information under the Act without such information being disclosed to those challenging the blocking. The IEEPA amendment also grants the President the power to confiscate and vest in the United States Government property of countries or persons involved in hostilities or attacks against the United States. Though this authority has not been used, it is a powerful new tool available to the Executive and a deterrent effect to those who would support terror.

New Tools To Follow the Money and To Deter Money Laundering

The Act also strengthens existing money laundering provisions and enhances the Treasury Department's ability to deal with this problem—which, in many respects, is related to the issue of terrorist financing. For example, the Act now requires that trades or businesses receiving more than $10,000 in coins or currency file reports with FinCEN. In addition, as of January 1, 2002, certain money service businesses are required to register with FinCEN and are now required to file suspicious activity reports (SAR's) for money orders, travelers checks, and all transactions by money transmitters. While Congress gave Treasury the authority to impose some of these requirements before the Act was enacted, the Act extended the requirement to underground money transmitters. We have acted promptly to take full advantage of this new extension of authority. To date, it appears that registration is on track, and we will be able to begin the process of finding those underground money remitters who fail to register and charge them criminally if they have not registered in accordance with the law. In addition, the Act has given sharper teeth to these provisions by increasing civil and criminal penalties for Bank Secrecy Act violations.

In all, the Act enables us to fulfill our mission of thwarting the criminal use of the financial system in a way that was unavailable or impossible before October 25, 2001.

Conclusion

Mr. Chairman, we are engaged in a long-term battle against illegal abuse of the financial system. Whether it is terrorist financing or classic narcotics money laundering, we need to take every measure possible to combat the evil deeds that soil our financial system and pose a real threat to our security.

Treasury will continue to use the powers and assets at its disposal to ferret out terrorist financiers and networks and choke the funding source for terrorists here at home and abroad. We will continue to work in close coordination with our sister departments and agencies and with our international partners to make our campaign against terrorist financing as effective as possible. Furthermore, we will continue to fight the battle against money laundering and the criminal misuse of the financial system. An essential part of this mission is the complete and efficient implementation of the provisions of the Act. We are ready for this sustained effort, and we appreciate your support.

Mr. Chairman, this concludes my formal testimony. I would be pleased to answer any questions that you, or Members of the Committee, may have regarding the Administration's goals and policies regarding terrorist financing and the Act.

Thank you.

PREPARED STATEMENT OF MICHAEL CHERTOFF

ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION

U.S. DEPARTMENT OF JUSTICE

JANUARY 29, 2002

Chairman Sarbanes, Ranking Member Gramm, Members of the Committee, I am pleased and honored to appear before the Committee on Banking, Housing, and Urban Affairs to address our progress on the financial front of the ongoing war on terrorism. As Assistant Attorney General of the Criminal Division, I appreciate the opportunity to provide you with a summary of the Department of Justice's efforts in this endeavor, including our actions to implement the authorities set forth in Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001.

Initially, I would like to thank the Members of this Committee and Congress for their prompt response to the terrorist threat posed to the United States and all civilized countries. The USA PATRIOT Act provided those of us whose mission it is

to protect the people of the United States with a wide array of new measures that will serve to enhance our ability to carry out this work. We welcome the new authority granted by the USA PATRIOT Act and are committed to using our new powers in a vigorous but responsible manner.

As the Members of this Committee are well aware, our country faces an extraordinary and grave threat to its national security and the safety of our citizens. As a result of the terrorist acts of September 11, 2001, in which over 3,000 innocent civilians were murdered by terrorists in New York City, in Pennsylvania and at the Pentagon, the United States is actively pursuing a worldwide anti-terrorism campaign today. Osama bin Laden has told the world that, "the battle has moved inside America." Let there be no doubt: He and the forces of al Qaeda and other terrorist groups intend to continue their heinous acts of terrorism.

Accordingly, preventing future terrorist attacks and bringing terrorists to justice is now the top priority of the Department of Justice. Law enforcement is currently engaged in a cooperative effort to identify, disrupt, and dismantle terrorist networks. Terrorism requires financing, and terrorists rely on the flow of funds across international borders. To conceal their identities and their unlawful purpose, terrorists exploit weaknesses in domestic and international financial systems. As this Committee well knows, therefore, curtailing terrorism requires a systemic approach to investigating the financial links to the terrorist organizations.

As you may recall, on September 24, 2001, less than 2 weeks after the terrorist attacks, Attorney General John Ashcroft appeared before the House Judiciary Committee, and then on September 25, before the Senate Judiciary Committee to testify about the Administration's proposed new money laundering legislation. The Department of Justice encouraged the prompt adoption of the Administration's bill because it was necessary to update our money laundering laws. The proposed legislation included a large number of proposals that would provide law enforcement with new investigative tools to prosecute financial crimes related to terrorism and to enhance our ability to cooperate with our international counterparts in the tracing, freezing, and forfeiture of funds used to support terrorist organizations.

Due in great part to important work done by this Committee, Congress responded expeditiously, enacting a major part of the Administration's proposal. On October 26, 2001, 1 month after I had the honor of last appearing before you, Congress passed the USA PATRIOT Act, which included as Title III, the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. Title III of the USA PATRIOT Act has provided law enforcement with important new authority to investigate and prosecute the financing of crime, including terrorism.

Among the many new provisions of the USA PATRIOT Act is the authority to seize terrorist assets, both foreign and domestic, if the property (or its owner) is involved in, related to, or used in support of acts of domestic or international terrorism. The new law also furthered our ability to fight transnational crime by making the smuggling of bulk cash across our border unlawful, adding terrorism and other offenses to the list of racketeering offenses, and providing prosecutors with the authority to seize money subject to forfeiture in a foreign bank account by authorizing the seizure of such a foreign bank's funds held in a U.S. correspondent account. Other important provisions expanded our ability to prosecute unlicenced money transmitters, provided authority for the service of administrative subpoenas on foreign banks concerning records for foreign transactions, and allowed law enforcement more immediate access to reports of currency transactions in excess of $10,000 by a trade or business. These provisions will prove to be powerful new weapons in our fight against international terrorism, as well as other kinds of international criminal activity.

The Financial Aspects of U.S. Anti-Terrorism Initiatives

Mr. Chairman, I would like to offer this Committee a brief summary of the Department's work to date using our present money laundering laws against terrorism. While I am not, of course, at liberty to disclose information that might compromise or undermine ongoing criminal investigations, I am nevertheless able to provide a list of areas in which the Department of Justice, in conjunction with other departments and agencies, is making headway to expose terrorist financing and to promote robust cooperation with our international partners in the global war on terrorism.

Through financial analysis, we continue our work to reconstruct the web of planning and finance that supported the September 11 terror attacks, and we continue to work to detect other threats to our national security, whether by persons affiliated with al Qaeda or by other state or nonstate actors who target the United States or its interests anywhere in the world. Moreover, we have found that, as in many other criminal cases, following the money trail not only leads to other coconspira-

tors, but also provides strong proof of the conspiracy, its membership, and its criminal actions.

Within days of September 11, the Department established the Financial Review Group (FRG), an interagency task force investigating terrorist financing and operating out of FBI Headquarters. The FRG consists of over 100 agents and analysts from the Federal law enforcement community, including the Department of the Treasury and analysts from the National Drug Intelligence Center. The FRG is under the leadership of the FBI's Financial Crimes Section, and Criminal Division attorneys from the Terrorism and Violent Crimes Section, the Asset Forfeiture and Money Laundering Section, and the Office of International Affairs, under my supervision. Over the past several months, the FRG has compiled and analyzed financial information gathered by Federal agents and U.S. Attorneys' Offices around the country in the course of the ongoing terrorism investigation. By collecting this information in one central location, we have created a central depository for relevant evidence—bank records, travel records, credit card, and retail receipts—for financial and forensic analysis. This evidence can then be interpreted and integrated with the fuller body of terrorist evidence collected by law enforcement and others. The work of the FRG is, of course, international in scope as we continue to work with our counterterrorism partners in other countries to follow the money trail. I fully expect the FRG will play a continuing critical role in all terrorist financing investigations.

At the same time we established the FRG, the Department created a task force of prosecutors to work with the FRG and other law enforcement entities in developing terrorist financing cases, with an emphasis on nongovernmental organizations and charities that may be providing cover for terrorist activity. This Terrorist Financing Task Force, located in the Terrorism and Violent Crime Section of the Criminal Division, also includes representatives from the Criminal Division's Fraud, Asset Forfeiture and Money Laundering, and Appellate Sections, the Tax Division's Criminal Enforcement Sections, and Assistant U.S. Attorneys from Virginia, New York, and Colorado.

The FRG has made substantial progress in tracing financing related to the September 11 attacks, as well as the financial underpinnings of Osama bin Laden's al Qaeda organization. Through financial information, we have established how the hijackers received their money, how and where they were trained to fly, where they lived and—perhaps most significantly—the names and whereabouts of persons with whom they worked and came into contact.

The Terrorist Financing Task Force and the FRG are working directly with the Anti-Terrorism Task Forces, or ATTF's, which the Attorney General created in each judicial district. The ATTF's are comprised of Federal prosecutors from the U.S. Attorney's Office, members of the Federal law enforcement agencies, as well as the primary State and local law enforcement officials in each district. They coordinate closely with many of the existing FBI Joint Terrorism Task Forces (JTTF's). The ATTF's form a national network, which is the foundation of our effort to coordinate the collection, analysis, and dissemination of information and to develop the investigative and prosecutorial anti-terrorism strategy for the country.

The efforts of the FRG, the Terrorist Financing Task Force and the ATTF's, along with the work of the Treasury Department, have resulted in targeted law enforcement actions that are at the heart of the Administration's assault on terrorism. On November 7, 2001, the Attorney General announced that a nationwide enforcement action against the al Barakaat network, including coordinated arrests and the execution of search warrants in Massachusetts, Virginia, and Ohio. These actions were coordinated with Treasury's execution of blocking actions pursuant to the Executive Order 13224 against al Barakaat-related entities in Georgia, in Minnesota, and in Washington State. More recently, on December 4, 2001, the President, along with the Attorney General and the Secretary of the Treasury, announced the designation and blocking action against the Texas-based charity known as the Holy Land Foundation for Relief and Development, alleged to be a North American "front" for the terrorist organization Hamas. These actions demonstrate that our fight against terrorist financing is a broad-based effort extending well beyond the al Qaeda network.

In addition to the coordinated shutdown of al Barakaat's operation on November 7, the United States Attorney for the District of Massachusetts is prosecuting the principals of al Barakaat's Boston branch for operating an unlicenced money transmitting business. Between January and September 2001, while operating without a license under Massachusetts law, Barakaat North America knowingly caused the transfer of over $3,000,000 to banks in the United Arab Emirates. On November 14, 2001, a Federal grand jury in Boston returned an indictment charging Liban Hussein, the President of al Barakaat, and his brother, Mohamed Hussein, with a violation of 18 U.S.C. § 1960 (prohibition of illegal money transmitting businesses).

Mohamed Hussein has been detained pending trial, and we are seeking to extradite Liban Hussein through a request made to Canada.

There is another aspect of our terrorist financing efforts that is particularly promising. We are using computers to analyze information obtained in the course of criminal investigations, to uncover patterns of behavior that, before the advent of such efficient technology, would have eluded us. Through what has come to be called "data mining" and predictive technology, we seek to identify other potential terrorists and terrorism financing networks. In our search for terrorists and terrorist cells, we are employing technology that was previously utilized primarily by the business community.

We have reason to believe that terrorists have long utilized identity theft and Social Security number fraud to enable them to obtain employment and access to secure locations, such as airports. In addition, they have used these and similar means to obtain driver's licenses, hazardous material licenses, and bank and credit accounts through which terrorism financing dollars are transferred. The Utah ATTF, under the leadership of U.S. Attorney Paul Warner, recently undertook a computerized data verification operation that uncovered fraud committed by some 60 persons employed in sensitive locations throughout the Salt Lake City International Airport. These efforts are part the Attorney General's stated goal of aggressively using existing law enforcement tools and Government-maintained data to bolster our national security.

As you know, in addition to *United States* v. *Liban Hussein, et al.,* in Boston, a number of other criminal prosecutions related to terrorism are underway. For example, last month, a Federal grand jury in Alexandria, Virginia, returned an indictment charging Zacarias Moussaoui of France with six criminal conspiracy charges, each of which carries a maximum penalty of death. As the indictment alleges, Moussaoui is linked to the al Qaeda organization in part through financial connections. And, earlier this month, a Federal grand jury in Boston indicted another al Qaeda-trained operative for his attempt to destroy an American Airlines jet in December over the Atlantic, in part for a new offense created by the USA PATRIOT Act (18 U.S.C. 1993(a) (attempted destruction of mass transportation vehicle)). We will bring all available financial evidence and analytic techniques to bear in these prosecutions, as well.

And the Department of Justice is also using the civil forfeiture laws to combat the financing of terrorism. While few details are publicly available at this point in time, bank accounts used by, or related to, the September 11 terrorists have been seized by the United States Attorneys in New Jersey and the Southern District of New York.

We continue to work with other Government departments and agencies, including the Department of the Treasury's "Operation Green Quest," in connection with the investigation and freezing of bank accounts and assets related to various organizations claiming to be charitable entities, but which have channeled funds to al Qaeda or other terrorist organizations.

In conjunction with our international partners, we have made substantial progress in the global war against terrorism. Even before September 11, the Criminal Division was involved in efforts to attack terrorist financing on a global scale. Beginning in 1997, we played a key role in negotiations that led to the development of the International Convention for the Suppression of the Financing of Terrorism. This Convention obligates State parties to create criminal offenses specific to terrorist financing, and to extradite or submit for prosecution persons engaged in such offenses. On October 18, 2001, it was my privilege to testify before the Senate Foreign Relations Committee in support of this important international instrument and the implementing legislation. The Senate is to be commended for its swift action to grant advice and consent to ratification of that Convention. We look forward to working with the Congress to resolve any outstanding issues regarding the Convention's implementing legislation.

The Department of Justice, together with the Departments of Treasury and State, continues to plays a leading role in the G–7 Financial Action Task Force against Money Laundering (FATF). Prior to September 11, the FATF adopted its 40 Recommendations on Money Laundering, which have become the global standard for an effective anti-money laundering regime, and fostered an initiative on "Non-Cooperative Countries and Territories" (NCCT), which endeavors to identify publicly the locations of the most prevalent money laundering activities in the world and the jurisdictions with the weakest anti-money laundering legal and regulatory framework. Following September 11, FATF convened an emergency session in Washington on terrorist financing and agreed to focus its efforts and expertise on the global effort to combat terrorist financing. Attorney General Ashcroft addressed the group of international anti-money laundering experts on October 30. At the conclusion of this

extraordinary session, the FATF issued new Special Recommendations on Terrorist Financing, which, among other things, call upon all countries to criminalize the financing of terrorism and terrorist organizations, freeze and confiscate terrorist assets, report suspicious transactions linked to terrorism, and impose anti-money laundering controls on nontraditional banking systems, such as hawalas. The FATF set forth a timetable for action, which requires the development of additional guidance for financial institutions on the techniques and mechanisms used in the financing of terrorism.

As you know, the Criminal Division also works extensively to provide assistance to countries that seek to improve their money laundering and asset forfeiture laws and enhance their enforcement programs. Prior to September 11, the Criminal Division designed and presented a training course to share with foreign governments and practitioners our knowledge and expertise in rooting out terrorist financing. Since September 11, we have placed increased emphasis on providing training and assistance to other countries to aid them in developing mechanisms to detect and to disrupt financial crime. At present, we have attorneys from the Asset Forfeiture and Money Laundering Section participating as members of interagency training and technical assistance assessment teams overseas. These teams will evaluate the various countries' mechanisms to identify money laundering and to freeze or seize terrorist assets. The assessment reports will be used to develop specific action plans for each of these countries as we provide training and technical assistance in the future.

Similarly, we have already held several training sessions on the new USA PATRIOT Act provisions for our own prosecutors and law enforcement agents. These efforts include a conference for prosecutors in December at our National Advocacy Center in South Carolina and a joint national Justice/Treasury conference earlier this month in New York as part of the National Money Laundering Strategy. We have additional training sessions scheduled for February.

Implementation and Use of the New USA PATRIOT Act Authorities

We are working in close coordination with other departments and agencies within the Executive branch to ensure the new authorities of the USA PATRIOT Act are used appropriately and implemented consistent with Congressional intent. The provisions of Title III of the USA PATRIOT Act provide important new authority to investigate financial crimes and attack those crimes on a system-wide basis, yet we remain ever mindful of our obligation to implement those authorities in a manner that protects the rights of U.S. citizens. Accordingly, and shortly after enactment of the USA PATRIOT Act, the Department issued interim guidance to the United States Attorneys regarding the provisions of the new legislation, including Title III.

The Department is also working closely with other departments and agencies, particularly the Departments of State and Treasury and FinCEN, to implement the various sections of the USA PATRIOT Act. On a daily basis, there are interagency meetings involving the drafting of implementing regulations and other guidance to ensure that the new authorities are used effectively and in a manner consistent with Congressional intent.

Some of the new provisions in the Act have already been deployed with successful results. For example, the Department of Justice relied on the new civil forfeiture authority provided in the USA PATRIOT Act to seize six bank accounts in New Jersey and three in Florida related to the September 11 terrorists. On November 8, 2001, the United States Attorney's Office for the District of New Jersey obtained nine seizure warrants for bank accounts used by the terrorists based on the newly enacted USA PATRIOT Act authority codified at 18 U.S.C. 981(a)(1)(G), which provides for the seizure of all assets owned, acquired, or used by any individual or organization engaged in domestic or international terrorism. Notice of the proposed forfeiture of these accounts has been made and, not surprisingly, no one has claimed an interest in the accounts.

In addition, we recently used Section 319 of the USA PATRIOT Act to good effect. Section 319(a) provided us with a new tool to seize and forfeit criminal assets deposited into a foreign bank account through the foreign bank's correspondent bank account in the United States. This Section provides that assets which are subject to forfeiture in the United States, but which are deposited abroad in a foreign bank may be deemed to be held in the foreign bank's correspondent account in the United States. Thus, where a criminal deposits funds in a bank account in a foreign country and that bank maintains a correspondent account in the United States, the Government may seize and forfeit an equivalent sum of money in the correspondent account, irrespective of whether the money in the correspondent account is traceable to the proceeds deposited in an account held by the foreign bank.

Although I was recused from the case because of a past representation, I can report that last month we recovered almost $1.7 million in funds using Section 319, which will be used to compensate the victims of a fraud scheme. On January 18, 2001, a grand jury in the Southern District of Illinois indicted James R. Gibson for various offenses, including conspiracy to commit money laundering, mail and wire fraud. Gibson defrauded clients of millions of dollars by fraudulently structuring settlement agreements for numerous tort victims. Gibson and his wife, who was indicted later, fled to Belize, depositing some of the proceeds of their fraud scheme in two Belizean banks.

Our efforts to recover the proceeds at first were unsuccessful. Although the government of Belize initially agreed to restrain the assets, a Belizean court ordered the freeze lifted, because local law prohibited legal assistance to the United States: The treaty providing for legal assistance between the two countries has not entered into force. The court also prohibited the government from assisting the United States law enforcement agencies further, including providing information regarding Gibson's money laundering activities. Efforts to break the impasse failed, and all the while the Gibsons systematically looted their accounts in Belize.

Following the passage of the USA PATRIOT Act, and interagency consultation, the Criminal Division authorized the use of the Section 319(a) authority. A seizure warrant was served on the correspondent bank, and the remaining funds were recovered. In our judgment, this case presents a compelling example of the need for, and appropriate use of, the new authority under Section 319(a).

While this instance involved fraud, the facts of this case demonstrate the utility of this particular tool, particularly in the area of terrorist financing. Section 319(a) is, of course, an important enhancement to the law enforcement's ability to pursue assets overseas. It is also a very powerful tool and one that can affect our international relationships. Accordingly, the Criminal Division is developing a policy to provide prosecutorial oversight regarding the use of this new provision.

Similarly, Section 319(b) of the Act provides new summons and subpoena authority with respect to foreign banks that have correspondent accounts in the United States. This section authorizes the Attorney General and the Secretary of the Treasury to issue subpoenas and summonses to foreign banks that maintain correspondent accounts with banks in the United States in order to obtain records related to the U.S. correspondent accounts. We also anticipate delegating authority to use Section 319(b) to a level below the Attorney General, but because of the international sensitivities involved, we anticipate that the use of such authority will remain subject to departmental review and approval and interagency consultation. I am currently reviewing a proposal regarding the best way to implement this important new authority.

Earlier I mentioned that the Department is working to implement the new USA PATRIOT authorities with a view to balancing law enforcement effectiveness and valid privacy interests. Section 358 of the USA PATRIOT Act exemplifies the Department's efforts in that regard. Among the important changes made by Section 358 is an amendment to the Right to Financial Privacy Act of 1978. As you know, the Right to Financial Privacy Act, 12 U.S.C. § 3402, places restrictions on the Government's ability to obtain records from financial institutions. Although the USA PATRIOT Act did not change the general statutory authority or process for obtaining financial information through subpoenas or summons, as amended by Section 358, the principal provisions of the Right to Financial Privacy Act no longer apply to letter requests by a Government authority authorized to conduct investigations or intelligence analysis for purposes related to international terrorism. While we continue to conduct financial investigations using subpoenas and summonses subject to the full protections of the Right to Financial Privacy Act, the Department is currently studying how to implement this new USA PATRIOT Act authority.

We are quite enthusiastic about the new investigative and prosecutorial tools set forth in the USA PATRIOT Act. As described in detail earlier, Section 319 is of critical importance. This provision enhances our ability to seize and forfeit criminal assets previously beyond our reach and it provides a mechanism to obtain foreign bank records through administrative subpoenas. We are presently implementing it in consultation with the Treasury Department and the State Department. We have plans for other provisions as well. Although presently subject to the very restrictive 1 year limit of 18 U.S.C. 984(c), the new authority to forfeit terrorist assets, codified at 18 U.S.C. 981(a)(1)(G), has been used effectively already, and we believe it will be of enormous importance to prosecutors. We are also confident that other USA PATRIOT Act tools, such as the enhanced ability to prosecute unlicenced money transmitters acting in violation of the amended 18 U.S.C. 1960, and to seek forfeiture based on conspiracies to evade the reporting requirements in Title 31, will be of substantial future use in the fight against terrorism.

Conclusion

I would like to conclude by expressing the appreciation of the Department of Justice for the continuing support that this Committee has demonstrated for the Administration's anti-money laundering enforcement efforts.

Mr. Chairman and Members of the Committee, thank you for this opportunity to appear before you today. I look forward to working with you as we continue the war against terrorist financing. I welcome any questions you may have at this time.

PREPARED STATEMENT OF RICHARD SPILLENKOTHEN

DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JANUARY 29, 2002

Introduction

Mr. Chairman, I am pleased to appear before the Committee on Banking, Housing, and Urban Affairs to discuss the Federal Reserve's work on implementing the USA PATRIOT Act and our efforts to help law enforcement track terrorist financing activities. The U.S. Government's response to the terrorist attacks on September 11 has necessitated unprecedented cooperation among Federal bank supervisors, the private sector, law enforcement agencies, and the international financial community. Over the past several months, the Federal Reserve has played an important role in many joint activities with bank supervisory and law enforcement authorities and the banking community here in the United States and abroad.

As you requested, today I will describe many of the Federal Reserve's efforts—some of which you may appreciate can only be discussed in general terms in order to avoid compromising on-going law enforcement inquiries. At the outset, I will discuss our current robust anti-money laundering program and the ways that we are enhancing it to address terrorist financing. I will then describe how the Federal Reserve is actively involved in the implementation of the USA PATRIOT Act; how the Federal Reserve staff has been participating in the work of numerous international organizations; and how we have been providing support and technical assistance to law enforcement.

As a preliminary matter, I would like to highlight an important fact about terrorist financing activities that is presenting a major challenge to the Federal Reserve, the other bank supervisory agencies, the banking community, and law enforcement. Terrorist financing activities are unlike traditional money laundering in a very significant respect. Money used to finance terrorism does not always originate from criminal sources. Rather, it may be money derived from legitimate sources that is then used to support crimes. Developing programs that will help identify such funds before they can be used for their horrific purposes is a daunting task, but we are trying to meet this responsibility along with our colleagues at the U.S. Departments of Treasury and Justice, the Securities and Exchange Commission, and other U.S. and international regulatory and law enforcement agencies.

Fortunately, we have a strong foundation upon which to build. Many of the provisions of the USA PATRIOT Act are amendments to the Bank Secrecy Act (BSA), the core of U.S. anti-money laundering efforts. Therefore, I would like to first describe our existing BSA compliance examination program, then explain how we are revising it to address terrorist funding activities and the new provisions of the USA PATRIOT Act.

The Federal Reserve's Anti-Money Laundering Program

The Federal Reserve has a longstanding commitment to combating illicit activity by or through the domestic and foreign banking organizations that it supervises. In 1993, in recognition of the importance of fighting financial crimes such as money laundering, the Board created the Special Investigations Section in its bank supervision division. This Section's functions continue to include overseeing the Reserve Banks' Bank Secrecy Act compliance examination programs, reviewing information developed during the course of examinations, and conducting specialized inquiries to determine whether any of our supervised banking organizations are involved in violations of law. Section staff notifies the appropriate law enforcement agency when apparent violations are detected, and provides support and technical assistance when requested. The Special Investigations Section also conducts financial investigations, provides expertise to the U.S. law enforcement community for investigation and training initiatives, and provides training to various foreign central banks and Government agencies.

Throughout the Federal Reserve System, the Reserve Banks have designated senior experienced examiners as BSA/Anti-Money Laundering Contacts. During every Federal Reserve examination of a State member bank or U.S. branch or agency of a foreign bank, specially trained examiners review the institution's compliance with the BSA. Examiners also evaluate compliance with regulations that require banks to establish internal control and training procedures and to perform independent testing to assure and to monitor compliance with the BSA. Prior to commencing an examination of a State member bank or U.S. branch or agency of a foreign bank, examiners also make use of the BSA database of Currency Transaction Reports (CTR's) and Suspicious Activity Reports (SAR's) filed by the particular banking organization in order to check, among other things, whether the bank, branch, or agency has adequate systems in place to identify and report currency transactions and suspicious activities in accordance with Treasury's and the Board's rules.

When supervised institutions fail to have the appropriate internal controls and procedures for compliance with the BSA, as well as for anti-money laundering purposes, the Board may issue formal enforcement actions and assess civil penalties to correct the systemic deficiencies. These actions are public and are available on the Board's website. In cases of significant BSA violations, relevant examination materials are referred to Treasury for action under its authority to assess fines for BSA violations. When potential money laundering (or other criminal activity) is identified through an examination, or self-disclosure, or from information received from law enforcement, a targeted examination may be conducted, and all relevant information is referred to the appropriate law enforcement agency.

The Federal Reserve's examiners are provided with comprehensive training on the latest trends in money laundering. However, even with appropriate training, it is still difficult for the most experienced examiners to detect sophisticated money laundering schemes during the course of an examination. In this regard, I must emphasize that our examiners are not criminal investigators. It is the examiner's primary responsibility to evaluate the effectiveness of the institution's own policies and procedures to identify and manage the risks associated with money laundering. As a Federal bank supervisory agency, we view the Federal Reserve's role as complementary to the law enforcement duties of criminal justice agencies.

Working with Treasury on the Implementation of the USA PATRIOT Act

On November 26, 2001, the Board issued a supervisory letter to all domestic and foreign banking organizations under its supervision concerning the USA PATRIOT Act. The letter described the provisions of the Act, highlighted those that should receive banking organizations' and Federal Reserve supervisors' immediate attention, and described new rules that would be issued under the Act.

As you are aware, the primary responsibility for these regulations rests with Treasury; however, at the request of Treasury staff and consistent with statutory requirements for consultation, the Federal Reserve has been actively assisting that agency. Treasury has established twenty working groups for the different regulatory projects required by the USA PATRIOT Act, and Federal Reserve staff is involved in fifteen of these groups.

Along with Treasury, Federal Reserve staff started working on those provisions of the USA PATRIOT Act that have effective dates in the immediate future. Treasury's recently proposed rules on the prohibition of correspondent accounts with shell banks; the recordkeeping requirements on foreign bank ownership and designation of agents for service of legal process for correspondent accounts; and the broker-dealer suspicious activity reporting requirements all reflect consultation with the Federal Reserve.

Further, Treasury is expected to issue more proposed rules shortly, one setting forth minimum standards for financial institutions to verify the identification of their customers and another requiring financial institutions to conduct due diligence to identify suspicious activities involving correspondent and private banking accounts. Board staff is providing material assistance to Treasury in the drafting of both of these regulations.

USA PATRIOT Act Examination Enhancements

As USA PATRIOT Act effective dates have approached and proposed rules have been issued, the Federal Reserve has been making certain that banking organizations are aware of the new requirements and have been taking reasonable steps to comply. We are doing this through the bank examination process—a process that is being significantly enhanced throughout the Federal Reserve System.

At the Board, we have established a USA PATRIOT Act Working Group comprised of senior, experienced Bank Secrecy Act/Anti-Money Laundering examiners from throughout the Federal Reserve. This Working Group, which is charged with

overseeing the System's implementation of the new law, is drafting new examination procedures and developing a new training curriculum for examiners who conduct Bank Secrecy Act and anti-money laundering examinations.

We have also increased the staff of the Board's bank supervision division to include several senior examiners from our Reserve Banks to draw upon their field experiences. These new Special Examiners will lead the Working Group; coordinate the System-wide adoption and consistent application of the new examination procedures and training program; and consult with the other Federal supervisors on common issues.

Cooperation with the Private Sector

The Federal Reserve believes that banking organizations and their employees are the first and strongest line of defense against financial crimes and, in particular, money laundering. A banking organization's best protection against criminal activities is its own policies and procedures designed to identify and understand with whom it is conducting business and to identify suspicious activity.

While many of our banks have robust compliance procedures in place, clearly, the recent events underscore the absolute need for banking organizations to conduct effective enhanced due diligence. We are working with law enforcement and the industry to see whether there are any specific indicators of terrorist-related money laundering that may be distinguishable from money laundering involving corruption or drugs. This effort will be crucial not only for law enforcement to identify suspects but also for supervisors to determine if there is a way in the future for potential suspicious activity related to terrorism to be detected proactively.

Another example of industry cooperation is our work with the New York Clearing House (NYCH), which is comprised of representatives from some of the leading U.S. and international financial institutions. On October 11, 2001, senior executives from the NYCH member institutions, and senior level representatives from the Federal Reserve, law enforcement, Treasury and Justice, and other Federal bank supervisors met for the first time to plan how to work together to identify and intercept the flow of funds to and from terrorists and their organizations.

Under the auspices of the NYCH and in cooperation with the Federal Reserve and the other bank regulators, working groups have been established to: Review account opening and monitoring procedures; develop a database for financial institutions to share information about suspicious activity with law enforcement and each other; determine patterns of terrorism financing; broaden international cooperation on information sharing; and ensure that a useful flow of information between law enforcement and financial institutions continues. Federal Reserve staff participates in all of these groups.

Since the issuance of our supervisory letter in November to Federal Reserve-supervised financial institutions, Board and Reserve Bank staffs have reached out to the banking industry, fielding numerous written and telephone inquiries and participating in many seminars, conferences, and meetings with banking organizations and their representatives. Federal Reserve staff welcomes the opportunity to assist the industry in responding to new challenges, and we believe that a strong relationship with our supervised organizations can only further our collective goals.

Banks and other financial institutions have raised many questions about how they ensure that they are not doing business with shell banks and ensure that they have all necessary ownership information about the foreign banks with whom they are doing business. Working with Treasury, the NYCH, and the Federal Reserve and other bank regulatory agency staff, banks have begun using the "certification process" provided for by Treasury's regulations and have been searching for correspondent accounts with shell banks through deposit accounts, as well as other business lines. Through our contacts with banking organizations examined by the Reserve Banks we have learned that several correspondent accounts with shell banks have been closed by U.S. banks.

Financial institutions supervised by the Federal Reserve have also raised questions about the application of the requirement to determine ownership of foreign correspondent banks. Treasury has specifically requested comments on this provision in connection with its proposed regulations. In the meantime, we believe that banks are making their best efforts to comply. We are encouraged that banking organizations have taken steps to prepare for compliance with the USA PATRIOT Act, and we have seen an increase in the number of banks that have improved existing systems or implemented new or more sophisticated systems to monitor funds transfers and identify suspicious activity.

International Initiatives

The international supervisory community plays an important role in ensuring that banking organizations make every effort to stop illicit activity. The Federal Reserve's foreign initiatives include bilateral, as well as multilateral efforts. Over the years, we have provided extensive training and technical assistance on anti-money laundering procedures to foreign law enforcement officials and central bank supervisory personnel in dozens of foreign countries including Russia, Poland, Hungary, the Czech Republic, and a number of the Baltic states, as well as Brazil, Ecuador, Argentina, and other countries in Africa, and the Middle and Far East.

With respect to multilateral organizations, Board staff participates in the Financial Action Task Force (FATF). The FATF, established in 1989 at the G–7 Economic Summit, develops and promotes policies to combat money laundering. The FATF has working groups that are reviewing some of the same issues addressed by the USA PATRIOT Act such as minimum standards for customer identification and due diligence requirements for correspondent banking, as well as other practices susceptible to money laundering.

The FATF held an extraordinary plenary session in October in response to the terrorist attacks and adopted eight special recommendations regarding terrorist financing. To implement the new recommendations, FATF members agreed to draft guidance for financial institutions on the techniques and mechanisms used in the financing of terrorism and to provide technical assistance to nonmembers to assist them in complying with the special recommendations. Board staff is involved in all of these projects.

Another important international initiative to which the Federal Reserve contributes is the Basel Committee on Banking Supervision. The Basel Committee is comprised of representatives of central banks and supervisory agencies from a dozen countries. The Committee does not possess any supervisory authority but formulates broad supervisory standards, guidelines, and recommendations for best practices.

On October 4, the Basel Committee issued minimum standards for customer due diligence for banks. In issuing these standards, the Chairman of the Committee, William J. McDonough, President of the New York Reserve Bank, reiterated that due diligence is an essential element of banks' risk management systems, the importance of which has been underscored by the recent terrorist attacks.

Another organization working on anti-terrorist financing initiatives is the Wolfsberg Group. It is comprised of representatives from several large multinational financial institutions. This Group held a meeting on terrorism financing in early January and invited Government and banking experts to discuss these issues. Board staff attended and gave a presentation on U.S. initiatives taken since September 11. The Group intends to issue a paper identifying "best practices" on the prevention of terrorism financing and hopes that these practices will be adopted by the international banking community.

The Board also participates in the G–7 group, composed of the finance ministers and central bank governors of large industrial countries, and the G–20 group, composed of ministers and governors of emerging-market countries. Following the G–7 meeting in Washington on October 6, 2001, the G–7 ministers and governors issued a statement that highlighted the commitment of its members "to vigorously track down and intercept the assets of terrorists and to pursue the individuals and countries suspected of financing terrorists." On November 17, 2001, finance ministers and central bank governors of the G–20 announced a comprehensive action plan of multilateral cooperation to deny terrorists access to their financial systems. The plan commits members of the G–20 to take a number of concrete steps in cooperation with other international bodies to combat terrorist financing and money laundering.

Assistance to Law Enforcement

Earlier in my testimony, I emphasized that as a Federal bank supervisory agency we view the Federal Reserve's role as complementary to law enforcement's duties. That being said, however, bank supervisors have an important role in ensuring that criminal activity does not pose a systemic threat to the financial system. Since its inception, our Special Investigations Section staff has provided financial investigative expertise to law enforcement agencies, and we have continued and expanded those efforts. Also, since September 11, many of our Reserve Banks have assisted law enforcement in various ways.

Shortly after September 11, the FBI sought our assistance in circulating a list of suspected terrorists to banks. The Bureau wanted the banks to check their account and transaction records against this list and report any positive responses to law enforcement as quickly as possible. Within 24 hours of that request, the Federal Reserve and the other Federal banking supervisors disseminated the list to virtually

every banking organization in the country. The Federal Reserve distributed this list by issuing a supervisory letter to all of its banking organizations.

Soon thereafter, Treasury's FinCEN set up a telephone hotline so that banks and others could report suspicious activities related to terrorism through FinCEN to the FBI, thereby enabling law enforcement to receive information on almost a real time basis. We advised the financial institutions supervised by the Federal Reserve about this new procedure as soon as it was in place by issuing another supervisory letter.

From the middle of September through October, the proliferation of various requests continued as banks received increasingly longer lists from a variety of law enforcement sources, both domestically and abroad. To alleviate the burden of searching for names on these multiple lists, many of which were duplicative, the FBI and other law enforcement agencies prepared a unified "Control List" to supersede all other lists.

To ensure that the broadest number of financial institutions received this Control List, it was agreed that electronic communication would be the most efficient and expeditious method of distribution. The New York Reserve Bank, working with the U.S. Attorney for the Southern District of New York, devised a dedicated e-mail account that allows banks to receive one Control List from law enforcement. Banks respond with positive information back to this same e-mail account, and the information is then forwarded promptly to law enforcement for further action such as an issuance of a subpoena. The Federal Reserve and the other Federal bank supervisors issued a Joint Agency Request explaining this system to almost 20,000 financial institutions. Cooperation from the banking industry has been outstanding despite the time consuming effort that is needed to run name checks on many similar names with few identifiers. This system continues to be active, and, to date, there have been over two hundred responses forwarded to law enforcement.

The Federal Reserve provided the Control List to the Basel Committee for circulation among its member countries. In addition, the Federal Reserve sent the Control List to over a dozen other central banks around the world.

The Control List is different, of course, from Treasury's Office of Foreign Assets Control (OFAC) list. OFAC disseminates its own list for which many banks have automated filters to block transactions and assets or to deny transactions altogether. Most banks are notified of additions and modifications to the OFAC list through Fedwire, the Federal Reserve's large value electronic payments system. The OFAC list has been amended numerous times since September 11, and U.S. banks have diligently complied with their responsibilities to block and freeze accounts.

Finally, I can report that starting on September 17, 2001 the New York Reserve Bank, at the request of law enforcement and pursuant to subpoenas, began searching the records of Fedwire for information related to terrorist acts. Search results have been provided to various law enforcement agencies, which have reported to us that the information we provided has been useful in their on-going investigations.

In addition, multiagency teams led by various U.S. Government agencies have been deployed to foreign countries to analyze bank and other financial records. On several of these occasions, senior Reserve Bank examiners have traveled and worked with the teams. The feedback we received is that our expertise was of great assistance and that the foreign jurisdictions welcomed the presence of a central bank examiner on the investigative teams. Based on information developed by the team members, OFAC included new entities and individuals on its lists.

In the wake of the terrorist attacks, the FBI formed the Financial Review Group (FRG), a multiagency law enforcement task force to trace transactions and assets of terrorists and their supporters here and abroad. Recognizing the particular expertise that we have in financial investigations and our facility with bank records, representatives from the group of specialized examiners that I referred to previously—the Federal Reserve's Special Investigations Section—were requested to participate. Staff from this group regularly participates in the FRG's efforts.

Over the past several months, Federal Reserve staff has assisted in the evaluation of financial data collected by the FRG and has provided other valuable services to the law enforcement officials participating in the FRG. For example, a need very quickly developed for information on specific foreign banking organizations. Law enforcement sought details such as ownership, organizational structure, nonbank subsidiaries, and geographic location of operations. Special Investigations Section staff was able to obtain this information very promptly. Additionally, FRG staff needed information relating to funds transfer systems; wire transfer practices, particularly in the Middle East; nontraditional funds transfer methods; and general banking practices, such as account opening procedures. Federal Reserve staff helped to answer these questions.

The Federal Reserve has also provided assistance and technical support to the OFAC's Foreign Terrorist Asset Tracking Center. This OFAC group gathers information relating to terrorist groups' methods of fundraising and funds movement.

Conclusion

As a bank supervisor, the Federal Reserve believes that it is necessary to take all reasonable and prudent steps to assure that banking organizations are not victims of, and do not knowingly participate in, illicit activities such as money laundering and the funding of terrorist activities. Bank supervisors must ensure that criminal activity does not pose a systemic threat, and that banking organizations operating in the United States protect themselves fully from such illicit activities.

All of the actions I described underscore the Federal Reserve's significant commitment to the bank regulatory community's anti-money laundering and anti-terrorism mission. We will continue our cooperative efforts with the Congress, the banking industry, the other bank and securities supervisors, and international communities to develop and implement effective programs addressing the ever-changing strategies of terrorists and other criminals who attempt to launder funds through banking organizations here and abroad. The Federal Reserve will also continue to lend our expertise to the U.S. law enforcement community anywhere in the world when it seeks to track or intercept terrorist funds.

PREPARED STATEMENT OF ANNETTE L. NAZARETH

DIRECTOR, DIVISION OF MARKET REGULATION
U.S. SECURITIES AND EXCHANGE COMMISSION

JANUARY 29, 2002

Chairman Sarbanes, Ranking Member Gramm and Members of the Committee, I am pleased to appear before you today to testify on behalf of the Securities and Exchange Commission (SEC or Commission) concerning steps the Commission has taken to assist in the financial aspects of U.S. anti-terrorism initiatives, and the implementation of the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001—which is Title III of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (USA PATRIOT Act).

My appearance before you today comes during a period of close intergovernmental cooperation. The Departments and Agencies represented by those of us testifying on this panel and the other members of Government and independent private sector working groups put into place after the horrible attacks of September 11, 2001 are working to implement the USA PATRIOT Act's new mandates in the fight against money laundering and terrorism. Chairman Pitt has made clear the Commission's full partnership in these efforts. Within hours of the September 11 attacks, the Commission and its staff began the process of identifying and executing the steps we could effectively take in this collaborative effort. The enactment of the USA PATRIOT Act further strengthened this process.

Financial Aspects of the War on Terrorism

I will first address the SEC's contributions to the financial aspects of the Government's anti-terrorism efforts that respond most directly to questions raised by the attacks. There are two key components to this work. First, on September 12, 2001, the staff of the Division of Enforcement commenced a review of certain trading activity preceding the terrorist attacks on September 11. Working with the surveillance staff of the U.S. securities self-regulatory organizations, Commission staff reviewed trading activity in over 125 individual securities and index products. The results of this inquiry have been, and continue to be, shared with criminal law enforcement authorities.

Second, we have supported the effective use of the "Control List" of individuals or entities identified by the Federal Bureau of Investigation and other law enforcement agencies in their ongoing investigations of the events of September 11. At the request of the Department of Justice, the Commission issued a release to enlist the voluntary review by securities-related entities of the Control List to identify name matches with accounts at each institution.[1] The Commission's release followed meetings among Government and private sector representatives working together to uncover financial aspects of the terrorist attacks. To date, the Commission has re-

[1] *See* Securities Exchange Commission Press Release No. 2001–115 (October 18, 2001).

ceived nearly 1,800 responses to this release and has coordinated the collection of account documentation relevant to these responses. Under what have often been challenging personal and professional circumstances, securities firm personnel have searched their records in order to aid the Government's efforts. The cooperative efforts and practices developed through this early work are helpful to us as we consider how to encourage ongoing cooperation among financial institutions and Government, as Congress has called for in Section 314 of the USA PATRIOT Act.

Implementation of the USA PATRIOT Act for the Securities Industry

We have also taken up the clear mandate Congress gave us in the USA PATRIOT Act. The Commission is an active participant in working groups, led by the Department of the Treasury (Treasury), that were established to help implement the USA PATRIOT Act. SEC enforcement and regulatory staff are providing their expertise in support of the working groups' efforts.

Regulatory implementation of the USA PATRIOT Act is proceeding on time. This progress builds on the strong foundation of preexisting U.S. financial regulation and anti-money laundering efforts. New regulations, either proposed or soon-to-be proposed, should provide appropriate tools to deny money launderers and terrorists the use of the Nation's financial institutions to launder the proceeds of crime for profit, or for the furtherance of their criminal activities, including terrorism.

One important tool is the proposed suspicious activity reporting rule for broker-dealers. Treasury proposed this rule on December 20, after close consultation with Commission staff. This proposal, which Treasury had underway well before September 11, was completed shortly after the enactment of the USA PATRIOT Act. It will require broker-dealers to file with the Government reports of suspected illegal activity through their firms. These reports are widely known as SAR's.[2]

SEC and Treasury staff readily reached consensus on extending comparable obligations to file SAR's across financial institutions. Treasury's proposal would implement a SAR regime for broker-dealers that closely mirrors existing requirements for depository institutions. In its proposal, Treasury points to the importance of strong compliance procedures and states that, for broker-dealers as for banks, the proposed suspicious transaction reporting requirements require financial institutions to evaluate customer activity and relationships for money laundering risks. The proposed rule focuses broker-dealers on the money laundering risks stemming from their client-base and the types of business in which they engage. For instance, because so little broker-dealer business is done in cash, there is relatively little "placement stage" money laundering risk at broker-dealers.[3] Nonetheless, the rule requires broker-dealers to remain vigilant with respect to any cash or cash equivalent business in which they may engage. This risk-based approach to identifying and to reporting suspicious transactions should empower broker-dealers to focus their SAR detection and reporting resources appropriately.

As the Committee knows, broker-dealers affiliated with banks have already long been subject to the bank regulators' SAR rules. Other broker-dealers have filed SAR's on a voluntary basis. We believe that this rulemaking proposal completes the process of assuring that all broker-dealers report possible money laundering. Moreover, this rulemaking will enable all broker-dealers registered with the Commission to be subject to the same SAR rule. In particular, we expect, as a result of Treasury's consultation with the Board of Governors of the Federal Reserve System, that the bank regulators will determine, once Treasury's broker-dealer rule becomes effective, that bank-affiliated broker-dealers should be subject to Treasury's rule, rather than two separate SAR rules.

Apart from Treasury's proposed SAR rule for broker-dealers, we are also working with the other members of the working groups, including the bank regulators, the Commodity Futures Trading Commission, Department of Justice, and Internal Revenue Service to move forward with the full complement of rules called for under the USA PATRIOT Act. Significant steps are underway that should increase the information financial institutions have about customers they accept, as well as improve their decisions about whether to engage in certain business at all.

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[2] 66 FR 67670 (December 31, 2001).

[3] In the "placement" stage, cash is converted to monetary instruments, such as money orders or travelers checks, or deposited into financial institution accounts. In the "layering" stage, these funds are transferred or moved to other accounts to further obscure their illicit origin. In the "integration" phase, the funds are used to purchase assets in the legitimate economy or to fund further activities. *See Anti-Money Laundering: Efforts in the Securities Industry* (GAO–02–111, October 2001) and *The 2001 National Money Laundering Strategy,* prepared by the U.S. Department of the Treasury, in consultation with the U.S. Department of Justice (available at *www.ustreas.gov / press / release / docs / ml2001.pdf).*

For example, on December 19, Treasury issued a proposed rule to implement the USA PATRIOT Act's new prohibition against providing correspondent accounts to foreign shell banks that are not affiliated with a supervised bank.[4] Commission staff consulted with Treasury throughout its rule drafting process, providing technical assistance as Treasury considered the scope of accounts that would be considered to be "correspondent accounts." The proposed rule includes procedures designed to aid firms in meeting the challenges of determining whether their customers, or their customers' customers, are foreign shell banks. It also takes a bold step forward in excluding from the American financial system any "brass-plate" bank that blocks official scrutiny of the actors behind it. We look forward to working with Treasury to respond to technical questions received during the notice and comment process on this proposed rule.

Other forthcoming rulemaking projects should complement the shell bank proposal. In particular, interagency discussions are underway concerning the identification of customers at account opening (as required under Section 326 of the USA PATRIOT Act) and due diligence policies for correspondent and private banking accounts (as required under Section 312). We expect that rule proposals in the coming months under these provisions will direct financial institutions, along with their examiners, to use risk-based approaches to acquiring and assessing information necessary to address money laundering.

Section 352 of the USA PATRIOT Act also requires financial institutions to establish anti-money laundering programs by April 24, 2002. In order to implement this provision fully and effectively, the National Association of Securities Dealers-Regulation (NASDR) and the New York Stock Exchange (NYSE) have stepped forward to create a regulatory framework. The NASDR and the NYSE developed a rule that was vetted fully through the Section 352 interagency working group. We expect the NASDR to file this proposed rule for Commission consideration shortly. A companion rule is scheduled to be considered by the NYSE Board in February. These proposals by the securities industry's self-regulatory organizations (SRO's) will, when completed, enable frontline examiners for broker-dealers, as part of their ongoing responsibilities, to examine and enforce this key provision of the USA PATRIOT Act.

In addition to its role in these rulemaking efforts, the Commission is continuing in other ways to focus its attention, and the securities industry's attention, on money laundering. Bank Secrecy Act provisions that are applicable to broker-dealers have been included in our examination program for decades.[5] In addition, we have long had an open dialogue with a Securities Industry Association-affiliated group of senior broker-dealer compliance officials who meet to share anti-money laundering approaches with one another, and with Government.

A current, broader Commission examination initiative was announced in May 2001. Commission staff, along with staff from the NYSE and NASD, began conducting a series of comprehensive risk-based anti-money laundering examinations to assess industry practices for anti-money laundering compliance.[6] Preliminary results of the examinations, which have not been completed, support the recent assessment of the U.S. General Accounting Office in its October 2001 report.[7] Larger firms, which effect the most securities transactions and hold most of the U.S. market's accounts and assets, have for the most part implemented a broad range of anti-money laundering measures. Middle-sized and small firms, however, have further to go in focusing attention on money laundering risks. The ongoing examinations are helping shape our understanding of existing practices at all types of firms, and of how they should be strengthened.

The working groups established by Treasury to implement the USA PATRIOT Act also are addressing other mandates of the USA PATRIOT Act. As mentioned earlier in my testimony, progress has been made in developing a proposal to facilitate the sharing of information between Government and financial institutions that may be critical in the fight against terrorism. In addition, interagency groups have had initial discussions regarding the definition of key terms under the USA PATRIOT Act, including the definition of "concentration accounts" as called for under Section 325.

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[4] 66 FR 67460 (December 28, 2001).

[5] In addition, because the Commission has incorporated Bank Secrecy Act (BSA) recordkeeping and reporting requirements into its own rules, the Commission enforces these BSA requirements. *See* Securities Exchange Act Rule 17a–8.

[6] *Money Laundering: It's on the SEC's Radar Screen,* Remarks by Lori A. Richards at a conference program entitled *Anti-Money Laundering Compliance for Broker-Dealers,* organized by the Securities Industry Association (May 8, 2001).

[7] *See supra,* note 3.

Another group has also begun the analysis of Government-wide access to information called for under Section 361.

The SEC staff also has been working with Treasury and the private sector to address the application of the Bank Secrecy Act to investment companies registered with the Commission under the Investment Company Act of 1940. While investment companies have not to-date been directly covered by Bank Secrecy Act regulations, the broker-dealers that sell the funds are covered. Later this year, we expect a broader interagency working group under Section 356 to submit a report concerning regulations to apply the Bank Secrecy Act to registered investment companies along with hedge funds and personal holding companies. In the near term, however, the working group already is addressing the application of Section 352 (anti-money laundering programs) to investment companies. Moreover, as you may know, the Investment Company Institute (ICI) issued a paper entitled Money Laundering Compliance for Mutual Funds in May 1999 in order to focus its members' attention to the money laundering risks they face. Since the enactment of the USA PATRIOT Act, the ICI has offered its cooperation in extending these provisions to its members.

I am heartened to be able to provide the Committee with so many examples of action taken since the adoption of the USA PATRIOT Act. Together, the regulators and the industry have made substantial progress on some difficult issues in a short period of time. On behalf of the Commission, I appreciate the opportunity to participate in this hearing. We look forward to continuing to share our views with this Committee, the Treasury, and other participants in the implementation of the USA PATRIOT Act. I would be happy to try to respond to any questions the Committee may have.

RESPONSE TO A WRITTEN QUESTION OF SENATOR REED FROM KENNETH W. DAM

Q.1. Could you give us some sense of how you feel that process is going, whether our institutions are being more careful about who they deal with?

A.1. We believe that financial institutions have taken greater care in identifying their customers in the wake of the September 11 terrorist attacks. Our evidence is mostly anecdotal, and it would be hard to prove this contention empirically since there are no baseline surveys or data that we can use to assess a change in behavior by financial institutions.

Following the September 11 attacks, the American Banker's Association (ABA) formed an eight-member Account Opening Best Practices Group representing a cross-section of the ABA's membership. The Best Practices Group joined its efforts with a similar initiative organized by the New York Clearing House. In January 2002, the ABA released an industry resource guide on *Identification and Verification of Account Holders* in printed and electronic form.

The resource guide recognized that the easy falsification of identity documents is one of the major challenges facing financial institutions in verifying a customer's identity at the account opening phase of a relationship. Additionally, financial institutions are not able to quickly and accurately access Government or commercial databases to verify information that they are provided. The resource guide called on each institution to examine its own operations and make appropriate risk-based determinations about whether any adjustments to their account opening procedures are necessary.

The ABA resource guide recommended that financial institutions obtain certain information when opening personal and business accounts. The resource guide advised institutions to obtain and record, at a minimum, the following information when opening personal bank accounts: (1) the individual's name; (2) a Tax Identification Number; (3) address; (4) telephone number; (5) occupation; (6) date of birth; and (7) information concerning the person's business, if opening a sole proprietor business account. The guide urged financial institutions to verify the accuracy of the information provided by the customer to the extent practicable.

For new accounts opened by a business (partnership, corporation, business trust or other entity other than a sole proprietor), the ABA guide directed that institutions should, at a minimum, obtain and record the following information: (1) business name; (2) business Tax Identification Number; (3) principal place of business operations; (4) business mailing address; (5) phone number; (6) type of business organization (corporation, partnership, trust, other); (7) ownership information, such as whether the business is publicly held, the number and/or identity of the owners; and (8) the website or the e-mail address of the business, if applicable. The ABA guide recommended that financial institutions verify the information provided by the business and, to the extent practicable, obtain documents confirming the existence of the business (such as its articles of incorporation) and conduct a site visit.

The ABA guide also instructed financial institutions that it was imperative to determine at the time of an account opening whether a potential customer appears on any list of known or suspected terrorist suspects or organizations that may have been provided to the institution by law enforcement or other Government agencies. The financial institutions were urged to follow appropriate reporting processes if a match was identified.

Thus, it is clear from the ABA guide that financial institutions are now paying more attention to their account opening procedures. We expect that all financial institutions will pay even more attention to their procedures when a Treasury-led interagency working group completes its work on devising regulations to implement Section 326 of the USA PATRIOT Act.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR BAYH FROM KENNETH W. DAM

Q.1. Last Tuesday, you announced that the Administration's fiscal year 2003 budget would seek an increase in the fiscal year 2003 budget of the Financial Crimes Enforcement Network (FinCEN) by 6.3 percent or $3.3 million, to $52.3 million. FinCEN is charged with implementing the money services businesses regulations, which include hawala.

Prior to September 11, many of the agencies involved in tracking and cutting off terrorist funding did a poor job of coordinating and consulting each other. Part of the problem could have been a resource problem, and therefore solved by providing those agencies with additional funding. If Congress is, however, going to approve this budget increase for FinCEN—an agency that has been criticized in the past—there has to be accountability for how the money will be spent.

Could you please specify how the Administration plans on using the $3.3 million? Will it go to salaries and expenses? Will it go to enforcement or outreach? Please be as specific as possible.

A.1. FinCEN requests $52,289,000 and 254 full-time equivalents in its fiscal year 2003 budget. This request is a net increase of $3,293,000 and 16 FTE over the fiscal year 2002 funding level of $48,996,000. The increase includes $1 million and 8 FTE to begin to meet the challenges of the USA PATRIOT Act. Also included in this increase are $2,293,000 and 8 FTE to allow FinCEN to continue operations at the current level.

The $2,293,000 will provide funding for the following areas: $2,061,000 to maintain current operating levels; $400,000 to annualize the 17 positions authorized by the Homeland Security Emergency Supplemental; $313,000 to pay the full Government share of the accruing cost of retirement for current CSRS, as proposed in the fiscal year 2003 President's Budget; and a reduction of $481,000 to reflect the Secretary's expectation of reasonable savings from better business practices. FinCEN is also requesting $354,000 for the continuation of its efforts related to the Money Services Businesses (MSB) regulatory program. This request is to cover the costs of maintaining current levels of operation within the MSB program.

Q.2. As you know, I am interested in hawala and believe that this system is exploited by terrorist organizations to move money around the world and finance their criminal acts. For that reason, I had hawala explicitly included in the money services businesses regulations as part of the 2001 Act.

The regulations required money services businesses to register and to begin to file suspicious activity reports by December 31, 2001. Since many of the money transfer businesses are very small businesses, it will take time to educate them about the registration and reporting processes. Could you tell the Committee what type of outreach FinCEN, or other parts of the Department of the Treasury, are currently undertaking with regard to money transfer businesses? What type of outreach has FinCEN conducted with regard to hawala?

A.2. FinCEN has engaged in a multifaceted outreach program to MSB's for the last 18 months. Upon signing a contract with the public relations firm Burson-Marstellar in the summer of 2000, focus groups were organized to help FinCEN design an effective outreach campaign. Through State licensing lists from the 45 States that require some form of licensing and by using commercial databases, an initial registration contact list of approximately 10,745 entities was compiled. Attempts to contact each of the entities on the list were made, through the fall of 2001, to verify addresses and to establish a point of contact. It was subsequently determined that approximately 2,000 entities were either duplicates or no longer in business. An initial mailing which included the registration form and a fact sheet was done in December and coincided with the launching of FinCEN's dedicated website, *www.msb.gov*.

These initial efforts produced excellent results. By mid-January, approximately 80 percent had responded and, within 30 days, approximately 9,500 responses were received. A follow up "Reminder" postcard has been sent to the balance. In addition, SAR filings have begun.

The next phase of the campaign, dealing primarily with SAR filing requirements, will include targeted advertising to communities with large concentrations of businesses who serve those for whom English may be a second language. This phase of the campaign will also include extensive speaking engagements, meetings with community groups, and the distribution of user-friendly materials such as a Quick Reference Guide, posters, the development of a video and, possibly, a CD-ROM.

With respect to the registration of hawalas, these money transfer operations fall within the money transmitter definition. Therefore, those that operate independently of the other money transfer companies are required to register. Our goal is to reach as many enterprises as possible with information that assists a business to comply with the MSB rules. Of course, determining whether a particular business type or individual business enterprise, such as hawala, is in compliance with the MSB rules, will involve field-level resources. The Internal Revenue Service (IRS), through both its civil arm responsible for Bank Secrecy Act (BSA) compliance examination and its law enforcement component, is undertaking that effort. In addition, as the IRS and other law enforcement agencies, such as the Customs Service and the FBI, identify nonregistered

hawalas during the course of their criminal investigations, the MSB rules, which carry severe criminal penalties for noncompliance, become useful law enforcement tools.

Q.3. Treasury is charged with producing the study on hawala, that I requested as part of the 2001 Act. In 1998, FinCEN produced a report on hawala. It was very well done. I am hopeful, however, that this new report will not be a duplication of the 1998 report. Instead, I expect to see a report that addresses terrorist financing issues, including those raised prior to September 11. The report should also examine new tools that the law enforcement community needs to deal with hawala. Has Treasury decided how it will undertake the study? Who was selected to produce that report? When do you expect that drafts will be available for our review?

A.3. FinCEN will draft the report, as required under Section 359 of the USA PATRIOT Act. The report will be produced by using information developed by and transferred from existing in-house staff, as well as the results of an ongoing contract that was in process prior to September 11. FinCEN expects that its report will go well beyond the scope of its 1998 report, and will address law enforcement and regulatory challenges posed by alternative remittance systems and their associated risks. FinCEN has established a Non-Traditional Methodologies Analysis Section, whose initial mission is to build an expert knowledge base on alternate remittance systems, including hawala. Although the unit will not be fully staffed by early summer 2002, its work has already begun.

The contract referred to above requires the contractor to analyze information developed from law enforcement investigative cases to determine the risks posed by systems, such as hawala, in terrorist financing; the challenges to law enforcement raised by such systems; regulatory issues raised by the existence of such systems; and possible regulatory initiatives that could be adopted to reduce or eliminate terrorist financing risks associated with such systems. This information will be combined with the other knowledge and intelligence developed independently by FinCEN as part of its own research and analysis; ongoing interagency law enforcement and regulatory discussions; and other seminars, conferences, and information exchanges on alternative remittance systems. FinCEN will update your staff on its progress within the next 3 months.

RESPONSE TO A WRITTEN QUESTION OF SENATOR CORZINE FROM KENNETH W. DAM

Q.1. Is there progress in the Gulf States?

A.1. The United States has tax information exchange agreements with 19 countries, mainly in the Caribbean and Central America. These tax information exchange agreements provide for the exchange of information for the purposes of administering and enforcing our tax laws. All of these agreements contain strict confidentiality requirements that are intended to ensure that information exchanged under the agreements can only be disclosed to persons or authorities involved in the Administration or enforcement of tax laws and can only be used for tax purposes. In our recent efforts to expand this network of tax information exchange agreements, we have focused on significant financial centers.

In addition to our tax information exchange agreements, we have a very broad network of tax treaties that include provisions for the exchange of information for the purposes of administering and of enforcing our tax laws. These tax treaties contain the same strict confidentiality protections. Our tax treaty network, which covers 49 countries, includes treaties with Egypt, Israel, and Tunisia.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM MICHAEL CHERTOFF

Q.1. Some critics claim that the Department of Justice is insufficiently engaged in righting money laundering as a separate crime committed by financial intermediaries (as opposed to "own funds" money laundering). They cite the disappearance of a separate money laundering section in the Criminal Division, the falling rate of money laundering prosecutions, and the fact that money laundering counts are often the first bargained away by prosecutors. To what extent do the recent "Wire Cutter" and al Barakaat investigations, and the Brennan prosecution in the District of New Jersey, indicate a general change in direction? Has that change in policy been communicated to the United States Attorneys? Would a national strike force, aimed at financial intermediaries, confirm the broader interest of the Department in money laundering?

A.1. The Department of Justice is fully committed to combating money laundering systems and those financial intermediaries who control them. Ever since our first money laundering laws were enacted in 1986, the Department has aggressively pursued an agenda to "follow the money," whether it be criminal proceeds or, as a result of more recent events, funds used to finance acts of terrorism. It has been and remains our mission to follow that money around the globe as we try to identify, seize, and forfeit criminal funds. We have not wavered from that mission over the years and, in fact, are pursuing it with a renewed vigor as a result of the September 11 attacks.

Happily, I am very pleased to report that our critics simply have their facts wrong when it comes to the Department's commitment to fighting money laundering. The Asset Forfeiture and Money Laundering Section, staffed with over 30 attorneys, provides nationwide support, training, and guidance to a network of Assistant United States Attorneys engaged in money laundering investigations. Additionally, it litigates cases involving money laundering organizations or systems which are international, multijurisdictional, or otherwise complex—cases not suited to a single U.S. Attorney's Office, and which draw on the strengths and the expertise of the Section. The Section has engaged in a number of groundbreaking cases involving the Black Market Peso Exchange, offshore banks, and attorneys and accountants acting as "gatekeepers" into financial markets.

Prior to the enactment of the Civil Asset Reform Act of 2000, the forfeiture provisions of our money laundering laws were our primary vehicles for forfeiting criminal proceeds. As a result it made sense to combine the expertise of the two sections that handled money laundering and asset forfeiture into one section. As a result of this consolidation, our attorneys are experts in both areas and provide valuable assistance and training on the use of the money

laundering and asset forfeiture laws to Federal, State, and local law enforcement agents and prosecutors, as well as to our foreign counterparts.

Moreover, our statistics show no decline in money laundering prosecutions. According to the data collected by the U.S. Sentencing Commission for fiscal year 2000, the latest available data, 991 defendants were convicted of money laundering offenses. While this is down slightly from 1999 (1,001), it is up from prior years (913 in 1998, 895 in 1997, and 827 in 1996). An analysis of the seriousness of the offense for those convicted has also remained fairly stable. The percentage of defendants who were sentenced as a leader, manager, or organizer—an approximate indication as to whether we are attacking the "brains" of the organization—remains roughly consistent over time at 20 percent. The percentage of defendants whose sentencing scores for the most serious money laundering charge reflected the laundering of in excess of $350,000—again an approximate measure of the significance of the cases we bring—has remained relatively stable at roughly 42 percent.

I would point out, however, that we anticipate a decline in the number of money laundering prosecutions over the next few years as a result of two developments. First, as a result of the Civil Asset Forfeiture Reform Act of 2000, which became effective in August 2000, prosecutors no longer need to charge money laundering in order to pursue the forfeiture of the proceeds of most Federal crimes. Section 2461(c) of Title 28, United States Code, now authorizes criminal forfeiture for any offense where civil forfeiture of property has been authorized, thus allowing for the criminal forfeiture of proceeds of any specified unlawful activity. Second, as a result of the changes in the sentencing guidelines for money laundering and fraud offenses that became effective on November 1, 2001, there is now a closer correlation between the offense levels for fraud and money laundering for those persons who commit both offenses and less of a need to resort to money laundering charges to attain adequate sentences for fraud offenses. As a result of these two developments, it would not be surprising to see money laundering charged in fewer cases in the future.

With regard to the allegation that prosecutors bargain away money laundering crimes, we have no data or evidence that would support that conclusion. As pointed out in the Department's 1996 "Report for the House and Senate Judiciary Committees on the Charging and Plea Practices of Federal Prosecutors with Respect to the Offense of Money Laundering," Department of Justice guidelines on plea agreements strictly control the circumstances in which prosecutors can bargain away the most serious charge.

There has been no change in the Department's overall strategy against money laundering except to the extent that we have placed a greater emphasis on seeking to identify and disrupt terrorism financing since September 11. The cases cited in your question include a drug money laundering case (Wire Cutter), a white collar money laundering case (the Brennan prosecution), and a terrorism financing case (al Barakaat), demonstrating that the Department is focusing on all kinds of money laundering. These cases are simply the most recent examples of our constant efforts to ensure that we remain flexible to the changes in operation made by money laun-

dering organizations. Our primary strategy, as set forth in the *2001 National Money Laundering Strategy,* is to focus law enforcement efforts on major money laundering organizations and systems. This strategy is communicated to our prosecutors and agents in the field through a comprehensive program of conferences, training, and publications.

With respect to your suggestion that a national strike force aimed at financial intermediaries might confirm the broader interest of the Department in money laundering, we believe that such a demonstration of commitment is not necessary. The Department's commitment has been stated clearly and frequently. For example, in a speech before an international conference on organized crime in Chicago in August 2001, Attorney General Ashcroft told the assembled group of law enforcement experts that: "The Department of Justice is committed to helping you use our money laundering laws to the fullest extent possible to identify, investigate, and prosecute those who would launder the illegal proceeds of organized crime by giving law enforcement the tools to follow the trail." And, there should be no question of the Department's commitment in this area.

This is not to say, however, that every possibility of increasing the effectiveness of our anti-money laundering enforcement should not be explored. As a result of the ingenuity and adaptability of money launderers, barriers remain to effective money laundering prosecutions, including an increasing reliance on bulk cash transfers, offshore accounts, and global financial institutions. As money laundering continues to become more sophisticated and global in nature, it is increasingly important to ensure that our money laundering laws—drafted in the 1980's to deal primarily with a domestic problem—keep up-to-date with these new developments. In this regard, we would like to express our appreciation to you for the powerful new anti-money laundering provisions in the USA PATRIOT Act. These provisions represent a significant milestone in addressing the needs of law enforcement to meet the continuously evolving challenges posed by money launderers. We look forward to working with you to keep our money laundering laws up to date and to fill gaps in the laws as they arise. Similarly, we must ensure that our investigative resources and techniques continue to develop. With respect to your suggestion of a national strike force aimed at financial intermediaries, we believe that our current network of Organized Crime Drug Enforcement Task Forces and High Intensity Financial Crime Areas, along with the anti-terrorism resources of the FBI's Financial Review Group and the informal network of money laundering contacts maintained by the Criminal Division's Asset Forfeiture and Money Laundering Section, are sufficient to address the challenges we face at this time. We welcome the opportunity to discuss with you this and any other possible recommendations for improving our ability to effectively address international money laundering.

Q.2. What principles should govern sharing of information about specific individuals by Government agencies with U.S. financial institutions (or the sharing of such information among financial institutions) under Section 314 of Title III of the USA PATRIOT Act? What procedures do you envision being adopted to structure and

control the contemplated information sharing, and to determine when a person is "reasonably suspected based on credible evidence of engaging in terrorist acts or money laundering activities?"

A.2. Any procedures promulgated under Section 314 of the USA PATRIOT Act should be guided by the principle that the private sector is an important component of our counterterrorism and money laundering efforts, and that information sharing should be maximized consistent with legitimate privacy concerns. In the September 11 investigation, the public-private partnership is best exemplified by the cooperation the FBI has received from the financial industry. In the immediate aftermath of the attacks, the FBI Financial Review Group (FRG) compiled a "financial control list," consisting of names of person who were demonstrably linked to the dead hijackers, the events of September 11, or terrorism in general both in the United States and abroad. We distributed that list, along with a financial profile the FRG developed of the hijackers, to financial industry groups to query their records for financial information related to the suspects. Where records were discovered, the private institutions reported their existence pursuant to the existing law and we obtained those material, generally through the use of subpoenas. This cooperative effort was complemented by periodic briefings we held with the international banking, credit card, and securities organizations who coordinated these organization's effort to assist our terrorist financing investigations.

Q.3. Do the data mining and predictive technology efforts about which you testified make use of Bank Secrecy Act information? Are they coordinated with Treasury's Financial Crimes Enforcement Network, the Foreign Terrorist Asset Tracking Center, and the Office of Foreign Assets Control? If not, why not? Are the results of the efforts available to FinCEN, FTAT, and OFAC?

A.3. The data mining and predictive technology efforts about which I testified, though FBI-based, seek to rely on data that exists anywhere in the world and to use the best technology available, irrespective of its source. The FRG includes members of the Treasury Department, including the Financial Crimes Enforcement Network (FinCEN) and the Office of Foreign Assets Control (OFAC), and makes use of their data. At the same time, our analysis is available to Treasury both through the FRG and the National Security Council's Policy Coordinating Committee on Terrorist Financing (PCC), which is chaired by the Treasury Department and includes senior FBI and Department of Justice officials. To accomplish our data mining goals, we are also engaged in discussions with the private sector in an effort to bring the most advanced technology to bear on the problem of this Nation's national security.

RESPONSE TO WRITTEN QUESTION OF SENATOR JOHNSON FROM MICHAEL CHERTOFF

Q.1. Has the Bank Secrecy Act been an effective tool in combating financial crimes and potential terrorist activity? What provisions of the Act have proved to be particularly useful in combating illegal activity? Please provide some examples of enforcement actions that have been based on BSA authority in the past several years.

A.1. The Bank Secrecy Act (BSA) has been the cornerstone of the Government's anti-money laundering regime since its enactment. The BSA requires domestic financial institutions to report to the Government on transactions in currency in excess of $10,000. Such reports are known as Currency Transaction Reports or "CTR's." The BSA also requires those who traverse the United States border (in either direction) with negotiable instruments in bearer form, valued in excess of $10,000, to report that event to the Government. Such reports are known as Currency and Monetary Instruments Reports or "CMIR's." The BSA further requires U.S. persons with foreign bank accounts valued at more than $10,000 to report annually on that account to the Government. Such reports are known as Foreign Bank Account Reports or "FBAR's." Finally, the BSA requires domestic financial institutions to report to the Government certain suspicious transactions. Such reports are known as Suspicious Activity Reports or "SAR's." All of these reports, and the many other obligations imposed on financial institutions under the BSA, have proven useful in the fight against money laundering and in the fight against terrorist financing. The traditional money laundering model involves a three stage process:

1. Placement of illegally derived funds into the financial services system;
2. Layering of those funds to further obscure their origin and ownership; and
3. Integration of the funds into apparently legitimately derived assets.

Despite the extreme difficulty in quantifying its impact, law enforcement has long recognized the Bank Secrecy Act's reporting obligations as deterrents that are also highly useful in identifying the placement of illicitly derived currency in the financial system. The transparency brought about as a result of CTR's makes it harder to deposit large amounts of illicitly derived currency in banks and financial institutions. Likewise, CMIR's deter the transport overseas of larger sums of currency or other bearer form negotiable instruments and provide important information about such transportation of funds and negotiable instruments.

Both the CTR and CMIR have proven invaluable to law enforcement efforts addressing money laundering. BSA data plays some contributing role in almost every financial investigation. The CTR helps identify the parties involved in large currency transactions and deters others from engaging in such activity. The CMIR helps identify the parties involved in the international movement of currency and other negotiable, bearer form instruments. While these reporting obligations help identify those who place larger sums of ill-gotten gains into the financial services system and deter others from doing so, the most valuable reporting measure of the BSA is the SAR, which requires domestic financial institutions to report to the Government transactions that have no apparent business purpose or fail to comport with the context of a customer's ordinary banking needs. The SAR not only has deterrent value, it also has proactive value to law enforcement. It is a report from a financial institution, informing the Government of suspicious activity by that financial institution's customer. It can be and has been invaluable in identifying possible criminal activity. The SAR has proven its

utility in identifying numerous possible money laundering violations. The SAR, particularly, and the BSA data, generally, is beginning to prove itself an invaluable tool in addressing possible terrorist financing violations, including providing material support or resources to designated foreign terrorist organizations or in support of terrorist activity. BSA data has been extremely useful in identifying financial and other links between various terrorist operatives, including al Qaeda members.

The Bank Secrecy Act provisions that are the most important to our efforts to investigate and prosecute terrorist financing is the system of currency transaction reporting. This system creates the financial footprints that, prior to the BSA, would not have existed for cash transactions. I can give two examples of how these provisions assisted our recent counterterrorism efforts.

In my testimony, I referred to our creation of the FRG, an interagency task force investigating terrorist financing and operating out of FBI Headquarters. One of the first tasks undertaken by the FRG was to create a financial profile of the 19 dead hijackers—information that would describe with whom they came in contact, what banks and credit cards they used, and what borders they crossed. As part of this effort, the FRG analyzed information collected by FinCEN including the CTR's, SAR's, and CMIR's. In the early stages of the investigation, the FRG's focus on Zacharias Moussaoui uncovered evidence that he deposited some $30,000 in an Oklahoma bank account within days of his arrival in the United States. Prior to the BSA, it would have been difficult to determine the source of this income and whether it came from overseas. Somewhat surprisingly, Moussaoui actually declared this cash on a CMIR he filed at the border, and the report allowed investigators to discern where that money came from. Had he not followed the law in this instance, we could have used the CMIR violation to charge him while the investigation continued. The fact that he did gave us a leg up in tracing that money back to its London source.

The second example involves the November 7, 2001 action against the al Barakaat network, including coordinated arrests and the execution of search warrants in Massachusetts, Virginia, and Ohio. These actions were coordinated with Treasury's execution of blocking actions pursuant to the Executive Order against al Barakaat-related entities in Georgia, Minnesota, and Washington State. These actions were made possible by BSA information that had been received and analyzed. This information resulted in the detection of the al Barakaat network that transmitted monies collected from the ethnic communities that relied on this al Qaeda-related business to send remittances home. Were it not for the BSA-mandated reporting system, al Barakat might not have been discovered.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM RICHARD SPILLENKOTHEN

Q.1. What issues raised by implementation of Title III of the USA PATRIOT Act are of most concern to you, as Director of the Division of Banking Supervision and Regulation?

A.1. Since the Federal Reserve testified in January about the USA PATRIOT Act, the staffs of the Board and the Reserve Banks have

continued their work on implementing the law, as well as their efforts to help law enforcement track terrorist financing activities. Federal Reserve staff has been assisting the Treasury Department develop the new rules required by the law, and it has been providing information about the USA PATRIOT Act to the banking organizations supervised by the Board and to the examination staff about the law and the new regulations. Board staff has also been actively reviewing the Federal Reserve's existing anti-money laundering programs and considering all of the changes that will be necessary when the USA PATRIOT Act regulations are final. We have also been participating in the work of numerous international organizations and providing continued support and technical assistance to law enforcement.

Board staff has found that the USA PATRIOT Act has had and continues to have a notable impact on the Federal Reserve System's supervision program. There are generally four major areas that the Federal Reserve is concentrating on and expanding its efforts: Awareness, implementation, compliance, and enforcement.

The Federal Reserve has been taking steps to ensure that the banking organizations under its supervision and the examination staff who interact with them are aware of the USA PATRIOT Act and its requirements. On November 26, 2001, the Board issued a supervisory letter to all domestic and foreign banking organizations under its supervision concerning the USA PATRIOT Act. The supervisory guidance letter described the provisions of the Act, highlighted those that should receive banking organizations' and Federal Reserve supervisors' immediate attention, and described new rules that would be issued under the Act. The Federal Reserve has also issued subsequent supervisory letters on USA PATRIOT Act provisions concerning applications and information sharing. Over the past 6 months, Board and Reserve Bank staff have also attended conferences, made presentations, and engaged in an ongoing dialogue with the industry about the USA PATRIOT Act and its implications.

The Federal Reserve is also committed to the swift and effective implementation of the USA PATRIOT Act. We continue to work closely with the Treasury Department by assisting in the drafting and review of proposed rules. Also, by drawing upon our financial expertise, we hope to ensure that proposed rules are not only comprehensive and address the needs of law enforcement, but also that the objectives of the rules are clearly understandable by the industry and, to the extent possible, the rules are consistent with prudent, safe and sound banking practices.

Once the USA PATRIOT Act provisions are implemented through final regulations, the Federal Reserve must evaluate the banking organizations under its supervision for compliance. This is a tremendous undertaking that will involve some revisions to our existing examination protocols and require extensive training not only for banking organizations but also for our examination staff. However, we are not waiting for final rules and have already begun to prepare. As USA PATRIOT Act effective dates have approached and proposed rules have been issued, the Federal Reserve has been making certain that banking organizations are taking reasonable steps to comply. We are doing this through our existing bank ex-

amination process—and through our continued dialogue with the industry.

At the Board, we have established a USA PATRIOT Act Working Group comprised of senior, experienced Bank Secrecy Act/Anti-Money Laundering examiners from throughout the System. This Working Group, which is charged with overseeing the System's implementation of the new law, has been drafting revised examination procedures and is developing a new training curriculum for examiners who conduct Bank Secrecy Act and anti-money laundering examinations that, in the future, will include USA PATRIOT Act provisions.

We have also increased the staff of the Board's bank supervision division to include several senior examiners from the Reserve Banks to draw upon their field experience. These new Senior Special Examiners are leading the Working Group and will coordinate the System-wide adoption and consistent application of the new examination procedures and training program. We are also working closely with the other bank regulatory agencies to ensure that there is consistency on common issues.

Another important area is our continued support of law enforcement particularly with respect to the provisions of the USA PATRIOT Act. In the Federal Reserve's January 2002 testimony, we described the supervision division's Special Investigations Section. This Section conducts financial investigations, provides expertise to the U.S. law enforcement community for investigation and training initiatives, and provides training to various foreign central banks and government agencies. We have continued to work with the FBI's Financial Review Group and Treasury's Operation Green Quest as well as other law enforcement agencies in support of their ongoing terrorist and anti-money laundering investigations.

Q.2. Do you have any figures about the number of shell bank correspondent accounts that have been closed, pursuant to 31 U.S.C. 5318(j), or the number of certifications received by banks under your supervision, to permit such accounts to remain open?

A.2. We do not have specific figures. However, as stated previously, we have been engaged in an ongoing dialogue with the banking industry through the efforts of the USA PATRIOT Act Working Group, and, based on these contacts, the Board staff can provide some general information about how banking organizations are meeting their obligations to terminate prohibited shell banking relationships.

All of the financial institutions with whom we have had contact are using the certification process proposed by the Treasury Department. Banking organizations have made significant efforts to send out requests for and to obtain the required information from their foreign bank correspondent customers. It is our experience that the response rate from these customers has been very good (perhaps as high as 90 percent). Reserve Bank examiners have been advised that fewer than 20 accounts have been identified as "shell banks" and, therefore, closed.

Banking organizations have also indicated that they are making follow-up requests to foreign bank correspondent customers that either have failed to respond or have provided incomplete informa-

tion. Examiners have been advised that there will be additional account closings if this information is not forthcoming.

Q.3. How would you assess the risk that banks that are experiencing (or that fear) larger than expected loan losses may become involved in money laundering by "looking the other way" when seeking to attract deposits? How is that possibility reflected in the Federal Reserve Board and the Federal Reserve Bank examination programs?

A.3. During an examination, the examiners review for compliance with specific Bank Secrecy Act reporting and recordkeeping requirements, as well as for compliance with the Federal Reseve Board's BSA compliance-related regulations that require the establishment of internal control and training procedures and to perform independent testing. Here at the Board, those rules are set forth in Regulation H. These internal controls include general customer acceptance and account opening procedures that are consistent with sound due diligence and are critical elements in the effective management of banking risk.

Also, prior to commencing an examination, examiners review FinCEN's BSA database of Currency Transaction Reports (CTR's) and Suspicious Activity Reports (SAR's) to check, among other things, whether the bank has adequate systems in place to identify and report currency transactions and suspicious activities. When potential money laundering (or other criminal activity) is identified, a targeted examination may be conducted, and all relevant information is referred to the appropriate law enforcement agency.

Loan losses and money laundering are both significant risks to banking organizations. We expect banks to develop effective systems to manage these risks across business lines and commensurate with their size and complexity. Federal Reserve examiners have not seen a direct correlation between a bank's loan losses and money laundering. However, if a bank were experiencing financial difficulties (for example, loan losses), we would expect that supervisory staff would pay increased attention to other areas including the BSA program, to determine if the bank is exposing itself to additional risk.

Q.4. What is your view of the proposed rules relating to the ban on foreign shell bank correspondent accounts? How do you respond to the questions about the rule raised by Chairman Sarbanes?

A.4. In 2001, the Senate Permanent Subcommittee on Investigations concluded, after a lengthy investigation into correspondent banking, that correspondent relationships with foreign banks—especially foreign shell banks—pose a particular risk of money laundering to U.S. banks. Partly in response to that finding, the Congress passed legislation that is now found in Section 313 of the USA PATRIOT Act, which forbids U.S. banks from doing business with foreign shell banks. The Treasury Department has published a proposed regulation banning U.S. bank correspondent relationships with foreign shell banks and setting forth a certification mechanism for banks to use to comply with their statutory obligation (see the response to the previous question). At the January 2002 hearing, Chairman Sarbanes commented on the importance of closing foreign shell bank accounts at U.S. banks.

The Federal Reserve supports the new law and the Treasury's proposed rules implementing it. As previously stated, we have found that banking organizations are diligently seeking to comply with their new statutory obligations through the use of the "certification" process established in Treasury's proposed rules.

Q.5. What principles should govern sharing of information about specific individuals by Government agencies with U.S. financial institutions (or the sharing of such information among financial institutions) under Section 314 of Title III? What procedures do you envision being adopted to structure and control the contemplated information sharing, and to determine when a person is "reasonably suspected based on credible evidence of engaging in terrorist acts or money laundering activities?"

A.5. Congress has established reasonable standards and safeguards for the sharing of information between and among financial institutions and law enforcement. Section 314 of the USA PATRIOT Act is but one example of Congressional direction in this area. Treasury has issued a final interim rule for Section 314(b) and a notice of proposed rulemaking for Section 314(a)—the two statutes that address information sharing among banking organizations and law enforcement. The public comment period for these rules has ended, and we understand that Treasury has received many comments.

Under Treasury's proposal, FinCEN is the principal agency responsible for handling the procedures that banking organizations have to undertake in order to share pertinent information about money laundering and terrorist financing activities. FinCEN and law enforcement are responsible for determining that credible evidence exists to make a request under Section 314(a). FinCEN must have procedures in place with law enforcement to assure that the only requests made under Section 314(a) are for those individuals or entities reasonably suspected to be engaging in terrorist acts or money laundering. As regulators, we are not in position to make this determination but rely on FinCEN and law enforcement to adhere to the statutory requirements.

At this time, the Board staff does not yet know how many banking organizations are availing themselves of the sharing provisions of Section 314(b). In this area, the inquiry should be directed to FinCEN.

In the interim, the Federal Reserve provided guidance about the provisions of Sections 314(a) and 314(b) of the USA PATRIOT Act to its examiners and the financial institutions its supervises through a supervisory letter on March 14, 2002.

RESPONSE TO WRITTEN QUESTION OF SENATOR JOHNSON FROM RICHARD SPILLENKOTHEN

Q.1. Has the Bank Secrecy Act been an effective tool in combating financial crimes and potential terrorist activity? Which provisions of the Act have proved to be particularly useful in combating illegal activity? Please provide some examples of enforcement actions that have been based on BSA authority in the past several years.

A.1. As previously stated, supervision staff believes that the SAR reporting requirements of the Bank Secrecy Act have been the most helpful part of that law in combating illegal activity. How-

ever, law enforcement is in the best position to respond to the part of this question relating to the Bank Secrecy Act. In our experience, law enforcement has recognized the importance of the SAR reporting system, has been diligent in their reviews of SAR's and has used them in many financial investigations. For instance, we understand that in some judicial districts, SAR review teams consisting of Assistant United States Attorneys and law enforcement representatives meet regularly to review and discuss SAR filings by banking organizations in their districts.

For our part, examiners are expected to review SAR's before each examination and Reserve Banks are expected to conduct a periodic, comprehensive review of the SAR's filed in their district to assist in identifying suspicious or suspected criminal activity occurring at or through supervised financial institutions. Examiners also assess the procedures and controls used by reporting institutions to identify, monitor, and report violations and suspicious illicit activities and assess the adequacy of anti-money laundering programs. We have learned that a preexamination review of SAR's assists our supervisory staff in assessing compliance with the SAR requirements and provides useful information regarding potential problems that may require special attention during the course of an examination.

By law, the Federal Reserve must evaluate the effectiveness and sufficiency of a banking organization's BSA compliance. The Federal Reserve does this at each safety and soundness examination it conducts. If a financial institution's BSA compliance program is found to be deficient, an appropriate enforcement action is taken. This could include the issuance of a cease and desist order, the assessment of a civil money penalty, the execution of a formal written agreement, or the issuance of an informal supervisory action, such as a Memorandum of Understanding. Over the past several years, the Federal Reserve has taken numerous enforcement actions involving compliance with the Bank Secrecy Act. Public formal enforcement actions, which are available on the Board's public website, include those against U.S. Trust Corp., the State Bank of India, the Gulf Bank, and Banco Popular de Puerto Rico.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SARBANES FROM ANNETTE L. NAZARETH

Q.1. Under the proposed suspicious activity reporting rule for broker-dealers, how is a broker supposed to know whether he is looking at a possible violation of the securities laws or something else? What would, or should, happen under the proposed rule if a broker-dealer finds a transaction that involves a breach of a Commission or SRO recordkeeping rule but that also appears to involve otherwise inexplicable transactions linked, say to an offshore financial center or a country on the FATF "noncooperative" list?

A.1. Section 103.19(c)(ii) of the Department of the Treasury's proposed broker-dealer suspicious activity reporting rule provides only a narrow exception to the SAR obligation. The exception extends only to violations that on their face would not be likely to be helpful to the fight against money laundering or terrorist financing.

The Treasury recognized in its proposed rule that securities firms often bring directly to the Commission or the SRO's instances of securities law violations by the firms themselves, or by their employ-

ees. The proposed exception would promote the continued reporting of securities law violations directly to the securities regulators, enabling the Commission and the SRO's to continue to enforce effectively the securities law, without compromising anti-money laundering efforts.

At times, financial institutions may not know what provisions of law a particular course of conduct violates, and would be required to file a SAR. In the event that a firm was able to identify that conduct violated both the securities laws (for example, provisions relating to market manipulation) and the narcotics laws (because the manipulation was being conducted to mask the payment for narcotics), then the exception would not be available and the suspicious activity would need to be reported on a Form SAR–BD.

Because the exception is only available if the violation is reported to the Commission or an SRO, there is little risk that nominal violations of the securities laws would be reported to securities regulators masking more significant unusual transactions. If any leads reported to securities regulators appear also to be connected to wider, money laundering offenses, the leads can be forwarded by securities regulators to the appropriate law enforcement agencies. Similarly, if a reported violation clearly is not a securities violation, the Commission, or SRO receiving the report, would direct the firm to file a SAR.

Q.2. Does the reference in the proposed suspicious activity reporting rules for broker-dealers to Rules 17 CFR 240.17a–8 and 17 CFR 405.4 create a circular situation in which it is impossible to know which report should be filed? Does the Commission intend to amend those rules to break any circularity? Will the final rule incorporate a reference to SRO rules relating to money laundering, to complement the references to Rules 17 CFR 240.17a–8 and 17 CFR 405.4?

A.2. The references in Treasury's proposed SAR rule for broker-dealers to Rules 17a–8 and 405.4 clarify that violations of the reporting, recordkeeping, and record retention rules under the Bank Secrecy Act that have been incorporated into the Commission's rules are not within the exception to the SAR requirement—and accordingly must be reported on a Form SAR–BD. For example, a firm that discovers that it or one of its employees acted with a customer to avoid the filing of a currency transaction report required under the BSA rules would need to file a SAR, even though the conduct would also violate Commission rules. The link between Rules 17a–8 and 405.4 and proposed Rule 103.19 is intentional and not, in our view, circular. If a firm discovered violations of 103.19, that too would need to be filed on a Form SAR–BD. While we do not expect confusion on the part of broker-dealers, we nonetheless look forward to considering any comments filed with Treasury by the broker-dealers, and will work with Treasury to address any questions.

We do not recommend that Treasury amend proposed 103.19 to refer to SRO rules. The SRO rules that make a direct reference to money laundering are the proposed New York Stock Exchange and NASD-Regulation rules regarding the establishment of anti-money laundering programs. Because the BSA itself requires broker-deal-

ers to have anti-money laundering programs in place by April 24, 2002 independent of complementary obligations under the SROs' rules, any discovered violation of the statutory requirement would have to be reported on a Form SAR–BD. Moreover, as a practical matter, a compliance failure represented by inadequate anti-money laundering programs would probably not be useful to law enforcement as a suspicious event in its core money laundering or in its terrorist financing investigations or prosecutions. Instead, the compliance program quality would be addressed through the regulatory process.

Q.3. You mention that Commission staff consulted with Treasury throughout the process of drafting the rules implementing the ban on foreign shell bank correspondent accounts? How do you respond to the questions about the rule raised by Chairman Sarbanes, especially in light of the Commission's general rules about "due diligence" as a necessary component of compliance with statutory obligations, *inter alia,* the 1933 Act?

A.3. Chairman Sarbanes' opening remarks at the hearing on January 29 addressed the need for reasonable approaches to the implementation of the ban on foreign shell bank correspondent accounts—both direct and "nested" accounts. The Chairman's remarks addressed both the process for implementing the foreign shell bank ban, and the limited exception for afffliates of regulated banks.

In discussions leading up to Treasury's draft rule, Treasury, law enforcement, and financial institution regulators contemplated a two-pronged approach to the implementation of the ban. First, as represented by Treasury's interim guidance and proposed Rule 104.40, financial institutions need to do a broad sweep of their overseas client base to gain certifications regarding the accounts. All recognized that this process—required of many accounts within a short time frame—is only part of the process.

The second prong of the approach to foreign shell bank correspondent accounts is found in Congress' mandate in Section 312 of the USA PATRIOT Act for due diligence policies, procedures, and controls for correspondent accounts. Depending on the nature of particular accounts—whether by size of account, geographical location, or other relevant factors—financial institutions will need to engage in appropriate risk-based due diligence to learn, among other things, whether an account holder is a foreign shell bank. Regulators can test whether financial institutions make reasonable judgments about due diligence through the examination of anti-money laundering programs, which are required under Section 352 of the USA PATRIOT Act. We do not believe that Treasury intends in its proposed rule for a financial institution to be able to rely on a certification about which it clearly has doubts.[1]

With respect to bank affiliates, Treasury has proposed that a foreign shell bank with 25 percent ownership by a regulated bank

[1] In its preamble, Treasury stated that it "expects that covered financial institutions as required by 31 U.S.C. 5318(j), will immediately terminate all correspondent accounts with any foreign bank that it *knows* to be a shell bank that is not a regulated affiliate, and will terminate any correspondent account with a foreign shell that it *knows* is being used to indirectly provide banking services to a foreign shell bank." (emphasis added) 66 FR 67460, at 67462 (December 29, 2001).

would fall within Section 313 (and, accordingly, would be, outside the ban). We understand that Treasury chose that threshold by reference to the bank holding company rules of the Board of Governors of the Federal Reserve System, a number with which financial institutions were familiar. *See* 12 CFR 225.2(e). We understand that Treasury viewed its position as conservative since under both banking and securities law, persons may be considered for some purposes to influence a financial institution with a lower percentage ownership. Treasury determined not to permit foreign shell banks with a lesser degree of ownership by a regulated bank to qualify for the exception. Because this particular provision was less relevant for institutions regulated by the Commission, Commission staff did not focus on it. Treasury or bank regulator staff may be able to provide the Committee with more information.

Due diligence provisions under the Securities Act of 1933 addressing reasonable investigations to have a reasonable ground to believe the accuracy of a registration statement are specific to the activities addressed in that Act, and the staff has not attempted to compare them with provisions under the Bank Secrecy Act. Instead, we are conferring with Treasury and other agencies with money laundering expertise regarding appropriate due diligence measures needed to detect and prevent money laundering.

Q.4. To whom is responsibility for money laundering compliance and enforcement on a Commission-wide basis assigned?

A.4. The Treasury has delegated to the Commission authority to examine brokers or dealers in securities to determine compliance with the requirements under the Bank Secrecy Act regulations. The Commission does not currently have enforcement authority under the BSA.

Both the Commission and SRO's examine broker-dealers for compliance with the BSA regulations. In order to provide SRO's with authority to examine their members with these provisions, the Commission adopted Rule 17a–8 under the Securities Exchange Act in 1982. Rule 17a–8 requires broker-dealers that already are subject to the BSA regulations to comply with the recordkeeping, reporting, and record retention provisions under the regulations. While both the Commission and SRO's have cited firms for related compliance failures, the actions taken were under the Securities Exchange Act, not the BSA. The staff is discussing with Treasury whether it should also delegate enforcement authority under the BSA to the Commission.

Staff from all of the Commission's offices work on the money laundering issues. The Division of Market Regulation generally coordinates interoffice consultations based upon the issues raised in particular projects.

Q.5. What is the progress of the money laundering program audits that the Office of Compliance and Inspection Director Richards described in her speech on money laundering last May? How many audits have been conducted? Can you provide us with a list of the firms that have been audited and expand on the summary in your testimony of what the audits have revealed?

A.5. Examiners from the Commission, NYSE, and NASD-Regulation are examining 26 broker-dealers to assess industry compliance

with the Commission's Rule 17a–8, as well as other anti-money laundering concerns, including approaches to suspicious transaction reporting.[2] Field work for 25 of the examinations has been conducted, and the staff is in the process of analyzing its findings.

Information the staff is gathering will help examiners to conduct more effective examinations of broker-dealers for compliance with the anti-money laundering program requirement that takes effect on April 24, 2002 and the suspicious activity reporting requirement to become effective later this year. It will also help the staff to work with the industry as it develops stronger approaches to combat potential money laundering and terrorist financing through their firms.

While the examinations are ongoing, they have so far revealed that most large firms have some type of anti-money laundering system in place. Mid-sized and smaller firms, however, have been less proactive in establishing anti-money laundering programs.

Strengths and weakesses are highly dependent on the sizes of the firms that the staff has examined. For example, one particular strength was that large firms generally have dedicated, knowledgeable staff and appropriate surveillance systems in place to detect suspicious activity. In addition, large firms tend to have more comprehensive procedures to ensure that pertinent areas of the firm are supervised for anti-money laundering compliance.

Weaknesses in anti-money laundering programs were more evident at mid- and small-sized firms. Many of these firms' procedures and surveillance systems evidenced a need for a greater focus on money laundering risks. In response to examiner requests for information on anti-money laundering programs, some smaller firms provided information on their anti-fraud departments, which may serve a different compliance purpose. In addition, supervision with regards to anti-money laundering procedures was not as stringent or focused as at large firms. Another weakness of smaller firms was that their training programs did not adequately cover anti-money laundering.

The identity of firms being examined is sensitive. Moreover, the staff prefers to maintain confidentiality of details of both the most and least effective anti-money laundering practices in order to limit the possibility of inadvertently providing road maps to people who would try to circumvent firm procedures. To the extent that examinations result in findings of significant violations of existing law, the staff would recommend the institution of public enforcement proceedings—either at the Commission or an SRO depending on the nature of the violations.

Q.6. How has the Division of Enforcement been involved in planning for money laundering compliance?

A.6. The Division of Enforcement maintains a strong interest in money laundering aspects of its enforcement cases. In the course of investigations, the staff uses a wide-range of tools to trace illegal proceeds and other assets. This tracing process sometimes reveals

[2] The program includes examinations of five firms with net capital greater than $500 million, eleven firms with net capital between $100 million and $500 million, and 10 firms with net capital less than $100 million.

possible criminal activity, which the staff refers to the criminal authorities.

In addition, the staff uncovered and prosecuted more than a dozen cases involving violations of the currency transaction reporting requirements in the 1980's and early 1990's. Our examination and enforcement programs have not uncovered serious problems under the CTR provisions recently. Commission staff reports any findings arising under both the Commission and the SROs' examination programs to FinCEN twice a year for its use in the overall administration of the BSA.

Enforcement staff also participate in working groups with other regulators and agencies that combat money laundering. For example, senior representatives of our Enforcement Division participate in the Bank Fraud Working Group established by the Fraud Section of the Department of Justice, as well as some of the money laundering working groups led by Treasury over the past decade.

Q.7. What principles should govern the sharing of information about specific individuals by Government agencies with U.S. financial institutions (or the sharing of such information among financial institutions) under Section 314 of Title III? What procedures do you envision being adopted to structure and control the contemplated information sharing, and to determine when a person is "reasonably suspected based on credible evidence of engaging in terrorist acts or money laundering activities?"

A.7. The SEC, like other Government agencies, has guidelines and safeguards for gathering and sharing information about specific individuals, entities, and organizations in furtherance of its statutory mandate. In our view, the rules implementing Section 314 of Title III should be designed to enhance the existing information gathering and sharing capabilities of Government agencies with respect to terrorist acts and money laundering activities, without limiting existing capabilities or providing a means for circumventing existing safeguards.

SEC staff is working cooperatively with the staff of the Treasury Department to implement the provisions of Section 314. Treasury issued proposed and interim rules under Section 314 on February 26, 2002. The anticipated construct for information sharing between Government agencies and financial institutions involves: (a) FinCEN, on behalf of a Federal law enforcement agency, requesting one or more financial institutions to determine whether the financial institution maintains accounts for, or has engaged in transactions with, a specified individual, entity, or organization; and (b) the financial institution searching its records and, if it identifies an account or transaction with any individual, entity, or organization named in the request, reporting certain identifying information to FinCEN. Within this basic construct, we contemplate a number of procedures for structuring and controlling the sharing of information. For example, we contemplate procedures requiring each financial institution to designate a contact person to receive information requests from FinCEN, and procedures prohibiting the disclosure of information requests except for purposes of responding to the requests (or, under certain conditions, sharing the information with other financial institutions). We also expect procedures to assure

that a person, entity, or organization that is the subject of an information request is "reasonably suspected based on credible evidence of engaging in terrorist acts or money laundering activities." In this regard, Treasury is considering a certification procedure by which a Federal law enforcement agency making a request through FinCEN must certify that each individual, entity, or organization in the request meets the statutory standard.

Treasury's proposed rules also provide for voluntary information sharing among financial institutions. In this regard, we anticipate procedures requiring a financial institution to notify FinCEN that it intends to engage in information sharing, procedures to restrict the use, and protect the confidentiality, of shared information, and procedures for reporting information resulting from information sharing efforts to FinCEN.

RESPONSE TO WRITTEN QUESTION OF SENATOR JOHNSON FROM ANNETTE L. NAZARETH

Q.1. Has the Bank Secrecy Act been an effective tool in combating financial crimes and potential terrorist activity? Which provisions of the Act have proved to be particularly useful in combating illegal activity? Please provide some examples of enforcement actions that have been based on BSA authority in the past several years.

A.1. The SEC does not routinely use the BSA as a tool in combating financial crimes or terrorist activity. While the Commission has obtained copies of suspicious activity reports (SAR's) or SAR information from the Financial Crimes Enforcement Network upon request, FinCEN takes the position that, as a civil enforcement agency, the Commission may not have routine, online access to SAR's or SAR information for use in its enforcement program.[1] The Commission examines broker-dealers for compliance with particular obligations under the BSA rules. Once the broker-dealer SAR rule comes into effect, we understand that the Commission's role will be to examine broker-dealers for compliance with the SAR reporting obligation, with access to that portion of the SAR database.[2] However, the Commission has maintained an ongoing interest in the money laundering aspects of its securities cases. Criminal authorities have conducted parallel criminal prosecutions for money laundering originally detected and referred to them by the SEC. Descriptions of three recent prosecutions that involved both securities law and money laundering allegations are set out below.

- *SEC* v. *William P. Trainor, et al.,* Litigation Rel. No. 17313 (January 15, 2002): The Commission sued William P. Trainor for his role in two frauds concerning the securities of HealthCare, Ltd.

[1] The Commission has online access to Treasury's Currency and Banking Retrieval System, which is used to examine broker-dealers with thc CTR, CMIR, and FBAR requirements. We understand that FinCEN currently is determining whether to modify the SEC's access to broker-dealer SAR's.

[2] The SEC examines broker-dealers for compliance with the BSA rules under the authority it has been delegated by Treasury. Until the suspicious activity report requirements become effective at the end of the year, the compliance obligations (with the exception of a broad-based anti-money laundering best practices series of examinations that began last year) principally focus on cash-based events, such as currency transaction reporting. Securities firms accept little cash, and generally have good compliance programs for assuring compliance with the CTR requirements. The Commission brought cases for CTR violations in the 1980's and early 1990's. These cases, however, were brought under the Securities Exchange Act, as the Commission does not have enforcement authority under the BSA.

(HealthCare) and Novatek International, Inc. (Novatek). The Commission alleged that Trainor and others participated in fraudulent "pump and dump" schemes involving the purchase and sale of HealthCare and Novatek securities, both of which claimed to own licenses to distribute medical diagnostic test kits designed to rapidly diagnose HIV, cholera, and other diseases. In addition, the U.S. Department of Justice filed criminal charges against Trainor in the U.S. District Court for the Southern District of Florida. The indictment charges him with twenty-one counts of wire fraud and money laundering.

- *SEC* v. *Jerry A. Womack,* Litigation Rel. No. 17293 (C.D. Cal., January 2, 2002): The Commission charged Womack with committing securities fraud in offering and selling $19 million in securities to about 400 investors nationwide between August 1997 and June 1999. Womack represented to investors that he would invest their money in the stock market pursuant to an investment strategy that he claimed to have developed and used successfully called the "Womack Dow Principle." In fact, Womack utilized only about a quarter of the investors' money for securities trading and suffered a net loss on that trading. Womack misused the majority of investor funds for personal and unrelated expenses and to pay some investors their purported profits and principal. Among other things, Womack used the funds to purchase homes, real property, art, jewelry, and cars and to pay for his honeymoon, for cosmetic surgery for his wife, and for his divorce settlement. In May 2001, Womack was convicted of wire fraud and money laundering in a criminal proceeding before the U.S. District Court for the Central District of California, arising out of the same facts as the Commission's case. He is currently in custody and awaiting sentencing.
- *Securities and Exchange Commission* v. *Charles O. Huttoe, et al.,* Litigation Rel. No. 16632 (D.D.C. July 20, 2000): The SEC filed a number of actions stemming from a massive market manipulation by Systems of Excellence, Inc. To date, six individuals also have been criminally charged with felonies stemming from the SEC's investigations. These individuals pled guilty to a wide-range of violations, including: Money laundering, securities fraud, conspiracy to commit securities fraud, bank fraud, and failure to file tax returns. In addition to these criminal sentences, the Commission will have recovered approximately $11 million from its enforcement actions related to this fraud. The Court-appointed Receiver holding these funds hopes to start distributing the funds to defrauded investors within the next several months.

United States Senate
WASHINGTON, DC 20510

The Honorable Paul O'Neill
U.S. Treasury Department
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

January 11, 2002

Dear Secretary O'Neill,

Since the national tragedy on September 11, we have been pleased with the attention that the Bush Administration and, in particular, the Treasury Department has placed on the role that financing plays in the execution of terrorist acts. By making terrorist financing a priority in the war on terrorism, the President has demonstrated that he understands that conventional war tactics are not going to be sufficient to protect our country from Al Qaeda or other terrorist networks.

As you know, when the Congress passed the comprehensive anti-terrorism bill earlier this year, the money laundering provisions contained within the legislation created an important new set of rights and responsibilities within the Treasury and within the financial services industry. We are writing you today to draw your attention to one specific provision, Section 325, that we hope you will act on as part of the anti-money laundering regulations your agency is developing to implement the new law.

This section, which establishes a new Bank Secrecy Act subsection at 31 U.S.C. § 5318(h)(3), and which was added during consideration of the money laundering legislation in the Senate Banking, Housing, and Urban Affairs Committee, explicitly authorizes the Treasury Secretary to prescribe regulations to close an existing loophole in the regulations governing how U.S. financial institutions operate their internal, administrative, financial accounts, often called concentration, omnibus or suspense accounts. These are the accounts used by U.S. financial institutions to temporarily aggregate incoming monies until those funds can be properly identified and credited to an appropriate account.

Prior to the terrorist attacks, most concerns about concentration account misuses stemmed from well-publicized allegations that these accounts had been used to break the audit trail in the laundering of drug money, perhaps most notoriously in the case of Raul Salinas, brother to former Mexican President Carlos Salinas. In the 1990s, Mr. Salinas was able to move almost one hundred million dollars through his financial institution, Citibank, by first having his private banker place his money in the institution's concentration account. The private banker did not disclose on wire transfer documentation or internal account records that the funds moving through Citibank's concentration account were associated with Mr. Salinas. The private banker then directed the funds to be transferred out of Citibank's concentration account and into client

accounts under the control of Mr. Salinas. While questions remain about the original source of the money, at least one Swiss official has determined that the funds were associated with illegal drugs.

U.S. banking regulators have identified the concentration account problem in the past, but have not eliminated it. Over four years ago, in July 1997, the Federal Reserve in its Sound Practices Paper on Private Banking issued this warning with respect to private banking operations:

"Private banking operations should have the policies and controls in place to confirm that a client's funds flow into and out of the clients account(s) and not through any other account, such as an organization's suspense, omnibus, or concentration accounts. Generally, it is inadvisable from a risk management and control perspective for institutions to allow their clients to direct transactions through the organization's suspense account(s). Such practices effectively prevent association of the clients' names and account numbers with specific account activity, could easily mask unusual transactions and flows, the monitoring of which is essential to sound risk management in private banking, and could easily be abused."

This warning was directed solely to U.S. private banks, rather than all financial institutions, and was issued as guidance, rather than binding regulation. Since then, there is evidence that private banks and other U.S. financial institutions continue to allow their clients to direct funds into the institution's own administrative accounts, without clear documentation linking the funds to the specific client.

We remain concerned about potential abuses of concentration accounts in the laundering of drug monies, but are also newly concerned that terrorists might seek to use concentration accounts to hide transfers of money among terrorist operatives around the world. This is a potential danger that the Treasury Department has been empowered to prevent. We urge you to act quickly on the new explicit authority allowing you to close the concentration accounts loophole by including for public comment a Section 325 proposed rule within the anti-money laundering rulemakings that will be issued over the coming year.

We look forward to continuing to work with you on this and other important matters facing our nation.

Sincerely,

U.S. Senator

Chuck Grassley
U.S. Senator

U.S. Senator