

Remarks by Assistant Secretary for Terrorist Financing and Financial Crimes Elizabeth Rosenberg ABA-ABA Financial Crimes Enforcement Conference

December 5, 2022

As Prepared for Delivery

Thank you for the opportunity to speak with all of you. This is a momentous time for anti-money laundering and countering the financing of terrorism, AML/CFT, policy. Sanctions are frequently on the front page of the major papers, and compliance is receiving unprecedented attention across a number of industries.

However, before I go into these topics, I want to acknowledge the untimely passing of the American Bankers' Association's Rob Rowe. Rob was a formidable foe at times, but he was an outstanding friend to our industry. His expertise and passionate commitment to anti-money laundering policy and rulemaking are unimpeachable—I consider myself lucky to have come to know him and only regret that I didn't have more time to work alongside him on the AML issues so vital to the broader success of our financial system. He will be sorely missed and leaves us with the solemn responsibility to carry forth on his work and vision of creating a stronger and more transparent financial system.

We are all witnessing dramatic shifts in the global order: countries are still grappling with the COVID-19 pandemic, Russia is engaged in a shocking and unjustifiable war in Europe, and the proliferation of digital assets and payment services are pushing the boundaries of finance—and the risk of illicit financial flows—to places that would have been unfathomable a decade ago. These tectonic shifts matter a great deal to the health and functioning of the financial system and to our understanding of the risks encompassed within this system. That, after all, is what the field of AML/CFT is all about: how we identify and manage certain illicit finance risks within the context of the broader financial risks this system seeks to measure and efficiently address. We know that risk is not a one-way ratchet, where less is always better.

Today, I'd like to share our thinking on some of the key risks we all confront today and how we think about balancing them alongside our broader policy goals.



RUSSIA

For many of you, the risk that is top of mind is the illicit finance threat posed by Russia. In February of this year, Russia launched an illegitimate and brutal invasion into Ukraine. This violence continues to this day—Russia is not only attacking on the battlefield, but also striking Ukraine's power grids and metropolitan residential areas specifically to inflict pain on Ukraine's civilian population.

Responsible nations of the world were quick to respond. Almost immediately after Russia's first strikes, the United States was one of over 30 countries to implement sanctions or other economic measures against Russia in response to the invasion. Since then, we have created an effective, expansive, and multilateral web of restrictions targeting Russia's ability to fund and wage its terrible war of choice.

Most recently, in the last few weeks, the U.S. Treasury designated Russian national Dmitry Kudryakov alongside a Belarusian national for their roles in exploiting the Guatemalan mining sector. Also, Treasury designated entities facilitating the transfer of Iranian drones into Russia.

The evidence is clear that these actions are effectively denying Russia the financial means to wage their horrifying war. The Russian economy will be in a fiscal deficit by the end of this year. The IMF expects Russia's economy to continue contracting for the next two years, Russia's stock market remains depressed below pre-war levels, and Russia's inflation rate remains in the double digits. Moreover, the U.S. intelligence community assesses that these actions have led to critical shortages of inputs needed for tanks, helicopters, and other critical military supplies.

And while governments can create the policies that lead to these outcomes, you all have played the essential role of implementing these policies by reassessing your understanding of Russian illicit finance risks and adapting your businesses in response.

So long as Russia continues to wage its war in Europe, we will continue to work in concert with our international partners and take more and novel economic and financial actions targeting Russia's ability to fund and execute its reprehensible war.

This is the root of a policy coming into effect today—a price cap on Russian oil. This policy is a way for the international community to apply economic pressure on Russia's main source of revenue, energy earnings, while also ensuring the global energy market remains well supplied.



As the risks Russia poses have evolved, so too has our need to assess those risks. The reports, analysis, and typologies you develop identify and enable us to better understand the evolving risks associated with Russian illicit finance and are paramount in keeping the pressure on Russia to cease their violence. In fact, in terms of understanding risk and risk exposure, financial institutions are on the front lines and serve as our eyes and ears on providing critical insight on emerging illicit finance threats.

In turn, the information you report to us helps to influence, shape and inform our actions, whether it is new policy guidance, enforcement actions, or advisories, to help both the public and private sectors better understand the risks in front of us and craft the appropriate responses.

RISK-BASED POLICY

As Secretary Yellen has stated before, the size and stability of our economy and financial sector make the United States, almost paradoxically, one of the most desired destinations for money laundering and illicit finance. While this creates numerous challenges, our resources are unfortunately not unlimited.

This means that we at the U.S. Treasury must also take a risk-based approach in crafting our policy responses, focusing our resources where they are needed and balancing the many risks we must manage.

BENEFICIAL OWNERSHIP

Take beneficial ownership transparency as an example. On September 29, 2022, the U.S. Treasury moved forward with our implementation of the monumental Corporate Transparency Act by announcing a new rule on beneficial ownership reporting. This rule will aid law enforcement, national security agencies, and other partners by giving them the information they need to identify and crack down on criminals, corrupt individuals, and others seeking to take advantage of our financial system for illicit purposes. Our approach seeks to balance the risk that opaque financial structures are abused to obscure illicit financial flows against the compliance burden placed on industry by the rule and the resources needed to collect this



information. We believe our approach strikes the right balance by focusing on the areas of greatest risk and giving our government tools to address them.

INVESTMENT ADVISERS

Investment advisers and the funds they manage offer another instance in which a risk-based approach is needed. According to the Investment Advisers Association, there are approximately 15,000 SEC-registered investment advisers who manage approximately \$130 trillion in assets. While this includes tens of trillions managed by mutual funds, exchange-traded funds, or other financial institutions that are subject to comprehensive AML/CFT obligations, there are significant parts of this sector subject to less stringent rules. The complexity of this population varies greatly: there are roughly 3,700 advisers to more than 40,000 private funds that have more than \$20 trillion in total assets, whereas there are 17,000 state-registered advisers who manage smaller amounts of funds and have only one or two employees.

Our preliminary research has identified several ways that investment advisers can be misused by illicit actors. We have seen investment advisers who facilitate the movement of illicit proceeds, such as those derived from foreign corruption, fraud, and tax evasion, into the U.S. financial system. In one instance, a Miami-based financial adviser used an investment fund scheme to launder 12 million dollars' worth of bribes into the U.S. financial system. Surrounding and supporting this false-investment scheme were complicit money managers, brokerage firms, banks, and real estate investment firms in the United States and elsewhere, that were operating as a network of professional money launderers.

Another example of abuse in the investment adviser sector is Heritage Trust, a Delaware-based trust formed in July 2017, for the purpose of holding and managing Russian oligarch Suleiman Kerimov's assets. Treasury's investigation into Kerimov, spurred by his first designation in 2018, revealed a complex web of legal structures and front persons to obscure his interest in the trust. Funds in the trust were subsequently invested in large public and private companies and managed by a series of U.S. investment firms and facilitators. Treasury blocked these funds in September of this year, but the magnitude and breadth of this scheme is indicative of the broader risk these vehicles can pose.

We are also concerned about how investment advisers and the funds they manage may offer foreign governments opportunities to invest in and gain access to firms involved in emergin



and critical technologies such as microelectronics, artificial intelligence, biotechnology and biomanufacturing, quantum computing, and advanced clean energy. According to our colleagues at the Department of Justice, the Chinese government routinely conceals its ownership or control of investment funds to disguise efforts to steal technology or expertise while attempting to avoid the scrutiny of the Committee on Foreign Investment in the United States, more commonly referred to by its acronym, CFIUS.

The systemic mismatch between AML obligations and the information available to those holding these obligations creates a real risk for our system. For instance, qualified custodians and prime brokers have AML obligations but do not have regular access to information about the clients of investment advisers they serve and may not see all investment activity by the investment adviser when conducted in omnibus accounts by the advisers. This structure limits the ability of custodians and brokers in identifying suspicious activity tied to the clients of the investment advisers.

Additionally, business activities in the investment adviser space are segmented, bloating the number of intermediaries, crossing international borders, and increasing the distance between the actual investor and those who move the assets around. These business practices promote obfuscation of the client or investor identity and outsource compliance responsibilities to those who are operating with an incomplete picture.

Lastly, on private funds—these businesses routinely invest funds on behalf of foreign legal entities, through arrangements that do not require them to disclose the ultimate beneficial owner. According to the most recent data we have, private funds held \$305 billion in assets that were beneficially owned by non-U.S. investors, but they did not have the information on hand to identify the specific owners in question. Further, many of these funds are domiciled in jurisdictions with uneven AML/CFT supervision and routinely rely on representations and warranties from intermediaries who cannot obtain client identity or information about the source of funds.

We know the investment adviser sector is diverse, ranging from small firms managing retiree assets to firms investing billions and trillions of assets on behalf of pension funds, insurance companies, and sovereign wealth funds, and that the risk may vary based on an adviser's clients and the services they offer. As noted in the U.S. Treasury's 2022 National Illicit Finance Strategy, our first step is to build a better understanding of this sector and the risk typologies within it. This exercise will help us build a risk-based approach that focuses our energy and resources the right way.



REAL ESTATE INCLUDING COMMERCIAL REAL ESTATE

Another sector we are examining to better understand risk is real estate, both residential and commercial. Much like the investment adviser sector, the real estate market in the United States is also incredibly broad and diverse, with corresponding differences in the kinds of risk different parts of this sector pose.

Treasury has promulgated comprehensive AML/CFT regulations for residential mortgage lenders and originators, as well as government-sponsored housing entities, which covers an estimated 76 percent of the \$43.4 trillion residential real estate market.

The remaining portion of the U.S. real estate market that is not subject to comprehensive AML/CFT regulation includes non-financed residential real estate transactions and certain commercial real estate transactions. We assess the size of this market is approximately \$20 trillion.

As you all are aware, starting in 2016, Treasury's Financial Crimes Enforcement Network, or FinCEN, issued a series of Geographic Targeting Orders to impose reporting requirements for certain non-financed residential transactions and, the resulting information is helping us to better understand associated risks. In December 2021, FinCEN also published an Advance Notice of Proposed Rulemaking seeking comment on potential systemic solutions to address the illicit finance risks in the real estate sector.

For illicit financiers, commercial real estate is an attractive market in which to hide and grow illicit funds because it is deep and liquid, identity-obfuscating legal entities are commonplace, financial intermediaries facilitating this activity are not subject to comprehensive AML/CFT regulations, and investors frequently pool funds for lending and purchases. In other words, the banal business activities at the core of this market are unfortunately well-suited to their illicit activities. These vulnerabilities are compounded when foreign investors purchase or invest in U.S. commercial real estate using foreign investment vehicles and legal entities/arrangements, further complicating efforts to identify ultimate beneficiaries and the sources of their wealth. At this point, it's not hiding a needle in a haystack, it is hiding a very particular needle in a stack of needles.

Recent high profile law enforcement cases involving the proceeds of corruption and narcotics demonstrates that criminal actors are indeed using commercial real estate properties to



obfuscate their funds. In one example, proceeds from international drug trafficking were invested in a hotel less than twenty miles from this location. In another case, the proceeds of fraud were alleged to have purchased three office properties worth more than \$60 million across the country.

As we continue to fine-tune our understanding of risk in this sector, I would just restate how important your information is to our understanding of these risks.

DE-RISKING

Finally, I want to address the other side of risk management—the one that receives less attention but is no less critical as a matter of policy: de-risking, or the practice of voluntary “over-compliance.”

The foundation and expectation of our anti-money laundering regime is that financial institutions implement a risk-based approach to identify and address risks. But what does that mean in practice?

Unlike a rules-based approach where everyone follows exactly the same rulebook, the risk-based approach offers both the public and private sectors the opportunity to create a bespoke set of practices tailored to the particular assets, interests, or businesses at issue even where the same fundamental program requirements exist for all regulated entities. Nevertheless, no two businesses are identical and therefore no two businesses face exactly the same risks.

Implicit in this approach is that areas of greater risk require more resources to mitigate, and areas of lower risk require fewer resources. The Anti-Money Laundering Act of 2020 embraces and enshrines in law a systematic risk-based approach, such as through the development of AML/CFT National Priorities and their integration into the supervisory and examination process.

There are, of course, challenges in implementing a truly risk-based approach. At the Financial Action Task Force, which adopted the risk-based approach to combating illicit finance in 2012, we have observed that countries and their financial institutions are keenly aware of where enhanced due diligence is needed but often can not readily identify the inverse: places where simplified due diligence should be expected and permitted. This is not meant to point the finger—in the U.S. government and in our private sector, too, it is a natural impulse to focus more on what is needed for high-risk areas than lower-risk parts.




While this impulse is understandable, it is not without costs. De-risking is chief among them and is illustrative of why a true risk-based approach must take into account both sides of this coin. One common form of de-risking is when financial institutions categorically cut off relationships or services to avoid perceived risks—for example, certain geographic regions—rather than applying a nuanced, risk-based approach.

I understand that financial institutions have to make profit-driven decisions to stay in business, and that profit concerns are often cited for severing services like correspondent banking relationships. Nevertheless, I have heard time and time again about the deleterious effects of categorical de-risking. Money service businesses losing accounts based on a bank's decision to categorically exclude them because of their location or status as a nonbanking financial institution. Moreover, the jurisdictions subject to these concerns are often emerging markets with underbanked populations and higher rates of poverty—places where access to these services could do immense good, if made available in a way consistent with a thorough risk-based approach.

To me, this reveals two concerns related to financial institutions' ability to assess risk. The first is that some financial institutions are not applying a risk-based approach, which would entail taking the time to truly understand their risks. Instead, they are applying a de facto rules-based approach, and cutting off business instead of truly matching resources to risk. While this gives the impression of a strong compliance policy, in reality it can leave significant gaps as institutions lose access to evolving information about these jurisdictions to analyze future trends or report on new suspicious activity. Money launders, terrorists, and sanctions evaders are always adapting their methods and financial institutions must adapt with them and not use their AML obligations to walk away entirely.

My second concern is that when experienced and responsible financial institutions such as those here today disengage from specific sectors or whole jurisdictions, we are empowering those with less stringent compliance and oversight by driving business toward them. Remittances are a good example of this. When remittances are unable to process through traditional financial networks, we empower cash smugglers, traffickers, and less reputable financial facilitators to take over this business outside of the United States. Should this type of business grow too large, it could undermine the centrality of the U.S. financial system, or of large, well-regulated, stable financial systems generally, and become a national security concern. Also, it imposes higher costs on precisely the populations least able to bear them, a factor which can lead to a host of economic, governance, and social challenges.



Congress has mandated the U.S. Department of the Treasury to study these concerns through the Anti-Money Laundering Act of 2020. My team will be coming out with a strategy to address de-risking, which will include recommendations on how to improve public-private engagement on this issue, regulatory guidance and adjustments, and international supervision.

CONCLUSION

I want to conclude my remarks by highlighting some commonalities among the constituencies represented here. I've spoken at length about how risk is unique to each jurisdiction, institution, and situation—it is different based on what each institution prioritizes and how it interacts with the world. What I want to note, however, is that there are also important commonalities that bind us, and our approaches, together. Some events, like the Russian invasion and the global pandemic, are so broad ranging that we all cannot help but be affected. Finally, and most importantly, all of us here are unified in our vision to work towards a safer, more transparent, and more prosperous financial system. Treating risk with the nuance and detail it deserves across these areas is one way I hope we can work together to achieve that shared goal

Thank you for your time and I look forward to carrying this mission forward with you all.

