

THE BUCK STOPS HERE: IMPROVING U.S. ANTI-MONEY LAUNDERING PRACTICES

A REPORT

BY THE

UNITED STATES SENATE CAUCUS
ON
INTERNATIONAL NARCOTICS CONTROL

ONE HUNDRED THIRTEENTH CONGRESS
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Table of Contents

Letter of Transmittal	2
Finding and Recommendations.....	3
Background	11
Scope of the Problem	11
Who are the Launderers?	12
Intent of this Report	12
How Do They Do it? Money Laundering Techniques and Methods.....	13
Overview	13
Bulk Cash Smuggling	13
How Money Laundering Works	16
Trade Based Money Laundering.....	19
Black Market Peso Exchange	22
Hawala	22
Conclusion	23
Gaps in the U.S. Anti-Money Laundering Framework.....	24
Overview	24
Cracking Down on Shell Corporations.....	24
Updating Anti-Money Laundering Legislation.....	25
Stored Value.....	27
Collecting Better Information on Money Laundering	29
The HSBC and Wachovia Cases and U.S. Anti-Money Laundering Laws.....	30
Countries of Particular Concern.....	32
Overview	32
Mexico	32
Central America	33
Colombia.....	34
China	34
Afghanistan	35
Conclusion	37
Endnotes.....	38
Appendices.....	43
Additional Comments from Senators Cornyn and Risch.....	44
Letter from Senators Feinstein, Grassley and Whitehouse to Secretary Geithner.....	46

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LETTER OF TRANSMITTAL

UNITED STATES SENATE
CAUCUS ON INTERNATIONAL NARCOTICS CONTROL


April 2013

Dear Colleague:

With an estimated \$1.6 trillion – 2.7 percent of global Gross Domestic Product – laundered in 2009, we believe that much more must be done to combat money laundering. Without more effective anti-money laundering regulations in place, the United States will be unable to assist our partners in combating violent drug traffickers and other transnational criminal organizations. In November 2012, Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen announced that the Obama Administration would conduct a wide-scale review of current Bank Secrecy Act regulations. We hope that our report will complement this effort.

Our report synthesizes information gathered by Caucus staff through briefings, interviews, and a review of documents from both government and non-government experts. We look forward to hearing your feedback on this report.

Sincerely,



Senator Dianne Feinstein
Chairman



Senator Charles Grassley
Co-Chairman



Senator Tom Udall



Senator James E. Risch



Senator Sheldon Whitehouse



Senator John Cornyn

FINDINGS AND RECOMMENDATIONS

Available information suggests that the United States currently seizes less than one percent of illicit outbound cash flows along the Southwest border and even less money laundered through the international financial system. As transnational criminal organizations are motivated and enabled by their enormous profits, the United States should place greater emphasis on investigating and disrupting money laundering operations.

Illicit funds are directly responsible for the violence and deaths caused by criminal groups around the world. Arresting money launderers and seizing funds is an integral part of our fight against these groups. We offer the following recommendations to strengthen current efforts:

STRONGER DEPARTMENT OF JUSTICE ENFORCEMENT

1. ***Finding:*** On December 11, 2012, HSBC, one of the largest banking and financial services institutions in the world, agreed to pay a \$1.92 billion settlement to federal and state authorities for charges that they failed to maintain an effective anti-money laundering program. U.S. authorities charged that HSBC had allowed over \$200 trillion in wire transfers to enter the United States unmonitored, including \$670 billion in wire transfers from Mexico and at least \$881 million laundered by Mexican and Columbian drug traffickers. In addition, over \$9.4 billion in physical money entered the United States from Mexico unmonitored. Similarly, in 2010, Wachovia agreed to pay \$160 million to settle charges that its weak anti-money laundering compliance program enabled more than \$373 billion to enter the bank unmonitored as required by law, \$110 million of which was shown to be Mexican drug money.¹ In both cases, no individuals were criminally prosecuted by the Department of Justice.

Recommendation: The Caucus calls on the Department of Justice to fully enforce existing criminal sanctions against both the financial institutions and the individuals knowingly and intentionally responsible for the criminal activity more forcefully in major money laundering cases involving foreign and domestic financial institutions. Without serious consequences for those who break the law, financial institutions will continue to avoid compliance with U.S. anti-money laundering rules and regulations. Strong enforcement

of federal law against financial institutions and employees who knowingly and intentionally engage in money laundering activities will ensure that the risk of working with criminals is far greater than the illicit profits those criminal activities produce. Without tough and appropriate penalties, sanctions will simply remain the cost of doing business for financial institutions.

CLOSING GAPS IN OUR MONEY LAUNDERING LAWS

2. ***Finding:*** In November 2012, Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen said that the Obama Administration would create a task force to review current BSA regulations. According to Cohen, the task force will develop “recommendations to address any gaps, redundancies or inefficiencies in our framework.”

Recommendation: In the 112th Congress, Senators Grassley and Feinstein introduced legislation, the Combating Money Laundering, Terrorist Financing and Counterfeiting Act of 2011, to update our country’s outdated anti-money laundering framework. The Administration included many of the legislation’s provisions in July 2011 Strategy to Combat Transnational Organized Crime. Key provisions of the Grassley/Feinstein legislation include:

- Makes all felonies predicate offenses for money laundering, whether committed in the U.S. or abroad;
- Increases the penalty for bulk cash smuggling from 5 years to 10 years;
- Gives wiretapping authority to investigate money laundering offenses;
- Strikes the requirement that the government prove a defendant knew the purpose and plan behind transportation of laundered money;
- Updates counterfeiting laws to capture state-of-the-art counterfeiting processes;
- Clarifies the prohibition of money laundering through the hawala system; and

- Closes a loophole by assuming the value of blank checks in bearer form is equivalent to the amount of money in a bank account.

The Caucus urges swift reintroduction and passage of the Combating Money Laundering, Terrorist Financing and Counterfeiting Act of 2011 in the 113th Congress.²

SHELL CORPORATIONS

3. **Finding:** Shell companies allow transnational criminal organizations to easily move and hide their money. According to a recent article in *The Economist*, untraceable shell companies are “the vehicle of choice for money launderers, bribe givers and takers, sanctions busters, tax evaders and financers of terrorism.”³ While shell companies often have legitimate uses, they are also the perfect mechanism for international money launderers since information on the actual owners or persons in control of the shell companies (also known as beneficial owners) is in many cases not available to law enforcement. Currently, there is no process in place to keep an updated list of the names of the beneficial owners of corporations formed under a state’s law. It is legal to incorporate a company without disclosing who owns it or ultimately controls its activities.

Recommendation: During the 112th Congress, Senators Carl Levin (D-MI) and Charles Grassley (R-IA) introduced a bill called the Incorporation Transparency and Law Enforcement Assistance Act. The bill would make it much more difficult for criminal organizations to hide behind shell corporations by requiring the disclosure of beneficial ownership information during the company formation process. This information would then be available to law enforcement upon receipt of a subpoena or summons. We urge reintroduction and swift passage of this bill in the 113th Congress.

We also urge the Administration to finalize a rule that was proposed on March 5, 2012 that all financial institutions be required to determine the beneficial owner of accounts that they hold. The rule proposes that financial institutions do this as part of their customer due diligence.

STORED VALUE

4. **Finding:** Stored valued instruments – including pre-paid gift or credit cards – are an increasingly popular means of storing, moving and laundering money. Remarkably, stored value is not subject to any cross-border

reporting requirements. This means that an individual crossing from the United States into Mexico with over \$10,000 stored on pre-paid cards is not required to declare these cards at the border. Criminals, including drug traffickers or terrorists, can easily store hundreds of thousands of dollars on pre-paid cards and literally walk across the U.S. – Mexico border without penalty.

Following a March 9, 2011 Caucus hearing on money laundering, Senators Dianne Feinstein (D-CA), Charles Grassley (R-IA) and Sheldon Whitehouse (D-RI) sent a letter to Secretary of the Treasury Timothy Geithner urging the Administration to quickly propose and finalize a rule making stored value subject to cross-border reporting requirements. On October 12, 2011, the Obama Administration submitted to the Federal Register a Notice of Proposed Rulemaking, but no final rule has ever been issued.

Recommendation: Over a year after a rule making stored value subject to cross-border reporting requirements was proposed, it still has not been finalized. The Caucus urges the Administration to immediately finalize this crucial rule.

BETTER DATA COLLECTION

5. ***Finding:*** Far too little is known about the financial structures and procedures of drug trafficking organizations, particularly those from Mexico. On both sides of the border, U.S. and Mexican officials' efforts to understand drug trafficking organizations' finances are severely lacking.

Recommendation: In collaboration with the Mexican government and the governments of other countries in which drug money that enters the U.S. financial system is also frequently laundered, the Obama Administration should enhance authorities' and businesses' focus on understanding, mapping and tracking drug trafficking organizations' financial structures and money transfers. This should include specific tasking within law enforcement agencies and other relevant government and private sector entities to make financial information regarding drug traffickers a priority.

PRIORITIZE MAJOR INVESTIGATIONS

6. ***Finding:*** Anti-money laundering investigations and enforcement efforts are most effective when they move beyond simply seizing cash or freezing

assets to targeting the organizational structures that facilitate illicit money flows. By utilizing the information available from these seizures, law enforcement can develop a framework to more effectively combat money laundering and disrupt criminal groups. Recent work by Immigrations and Customs Enforcement (ICE) to utilize fingerprints and bill numbers on seized cash is a prime example of such work.

The same principles hold true for asset seizures, other than bulk cash. Electronic movement of money, including wire transfers, leaves paper trails and virtual fingerprints that can be equally useful in targeting money launderers. One such example is Western Union's 2010 settlement with the Arizona Attorney General's Office which requires the company to provide data on unusual money transfers. This kind of information allows investigators to identify and dismantle money laundering networks through suspicious patterns of behavior.

Recommendation: Law enforcement and regulatory agencies should prioritize major investigations that target money laundering facilitators. These so-called "facilitators" are often white collar professionals who are responsible for assisting in the transfer of money on behalf of violent criminals. Strong enforcement and penalties for these facilitators should have a deterrent effect, making it more difficult for criminal groups to find facilitators to assist them in laundering their money, which will in turn make it more difficult for them to launder funds in the U.S. All agencies involved in anti-money laundering investigations should coordinate their efforts to go beyond seizures and asset freezes to attack the architects of illicit financial structures.

RENEW FOCUS ON CUSTOMS INSPECTIONS

7. ***Finding:*** Trade based money laundering is defined as "the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origin."⁴

Given the volume of international trade and the prevalence of trade based money laundering schemes, too little attention is paid to customs inspections. Since the creation of the Department of Homeland Security (DHS), insufficient resources have been allocated to DHS's customs mission. Specifically, the hiring of customs inspections officers has not kept pace with both legitimate and illegitimate trade demands. While the number

of Border Patrol Agents patrolling the Southwest border in between official ports of entry has nearly doubled since 2004 (from 11,684 to 23,306), the number of customs inspectors has risen by only about 12 percent in the same time (from 19,525 to 21,893). This negatively impacts both our competitive edge in the trade arena and our ability to combat trade fraud and money laundering operations.

The Department of Homeland Security's Trade Transparency Units are an important tool in combating trade based money laundering. Trade Transparency Units provide important links between the United States and its foreign partners to identify suspicious trade patterns and prevent money laundering and smuggling activities. At a cost of about \$200,000, Trade Transparency Units are also relatively inexpensive to establish, requiring only the cost of computer equipment and training. The recent expansion of these to nine nations with two more in progress is encouraging as is the move towards regional Trade Transparency Units where all nations in a given area share trade information.

Recommendation: Within current budgetary constraints, DHS should increase the focus given to the customs aspect of its mission and ensure sufficient resources are devoted to its customs work. Targeted customs inspections and investigations are crucial in disrupting trade based laundering systems. Recognizing that disrupting the financial operations of transnational criminal organizations is critical to combating their illegal activities, DHS should make greater efforts to detect trade based money laundering at all ports of entry into the United States. As part of this effort, the number of Trade Transparency Units should be increased, particularly in countries where money laundering is prevalent. These units are a relatively low cost tool that can effectively detect suspicious trade based money laundering schemes. DHS should continue to train willing foreign partners and move towards regional Trade Transparency Unit models where appropriate.

IMPLEMENT ALL PROVISIONS OF THE 2007 NATIONAL MONEY LAUNDERING STRATEGY

8. ***Finding:*** The 2007 National Money Laundering Strategy provides a comprehensive list of changes needed for an effective anti-money laundering program in the United States. It is critical that these obligations are fulfilled.

Unfortunately, after five years, almost none of the recommendations have been implemented.

Specifically, the Department of Treasury's Financial Crimes Enforcement Network (FinCEN) has yet to implement the mandatory registration of all U.S. money service businesses. While it has taken steps to ease the registration process, it must also take steps to further facilitate the registration requirements.

In its investigatory support role, FinCEN must devote sufficient resources to the robust analysis of financial crimes. With over one million Suspicious Activity Reports filed each year, there is an enormous amount of financial information that FinCEN must process. While data sharing with other law enforcement agencies is reported to be well-coordinated, concerns remain about the FinCEN's ability to process this data.

Recommendation: The Administration should enforce all provisions of the 2007 National Money Laundering Strategy, including the requirement that all money service businesses register with FinCEN. FinCEN should also ensure that its technology is better used to process all financial information. In addition, proactive analysis of financial information should be a priority.

To support its investigatory mission, FinCEN should enter into Memoranda of Understanding (MOUs) with Immigrations and Customs Enforcement or other federal law enforcement agencies to detail special agents to FinCEN. Finally, Congress should ensure that FinCEN has adequate resources to carry out its mission. The Caucus believes that a more effective FinCEN could pay for itself over time with the assets that are seized.

CLOSE THE CASH CARRIER LOOPHOLE

9. ***Finding:*** As a result of Mexico's efforts to implement stronger anti-money laundering measures, illicit cash is having a harder time getting into the Mexican financial system. Dollars are increasingly moving north from Mexico into the United States. A significant amount of this money is coming via cash carriers across the Southwest border. Commercial cash carriers are currently exempt from filing Currency and Monitoring Instrument Reports (CMIRs) at the U.S. border. This means that there are no reporting requirements or controls on the funds as they are transported across the border. Nothing is known about the source of these funds and

once across the border, they can be placed in U.S. bank vaults and laundered through the global financial system.

Recommendation: The Obama Administration and Congress should immediately close this loophole. Just like any other entity transporting cash or currency over \$10,000 into or out of the United States, commercial cash carriers should be subject to U.S. reporting requirements.

Background

Scope of the Problem

Over the last three years, the Senate Caucus on International Narcotics Control has released bipartisan reports focused on U.S. counternarcotics policies and efforts in Mexico, Central America, the Caribbean and Afghanistan. In carrying out this work, we have become convinced that we cannot stop the drug trade without first cutting off the money that flows to drug trafficking organizations. Money laundering – very often through legitimate U.S. businesses and financial institutions – must be stopped to make real progress in curtailing the drug trade.

The United Nations Office on Drugs and Crime estimates that \$1.6 trillion, or 2.7 percent of global Gross Domestic Product (GDP), was laundered in 2009. **If one only takes into account financial flows related to drug trafficking and other transnational organized crime, \$580 billion or 1 percent of global GDP was laundered in 2009.**⁵

John Cassara, a former Treasury agent and an anti-money laundering expert, explains that we should be most concerned with how few U.S. drug proceeds are captured by authorities. He writes:

“The Office of National Drug Control Policy estimates that Americans spend approximately \$65 billion per year on illegal drugs. Yet according to the Drug Enforcement Administration (DEA), only about \$1 billion is seized per year domestically by all federal agencies combined. The approximately 1.5 percent successful seizure rate is actually even more depressing because identifying bulk cash related to drugs is probably the most straight forward anti-money laundering investigation. So we can infer the seizure rate is much worse for other kinds of money laundering in the United States that collectively total in the hundreds of billions of dollars.”⁶

Statistics regarding the amount of illicit drug proceeds leaving the United States vary widely which speaks to how little U.S. authorities know about how much money is moved, stored and laundered annually. The National Drug Intelligence Center estimates that Mexican and Colombian drug trafficking organizations “annually generate, remove and launder between \$18 billion and \$39 billion in wholesale distribution proceeds,” much of it across the U.S. Southwest border.⁷ While statistics on illegal activities are never easy to come by, we must do

significantly more to bring to light the extent to which proceeds from crime flow through our legitimate financial institutions.

Who are the Launderers?

In several briefings, Caucus staff was told that increasingly, it is not drug trafficking organizations themselves who launder money but instead third-party contractors.⁸ These individuals act as “facilitators” helping transnational criminals to launder money through the legitimate financial system. In July 2011, President Obama released his *Strategy to Combat Transnational Organized Crime* which effectively explains the role of these facilitators:

“Transnational organized criminal networks rely on industry experts, both witting and unwitting, to facilitate corrupt transactions and to create the necessary infrastructure to pursue their illicit schemes, such as creating shell corporations, opening offshore bank accounts in the shell corporation’s name, and creating front businesses for their illegal activity and money laundering. Business owners or bankers are enlisted to launder money, and employees of legitimate companies are used to conceal smuggling operations.”⁹

Heather Lowe, with the Washington, D.C. based research and advocacy organization Global Financial Integrity, points out that much more needs to be done to hold these facilitators accountable. She explains, “One of the biggest problems that I see in getting to grips with transnational crime is that we do not hold facilitators accountable in a way that dissuades them, their colleagues and anyone else looking to get a piece of the action but who may not otherwise be a hardened criminal, from getting involved.”¹⁰

Intent of this Report

Clearly, much more needs to be done to combat money laundering and bulk cash smuggling. This report will outline the scope of the problem, describe the U.S. anti-money laundering framework and its main gaps and propose solutions for how we can best strengthen our anti-money laundering laws.

How Do They Do It? Money Laundering Techniques and Methods

Overview

This section will explore the techniques and methods used by money launderers and bulk cash smugglers. Later sections of the report will focus on gaps in our anti-money laundering framework and steps we can take to fill these gaps.

Bulk Cash Smuggling

While we must be much more vigilant in stopping money laundering through legitimate financial institutions, bulk cash smuggling occurs outside formal financial institutions and continues to be the most widely used method of moving illegal proceeds along the Southwest border between the United States and Mexico.

According to a recent Woodrow Wilson International Center for Scholars paper authored by Celina Realuyo, “Cash remains the preferred payment method by criminal enterprises cross the globe, including the Mexican cartels. Cash is king!”¹¹ Realuyo cites a number of interesting statistics about bulk cash smuggling from the National Drug Intelligence Center. For example:

- The U.S. seized \$798 million in bulk cash between January 2008 and August 2010;
- Since 2002, Mexico has seized over \$457.5 million in bulk cash; and
- Bulk cash seizures in Mexico in 2010 included \$32.4 million and 87.3 million pesos (equal to about \$7 million). This totals about \$39.4 million¹²

Realuyo points out that \$39.4 million in Mexican seizures is “a pittance”¹³ when you consider the billions of dollars generated and smuggled by Mexican drug trafficking organizations.

The U.S. government has taken a number of steps to combat bulk cash smuggling, but the Caucus believes far more remains to be done. Under current law, cash or monetary instruments worth more than \$10,000 are subject to federal reporting requirements when one enters or exits the United States.¹⁴ This is at the

core of our regulations to prevent bulk cash smuggling across the U.S. – Mexico border.

A number of federal agencies are responsible for combating bulk cash smuggling, including Customs and Border Protection (CBP), Immigration and Customs Enforcement (ICE), the Drug Enforcement Administration (DEA) and a variety of state and local agencies. As recognized in the 2007 National Money Laundering Strategy, strong coordination and close cooperation amongst these agencies is essential to combatting money laundering.¹⁵ The opening of ICE's Bulk Cash Smuggling Center in 2009 and the training it provides to a range of law enforcement agencies is an important step towards better coordination in the fight against bulk cash smuggling.



*Bulk cash seized by Immigrations and Customs Enforcement
Source: Immigrations and Customs Enforcement*

Another essential tool to stem the flow of bulk cash was the reestablishment of Customs and Border Protection's Outbound Enforcement Program in March 2009.¹⁶ With the creation of the Department of Homeland Security following the attacks of September 11, 2001, there was an understandable focus on illicit traffic entering – rather than leaving – the United States. Since the restoration of the Outbound Enforcement Program, CBP had seized \$67 million worth of bulk cash through February 2011.¹⁷

Beginning in 2005, CBP has partnered with ICE through Operation Firewall to interdict illicit bulk cash shipments in the United States, at our borders and internationally.¹⁸ Their joint efforts have resulted in more than \$611 million being seized as of March 2012.¹⁹

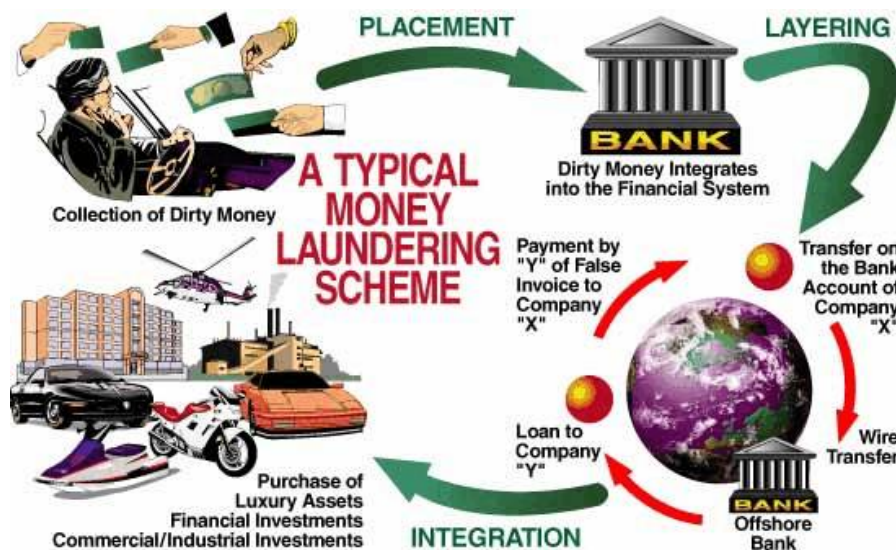
While efforts such as Operation Firewall are temporary by their nature, they can yield information for subsequent intelligence-driven operations. Recently, ICE has been able to utilize fingerprints found on bulk cash seizures and track bill numbers on seized cash through the Federal Reserve.²⁰ These efforts should be replicated and intensified. Such work results in greater disruptions to transnational criminal organizations by attacking their laundering infrastructure rather than simply seizing cash at the border.

The renewed U.S. focus on outbound cash smuggling is welcome, but unfortunately still stops only a tiny fraction of the enormous amount of bulk cash smuggled abroad. For example, John Cassara stated that of every 100 dollars in bulk cash smuggled across the U.S. southern border each year, only 25 cents is seized.²¹

The Caucus recognizes the inherent difficulties of combating bulk cash smuggling including the enormity of cross-border traffic flows, the variety of methods smugglers utilize and the need to facilitate legitimate cross-border commerce without undue delays. Nevertheless, a number of strategies can be employed to combat bulk cash smuggling. These include increasing penalties for bulk cash smuggling which is included in the Combating Money Laundering, Terrorist Financing and Counterfeiting Act of 2011, the legislation introduced by Senators Grassley and Feinstein in the 112th Congress.

How Money Laundering Works

This section will review the main steps involved in money laundering by transnational criminal organizations.



The Money Laundering Cycle
Source: United Nations on Drugs and Crime

Placement

Placement is defined as the stage at which illegal funds enter the financial system for the first time. Typically, this means the transformation of illicit cash into an asset that is easier to transfer or manipulate and therefore more useful to the money's end user. There are a number of possible methods that money launderers can utilize including cash deposits into bank accounts, depositing cash with non-bank financial institutions, wire transfers and placement of money onto pre-paid stored value cards. Each of these methods offers opportunities for criminals and their associates to access the international financial system.

The most straightforward way to integrate the proceeds of illegal activity into the financial system is through a bank account. As with any customer, this enables the account owner to move funds between banks nationally and internationally. In accordance with the Bank Secrecy Act, cash deposits and withdrawals in the United States exceeding \$10,000 require the filing of a Currency Transaction Report (CTR). The Bank Secrecy Act also requires that institutions report any suspected criminal activity.²²

While this can be a small bump in the road for most, money launderers are experts at finding ways to avoid detection. The primary method is known as **structuring** and involves breaking up large cash deposits into smaller ones and thereby avoiding reporting requirements. Alternating the type of deposit between cash and other financial instruments, such as money orders, is another method of structuring to avoid suspicion. Structuring can also refer to the intervals at which deposits are made and can be as simple as waiting hours, days, or weeks between deposits to avoid any suspicions.

A recent case involving Los Angeles area Angel Toy Corporation illustrates this point. Over the course of four years, the company deposited over \$8 million in cash from cocaine sales. While multiple cash deposits were made in a single day, they were always under \$10,000.²³ The launderers were able to avoid detection and launder significant sums before an ICE investigation put a stop to the operation, resulting in the conviction of the launderers.

Structuring can also be more complex involving scheduling wire transfers at timed intervals into different accounts, often using “funnel accounts” to place illicit funds into the financial system and rapidly relocate them. In this practice, a criminal organization or its agents will deposit proceeds from drug sales and other criminal activities in locations around the United States. The money in these accounts is then funneled into another bank account, often abroad, to avoid raising any alarm.²⁴ Such accounts are typically empty or almost empty before accepting huge inputs and then rapidly emptying again.²⁵ By utilizing Bank Secrecy Act data, law enforcement can identify these suspicious activity patterns and investigate the legality of the funds transiting funnel accounts.

While wire transfers can be used as part of a structuring scheme, they can also operate as the sole means for initial placement of illicit funds into the financial system. In this instance, a criminal takes cash proceeds from drug sales or other crimes to a money service business and transfers the funds electronically to another person, bank account, currency exchange or other financial institution. Money orders can serve the same function.

According to the Treasury Department’s Financial Crimes Enforcement Network (FinCEN), there were over 200,000 money service businesses in the United States in the late 1990s.²⁶ Despite the fact that they are required to register with FinCEN in accordance with the Bank Secrecy Act and comply with all relevant anti-money laundering control provisions, fewer than 39,000 were registered as of December 2012.²⁷ Experts estimate that only approximately 20

percent are currently registered.²⁸ This problem was identified in the 2007 National Money Laundering Strategy, but not been strongly enforced. It is imperative that at the very least FinCEN hold money service businesses to their obligations under the law.

Layering

After illicit money has been placed into the financial system, the second step in the money laundering process is known as **layering**. At this stage, money is moved, disguised and converted as launderers seek to obscure the money's illegal origins and sever the evidentiary link between the crime and its proceeds. Often this entails routing the money through multiple bank accounts, corporations, and shell companies.

Layering can also involve moving money into different jurisdictions around the world, particularly those with greater bank secrecy protections and lax enforcement of international anti-money laundering statutes. In addition, money launderers may purchase different types of financial instruments and attempt to disguise the money movement as payments for legal commercial activity. The goal of layering is to confuse the paper trail and move the money farther away from the crimes that generated them and to cause it to appear legitimate.

Just as money transmitters can be used in the initial stages of money laundering to place illicit cash into the financial system, so too can they be used in the secondary stages. Money laundering facilitators often move funds across international boundaries via wire transfer. This serves the purpose of increasing the distance between the crimes that generated the funds as well as increasing the appearance of legitimacy. A bank to bank transfer appears far less suspicious than large cash deposits.

Money launderers can also use their illicit money to purchase other financial instruments to further conceal the true source of their funds. Once these funds are deposited into the financial system, money laundering facilitators, just like legitimate investors, can purchase stocks, bonds, foreign currency or a variety of other financial instruments. For transnational criminal organizations, this not only diversifies their investment and yields potentially higher returns, but also adds another layer of legitimacy to their money. Once the instrument is sold, the proceeds of that sale appear legitimate and it is increasingly difficult to tie those proceeds to the crime that enabled the initial investment. This can be particularly

effective since it is most often “white collar” professionals moving the money rather than the criminals who first generated the profits.

Integration

The culmination of the money laundering process is known as **integration**. This is the point at which having been successfully laundered and disguised, illegitimate funds appear to be derived from legitimate economic activity. These funds are now available for a trafficker or criminal for use as they see fit. This may be used to invest in the legitimate economy such as real estate, restaurants, or other businesses. The “clean” money can also be utilized to further the organization’s criminal ventures by paying off corrupt officials, purchasing arms or drugs or hiring more personnel.

Money laundering does not always break down along the clear lines of placement, layering and integration. There is significant overlap and interplay between the three stages. Additionally, not all illicit money is laundered or ever enters the formal financial system. Nevertheless, the three stages provide a strong framework for understanding and examining the money laundering process. Transnational criminal groups ultimately operate in order to profit from their illegal activities and it is laundered money, uninhibited by any association with crime that allows them to conduct their unlawful undertakings.

Trade Based Money Laundering

Trade based money laundering is estimated by some experts to be the largest money laundering method in use in the United States today.²⁹ However, we do not know this with certainty, because trade based money laundering has never been systematically examined. At its core, trade based money laundering is “the process of disguising the proceeds of crime and moving value through the use of trade transactions in an attempt to legitimize their illicit origins.”³⁰ Simply put, this method of money laundering uses trade goods in ways that facilitate illicit value transfer.

In its most basic form, trade based money laundering involves the purchase of goods with the proceeds of drug sales or other crimes either in cash or through electronic transfers. These goods are then often transported across borders in order to pay a supplier or disguise the criminal origin of the funds used to buy the goods. This allows criminals to “transfer earnings back home to pay bills and buy new

drug supplies while converting dollars to pesos [or any other local currency] in a transaction relatively easy to explain to authorities.”³¹

Trade based money laundering commonly involves invoice fraud. The quantity, quality and price of the goods sold are manipulated. Under and overvaluation of traded goods can allow money launderers to settle debts. For example, a money laundering facilitator can value exported goods as \$200,000 when they are actually worth \$100,000. The recipient of those goods will then pay \$200,000 to the sender which includes a \$100,000 payment to the sender on top of the goods’ actual value.³²



*Law enforcement officers inspect suspect shipping container
Source: John Cassara, Money Laundering Expert*

Such a transaction allows for the settling of debts between those engaged in illicit activities. The same can be done in reverse by under-invoicing the true value of the traded good. If one party sends \$500,000 worth of a commodity but lists the value at \$200,000 on the invoice and is paid that amount by the recipient, they have effectively transferred \$300,000 to the recipient.

Experts at Global Financial Integrity have estimated that \$642.9 billion in cumulative illicit financial flows from Mexico between 1970 and 2010 can be

attributed to trade mispricing, and have concluded that “trade mispricing is the preferred method of transferring capital out of the country.” Global Financial Integrity also found that illicit financial flows from Mexico have been rising since 1970, with an increase from 4.5 percent of Mexican Gross Domestic Product before the adoption of the North American Free Trade Agreement (NAFTA) to an average of 6.3 percent of Gross Domestic Product during the 17 years after NAFTA was implemented. While the data sources used by Global Financial Integrity do not allow the organization to determine what specific illicit activity the trade mispricing activities are enabling or obscuring, at least a portion of this massive amount of trade mispricing activity is likely to be related to the drug trade.³³

Trade based money laundering poses a number of significant and complex challenges for law enforcement and regulators, not the least of which is the sheer enormity of global trade. With global trade volumes and values at or near record levels, launderers have an endless number of opportunities to conceal their illicit monetary flows. While this can make the problem seem insurmountable, a number of concrete steps can be taken to identify and seize the proceeds of crime.

One such action is the creation and expansion of Trade Transparency Units (TTUs). Operated by Immigrations and Customs Enforcement (ICE), these units use sophisticated computer programming to analyze trade flows between the participating countries and the United States to identify suspicious patterns provided by the Data Analysis and Research for Trade Transparency System.³⁴ This analysis allows customs officials to detect anomalies such as over or undervaluing of traded goods and provides actionable leads to investigate suspected money laundering.

ICE has successfully established TTUs with nine partner nations across the globe.³⁵ In exchange for the computer systems and necessary personnel training, these units share customs data to identify suspicious trade between the U.S. and their respective countries to coordinate actions against money launderers and criminal networks. ICE has informed Caucus staff that they are moving towards a regional TTU model in Latin America so that all countries involved can share data rather than sharing it solely on a bilateral basis with the United States.³⁶ The Caucus welcomes this effort and recommends replicating the program in countries where it would be most effective. These units are net revenue raisers when operated properly.³⁷

Still, challenges and shortcomings remain with regard to the Department of Homeland Security's enforcement efforts against trade-based money laundering, particularly at the Southwest border. Since 2004, the number of Border Patrol agents has nearly doubled while the number of customs inspectors has only increased by 12 percent.³⁸ Not only is this lack of attention a security cost, but it is also an economic one. Without adequate resources for customs inspections, the Department of Commerce estimates average Southwest border crossing times will rise to 99 minutes in 2017, costing the U.S. and Mexico a combined \$12 billion.³⁹ Within current budget constraints, DHS should increase the focus given to the customs portion of its mission.

Black Market Peso Exchange

A variation of trade based money laundering is the Black Market Peso Exchange which has long enabled drug traffickers operating in the United States to pay their suppliers in Colombia. With its origins in an era of high tariffs, the black market peso exchange allows drug traffickers in the United States to pay their Colombian suppliers without physically moving the currency to Colombia.⁴⁰ A money broker in the United States accepts the drug dollars from a U.S.-based agent and then provides Colombian pesos to the supplier in Colombia through Colombian merchants seeking to import U.S. goods. The agent then uses the drug dollars to purchase those goods and ships them back to Colombia.⁴¹

This system allows U.S. based criminals and launderers to avoid the dangers of smuggling large amounts of cash across borders. Yet, it too is vulnerable when strong investigatory efforts to target money laundering are made by law enforcement and regulatory agencies.

Hawala

Hawala is a system that allows for the transfer of money without the direct movement of money through a formal financial institution. Only in recent years has hawala come onto the radar for many in the United States, but it represents a significant potential threat both in terms of money laundering and terrorist financing. It should be emphasized that the majority of hawala do not involve illegal activity, but serve as an alternative way to send remittances or a "poor man's banking system."⁴²

Hawala has been in existence for hundreds of years and works largely on trust, often utilizing familial or other close connections to ensure delivery of

payments. The transfer begins when a hawaladar (a person/small company that is part of a hawala network) in one location accepts cash from a person wishing to send money to a person in a second location. That sender is given a code by the hawaladar, which he or she will then provide to the intended recipient. The hawaladar who received the cash then contacts another hawaladar in the recipient's location to arrange delivery of the money. When the recipient produces the code, the hawaladar delivers the previously agreed upon sum of money.⁴³ The hawaladars eventually settle their accounts through wire transfers, cash handovers or trade.

The majority of hawala transfers are for legitimate purposes and are legal in the United States so long as the hawala is registered as a money service business with FinCEN and licensed in the state in which it is doing business. However, like other informal money transfer systems, hawala is vulnerable to illicit finance. Illegal monies are harder to detect in hawala because of the informal nature of the system and the lack of extensive record keeping.⁴⁴

The system's prevalence in Afghanistan and its role in the Afghan drug trade make it a particular concern for the United States. Though a hawala network may seem difficult to penetrate, the same investigative techniques used to uncover other money laundering schemes can be effective. These include close monitoring of trade records, large cash transfers, and the enforcement of financial regulations. By utilizing these techniques, the Treasury Department was able to uncover the role two Afghanistan-based hawala networks played in laundering drug proceeds and supporting the Taliban in June 2012. Haji Khairullah Haij Sattar Money Exchange and Roshan Money Exchange have been included on Specially Designated Nationals list by the Treasury Department and had their assets frozen and seized due to investigations of the money's source, destination and use.⁴⁵

Conclusion

Financial gain is the key motivation behind most criminal activity in the world today and it is laundered money that enables transnational criminal organizations to run their operations. The methods described above are just a few of the ways criminals and their facilitators launder funds. Money launderers are flexible and able to change and adapt their methods quickly to avoid detection. U.S. anti-money laundering laws and regulations must constantly be updated to keep up with launderers' new tactics.

Gaps in the U.S. Anti-Money Laundering Framework

Overview

The Treasury Department is currently reviewing the U.S. Bank Secrecy Act provisions which is a very welcome step. In November 2012, David Cohen – the Treasury Department’s Under Secretary for Terrorism and Financial Intelligence – said that the Obama Administration would create a task force to review current regulations. According to Cohen, the task force will come up with “recommendations to address any gaps, redundancies or inefficiencies in our framework.”⁴⁶

This section will describe many gaps in the U.S. anti-money laundering framework which the Caucus believes must be filled. We hope that it will be useful to both Congress and the Administration as our anti-money laundering framework is updated.

Cracking Down on Shell Corporations

According to a recent article in *The Economist*, untraceable shell companies are “the vehicle of choice for money launderers, bribe givers and takers, sanctions busters, tax evaders and financiers of terrorism.”⁴⁷ The article notes that shell companies – which exist on paper only, without real employees or offices – often have legitimate uses.⁴⁸ However, they are also a perfect mechanism for international money launderers since information on the actual owner (also known as the beneficial owner) is often not available to law enforcement.

In the United States, it is far too easy for U.S. corporations to have “hidden owners.” Currently, there is no process in place to keep an updated list of the names of the beneficial owners of corporations or limited liability companies (LLCs) formed under a state’s laws.

Approximately two million corporations are formed in the United States every year. In a letter to Congress, Global Financial Integrity, Global Witness and other financial watchdog organizations, raised serious concerns about most states allowing the anonymous incorporation of companies. Some states do require the listing of shareholders, but these can be other “nominees” who serve as front people for shareholders. Perhaps most disturbingly, the letter points out that “typically, less information is provided to incorporate than is required to obtain a driver’s license or open a bank account. It is currently legal for a person to

incorporate a company without disclosing who benefits from its existence or ultimately controls its activities.”⁴⁹

In the 112th Congress, Senators Carl Levin (D-MI) and Charles Grassley (R-IA), introduced the Incorporation Transparency and Law Enforcement Assistance Act which would require the disclosure of beneficial ownership information during the company formation process. This information would then be available to law enforcement upon receipt of a subpoena or summons. The bill – which is supported by the Obama Administration – would make it much more difficult for criminal organizations to hide behind shell corporations. Assistant Attorney General Lanny Breuer from the Justice Department’s Criminal Division explained that this legislation is a key tool in going after illicit proceeds. He said:

“It is essential to our national and economic security that we close the loophole enabling some of the world’s worst actors in the criminal underworld to use shell companies established in the United States to move and hide their money. The proposed legislation represents an important step towards that goal.”⁵⁰

At a fiscally challenging time, it is important to ensure that this new legislation does not impose a burden on states as they implement it. That is why the Departments of Justice and Treasury have offered \$30 million of asset forfeiture funds to pay for the cost of implementing the legislation.

The Caucus believes that Congress should expedite passage of the Incorporation Transparency and Law Enforcement Assistance Act in the 113th Congress.

Updating Anti-Money Laundering Laws

In the 112th Congress, Senators Charles Grassley (R-IA) and Dianne Feinstein (D-CA) introduced legislation to update our country’s outdated anti-money laundering framework. The bill – the Combating Money Laundering, Terrorist Financing and Counterfeiting Act of 2011 – includes the following key provisions:

- **Makes all felonies predicate offenses for money laundering, whether committed in the U.S. or abroad.** This brings the U.S. in line with the majority of Organization for Economic Cooperation and Development (OECD) countries’ approach to predicate offenses, deleting our enumerated

lists of predicate offenses (one for crimes committed in the U.S. and one for crimes committed abroad), and decreasing “holes” in our anti-money laundering laws that allow criminals engaged in transnational crime to exploit those holes through jurisdictional arbitrage. It will also make the existing felony of tax evasion a predicate offense for money laundering, making it easier to prosecute foreign criminals when they are stashing their ill-gotten gains in the U.S. without paying taxes due on those funds in their own countries, when their layering efforts may have successfully broken the evidentiary link between the funds and another underlying crime such as drug trafficking.

- **Strikes the requirement that the government prove a defendant knew the purpose and plan behind transportation of laundered money.** This closes a loophole that allows “mules” to transport laundered money or goods with impunity.
- **Closes a loophole by assuming that the value of blank checks in bearer form is equivalent to the amount of money in a bank account.** It is an offense for any person to transport monetary instruments in bearer form into or out of the United States without filing a report with Customs and Border Protection, if the aggregate value of the monetary instruments exceeds \$10,000. There is some confusion, however, over how a check that has the dollar amount left blank (i.e., to be filled in by the bearer) shall be counted toward the \$10,000 threshold requirement. Leaving the amount blank on a check is, in fact, an increasingly common form of international money laundering perpetrated by individuals trying to evade the \$10,000 reporting requirement. This bill resolves that problem by making the value of any check in bearer form in accounts that contain \$10,000 or more in the account during the period the check was transported equivalent to the amount of money in the account.
- **Updates counterfeiting laws to capture state of the art counterfeiting processes.** Current counterfeiting law covers plates, stones and other devices that may be used in making counterfeit currency, but as technology progresses, the security features (such as holograms) used to protect against counterfeiting have progressed beyond the more traditional forms of counterfeiting. This section adds a provision to the current counterfeiting laws to include any materials, to include security features and counterfeit deterrents that may also be used to make, alter, forge or counterfeit either domestic or foreign currency.

- **Clarifies the prohibition of money laundering through the hawala system.** This was already included in the PATRIOT Act but is again included for clarification purposes.
- **Gives wiretapping authority to investigate money laundering offenses.** Under this provision, money laundering, currency reporting and counterfeiting will be added to the offenses for which an application for a wiretap may be made.
- **Increases the penalty for bulk cash smuggling to 10 years imprisonment.** Currently, the penalty is set at 5 years imprisonment.
- **Fixes the ambiguity of how to treat the commingling of funds.** This provision clarifies that a case can aggregate a series of closely related transactions under the \$10,000 threshold to meet the requirement of \$10,000 in criminally-derived property if the individual transactions are “closely related to each other in terms of time, the identity of the parties involved, the nature of the transactions and the manner in which they are conducted.”
- **Enables the government to charge a defendant who engages in a series of money laundering transactions for a single money laundering offense.** This would eliminate the current requirement that each transaction be charged separately in an indictment. However, it does not preclude the government from charging each transaction as a separate violation if it elects to do so.

Although it did not pass in the 112th Congress, the Caucus believes that the Combating Money Laundering, Terrorist Financing and Counterfeiting Act should be reintroduced and passed in the 113th Congress. With the right tools, the Department of Justice will have greater success prosecuting money launderers. Many of these tools can be found in this bill.

Stored Value

On March 9, 2011, the Caucus held a hearing on money laundering and bulk cash smuggling across the Southwest border. At that hearing, Senators learned about the use of stored value – including pre-paid gift or credit cards – as an increasingly popular means of money laundering. Remarkably, stored value is not subject to **any** cross-border reporting requirements. For example, an individual

crossing from the United States into Mexico with over \$10,000 stored on pre-paid cards is not required to declare these cards at the border. Put another way: under current law, a criminal, drug trafficker or terrorist with hundreds of thousands of dollars on pre-paid cards could literally walk across the U.S. – Mexico border without penalty.

At the Caucus's March 9, 2011 hearing Richard Stana, Government Accountability Office Director for Homeland Security and Justice Issues, explained to Senators that "regulatory exemptions heighten the risk that criminals may use stored value to finance their operations."⁵¹

Following the Caucus hearing, Senators Feinstein, Grassley and Whitehouse sent a March 14, 2011 letter to Secretary of the Treasury Timothy Geithner urging the Administration to immediately propose and finalize a rule to make stored value cards subject to cross-border reporting requirements. The letter stated that, "Without this rule in place, our laws will continue to lag behind drug trafficking organizations as they develop new ways to transport illegal proceeds from the United States to Mexico."⁵² (A copy of this letter is included in the report's appendix).

On October 12, 2011, the Administration submitted to the Federal Register a Notice of Proposed Rulemaking that would make stored value subject to cross-border reporting requirements. Specifically, the proposed rule would add pre-paid gift and credit cards – and potentially funds on cell phones – to the list of other monetary instruments that must be declared at U.S. borders if they exceed \$10,000. This was welcome news. Immigration and Customs Enforcement (ICE) notified the Caucus that they have acquired card reader technology that could immediately be deployed at the border to help enforce this new law. **Unfortunately, more than one year after the rule has been proposed, it still has not been finalized. The Caucus urges the Obama Administration to immediately finalize this crucial rule.**

The Caucus is pleased, however, with a separate rule which was implemented on July 26, 2011 that puts in place Suspicious Activity Reporting (SAR) for stored value cards. Previously, merchants were not required to submit Suspicious Activity Reports with the Financial Crimes Enforcement Network (FinCEN) for the purchase of stored value instruments, no matter what the dollar amount. A Suspicious Activity Report – submitted for the international transport of cash, money orders, or traveler's checks – is now also required for stored value. In its May 2011 report on Mexico, the Caucus recommended that "The Secretary

of the Treasury must quickly finalize a proposed rule to make the purchase of stored value subject to Suspicious Activity Reports (SARs).” We are pleased that this recommendation was implemented by the Administration.

Still, much remains to be done in ensuring that we treat illegally obtained stored value the same way that we treat illegal bulk cash proceeds. Without federal regulations in place making stored value subject to cross-border reporting requirements, our laws will continue to lag behind as drug trafficking organizations develop new ways to transport illegal proceeds from the United States to Mexico.

Collecting Better Information on Money Laundering

Far too little is known about the financial structures and procedures of drug trafficking organizations, particularly those from Mexico. On both sides of the border, the efforts by U.S. and Mexican authorities to fully understand drug trafficking organizations’ financial operations are severely lacking. The Caucus recommends that the Administration focus on understanding, mapping, and tracking the financial structures drug trafficking and other criminal organizations. The Administration should collaborate with the officials from Mexico and other countries in the region to gain a greater understanding of how drug money enters into and flows through the U.S. financial system. This should include specific tasking within law enforcement agencies and other relevant government and private sector entities to make financial information regarding drug traffickers a priority.

For example, the National Drug Intelligence Center estimates that Mexican and Colombian drug trafficking organizations “annually generate, remove and launder between \$18 billion and \$39 billion in wholesale distribution proceeds,” much of it across the U.S. Southwest border.⁵³ Broad ranging statistics such as this tell us far too little about the nature of illegal financial flows. Accurate and timely information must be collected on the financial structures of drug trafficking organizations and other transnational organized criminals to give U.S. law enforcement a fighting chance.

The HSBC and Wachovia Cases and U.S. Anti-Money Laundering Laws

As Congress and the Obama Administration consider how best to improve our anti-money laundering framework, we must also make a much better effort to enforce existing U.S. laws. Nowhere is this clearer than in the recent cases in which HSBC and Wachovia admitted to violating U.S. anti-money laundering laws and did not face criminal prosecution from the Department of Justice.

On December 11, 2012, HSBC entered into a Deferred Prosecution Agreement with the Department of Justice for violating federal laws designed to prevent drug trafficking organizations, terrorist organizations and other criminals from laundering money into the United States. HSBC agreed to pay what some have referred to as a “record \$1.92 billion” to federal and state authorities.⁵⁴ HSBC had been charged with failure to maintain an effective anti-money laundering program, failure to conduct due diligence on its foreign correspondent affiliates, and for violating sanctions and the Trading with the Enemy Act.⁵⁵ More specifically, HSBC is required to have a money laundering control monitoring system in place to detect irregularities and patterns of transactions that may be indicators of money launderers. Bank compliance officers review these reports and file Suspicious Activity Reports based on that data. HSBC had a compliance system in place but essentially turned it off for three years with respect to transactions classified as regular to medium risk. They were also incorrectly categorizing business risks. For example, transactions coming from Mexico were designated as regular risk when in actuality they should have been designated as high risk.

According to a report issued by Senator Carl Levin’s Homeland Security and Governmental Affairs Permanent Subcommittee on Investigations, HSBC “exposed the U.S. financial system to a wide array of money laundering, drug trafficking and terrorist financing risks.”⁵⁶ According to Department of Justice press statements on the subject, HSBC had allowed over \$670 billion in wire transfers and over \$9.4 billion in physical money to enter the United States from Mexico unmonitored. At least \$881 million in Mexican drug proceeds entered the United States illegally.

But, that’s not all. As Heather Lowe from Global Financial Integrity points out, this is just a small portion of the money that has gone unchecked by HSBC. She explains that legal documents from the case show that HSBC admitted to failing to apply legally required money laundering controls to \$200 trillion in wire transfers alone over a three year period. She writes, “The question everyone in the

world should be asking right now is *what other criminal money might have been among the \$200 trillion that flowed through the bank, unchecked and unchallenged?*”⁵⁷

The Caucus is disappointed that no criminal sanctions were sought by the Justice Department in the HSBC case. Failing to seek criminal sanctions sends the wrong message to global financial institutions and quite simply encourages further money laundering through the U.S. financial system. A recent *New York Times* editorial explains, “Once criminal sanctions are considered off limits, penalties and forfeitures become just another cost of doing business, a risk factor to consider on the road to profits.”⁵⁸

In 2010, Wachovia agreed to pay \$160 million to settle similar charges that its weak compliance allowed \$110 million in Mexican drug money to flow through its banks, as well as more than \$373 billion in unmonitored transactions.⁵⁹ In that case as well, no individuals were criminally prosecuted.

In a recent speech, Heather Lowe explained why the money that is laundered through the U.S. financial system really is “blood money.” She says:

“Blood money is a pretty inflammatory term, but it really is accurate. It probably is safe to say that the Mexican drug money that Wachovia bankers laundered was probably at least in part Los Zetas money. I don’t have to tell you about the daily terror that Los Zetas money is financing in Mexico and other countries, but I will remind you that Los Zetas are also working with Hezbollah. So you have to ask yourselves *what terror activities* the Wachovia money launderers were helping finance around the world. We are indeed talking about blood money.”⁶⁰

The Caucus calls on the Department of Justice to seek criminal sanctions much more forcefully in major money laundering cases, involving U.S. banks. Without serious consequences for those who break the law, banks will continue to avoid compliance with U.S. anti-money laundering rules and regulations.

Countries of Particular Concern

Overview

Money laundering is a global problem and no country, despite the best efforts of their regulatory and enforcement bodies, is immune to its effects. There are, however, a number of countries that are of particular concern due to the presence of drug trafficking and organized crime or their lax enforcement of international anti-money laundering statutes.

The following section provides an assessment of certain jurisdictions of concern, particularly those with a narcotics nexus.

Mexico

Due in part to its location between the United States and the drug producing and transit nations of Central and South America, Mexico plays a major role in the laundering of drug proceeds. The strength of Mexican drug trafficking organizations and their massive criminal operations ensures that large sums of money must reach Mexico either via bulk cash smuggling or money laundering.

To its credit, the Government of Mexico has recently enacted a number of anti-money laundering statutes to combat the flow of illicit cash from the United States. The Mexican government first imposed limits on U.S. dollars exchanges and deposits in August 2010. In October 2012, the Mexican Congress took these efforts a step farther by passing a national law that creates a financial analysis unit within the Attorney General's office, enhances "know your customer" regulations, requires increased reporting for financial entities, and sets cash payment thresholds for certain activities and industries identified as vulnerable to money laundering.⁶¹

As a result of Mexico's enhanced efforts to combat money laundering, drug trafficking proceeds are now reported to be returning north back into the United States.⁶² This can be accomplished via courier in amounts below \$10,000 to avoid declaration requirements, but also in amounts over \$10,000, declared and accompanied by a Currency Monitoring Instrument Report (CMIR). In a gross violation of "know your customer" requirements, there are reports of banks accepting these CMIRs as proof of legitimacy and not filing Suspicious Activity Reports.⁶³ Banks must be held accountable to a higher burden of knowledge in order to fulfill their duties under the Bank Secrecy and PATRIOT Acts.

Even more troubling, however, are reports of armored cars carrying U.S. dollars from Mexico across the border and then depositing this cash into bank vaults in the United States.⁶⁴ Due to an outdated loophole in U.S. regulations, businesses that transport currency across U.S. overland borders are not subject to any reporting requirements and can skirt “know your customer” regulations. This means that these vehicles can pick up hundreds of thousands of dollars from loosely regulated *casas de cambio* or even individuals and truck this money across the border for integration into the U.S. and global financial system. One can scarcely imagine a more convenient method for Mexican transnational criminal organizations to launder their illicit proceeds. This loophole must be closed immediately.

Central America

Just as stronger enforcement efforts in Mexico have resulted in greater levels of drug trafficking and drug-related violence in Central America, so too has money laundering shifted into the region. Evidence of this can be seen in bulk cash movements alone. As just one example, in August 2012, a sophisticated cash smuggling operation involving Mexicans posing as journalists was caught attempting to smuggle \$9.2 million into Nicaragua.⁶⁵

Central America is also a major money laundering concern because two countries in the region, Panama and El Salvador, use the U.S. dollar as their currency. Using the U.S. dollar means that drug proceeds transported the United States into those countries can be integrated into the financial system without arousing suspicion or the need for conversion into local currency.

Panama is also of significant concern due to its large free trade zone. While the free trade zone certainly serves a legitimate economic purpose, it is also vulnerable to money laundering, particularly trade based money laundering. Experts have also spoken of pre-paid cards, loaded with thousands of dollars in other countries and redeemed in Panama.⁶⁶

Central America is increasingly popular with transnational criminal organizations and the professionals who launder their proceeds. Drug traffickers have been known to say that they are “washing their money in Guatemala and El Salvador and drying it in Panama.”⁶⁷ U.S. policies and assistance to the region should emphasize anti-money laundering measures and training in recognition of their ability to disrupt and displace these criminal groups.

Colombia

As the source of 95 percent of cocaine consumed in the United States, it is no surprise that Colombia has a long history of money laundering related to drug trafficking. The previously discussed Black Market Peso Exchange originated as a means to repatriate the proceeds of cocaine sales from the United States to Colombia. A recent multi-year investigation, Operation Pacific Rim, led by Immigration and Customs Enforcement, uncovered a Colombian network suspected of smuggling cocaine worth \$24 billion.⁶⁸ The investigation began after the interception of more than \$28 million in bulk cash at a Colombian port.⁶⁹



An Immigration and Customs Enforcement-led investigation seizes \$41 million payment for cocaine hidden in fertilizer shipments from Mexico to Colombia.

Source: Immigration and Customs Enforcement

At the same time, Colombia has made great strides to combat money laundering. The Colombian National Police is among the best regarded services in the world with respect to their anti-money laundering efforts. Former Colombian security officials stressed the importance of having a professionalized police force, close cooperation with the U.S. government, and strong financial intelligence units for effective anti-money laundering work.⁷⁰ Colombia has also been effective as a result of its strong asset forfeiture law. Colombia's success in combating drug-related money laundering should serve as a model for other countries.

China

Due to its expanding economic prowess, China is becoming increasingly important to money launderers around the world. Numerous law enforcement officials have expressed concern at suspicious wire transfers headed to China.⁷¹ Experts have also pointed to the importance of small Chinese banks processing enormous numbers of payments from Mexico for trade that may or may not actually exist to launder drug proceeds.⁷²

The enormous volume of legitimate trade also make it attractive to money launderers engaged in trade based laundering schemes, because the sheer number of financial transactions and container ships give launderers the cover they need to operate. China also attracts launderers because of its role in the production of counterfeit and pirated goods. These goods offer significantly larger profit margins upon resale in other countries.⁷³ Finally, as the source country for many of the precursor chemicals used in drug production, China has proven to be a natural partner for trafficking networks looking to reinvest their financial resources.

Afghanistan

Given its status as the leading producer of opium poppy and rampant corruption, it is no surprise that Afghanistan is a money laundering haven. The aforementioned hawala networks serve as the primary banking system for much of the country and are highly vulnerable to money laundering. Some experts estimate that over \$1 billion derived from the drug trade in Afghanistan is laundered every year in Helmand province alone.⁷⁴

Afghanistan is also deeply enmeshed in bulk cash smuggling. According to the State Department, the declared cash value leaving Afghanistan each year exceeds Afghanistan's official revenue of \$900 million.⁷⁵ In 2011 alone, an estimated \$4.5 billion was smuggled out of the country.⁷⁶ The Special Inspector General for Afghanistan Reconstruction (SIGAR) recently found that the bulk cash counting machines provided by the United States were not even in use at Kabul International Airport.⁷⁷ Furthermore, a separate departure area allows VIPs to depart without any inspection whatsoever.⁷⁸ This violates the Government of Afghanistan's pledge to implement the global Financial Action Task Force's recommendations.⁷⁹

Afghanistan must do more to combat money laundering and terrorist financing in the country. The failure to utilize bulk currency counters is symptomatic of the country's disdainful efforts thus far. The United States and wider international community must hold the Government of Afghanistan accountable to its commitments in the fight against money laundering.

In the meantime, the U.S. Department of Treasury and other departments should continue their analytic and investigatory efforts. The June 2012 placement of two hawala networks and their operators on the Specially Designated Nationals List, thereby freezing their assets and blocking U.S. entities from engaging in

transactions with them, was a welcome step in this regard and should be replicated.⁸⁰ If the Government of Afghanistan takes no action to combat money laundering, it will increasingly fall to these types of designations to prevent illicit funds entering the financial system and financing terrorist operations.

Conclusion

Simply put, illicit proceeds from crime are “blood money,” and blood money should have no place in the U.S. financial system. Therefore, much more needs to be done to improve the U.S. anti-money laundering framework. Existing laws also must be better enforced. In a time of fiscal constraint, improving our anti-money laundering laws will serve the dual purpose of combating transnational organized crime while also bringing much-needed revenue back to the United States Treasury.

We believe the recommendations in this report will complement the Obama Administration’s current review of anti-money laundering laws and regulations. We also hope that it serves as a guide as we consider relevant legislation in the next Congress. Among this report’s most important recommendations are:

- Stronger enforcement of anti-money laundering laws by the Justice Department, particularly in cases where banks are accused of not properly monitoring billions of dollars of illicit proceeds. This should include criminal prosecutions;
- Passage of the Incorporation Transparency and Law Enforcement Assistance Act to make it more difficult for criminal organizations to hide behind shell companies;
- Passage of the Combating Money Laundering, Terrorist Financing and Counterfeiting Act to close gaps in our anti-money laundering laws;
- Finalization of an Obama Administration rule to make stored value subject to cross-border reporting requirements;
- Closing of an outdated loophole that does not make armored cash carriers subject to reporting requirements; and
- Enforcement of the provisions outlined in the 2007 National Money Laundering Strategy.

¹ Deferred Prosecution Agreement Exhibit A at 5-6, *United States v. Wachovia Bank*, No. 10-20165-CR (S.D. Fla. Mar. 16, 2010).

² Senator Whitehouse was not a co-sponsor of the Combating Money Laundering, Terrorist Financing and Counterfeiting Act in the 112th Congress, but generally supports the goals of the legislation and urges consideration of it in the 113th Congress.

³ "Launderers Anonymous: A study highlights how easy it is to set up untraceable companies," *The Economist*, September 22, 2012.

⁴ "Best Practices on Trade Based Money Laundering", Financial Action Task Force June 20, 2008.
<http://www.fatf-gafi.org/media/fatf/documents/recommendations/BPP%20Trade%20Based%20Money%20Laundering%202012%20COVER.pdf>

⁵ United Nations Office on Drugs and Crime, *Estimating Illicit Financial Flows Resulting from Drug Trafficking and Other Transnational Organized Crimes*, October 2011, pg. 7.

⁶ John Cassara, "Back to Basics," March 5, 2009,
http://www.johncassara.com/index.php?option=com_content&view=article&id=10:back-to-basics&catid=2:articles&Itemid=8

⁷ National Drug Intelligence Center data.

⁸ Senate Caucus on International Narcotics Control briefings with the Department of Justice, the Drug Enforcement Administration, Immigration and Customs Enforcement and the Financial Crimes Enforcement Network (FinCEN).

⁹ Strategy to Combat Transnational Organized Crime, The White House, July 25, 2011,
<http://www.whitehouse.gov/administration/eop/nsc/transnational-crime>

¹⁰ Heather Lowe, "Players: The Role of Facilitators and Super-Fixers," Remarks at the Center for Complex Operations, Trans-Atlantic Dialogue: Combating Crime-Terror Pipelines, June 25, 2012.

¹¹ Celina Realuyo, "It's All About the Money: Advancing Anti-Money Laundering Efforts in the U.S. and Mexico to Combat Transnational Organized Crime," *Woodrow Wilson International Center for Scholars*, May 2012, pg. 7.

¹² National Drug Intelligence Center, *National Drug Threat Assessments from 2009 and 2011* and State Department, *International Narcotics Control Strategy Report 2011 (Volume 2)*.

¹³ Celina Realuyo, "It's All About the Money: Advancing Anti-Money Laundering Efforts in the U.S. and Mexico to Combat Transnational Organized Crime," *Woodrow Wilson International Center for Scholars*, May 2012, pg. 7.

¹⁴ Senate Caucus on International Narcotics Control hearing on "Money Laundering and Bulk Cash Smuggling across the Southwest Border," March 9, 2011.

¹⁵ *2007 National Anti-Money Laundering Strategy*, Department of the Treasury, pg.5-6.

¹⁶ Senate Caucus on International Narcotics Control Hearing, March 9, 2011.

¹⁷ Ibid.

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- ¹⁸ Senate Caucus on International Narcotics Control briefing with U.S. Immigration and Customs Enforcement (ICE), 11-27-12.
- ¹⁹ House Committee on Homeland Security, Subcommittee on Border and Maritime Security field hearing, "Stopping the Flow of Illicit Drugs in Arizona by Leveraging State, Local and Federal Information Sharing." <http://www.dhs.gov/news/2012/05/21/written-testimony-us-immigration-and-customs-enforcement-house-homeland-security> Accessed 12-7-12.
- ²⁰ Immigrations and Customs Enforcement briefing to Senate Caucus on International Narcotics Control staff, 11-27-12.
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APPENDICES

- I. Additional comments from Senators Cornyn and Risch
- II. Letter from Senators Feinstein, Grassley and Whitehouse to Secretary Geithner on Stored Value

Additional Comments from Senator John Cornyn and Senator Jim Risch

We share the Caucus’s finding that shell companies can sometimes be used by transnational criminal organizations to easily move and hide illicit funds, but we cannot support passage of the “Incorporation Transparency and Law Enforcement Assistance Act” as introduced during the 112th Congress. Though we agree with the intent of this legislation, we believe that it raises serious constitutional and policy concerns. We would like to take this opportunity to briefly explain some of these concerns.

First, we believe that the Incorporation Transparency and Law Enforcement Assistance Act may unconstitutionally commandeer state government officials to enforce a federal mandate. In *Printz v. U.S.*, the Supreme Court struck down a provision of the Brady Handgun Violence Prevention Act that required the chief law enforcement officer of local jurisdictions to conduct background checks on prospective firearms purchasers.¹ In that opinion, the Court ruled that: “The Framers rejected the concept of a central government that would act upon and through the States, and instead designed a system in which the State and Federal Governments would exercise concurrent authority over the people.”² Similar to the provision of the Brady Handgun Violence Prevention Act struck down in *Printz*, the Incorporation Transparency and Law Enforcement Assistance Act would require state officials to implement a federal regulatory regime—requiring them to exercise their executive authority to determine if an individual is a “beneficial owner” of or person exercising “substantial control” over a given corporation. State officials who fail to comply with the bill’s requirement that complete and updated beneficial ownership information be recorded would be subject to federal felony liability of up to 3 years imprisonment. We believe that these provisions of the legislation raise serious constitutional federalism and state sovereignty concerns.

The Incorporation Transparency and Law Enforcement Assistance Act, while well-intentioned, may also harm American small businesses. By allowing foreign countries to gain access to the beneficial ownership information, the bill could jeopardize the privacy and competitiveness of American businesses vis-à-vis their foreign state-owned counterparts. The bill may also impose a large compliance cost on small-to-medium size American businesses that are exempt from SEC registration and not equipped to continuously maintain and update their beneficial ownership information. This burden would disparately impact small and privately-owned businesses, because most of their publicly-traded counterparts would be exempt from the record-keeping and disclosure requirements in the bill.

The Incorporation Transparency and Law Enforcement Assistance Act also raises serious business privacy concerns. Under many state laws and constitutions, the state in question would be required to publicly disclose the beneficial ownership information of all businesses kept on file. This would threaten many legitimate businesses and transactions which require a degree of confidentiality in order to protect the identities of contracting parties and preserve market equities. Broad public disclosure of all beneficial ownership information of legitimate businesses may also create a market chilling effect in which businesses are afraid to expand their portfolios

¹ 528 U.S. 898 (1997).

² *Id.* at 919-920.

and pursue venture capital opportunities. Given the current poor state of the world economy, we have serious reservations about any legislation that would threaten to jeopardize the financial stability of the United States any further.

The Incorporation Transparency and Law Enforcement Assistance Act would also impose an impossible regulatory burden and large unfunded mandate upon the states. For instance, the National Association of Secretaries of State (NASS), whose members would be required to administer the law, has strongly opposed this legislation. For instance, NASS has written that:

“the legislation is a confusing, overly bureaucratic proposal that would needlessly set in motion a drastic revamping of the business incorporation process in the U.S., with questionable results. . . Completely altering the manner in which companies are established in the U.S. is not only unnecessary, it is also not an appropriate, effective, or efficient strategy for tracking beneficial ownership information. The implementation of the Incorporation Transparency and Law Enforcement Assistance Act would require an extensive and continuous funding source that does not exist, and few states can afford to finance. . . If enacted, the Incorporation Transparency and Law Enforcement Assistance Act would bring federal rulemaking and regulatory authority into an area that has traditionally been the jurisdiction of the states, significantly blurring the lines between federal-state roles.”³

Because state secretaries of state would play a critical role in enforcing any law requiring the increased record-keeping and disclosure of beneficial ownership information, we believe that the sponsors of this legislation should continue working with NASS to address some of these outstanding concerns.

We support the Senate Caucus on International Narcotics Control’s continued efforts to address the problem of rogue shell corporations that help to finance international criminal organizations. Unfortunately, for the reasons stated above, we do not believe that the Incorporation Transparency and Law Enforcement Assistance Act, in its current form, is the proper mechanism through which to address these concerns. We look forward to working with the sponsors of this legislation and members of the caucus to cut down on criminal financing through shell corporations in a way that is constitutional, economically feasible, and practically enforceable.



JOHN CORNYN
United States Senator



JIM RISCH
United States Senator

³ National Association of Secretaries of State (NASS). “NASS Company Formation Task Force”. Available at: http://www.nass.org/index.php?option=com_content&view=article&id=113&Itemid=401

United States Senate

SENATE CAUCUS ON
INTERNATIONAL NARCOTICS CONTROL
HART SENATE OFFICE BUILDING, ROOM 818-C
WASHINGTON, DC 20510

March 14, 2011

The Honorable Timothy F. Geithner
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Geithner:

We write to urge you to immediately propose and finalize a rule to make prepaid access, including stored value cards, subject to cross-border reporting requirements. Without this rule in place, our laws will continue to lag behind drug trafficking organizations as they develop new ways to transport illegal proceeds from the United States to Mexico.

On March 9th, the Senate Caucus on International Narcotics Control held a hearing on money laundering and bulk cash smuggling across the Southwest border. At the hearing, we expressed our deep disappointment that the Department of the Treasury (Department) failed to meet a statutory deadline imposed by Congress in Section 503 the Credit Card Accountability Responsibility and Disclosure Act of 2009 (P.L. 111-24)¹ and “issue regulations in final form implementing the Bank Secrecy Act, regarding the sale, issuance, redemption, or international transport of stored value, including stored value cards.”²

We were further disappointed to hear from a Department official testifying at the hearing that despite the fact that the Department issued a limited Notice of Proposed Rulemaking regarding prepaid access in June 2010, there is no current timeline for making the proposed rule final. While this proposed rule is far from perfect, including significant problems with overbroad exclusions such as limiting the reach to cards that have a \$1000 maximum load limit and exempting closed loop prepaid gift card programs, finalizing an initial rule would be a building block

¹ Codified at 31 U.S.C. § 5311 note (2006).

² *Id.*

for future efforts. Unfortunately, it appears that based upon the Department's testimony, it will not be finalizing any rule regarding prepaid access in the foreseeable future.

Thus, under current law, a criminal, drug trafficker, or terrorist with hundreds of thousands of dollars on pre-paid cards could literally walk across the U.S. – Mexico border without penalty. While the Department continues to contemplate a rule, law enforcement's hands are tied as they observe stored value cards crossing to Mexico and are unable to do anything.

At the hearing, Government Accountability Office Director for Homeland Security and Justice Issues Richard Stana explained to the Caucus that "regulatory exemptions heighten the risk that criminals may use stored value to finance their operations." We could not agree more. We believe that a rule making prepaid access, including stored value cards, subject to cross-border reporting requirements must be expeditiously proposed and finalized. Absent a renewed effort from the Department to propose and finalize a cross-border reporting requirement for prepaid access programs, including stored value, Congress will have to take action via the legislative process.

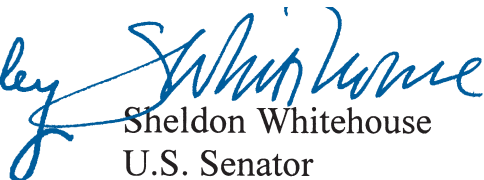
Sincerely,



Dianne Feinstein
Chairman



Charles E. Grassley
Co-Chairman



Sheldon Whitehouse
U.S. Senator