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Comment to FinCEN on ways to modernize AML/CFT rules and procedures

[Docket No. FinCEN-2021-0008] Review of Bank Secrecy Act Regulation and Guidance

The Association of Americans Resident Overseas (AARO), representing over 1000 members in 40 countries and speaking for many more, welcomes the invitation to comment on ways to streamline, modernize and update the anti-money laundering and countering the financing of terrorism (AML/CFT) regime of the United States.

AARO applauds the high-level objectives of AML/CFT rules, i.e. to assure and monitor compliance with the Bank Secrecy Act (BSA) with a view to protecting the financial system from criminal abuse and safeguarding the national security of the United States.[1] But there is great scope for improvement in the design of AML/CFT rules, which are substantially aligned internationally around standards[2] agreed by the Financial Action Task Force (FATF)[3]. We are aware of industry commentary calling attention to very high compliance costs while noting, nevertheless, that "the success of AML policies has been very limited"[4] and "more needs to be done [to] stem the flow of illicit finance…"[5] AARO is not well-placed to comment on these issues and will leave them to industry spokesmen.

However, in their current form, AML/CFT rules have contributed to serious problems Americans resident overseas face in terms of high costs of access to, or even exclusion from, US financial markets and services. Given the damage financial exclusion can cause, no expat account closures should proceed except on the basis of probable cause.

We make three recommendations.

I. Revise FATF international standards to end discrimination against expatriates

The outstanding feature of the International Standards is that, with no explanation, they formally embed discrimination against expatriates by deeming all non-resident customers to be "higher-risk".

In addition, their treatment of physical distance as suspicious seems archaic in the internet age with "non-face-to-face business relationships and transactions" similarly deemed higher-risk. Furthermore, the section on

[1] 31 USC 5311 (as amended by Section 6101(a) of the AML Act).
[2] FATF (2012-2021) International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation, FATF, Paris, France.
[3] FATF is an inter-governmental group whose US representative is the Treasury.
[4] Center for European Policy Studies, Anti-Money Laundering in the EU, *CEPS-ECRI Task Force Report*, Brussels, January 2021, p.i..
[5] Institute of International Finance and Deloitte LLP, « The global framework for fighting financial crime », London, 2019, p.1.

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"Preventative measures" includes a recommendation[6] explicitly requiring supplementary "due diligence" of correspondent banks. Since the US tax code effectively forces Americans resident overseas looking for brokerage and funds management services to "buy Wall Street", while their every-day financial activity is mostly in local currency, expats' personal financial management often involves foreign exchange transfers. Since these nearly all require correspondent banks, serving expats quickly becomes an un-rewarding, high- cost activity for expats' own banks. Finally, the rules oblige compliance officers in banks to deem accounts and transactions higher-risk on the basis of highly subjective judgements they are often not competent to make.

We are aware of no requirements for probable cause before a transaction or an account is deemed "higher-risk". But once this happens the account inevitably becomes vulnerable. "Enhanced" Customer Due Diligence (CDD), usually involving intrusive information gathering and other general harassment, becomes required and has often become prelude to the account's suppression.

These standards need to be revised[7] at both the international, i.e. FATF, level and in their transposition to laws and rules of the United States. This includes laws of individual states, most importantly New York. The biases which have made non-resident Americans unwelcome customers in US financial markets should be eliminated.

II. Make Customer Due Diligence (CDD) methodology transparent

AML/CFT rules require financial institutions to undertake CDD with regard to its entire client base. This involves (i) risk-profiling customers both when establishing a business relationship and *via* continuous monitoring an on-going basis; (ii) monitoring large classes of transactions and collecting detailed information about many that exceed a very low threshold, especially transfers that begin or end in the United States[8]; (iii) following alerts up with investigations; and (iv) reporting any activity or transaction deemed "suspicious". Any transaction suspected of money laundering or terrorist financing must be blocked. As noted above, there are many features that can necessitate an "enhancement" of this CDD.

From the perspective of bank customers these CDD rules and procedures, even if not "enhanced", are extremely opaque. The standards often target "factors" that are defined in very general, often subjective, terms that bank compliance staff, usually poorly placed to judge, can find difficult to interpret coherently. Given the volume of transactions that banks are obliged to monitor, and these limits to human judgement, AML/CFT compliance has increasingly relied on computer algorithms. But computers have even less judgmental capacity than human compliance officers. And incorporating concepts like "suspicious activities" and "unusual patterns of transactions" in algorithms that distinguish criminal behavior from innocent everyday activity is more art than science. The very high rate of false alerts (up to 98%) that is typical in large banks trying to identify suspicious transactions is indicative of the scale of the problem[9].

[6] Recommendation 13.
[7] Specifically, Section H ("Risk based approach") in the Interpretive Notes applying to Recommendation 10 (Customer Due Diligence) should be rewritten. In addition, the extraordinary measures beyond normal due diligence required in Recommendation 13 for dealing with Correspondent Banks should be lightened. Correspondent banks are an essential part of the global payments system.
[8] $3000 is a common threshold. For international transfers that begin or end in the United States, a proposed reduction of the threshold to $250 is under consideration.
[9] 98% is a European number. See the CEPS-ECRI Task force Report, "Anti-Money Laundering in the EU, Time to get Serious", CEPS, Brussels 2021. False alerts are unlikely to be less of a problem in the United States. Note that comments on FinCEN's

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Greater transparency would make the implementation of AML/CFT rules more cost effective as bank customers would be able to minimize inadvertent triggering of false alarms. Banks' methodology should be made public, expressed in clear and accessible language, as it pertains to: (i) risk-profiling of customers; (ii) thresholds and transaction characteristics that generate alerts calling for follow up; and (iii) criteria for deeming transactions to be "suspicious" or "unusual". Where due diligence relies on artificial intelligence – in which case algorithms are often proprietary and even the banks do not know what is in them – meaningful guidance about the underlying logic should be provided.

III. Consolidate Financial Reporting Requirements and Eliminate the FBAR.

The request for information specifically asks

- "…are the reports or records that are required to be filed or maintained highly useful in countering financial crime?" (Part III B)
- "Are there BSA reporting or record-keeping requirements that you believe do not provide information that is highly useful in countering financial crimes?" (Part IV B)

The resounding answer to these questions is that FinCEN 114 (FBAR) contributes nothing to countering financial crime, nor does it serve any other known purpose, and should be eliminated.

There are many things wrong with FBARs:

- Overlap and duplication in reporting requirements that apply to foreign financial accounts (notably Forms 8938 and 8966, required by FATCA, as well as FBARs) call for simplification and consolidation[10].
- Account information reported on FBARs is systematically wrong[11].
- Awareness of the FBAR and the obligation to file is very low, leading to poor compliance[12]. This is evidenced by the fact that filings of Form 8938, as part of tax returns, far exceed those of FBARs (2.0 million in 2019 compared to 1.4 million FBARS in the same year[13]). Given that thresholds for filing FBARS are much lower than for Form 8938 the opposite should be true[14].

Regulatory Impact Analysis of CDD (Federal Register Vol.80, 80309, December 24,2015) called attention to "substantially underestimated implementation and compliance costs."

[10] See, for example, the Government Accountability Office [GAO-19-180] and the National Taxpayer Advocate's "2022 Purple Book" (see Legislative Recommendation #8),

[11] Reported "maximum values" are based on local currency values at a date not reported, hence unknown, and converted to US dollars at the end-year exchange rate. Errors can be large. Closed accounts are reported while many new accounts are not reported until the following year.

[12] Although FBARs do not derive from the tax code and are not part of returns, courts have ruled that a tick-the-box question at the end of Schedule B, which a small number of filers (15.5% of the total in 2019) attach to their tax returns, constitutes sufficient warning of FBAR requirements.

[13] C.f. IRS written testimony before the Senate Finance Committee, Subcommittee on Tax and IRS Oversight on the Tax Gap, May 11, 2021.

[14] The GAO reports that around 40% of FBARs filers in 2015-6 reported maximum account values below thresholds for filing Form 8938 [GAO-19-180, Table 8].

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- Penalties levied for reporting failures or oversights have too often been grossly disproportionate.[15]

But the main reason we believe that FBARs play no role in FinCEN's work is that FinCEN itself seems to attach little or no importance to them.

Arguably the two most important vehicles for FinCEN to set out its priorities, objectives, methods and achievements are (1) the major (266 page) Mutual Evaluation Review undertaken in 2016, with FinCEN's active participation, by FATF[16]; and (2) its annual Congressional Budget Justification and Annual Performance Report and Plan. Anything important will receive high-profile attention in both of these documents. FBARs are notable for the minimal attention they receive in these reports.

The FATF report showcases the methods and applauds the successes of FinCEN's AML/CFT activities. It also calls attention to weaknesses. FBARs did not merit any mention in discussion of substance, appearing only occasionally as part of lists and in a table summarizing the full list of BSA reports received during 2012-14. The great bulk of BSA reports, 93% of the 20 million total in 2019, relate to actions involving financial movements, mainly currency transaction reports (CTRs) and suspicious activity reports (SARs). The FATF discussion of important intelligence sources focuses heavily on these, especially SARs. Of all the BSA reports that FinCEN collects, only FBARs are passive ones that do not relate to actions but simply state that accounts existed at some unknown date. The review cites no reported FinCEN actions that were motivated or assisted by FBAR filings.

The Budget Justification reports are FinCEN's own exposition of its priorities and methods. The FY2022 Justification does not even mention FBARs. It highlights SAR filings (roughly double the number of FBARs) and reports surveys of 13,000+ BSA data base users that report high levels of satisfaction with their use for detecting illicit activity. But no information is provided about frequency or usefulness of FBAR consultations, instances when FBAR filings motivated further investigation or contributions to discovery or prosecution of money laundering or financing of terrorism.

Thank you for offering us this opportunity to make our views known. We remain at your disposal.

The Association of Americans Resident Overseas

Paul Atkinson
Chairman, Banking Committee

Doris L. Speer
President

[15] The contrast with the low penalties reportedly paid by members of Congress and other senior Washington officials for failure to file timely information reports similar to the FBAR relating to their securities trading (as required by the STOCK Act of 2012) is striking.

[16] Financial Action Task Force, "Anti-money laundering and counter-terrorist financing measures – United States", *Fourth Round Mutual Evaluation Report, 2016, FATF*, Paris.