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ANTI-MONEY LAUNDERING: ARE WE WHERE WE WANT TO BE?

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**Introduction and Moderator:**

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**Keynote Speaker:**

THE HONORABLE CAROLYN B. MALONEY (D-NY)  
U.S. House of Representatives

**Panel Discussion:**

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## P R O C E E D I N G S

MR. KLEIN: Good afternoon.

GROUP: Good afternoon.

MR. KLEIN: Thank you. I'm Aaron Klein. I'm a fellow in Economic Studies and I'm the policy director for our Center on Markets and Regulation. And it's my pleasure to welcome you here to engage in what I think is kind of a critically important, but often under-thought-of issue in our broad economy, which is where are we in terms of our position about anti-money laundering rules, laws, and regulation?

I think a lot of folks here would remember that, as Rodgin reminded me earlier today, that Al Capone may be America's most famous gangster, but he did not go to jail for any violent crime. He went to jail for a financial crime.

Financial crimes have been a tool of law enforcement for a wide variety of purposes of decades. The comprehensive anti-money laundering system that we start with as a predicate was formed in the late 1960s with a goal to catch the Mafia and tax evaders. With dollar thresholds for transaction reportings of the then princely sum of \$10,000, which was more than an average median -- the average worker earned over a year, or as I once wrote, found in an infographic, for \$10,000 in cash you could buy a fully loaded, brand new Cadillac at the time this law was passed. In point of fact, you could buy two Cadillacs in cash, fully loaded, no transaction reporting.

From the '60s and '70s era of catching tax cheats and the Mob, the system was transformed and bootstrapped in the '80s to catch the new threat: drug cartels. With a broader focus on international flows of funds and different geography, the system was expanded.

Eighteen years ago today, a new threat arose to America and Congress responded in the PATRIOT Act with a section broadening our anti-money laundering regimes, strategies, and goals on a new and incredibly important focus that remains with us today: terrorism. Ancillary regimes were set up to deal with sanctions and other financial

crimes and financial tools the U.S. Government institutes for foreign policy, domestic policy, and to protect our citizens.

Eighteen years later, I think it's important to ask do we have the system we wanted to and are designed? Today, because we didn't index a number in 1968, that same \$10,000 threshold means that you cannot buy a single new car in America in cash without getting a transaction report being filed, when the original intent was meant to permit, you know, anybody from walking in and buying not one, but two Cadillacs. You can pick your thing; you can pay your college tuition. I don't even want to tell you what that's done.

This system on autopilot may not be the optimal system. It may not. Certainly, we can all agree the threats that we face today are radically different than the threats we faced 50 years ago. And, in point of fact, what we've learned in the 18 years since today's events ought to better inform policy for the next 18 years.

Deciding to hold this event I thought to myself and others who are the experts that we'd want to hear from? And I think there's no better person to start this than Congresswoman Maloney.

Congresswoman Maloney's been a leader on Capitol Hill for an incredibly long time. She currently serves as the vice chair of the Joint Economic Committee and she was the former chair and, I might add, the first woman to chair the Congress' Joint Economic Committee started in 1948. And I think it took too long to get our first female chair and, hopefully, we'll have another one soon enough.

She's also one of the most senior members of the House Financial Services Committee. She's currently the chair on the Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets. She's chaired multiple other subcommittees. She's passed multiple bills.

I remember very fondly legislation that she championed in the House and my former boss, Senator Chris Dodd, championed in the Senate, the CARD Act. The CARD Act was a giant deal. It enhanced consumer protection and stopped abuses. It changed

what's in all of your wallets and how that's regulated. Congresswoman Maloney was described by Money magazine as "the best friend a credit card user ever had," which makes her many of our best friends in this room.

But today, as the 18th anniversary of the horrific events of September 11, 2001, remind us, Congresswoman Maloney is from New York. And there's no place more impacted than New York. And not only did she fight at the time for those victims, she authored the James Zadroga 9/11 Health and Compensation Act to make sure all those suffering health ailments associated with 9/11 get the medical compensation and care they need and deserve.

That money eventually ran out, but Congresswoman Maloney never stopped. She continued to fight and this year led the successful reauthorization and replenishment of that fund to keep funding available for those who continue to suffer from 9/11. So I think it's all appropriate for us to both thank her for those continuing efforts and then, at the same time in our thanks, to take a silent moment to remember and honor the victims of 9/11 18 years ago today.

(Moment of silence)

MR. KLEIN: With that as a backdrop, Congresswoman Maloney, thank you for joining us at Brookings today and to share your thoughts on how our nation's anti-money laundering laws have evolved and where we need to go from here. Thank you very much.

(Applause)

CONGRESSWOMAN MALONEY: Thank you for letting me join you today. This topic is very timely because we've been working very hard this year to find a bipartisan path forward on reforms to the anti-money laundering system. And the central component of these reforms is a bill that I've authored called the Corporate Transparency Act, which would crack down on the illicit use of anonymous shell companies. This is one of the most pressing national security problems we face in this country because anonymous shell companies are the vehicle of choice for money launderers, criminals, and terrorists.

The reason they're so popular is because they can't be traced back to their true owners. Shell companies allow criminals and terrorists to move money around in the U.S. financial system and finance their operations freely and legally. Unfortunately, we know that the U.S. is one of the easiest places in the entire world to set up anonymous shell companies.

The reason why these shell companies are anonymous is because states don't require companies to name their true beneficial owners, the individuals who are collecting the profits and who outright own the company. We are the only -- the only -- advanced country in the world that doesn't already require disclosure of this information. And frankly, it's an embarrassment.

When the Panama Papers came out last year, one of the most common questions is why weren't there more Americans involved? And the answer is that Americans don't have to go to Panama to set up anonymous shell companies. They can do it right there in the United States.

But this isn't just an embarrassment we need to address. It's a problem that we really need to fix. These shell companies leave a gaping hole in our national security strategy. And the longer we wait to fix this problem, the more we put our country at risk.

As any FBI agent or prosecutor will tell you, far too many of their investigations hit a dead end at an anonymous shell company. And because they can't find out who the real owner of that shell company is, they can't follow the money past the shell company, past this pile of cash that they know is financing illegal activity. The trail goes cold and the investigation is stopped dead in its tracks.

Treasury conducted a pilot program a couple of years ago where they collected beneficial ownership information for real estate transactions in Manhattan and Miami for six months, and the results were stunning. Treasury found that about 30 percent of the transactions reported in those six months involved a beneficial owner or purchaser representative that had previously been the subject of a suspicious activity report. In other

words, these were potentially suspicious people buying these properties, and this was after Treasury and the press had announced to the world that they would be collecting beneficial ownership information in these two cities for six months. So this didn't even capture the criminals and the money launderers who simply avoided those two cities for this six-month period.

My bill would solve this problem by requiring companies to disclose their true beneficial owners to FinCEN at the time the company is formed. This information would only be available to law enforcement and to financial institutions, so that they can comply with their "Know Your Customer" rules. This bill will plug a huge hole in our national security defenses and would be a massive benefit to law enforcement. But this bill would also shore up the safety of our financial system and would streamline the compliance costs for financial institutions that are trying to make sure that terrorist and criminals aren't secretly using U.S. banks to move money around.

Treasury passed a rule three years ago that requires financial institutions to collect the beneficial ownership information for all of their corporate customers, which was a very important rule. If you think about it, no American, none of us, can walk into a branch of a bank anywhere and open up an account without identifying ourselves, saying what our name is, what our address is, and providing some proof that we are who we say we are. So why should companies be able to open up bank accounts and deposit millions, even billions of dollars without also identifying who owns them?

FinCEN's rule fixes that loophole and I think it makes our financial system safer. But it also puts the burden on the financial institutions to collect the information rather than putting the burden on the companies themselves. My bill would streamline this process by allowing financial institutions to access the FinCEN database of beneficial ownership information. That way financial institutions will be able to better police the financial system because they will truly know who their customers are and will also ease the regulatory burden on financial institutions at the same time.

This is a win-win. It helps law enforcement, it helps financial institutions better protect the U.S. financial system, and it also reduces unnecessary regulatory burden.

I want to take some time to address some of the concerns that have been raised about the bill because I think these concerns are not well-founded. First, some people have claimed that it would be overly burdensome on small businesses, but I don't think that that is true at all. All of the experience in other countries that already collect beneficial ownership information has proven that it is very cheap for small businesses to comply.

Critics have been -- made these wild claims about my bill costing small businesses millions of dollars and a lot of time. But in the U.K., where they already collect this information, the cost of compliance for the average small business was only \$200, and that's a one-time cost. To me, that is a very modest price to pay for national security.

In the U.K., the median company that had 1.1 owners, which means that the vast majority of small businesses only have one owner. So for these businesses, they will only have to file one name with FinCEN, just one. Just one name. And we're only asking for four pieces of very basic information: your name, date of birth, current address, driver's license number. For most businesses' owners it would take them five minutes to collect this information at most.

According to a study by the Global Financial Integrity, you have to disclose more information to get a library card than you have to disclose to create a corporation or an LLC. And you don't hear people complaining about the burdens of getting a library card. So I think the idea that this disclosure would be unduly burdensome is simply false.

The bill also goes out of its way to exempt every category of business that already discloses their beneficial owners, either to regulators or in public filings. This includes banks, credit unions, insurance companies, investment advisors, brokers, utilities, and nonprofits. The bill even exempts companies with more than 20 employees and over \$5 million in revenues because if you have 20 employees and are actually generating a

significant amount of revenue, then you're almost certainly a real business, not a shell company that is being used to launder money.

In fact, in almost all of the cases where law enforcement has uncovered a shell company that is being used for illicit purchases, the company had either zero or one employee. That's why we felt comfortable exempting companies that have more than 20 employees. So I think we've come a long way out of our way to ensure that the bill is appropriately tailored and is not burdensome on small businesses.

Second, most people, some people, have suggested that the IRS should collect this information and not FinCEN. Having the IRS collect this information would pose significant problems because the IRS has very strict rules on sharing information it collects. So law enforcement agencies, the fundamental reason why we want this bill, law enforcement agencies would not be able to access the information and financial institutions certainly wouldn't be able to access the information.

Why would we want to collect beneficial ownership information if law enforcement can't even use it? That would undermine the entire point of the bill. So I fundamentally oppose the IRS approach to beneficial ownership collection.

The approach I've taken in my bill is the product of years of work and years of compromises with different stakeholders, all with a view to building the broadest possible coalition of support. And I think that we've built a very large coalition. We have the support of 127 NGOs; all of the law enforcement groups, all of them; all of the banking trade associations; the credit union trade associations; human rights groups; state secretaries of state; most of the real estate industry; and many more.

We passed the bill out of committee with a healthy bipartisan support, which is rare in this Congress. And I am hopeful that the bill will pass the full House in October.

We also have significant momentum in the Senate, where Senators Warner, Cotton, Jones, and Rounds released a discussion draft that contained a beneficial ownership title that is very similar to my bill. In addition, Senators Whitehouse and Grassley



have introduced a companion beneficial ownership bill in the Senate Judiciary Committee, which the chairman of that committee, Lindsey Graham, has indicated he wants to move. And Chairman Crapo and Ranking Member Sherrod Brown on the Senator Banking Committee have held multiple hearings on beneficial ownership and have indicated that they're interested in moving legislation on this topic, as well.

Finally, we've been working very productively with the administration. Treasury Secretary Mnuchin testified in support of the beneficial ownership legislation several times and supports a bipartisan approach to the issue. So I'm very, very optimistic that the stars have finally aligned for beneficial ownership this Congress and that this bill will become law.

I think there's broad agreement that our AML system could be more effective and less burdensome. And so we're working hard to strike the right balance and to get these reforms across the finish line.

And with that, I'd like to thank the Brookings Institution for inviting me to speak at this fabulous event. And I think we're going to take some questions now, but I want to thank you for the work that you do all year long and have done in the past and will do in the future.

Thank you for having me. And as one who represents the 9-11 city, I have to say it's very poignant that today we're having this discussion because the need for this and my passion for passing this bill is totally tied to national security, where law enforcement tells me over and over again they're tracking the money and then they hit a wall. It's an LLC and they can't find out anything more.

So I think it's needed. I think it's important. And I hope very much that we'll be able to pass it this year. Thank you. And I'll take questions. (Applause)

Yes, uh-huh.

SPEAKER: Does your bill at all address the movement of money from the United States to other countries, and I'm thinking specifically of the UAE. I'm thinking of

China. I'm thinking Russia. That, frankly, ends up being another black hole in terms of (inaudible).

CONGRESSWOMAN MALONEY: You know, I heard your question. He says does it address moving of the money from, say, for example, the UAE across various countries and around the world. And I would say yes, because you'd be able to see who the beneficial owner is.

I have had cases where I have filed CFIUS complaints saying that I felt that this account and who was trying to buy this company was hiding behind an LLC and was a foreign bad actor and should not own this particular company in America. And I won one time. And they didn't -- they said, oh, we're going to sell it, we don't care, it's okay. And I said you've got to tell me who's buying it. And Treasury came back and they said they traced the money from one country to another country, to another country, to another county, to another country. They could never find out whose money it was or who was really behind that LLC. So it would stop that.

But what I find so startling about this, I think of our country as being a trendsetter, setting a high standard. Practically every single country in the world, the EU, England, all of our allies, they know who's buying property in their area. I represent New York City, the East Side of Manhattan. You can ride down the East Side of Manhattan at night, look up at buildings, and there are buildings that are completely -- that don't have one light on. They don't have one light on. And they are bank accounts; people don't live there. And it's a way you can stash money.

And whenever we have a terrorist attack, and we've had many attempts, some have been somewhat successful since 9-11 -- hurt only a few people, but still too many people -- and law enforcement will say, well, where did they get the money? Who financed it? And it's so easy now. You just buy an apartment, you've got a bank account that you can then pull the money out whenever you want.

Yes, sir.

SPEAKER: What would your bill do to help decrease the debt and deficit?

CONGRESSWOMAN MALONEY: Pardon me, the what?

SPEAKER: What would your bill do to help reduce our debt and deficit?

CONGRESSWOMAN MALONEY: Well, this is not a deficit reduction bill.

This is -- it's not a tax bill. It's a law enforcement bill. It's who is buying America? Who owns it? Law enforcement tell me and others repeatedly that they will be tracking money and they will hit a wall, they'll hit an LLC, they can't find out. They know that it's sex trafficking money. They know it's illegal guns. They know it's dope. They know it's bad activity, but they can't find out who owns it. They're completely protected.

SPEAKER: And there are no taxes (inaudible).

CONGRESSWOMAN MALONEY: Not really with the bill. I would say that it would crack down on money laundering, hiding money, possibly would have that benefit that they'd find out someone is hiding a huge amount of money that they should be paying taxes on. And a lot of our real estate in New York is bought by foreign people, foreign countries.

And I'm not kidding, I find it startling. I just ride down the street and I just look at these empty buildings and they are just basically bank accounts.

Yes?

MR. SCHROEDER: Thanks. Robert Schroeder, international investor. It seems like there's a number of constituents that would be fighting you. Real estate agents for one, as you mentioned; also, of course, some attorneys and law firms. And I understand that within each individual state, they call them sometimes secretaries of state, sometimes other names, but they also are against such legislation because they bring in a certain amount of income by setting up these corporations.

So can you tell me how you intend to overcome those in resistance? And who are the constituents in favor of this?

CONGRESSWOMAN MALONEY: Well, as I said, we've built a huge coalition. And, in fact, the secretaries of state have come out in support of the bill. They

don't want to do it. They don't want to keep these registries. And they have all come out and signed papers and support the bill. So secretaries of state support the bill.

And every single group -- now, originally the real estate industry makes a great deal of money selling real estate. So, originally, they were not in support of the bill, but now they support it. The realtors, the realtors organization has come out in support of the bill.

I think it's because of national security. Quite frankly, how dumb can you be? If you know terrorists can hide money so easily in your country, why in the world are you letting that happen and when we're trying so hard? And as I said, we had 127 NGOs.

What is really interesting to me, I've worked very hard to build a coalition that could pass it, law enforcement's totally for it. Usually when law enforcement says help me protect you, give me the tools to do the job to protect you, it happens. And so your point is true, there is an opposition to it, a lot of opposition to it, because the law enforcement is saying I will be better able to protect you, yet the bill hasn't passed.

So the only group that has come out in opposition -- you know, the banking groups are now supporting it; at first, they didn't. The trade associations, the credit unions, the human rights groups, the secretaries of state, and very importantly the real estate industry, which probably makes more money off of it than anybody in the real estate industry, and now they are officially supporting the bill.

The one organization that has come out in opposition is the lawyers, the lawyers association, and they say because it is so burdensome to small businesses. That's why I spent so much time going through the points showing out that it is not burdensome to them.

There is a *60 Minutes* program that was put together and you can get it on *60 Minutes*, and it goes through going to -- they go to 13 -- it's a sham. They have some guy come in and says he's representing, you know, a prime minister in Africa, and he has so much money he needs, you know, five houses and two boats and he wants to hide a billion

dollars in America. And they go through 12 lawyers that tell them you've come to the right place. They say whatever you do, don't go to a bank because they will reveal who you are, but I can hide it. I can hide it. Only one said what you're doing is illegal, get out of my office.

But they document it and I suggest you watch this film. Most people when they see this film afterwards are more dedicated to passing the bill and making it part of the fabric of America after seeing this bill. It'll make you quite angry.

MS. RAY: Hi. My name is Debra Ray. I actually report on the Canadian stock market. And so, you know, you were talking about hiding drug money, laundering drug money. And I was wondering if you were concerned about activities going on in marijuana stocks, especially with the CannTrust scandal where they're putting up fake walls and hiding some of their production efforts which are not licensed.

CONGRESSWOMAN MALONEY: Well, I think that's a very good question, but we have a bill that we have reported out of committee that addresses the cannabis banking issue, which I think is a really important one. We have roughly 12 states that have legalized cannabis in their states. And it has become really a national I would call it a police security problem because many people are hiding huge amounts of money because they have no access to a banking system. And what this bill would do, it would allow if your state has legal marijuana, then your banks can legally bank it in that state. So they're trying to address that particular challenge.

MS. RAY: Right. And something that I'm concerned about is because these marijuana companies, like Canopy Growth and Aurora Cannabis, they are actually making partnerships with legal marijuana producers in Colombia because Colombia has legalized marijuana since 2016. But my concern is some of the money that is being exchanged is actually money that was made by the cartels when it was illegal and it's actually blood money.

CONGRESSWOMAN MALONEY: Well, I can't talk about the blood money.

MS. RAY: Yeah.

CONGRESSWOMAN MALONEY: Each case is different. We are trying to address the challenge of banking cannabis in this country.

MS. RAY: Right.

CONGRESSWOMAN MALONEY: And we're moving forward with that legislation. I believe that it will be -- there's a huge effort to decriminalize marijuana and I believe that will happen, also, and that's happening in many states. It almost passed in my home state of New York and it's happened in several other states. And I think that that change is moving forward.

MS. RAY: Understood. Thank you.

CONGRESSWOMAN MALONEY: Thank you. Any other questions? Yes, uh-huh.

SPEAKER: Thank you. Corporations are chartered by states. Are there any specific states that are the worst offenders in this area?

CONGRESSWOMAN MALONEY: I really don't -- I don't know because we don't have any records on it yet now of who's -- because the law enforcement will go up to a wall, but they can't prove who's behind that wall. So we don't have any.

I would say that my own state, New York, because so much -- I'd say my own district is obviously -- has many LLCs that no one lives in those apartments or in those co-ops.

SPEAKER: It's chartered by New York State?

CONGRESSWOMAN MALONEY: I don't know who charters each one. It could be chartered federally. It could be chartered in New York State. It could be chartered some other state.

All of the state -- the secretaries of state from every single state has signed support of this legislation. There is not one state that is saying that they want to have their separate system.

Yes, uh-huh, in the back row.

SPEAKER: Yes. Have you got any estimates from law enforcement on how this bill might impact civil asset forfeiture?

CONGRESSWOMAN MALONEY: Pardon me?

SPEAKER: How the bill would affect civil asset forfeiture. So if all these anonymous companies are made known, will they be able to seize more money that's been generated illicitly?

CONGRESSWOMAN MALONEY: Probably. Again, it's an individual situation. My particular interest and focus is terrorism. I represent New York City. We lost 3,000 people on that day because they went to work, like you are doing today, just because they're American citizens. It's pretty horrifying. We've been dealing with the ramifications of it ever since, trying to rebuild and trying to help people repair, and it's devastating.

So I feel if law enforcement says this is going to help me protect you from terrorism, I'm for it, period. It will also help law enforcement crack down on other illegal activities, such as money laundering and hiding sex trafficking monies and so forth.

Yes, uh-huh.

MR. KLEIN: Congresswoman, I'll take the opportunity maybe to ask the last question building on what you said. Because the events of 18 years ago kind of changed everything. And our AML regime was enhanced through the PATRIOT Act. But 20 years later, we have a system that's very broad. We're trying to catch a lot of different folks.

It's also expensive. AML compliance costs are, when I do research, are often cited as the number one reason why financial institutions don't offer low- and no-cost bank accounts because of the cost of compliance.

I wrote a paper with Karen Gifford, who'll be joining the panel shortly, and Michael Barr, who assistant secretary for financial institutions at the Treasury Department. And in the paper, we quote that we found "enabling individuals to own their identity details in digitized form offers the possibility of enhancing personal privacy and information security. Portable digital identities supports financial inclusion efforts by reducing or eliminating

expensive and repetitive data collection associated with customer onboarding at banks.”

Historically, bank regulators have not exactly been at the cutting edge in accepting new technology for proof of identity. And as you well know, the federal government isn't really in the identity business. That we leave for the states and for the local libraries and their rigorous library card regimes, which I can attest are quite challenging in Montgomery County.

What do you think can be done to help make it easier and cheaper for people to prove to financial institutions that they are themselves and, correspondingly, to allow financial institutions to lower the cost of customer onboarding to, hopefully, attack this de-banking and de-risking problem?

CONGRESSWOMAN MALONEY: Well, I think you hit the nail on the head, Aaron. We need to leverage new technologies to make it easier for people to prove their identities. And your point that this would allow them to open up accounts for the unbanked without charges I think is an excellent one. I'll add it to my talking points. I think it's a great idea.

But we could do a better job of leveraging our existing databases. And, in fact, I have another bill in on the TSA pre-check database. They say they now have 12 million people in the TSA pre-check database. And I have a bill in that that database, banks should be able to access for “Know Your Customer.”

I remember when we put “Know Your Customer” as a burden on the banks. They were all extremely upset about the high cost, particularly the regional banks and smaller banks. They just couldn't absorb it. And they were constantly coming to me, telling me how hard it was for them. And if we could leverage this with this bill, with the TSA, then we could cut down, streamline, and make it much more efficient.

I fly to Washington every week and the TSA line is now longer than the other line, you know. And eventually, it's going to continue to grow. And I would say that they're checking is -- and the global entry, also, is very extensive. They really check it. It



takes them weeks to come back with whether or not you've met their criteria. So I think that's a very important database that we should also push that would be a database along your idea.

But your idea, also, of being for more unbanked to have the ability to be banked, because the burden of "Know Your Customer" is such an important one to the financial institutions. They don't want to make a mistake on something as important as national security. So it's extremely costly and they are very concerned that they may not catch something and it's a huge burden in time and money and effort, which is if we combined these, this would move forward.

I just have to share with you some of my colleagues on the Banking Committee when to some of the banking capitals. They went to Cyprus, which is the money laundering capital of the world. And guess what. They're moving forward with beneficial ownership. It's time for us to move forward with beneficial ownership.

Anyway, thank you so much. (Applause)

MR. KLEIN: Join me in thanking the Congresswoman for her time and thoughts on this and let me invite our panelists to come forward and as they do I will introduce them.

Rodgin Cohen is the senior chairman at Sullivan & Cromwell. He joined Sullivan & Cromwell in 1970 and has been at the forefront of banking finance and law as long as I have been involved in this. He is a member of the FDIC Systemic Risk Advisory Committee, the Board of Trustees for the United States Council of International Business.

And I think of all the many descriptions of Rodg that I have heard, my favorite is he is forever known as counsel to the situation whenever there is a situation in financial services that needs counsel, Rodgin is there and we are very grateful that he is here to provide his counsel and wisdom to us for the benefit of public policy. Rodgin has also been a strong and longtime supporter of Brookings and the Economic Studies Counsel.

Next is Karen Gifford who I mentioned was a coauthor of mine and serves

as an advisor to One World Identity. She is a council member at the World Economic Forum. Previously she worked at Ripple Lab as head of compliance. She has worked at a bunch of other financial consulting firms but served as counsel and officer at the New York Federal Reserve Bank for almost a decade had received her JED from Yale law.

Next to Karen, are a pair of Harvard guys. We will start with Juan Zarate. Juan Zarate served as a Deputy Assistant to the President and National Security Advisor for combating terrorism from 2005 to 2009. He was the first Assistant Secretary of the Treasury for terrorist financing, financial crimes. When I say 9/11 changed everything perhaps it changed nothing more than Juan's life and his work and for that we all owe him a great debt of gratitude in making sure that we have gone 18 years without a similar incident.

Currently, he serves as chairman of the Financial Integrity Network and a Senior Advisor at the Center for Strategic and International Studies and is a visiting lecturer back at Harvard.

Next to Juan is J.W. Verret who is an associate professor of law at the Scalia Law School, George Mason University. In addition to being a scholar and a gentleman on banking securities and corporate law, he serves as an, on the investor advisory committee at the Securities and Exchange Commission.

He was chief economist and senior counsel to the U.S. House Committee on Financial Services for Chairman Jen Henslerling and he is also the managing shareholder of VERITAS Financial Analytics, a compliance and expert witness firm. Ad J.W. is frequently able to espouse consistent and intriguing views on what securities law and banking and finance regulation mean for society and we are really thankful that you are spending your afternoon with us.

But let me start with a question for Juan who served in the Bush Administration and the White House and Treasury as I mentioned. What is your reaction to Congresswoman Maloney's speech? Where do you think she is right, where do you think she is wrong and what do you think is realistic to expect in terms of change?

MR. ZARATE: Well, it's great. Well, first of all good afternoon. Thank you, Aaron, for having me here, especially on 9/11, such an important anniversary. I loved Congresswoman Maloney's speech and I commend her for what are not just weeks and months' worth of work but years' worth of work. Not to mention others in industry as well as the Treasury, my partner Chip Pontzi who for 10 years was banging his head against the wall trying to make the argument very clearly that issues of systemic transparency in accountability and traceability that Congresswoman Maloney was talking about, are fundamental to national security.

Not just banking regulation, not just safety and soundness of the financial system but actually matters to understanding where money is coming from, where it's going and whose hands it sits. And that's exactly what I think Congresswoman Maloney is talking about.

I think there is all sorts of challenges and I think we will probably get into that in this panel. What's fascinating about having this discussion on 9/11 and listening to the Congresswoman is the anti-money laundering system and the sanction system both in parallel and in dovetail, it's more important now to national security than ever before. Even, you know, even after the 9/11 period.

And the reason for that is we are demanding more of the financial and economic system to reveal the vulnerabilities of America's enemies as well as to understand where criminality, listed financial activity and even rogue actors are accessing that financing system. You look at North Korea, Russian organized crime. You look at terrorist activities. There was a new enhanced executive order pronounced yesterday with respect to terrorist financing. So the list goes on and on as to how we are applying these tools.

At the same time, we are having fundamental debates and this is where there has been criticism of what Congress has been trying to do. Fundamental debates about whether or not the system is actually effective. Does the system actually do what we want it to do which is to prevent rouge actors and suspect and criminal actors from

accessing the financial system?

Because one of the things we asked the system to do in the private sector in particular post 9/11 was to protect the system from rogue actors to use financial tools and measures to exclude them and ultimately the strategy of the U.S. Treasury and the U.S. government has been, can you make it harder, costlier and riskier for rogue actors to raise and move money around the world, to access the elements of the financial commercial system.

There is a fundamental question underway and one that goes to the efficiency of the system as well as its effectiveness as to whether or not the systems doing that. Can the system allow for it? And I think what Congresswoman Maloney talked about is one piece of the puzzle. We have to understand beneficial ownership if we are to be assured that we are not letting money launderers use the U.S. system in bulk, in volume to hide or place their money. If we are sure the terrorist's financiers or networks aren't accessing the U.S. system.

If we are to be sure that Chinese front companies, Russian front companies, Venezuelan kleptocrats aren't accessing a high-end real estate. So all of that matters now more than ever before and I think what the Congresswoman laid out is one piece of the broader debate as to whether or not the system works as designed.

MR. KLEIN: What else do you guys, do you guys think in terms of where she was right or wrong or is it realistic to expect that we are going to get some change?

R: I'll be the optimist. I apologize for my voice. I think this legislation will be enacted. It's long overdue. It's only a relatively small piece of the puzzle but it's still a piece which needs to be put in place.

MR. VERRET: So I would jump in that I'm going to take the unpopular position on a very difficult day to take that unpopular position that I'm actually a critic of the beneficial ownership bill as designed currently. And here is why. Let's start with this question for everyone. Hypothetical.

Would you be okay with Finsen having access to your personal bank account log in and credit card log in information? And if the answer is no, and for me it's no and maybe for some of you it's no, then you accept that there's a value to financial privacy.

So the next question is does that become valueless if your financial privacy takes place through an LLC? And we have to think as we are thinking about that, let's remember when the World Bank tracks economic development, one of the top things they track is how long does it take to form a business?

And we are talking about here under this, this wasn't mentioned during the speech but what we are talking about here is a requirement to file with Finsen at the same time that you file with the State Secretary of State and if you get it wrong, you fail to knowingly file, you're looking at three years in jail.

So let me tell you -- let me describe the very real prospect here that lets say I inherit an interest in an LLC, stock in an LLC from my dad's small lawn mower business. And this only affects small business, right, the business with fewer than 20 employees. I inherit it and the lawyer says hey, don't forget to file this form with Finsen and I say yeah, stupid form. Maybe I should have filed it. I could be looking at three years in jail just for failure to file a form. If I knowingly failed to file that form.

That's an incredible tradeoff between financial privacy and anti-terrorism and anti, you know, criminal investigations. And I would add to this, lets also think about the benefit side of that equation which is as state law exists now, when you create an LLC, you have to provide the state with information about a registered agent for service of process. And you have to provide your registered agent for service of process with your information, your contact information. Your name and your address.

Will the terrorist financier who right now is -- whose law enforcement is hitting a wall when they go to the registered agent for service and processing agent and says here is the address and they say oh, that's bogus. Will the terrorist financier file the same bogus information on the form they sent to Finsen that they currently give to the

registered agent for service and processing? I think that they will.

So I think the costs are higher than have been described. The benefits are lower than have been described. And in an effort to add to the thinking rather than just being critical, I think representative Fred Sheila has offered a compromise using the regular IRS reporting regime that if you are an LCC that has income, go through the IRS reporting system. It's already going to have Schedule C, it's already going to have a lot of information you add to it and if there are issues about very carefully controlling access for anti-terrorism investigations to the IRS database, you can do that along the way as you reform the system in that way.

MR. KLEIN: So I could just say the IRS will have up to date information from 1973 next year. I mean, it's very slow but let me ask you a different question. Do you - - can I -- would you support anonymous personal bank companies? Bank accounts?

MR. VERRET: Anonymous personal bank accounts.

MR. KLEIN: Would you support that?

MR. VERRET: I think it's something worth talking about, sure. Yeah.

MR. KLEIN: Would anybody --

MR. VERRET: I mean, but what do you mean by anonymous?

MR. KLEIN: I mean, I can walk up and just say here is some money, give me -- I'll set up a pin and a number and you don't take any information from me but give me a debit card.

MR. VERRET: I think as we move toward fin techs challenging the existing system, I think we will have to think about the nature of identity and particularly the nature of business identity which can be quite complicated. And another angle to this, a complication that I think is not sufficiently appreciated by the proponents of this bill is, you know, when I teach beneficial ownership to my corporate law class. We take three days to study it because it's that complicated.

It's easy when you're a sole member owner but when you're a creditor, who

takes a secure interest that involves preferred stock or when you're an entity that owns through an entity through an entity, it gets very complicated. And when you're thinking about that academically it's fun. When you're thinking about it against a three-year prison sentence, it's an incredible compliance cost.

MR. KLEIN: So I want to turn to digital identity in a second because we have one of the worlds experts on digital identity with Karen but before we kind of move down that path, I want to go into an idea that Rodgin has talked about a lot which I think, you know, broadening the conversation beyond just beneficial ownership, there is a whole question about the purpose of the AML regime which this event is focused on which I think is about catching bad guys and protecting us and catching bad guys before they act.

And the current regime is much more focused on individuals and institutions and technology has evolved in a way in which you can -- most people interact with a wide number of financial institutions and the sum of the data collected across financial institutions for the purpose of getting bad guys hold aside tradeoffs in that are far greater.

You wrote kind of a ground-breaking article in the Journal of Banking Perspectives years ago and I think it influences today greatly where you called kind of the first person out there calling for this idea of a utility of the major financial institutions in enforcing AML.

Years later, the bank regulators have started moving in the direction that you first proposed with some guidance to allow this. Do you think the regulators have done enough to allow this utility to form? Does the government need to do more to encourage its formation?

R: Well, let me begin by echoing what Juan said and thank you, Aaron, so much for putting this together. As Aaron indicated, I am rather passionate about this issue and today of all days is an appropriate day to consider whether we really need to make a fundamental change in our AML system and as Aaron indicated to move to utility model.

Just a little background before I get to the direct answer. We have

remained mired for now 50 years in what is basically a siloed approach to AML. Every institution creates its own data base of information, every institution conducts its own KYC. Every institution does its own monitoring of transactions and every institution makes its own determinations about SAR filings.

Sharing is modest at best. This is not merely an inefficient system, much more importantly it is just ineffective. The proposition is simple. Financial institutions are being asked to make all these AML decisions with woefully incomplete information because they only know what is right before them. They don't know what any other institution has.

And as sophisticated as the algorithms may be today which larger institutions and maybe smaller institutions are employing, they are inherently less than satisfactory because they just can't be trained on enough data to really produce the answer. And we are not just talking about catching the bad guys although that's the fundamental point.

There is sort of an indirect aspect too. We are creating a plethora of false positives which detract from the ability of law enforcement since then other government agencies to catch the bad guys because these false positives clog the system. So the answer in my view is to eliminate the silo approach, have more and more informed, better informed decisions and that is the answer.

So to your, now sorry, with the lengthy introduction but to turn directly to the question. If we are going to get there this has got to be the responsibility of both the private sector and the public sector. The public sector is not going to embrace this unless the private sector not merely verbalizes its interest but it is willing to demonstrate a commitment time and resources through concrete action steps.

From the public sectors perspective as Aaron indicated, we are seeing some encouraging indications. But it's got to be more than just verbalized support. For this to work, the public sector has to be willing to say that the ultimately objective is not merely to supplement the current silo system but the idea of the utility is to replace it.



And there may be and probably are some necessary legal opinions which will be required along the way. This sounds enormously ambitious but there is precedent for this cooperative approach between the public and private sectors to resolving significant defects in AML and sanctions compliance and that was the work done a number of years ago to deal with cover payments which was a huge loop hole in our AML and sanctions system. Public sector, private sector got together. There was the will then and if we have that same will now we will have a way on a much larger scale.

MS. GIFFORD: I guess I would just jump on board Rodgin's proposal. I think it's I think it's an excellent one. I have read your paper and apologize, I did not have a chance to review it before this panel so it's been a while and I don't remember all the details.

One thing that I do recall thinking about at the time is just the privacy and security issues that are raised by creating a centralized repository of information about people and that that would have to be something that would be taken very seriously.

You know, since your paper came out, we had the Equifax hack and sort of, you know, have the dangers of creating big repositories of information probably even more obvious to everyone than they were at the time. So, I mean, I don't think that's an insurmountable problem but I do think it's important in getting together the right people who can address those kinds of challenges.

MR. ZARATE: Yeah. I couldn't agree more and I think what's interesting is we talked a little bit before the panel, technology is allowing sort of the intellection aperture to open the imagination to think through how to do combine the questions and concerns around privacy with the ability to actually discover risks that we care about?

And, you know, I'm a huge proponent of this utility idea. We are actually running a pilot with the Bank Policy Institute and a couple of banks to prove that you can do this with all the privacy safeguards in mind but can discover things that you wouldn't otherwise discover in the current model, right.

And I think it's important to underscore especially today and with this

audience and it goes a little bit to, you know, why are we doing this? Right. One of the major shifts post 9/11 was to say not only do we want to catch bad guys, not only do we want to prevent terrorists from attacking us and preventing them from having access to capital, but we actually want there to be protection of the financial system from financial crime risk at large. That became not only the policy mantra but that became the driving feature of all of the reforms, the regulations, the impetus for what we have seen.

And so it's not just how do we create a system that allows us to chase the next bad guy in a more efficient way or in a quicker way, it's actually how does the system itself driven by the private sector largely, manage the risk from this financial crime set of vulnerabilities. And how do we actually prevent these activities from happening to begin with or if they do happen, discovering them at a higher level more quickly in a more effective way.

You know, it's the question of why aren't we discovering the major corruption scandals, the major drug money laundering cases, you know, I call this the \$10 billion problem. You have these major, you know, organizations that are very savvy in how to work around the rules and at the end of the day, they're able to launder money.

So the purpose of the system is not to catch the corner drug trafficker, it's to try to actually capture the networks that need access to capital to do things that matter systemically and that are dangerous from a national security perspective. That I think is a major -- it's been a major policy shift and the challenge and attention that we often talk about is related to the fact that the design of the system which as Aaron, you described was built in the 60's, 70's, and 80's and even 90's, is an analogue system that isn't designed to what we are asking it to do.

And so this utility idea or other variations of how we use data, how we use machine learning, how we think about hashing information so you don't have PII floating all over the place, all of that is part of this debate about how do we get more effective at actually discovering systemically relevant financial crime and sanctions risk.

MR. VERRET: And the one thing I'll contribute to that is the fundamental

design or architecture of AML is a sort of a push up system but I think one of the things we learned in securities fraud, a lesson securities fraud can teach AML is that whistleblowers can be great resources.

Enron was effectivity caught by short sellers before anybody paid attention to it, the short sellers were on it. You know, it, the Harry Markopoulos was nobody at the SEC wanted to pay him attention. Any attention but he was right in so many ways. He was brilliant.

And the SEC has now moved post Dodd Frank towards something that I as a, I say most of the time I'm probably a critic of Dodd Frank but I support generally speaking the notion of whistleblowers. And I think a bounty type system for AML, why don't, why aren't we talking more about that?

Where it's sort of, you know, you're in, maybe you're like a compliance officer at a bank and you see something fishy and you're a higher up so like no, that's a big client, we can't do anything and you think there might be a big pay off if I just go ahead and file it myself. I think that's something we should be -- that should be on the agenda and part of this discussion.

As an economist you respond to incentives, whistleblowers, you respond to incentives. Let's add an incentive component to AML. You get better filings that would be, have more interesting content. You'd develop a bar around a specialty in the banking (inaudible) bar around AML bounty seeking filers. I don't know, it could be away to help --

MR. KLEIN: (inaudible) like.

MR. VERRET: Yeah. Why not.

MR. KLEIN: it's intriguing. I -- Juan, you mentioned the purpose of the system.

MR. ZARATE: yeah.

MR. KLEIN: And, you know, there is this balance between protecting the system from people with financial crimes accessing it and this bounds with the desire to

allow people to access the financial system because the vast majority of us are here to do --

MR. ZARATE: Law abiding.

MR. KLEIN: -- law abiding system and you're just as likely to be born law abiding if your name is Aaron Kline or you know, Akbar or Mohammed or there is lots of different pieces of information that disclose. There is also a huge cost burdens as the Congresswoman alluded to in putting in this compliance that are fixed costs, that are spread upon marginal users.

Karen, you and I coauthored this paper with the University of Michigan's now dean of the Ford School Michael Barr and we argued the U.S. was lagging in adopting new technology and financial services in part because of AML restrictions and simultaneously not allowing financial services company to adopt new technology to include -  
- enhance AML efficiencies.

And in the paper, I'll quote it. We said policy makers globally devoted two years to the -- years to two goals. Improving access and combating money -- anti-money laundering and terrorism. We made some inroads in each but we have also designed systems that actually work across purposes occasionally. We concluded "progress remains unacceptably slow." Two years ago. Do you think that's still the case? Has anything changed? Has anything changed?

MS. GIFFORD: You know, I think there has -- there has certainly been -- things are certainly happening but to say progress remains unacceptably slow I think is just sadly true. We wrote that paper because we were so excited about the potential for technology. We really, you know, I still feel this way that it -- the technology exists today that could vastly lower the cost of provision of financial services, that could improve anti-money laundering efforts and that could better protect people's privacy and security.

That's there today and it's really not being fully embraced and it's hard to see how it will be without some kind of broader policy vision that's articulated in a way that

industry can rely on. Industry really wants, you know, some kind of certainty. They want to be able to make business decisions and build things out.

And without the public sector saying like this is where we are going, starting to set standards, you know, saying with the regulatory framework could look like, they're not going to invest, you know, large resources on something. So and Rodgin was making the point earlier that there needs to be a public private effort and if there was to be a utility that did AML I think more broadly than that, there could be a public private effort to really upgrade the technological framework that we build financial services on.

And, you know, without that happening, I think progress is going to continue to remain really, really slow. You know, I was thinking about the whole like the debacle Facebook had with their planned currency and, you know, there is so many criticisms you could make about how they went about it and what they did but, you know, they were trying to create a payment system, they are a U.S. company trying to make a payment system and they did it outside the U.S.

And I just feel like that is such a terrible thing, you know, a U.S. company working on payments should be doing it in the U.S., should be doing it with the benefit of understanding what the rules are and getting guidance from policy makers and just I think the dialogue has broken down so much that we just, you know, it's hard to look on that as anything other than an embarrassment for everyone involved.

MR. ZARATE: I have a slightly --

MS. GIFFORD: Sure.

MR. ZARATE: -- Karen has great views and I respect the views but I have a slightly more optimistic view.

MS. GIFFORD: Okay.

MR. ZARATE: Because I think I see the Facebook announcement as a reflection of something broader happening which is new technology trying to capture not only business but payment rails and networks that are being either absented or not fully

developed by the formal financial system. Right.

And so with our clients, we see not only are there new technology firms and a lot of social media companies that are trying to use their databases, their platforms, their networks to then establish a payment network like the Facebook Libra announcement.

But also you're seeing technology companies begin to blend with existing formal financial, you know, system actors like medium and smaller banks to try to capture for example the unbanked because they not only say there's a business opportunity but the technology and the cultural awareness around compliance is allowing a sensibility around the management of that risk which is to say, you know, 10, 15 years ago you'd say look, its perhaps dangerous or risky to bank remittances from Minnesota Somalia Americans into east Africa if you don't know if it's going to Al Shabaab's hands, some pirate's hands or what's going to happen.

There are those that are trying to enter those kinds of payment channels and markets precisely because technology is allowing them to manage the data better but also, they're thinking more creatively about how do you actually manage the risk? And so I think there are still major challenges but I think the technology firms as well as entrants at the small and medium size are willing to take a bit more risk for both the business opportunity and given the ability to manage the risk in a more effective way.

MR. KLEIN: Well, if we can't have a conversation with the payment system without me jumping on the point of real time payments and I'll say seven percent of Americans are unbanked. Three times as many are underbanked. The definition of underbanked is I have used a check casher, a payday lender or a wire transmitter to move money. And it's because our existing payment system sucks. It is a technical term. It is a joke (laughter) compared to the fact that the rest of the world adopted real time payments sometime between 5 and 25 years ago.

In fact, the private sector and the banking sector deserve some credit for adopting real time payments technology absent a regulatory mandate that our central bank

has refused to give, despite having the legal authority to since 1987 under the Expedited Funds Availability Act. Had the Federal Reserve given that legal mandate when the Bank of England adopted real time payments in 2007, I think \$200 billion would have been saved by low-income individuals living paycheck-to-paycheck that instead went to bank overdraft fees, payday lenders and check cashers and pawnshops. Those are the winners with our payment system being a loser.

And now rather than use that regulatory authority, the Fed has announced that sometime in the next decade, maybe, they'll adopt a new payment system and new technology with the kind of -- this is the opposite of the goal that you're describing which is regulators putting clear guidelines out and the private sector adopting. This is the private sector adopting and regulators moving the goal posts.

But I've, sorry. That's -- I need to be a moderator and not a position person here. Real time payments gets me going.

MR. VERRET: Can I insert we mostly we agree about 85 percent but I think the, I diverge at the point of I think the way to get there is the Fed is not very efficient at running a payment system and it's terrible at managing conflicts of interest in its role as a provider of payments and a regulator of its competitor private sector system and a regulator of the clients of both.

It's terrible at managing those complex, get the Fed out of the business altogether and I think that crowding out, in you limited that crowding out, you get more of what you want through the private sector but that's it.

MR. KLEIN: It's a fair point. Let me turn to another piece of technology that didn't exist 18 years ago. Virtual currency. When we were discussing the Patriot Act and the AML, virtual currently wasn't a thing. Today virtual currency exists globally, it's used for a variety of purposes licit and illicit.

Do our existing AML rules make sense for virtual currency? You referenced the kind of Libra idea but there are lots of other virtual currencies that went out there without

a big public roll out and asking for public feedback. They just went live. Do they make sense? If not, should they be changed? Rodgin, what do you think?

MR. COHEN: Well, I think we clearly need to do a lot more on the AML virtual currencies and it's not just a question of what the rules are and how they apply. It's who enforces them. The idea that you would have a large part of the payment system that could move money which is self-policing, that just means ultimately you deteriorate to the bottom.

This, I think, you know, the virtual currencies and the technology behind it actually give the promise of really being able to develop the type of technological approach to AML that Karen was quite correctly referring to. So I don't think we have it down correctly yet and we have got to make sure that the virtual currencies or Libra if it does get off the ground is subjected to not the same but with the same effect KYC rules, filings of SARS, every aspect of KYC and that there is an appropriate enforcement mechanism.

And I continue to worry about that because if we don't get this right, virtual currencies have the opportunity to blow a total hole in our AML system as defective as it may be even today, it will become a largely meaningless.

MR. KLEIN: Are we at that big of a risk?

MR. COHEN: You know, everybody says oh, they're (inaudible) compared to (inaudible) currencies but we are going to wake up one day in all probability where virtual currencies or some form are going to be a real challenge to (inaudible) currency and then it's going to be too late to try and regulate it. It will have gotten too large, too global and will not be subject to regulation.

MS. GIFFORD: Well --

MR. ZARATE: I can't wait. I would take the opposite perspective. I think it would be great disciplining mechanism for the budgetary discipline that's just not present and the support for budgetary excess that the central banks have always provided over the history of the Federal Reserve despite their rhetoric to the contrary.



And the other thing that often I think it took some time to educate the folks at Treasury and the state AG's but I think they've gotten there. I think they get it. They're sophisticated now but when I first started House Financial Services trying got wok with them in 2013, 2012, they didn't understand that one of the fundamental promises of at least bitcoin as an example of crypto is that unlike cash, you know, if you have that sort of NYPD blue moment where you pressure someone and they give you their code, then you have an open source history of everything they've ever done that cash does not provide and you can see the minds of people flip like what, really? Oh wow, that's very interesting.

So it's a lot of promise actually for interdiction of very bad things once you sort of tap in the code just by the nature of the mechanism itself.

MR. VERRET: Can I piggy back off that? And in full disclosure, I've been an adviser to Coin Base for a number of years which is a big crypto exchange operator based in San Francisco. So I have watched the evolution both from the outside and the inside and I think what is fascinating is that we have reached this moment where there is a recognition that there is hope and promise in the technologies, there is the ability to think of these technologies as a way of providing new payment services to enable peer to peer transactions, to bring people into the system.

Even to think about traceability. You have, you know, Treasury authorities using a technology that allows them to trace, you know, digital identities using the public ledger. So it does become a real asset for law enforcement regulators. At the same time, a recognition that bad guys have figure doubt how to use this obviously, right. So it's a money laundering problem. We all know that ransomware is paid out in bitcoin. We know that terrorist groups are beginning to flirt a bit with these accounts. We have seen this with Hamas, we have seen this with others.

So we know the bad guys are accessing value in capital and we have seen North Korea with their cyber-attacks according to the most recent UN panel of expert report profit over \$2 billion worth based on their cyber activities and heists, much of which has

happened in the crypto context, either, you know, attacking crypto exchanges and stealing the money or just using crypto as a way of transacting.

So that, there's a real problem there and systemically there is a challenge of, you know, thinking about the, those organizations that are isolated or those regimes even that are isolated like the Venezuelan regime for example and the Russian regime beginning to connect their networks and their systems, something what we have called, you know, alliance of crypto rogues and beginning to tie their networks together. So that's a real challenge for the sanctions regime and others.

But the final point is the promise here is you have even Mark Carney, I know we have got some British colleagues in the audience, Mark Carney gave a speech at the end of August which I think was a bombshell which he talked about, you know, the central bank governors coming up with a new reserve currency that is crypto based and that the major central banks sort of coordinate and invest in.

And it goes to this evolution where initially there was a complete rejection of the technology and now you have the central bank governors around the world thinking about how to use this with by the way the regulators trying to figure out how do you endorse traceability transparency that's inherent in the money laundering system.

MR. KLEIN: So you mentioned cybercrimes, I mean, (inaudible) is another one where you're starting to blend the line here a little bit between terrorism, criminals, and governments. Is our AML regime set up and, you know, of sanctions set up to handle cyber war by nation states? I mean, is that something we want to tack on here?

MR. ZARATE: I think it has to be part of the broader national security discussion. I don't think that's the -- I don't think you put the full weight of that on the AML system. I think at that point the system begins to rupture and you are asking too much of it in a sense. But it is part of a broader question about are we defending the system properly, do we know who is in the system and how are they accessing capital whether it's through the formal financial system, new payment systems or crypto. That's part of a broader

national economic security debate which is upon us.

I think the big challenge there, Aaron, is the fact that you have nation states now involved so you're not just dealing with, you know, Chapo Guzman and the Mexican cartels or Russian organized crime, but you have nation states, rogue states, mafia states that are willing and able to access the financial system, misuse it, use cyber capabilities to profit and then to hide it.

We know the bank of Bangladesh case, the heist, came from the North Koreans. If it hadn't have been for a typo that the Fed caught, it would have been more than the \$81 million that north Korea was able to exfoliate through the swift payment system back through the bank of Bangladesh through casinos in the Philippines and back in the North Korean hands.

So I think to the extent that you have nation state actors blending with non-state networks, using the financial system, that's a huge problem and it requires a whole set of other tools and strategies in addition to the AML system.

MR. ZARATE: I won't, I mean, I don't know what NSA does or how they do it and I don't want to know and I shouldn't know (laughter). And actually that's part of the problem is we have learned a little bit too much about what they do. This whole conversation would be a lot easier if we didn't live in a world where I knew, we all know that a private, an Army private got ahold of sensitive diplomatic cable and shared them with the world through WikiLeaks. The Federal Reserve has been hacked. It -- thankfully I don't think Finsen has been hacked but I, I mean, who knows, right. The greatest hack that ever happened to me was the Office of Personnel Management.

MR. KLEIN: Right.

MS. GIFFORD: Yeah.

MR. ZARATE: Where the Chinese took my security clearance so, I mean, this kind of gets this question of --

MR. VERRET: And my fingerprints.

MR. ZARATE: There --

MR. KLEIN: Let me go to another topic that didn't exist 18 years ago in the way it does today which is state licensed cannabis. It was brought up earlier. Today 46 states allow for some form of medical cannabis. One in five Americans live in a state where marijuana is available for sale in commercial store fronts for recreational use.

Banks and regulators are faced with the situation on what to do for something on one ever dreamed of. Businesses operating with state government approval for drugs that remain federally illegal.

How do you think AML laws and rules are adopting to this situation and what do you think should be done about it? I mean, I gave a talk this morning before the Las Vegas Chamber of Commerce and this came up not just because they're state licensed cannabis stores, but now if you own real estate, maybe you have a tenant. If you're an architect, maybe you designed their facility. If you're running the power company, somebody is trying to pay their power bill in cash, this money infiltrates through the financial system which is designed never in the -- I assume, Juan, in your wildest dreams, did you ever think, or, Rodgin, as you guys were coming up with some of the laws here, let's design a system where in case 20 percent of Americans can live in a state that allow pot shops and how are they going to pay for it? What needs to be done with this?

MR. ZARATE: I just think banks are in an impossible situation where they're being asked to decide which felonies are okay to overlook and which ones aren't. I mean, it's just unfair. It's on Congress to move. And it seems like the momentum is there, I don't know if it's there yet but I think the tipping point is approaching.

MR. VERRET: I think absolutely right and I think, you know, the risk is exactly that you've described, Aaron. You know, and we deal with clients that are trying to figure out, okay, do we have to worry about the delivery trucks that are delivering food for the Friday afternoon lunch to these places and, you know --

MR. KLEIN: I hear they get very hungry on that.

MR. VERRET: They get very hungry. (Laughter) The Cheetos deliveries are persistent. But, you know, the one thing I have worried about and I have -- I said this from the get go and our Canadian friend mentioned this earlier. Is the fact that the risk tied to drug money laundering just grows more and more complicated.

Because if I'm a bad guy and I said this four or five years ago, if I'm a bad guy I'm going to find a way to blend my operations, my network in through what are considered legal and otherwise legitimate networks in Washington, Colorado, Nevada, wherever they are and I'm going to make it really hard for authorities whether in my home country or in in the U.S. to figure out where it is that I'm leering and placing my drug proceeds.

And so the question posed by our Canadian colleague is a great one because I don't know what's legitimate or not coming out of Columbia. I don't know what's from the Mexican cartel that's operating in and through the California dispensaries. I don't know. But if I were a drug trafficker, I would set up dispensaries and legal operations and make it really hard to distinguish between legal and illegal and that's what makes it even harder for the financial system --

MR. ZARATE: This is really --

MR. KLEIN: Juan, let me take the flip side on that and ask you this, right. If you cut off state licensed entities from access to the banking system, they end up with a bunch of cash.

MR. ZARATE: (inaudible) right. I'm not even arguing for that.

MR. KLEIN: No, I understand. A bunch of cash creates crime.

MR. ZARATE: Right.

MR. KLEIN: Right. It creates security which is against the will of the local voters who are going with this different approach.

In the state of Oregon they allowed so much cannabis production that the price radically fell to the point where probably you aren't an illicit drug operator because it's

no longer profitable in the state of Oregon.

In other places where bank access has been made more challenging, it keeps the price of state license up which creates more of an economic opportunity for the very black-market people that, you know, now there's a push pull between law enforcement and the will of the voters in these states and, you know, I have tried to be very careful in my words. There is no legal cannabis. There's state licensed.

MS. GIFFORD: Right.

MR. KLEIN: But what I heard --

MS. GIFFORD: I would just like to say --

MR. KLEIN: Karen lives in California.

MS. GIFFORD: Yeah, as somebody who lives in one of these states, I cannot wait for cannabis banking to get organized because it is super dangerous for people to be going around with large amounts of cash, you know.

There is, I live in a small town. There was a gun fight in my town and it makes sense because, you know, people are walking around with crazy amounts of cash. If you're a criminal why not hold people up?

So just like I don't know, you know, for example isn't proof, but I do feel that everyone benefits when the proceeds of businesses that have been licensed get into the banking system all kinds of checks can happen on those businesses that can't happen if they're forced out of the banking system. It just seems like basic common sense.

MR. VERRET: I agree. Right. That's right.

MS. GIFFORD: That they, you know, we come to terms with some of these issues and do it quickly because it's really, it's like you're helping criminals when you push money out of the banking system.

MR. COHEN: I would just totally agree with Karen and I want to come back if I can briefly to J.W's point because he has got to be right. The reason we have a problem is that we have a clash between state legislation and federal legislation. State legislation

can't solve that, only federal legislation can and that's the way to go.

MR. VERRET: Yeah, I would just --

MR. KLEIN: Would all three of you -- would all of your support the Safe Banking Act?

MR. VERRET: I have to read it.

MS. GIFFORD: Yeah, exactly.

MR. KLEIN: That doesn't stop a lot of members --

MS. GIFFORD: In principle.

MR. KLEIN: -- on the floor.

MS. GIFFORD: In principle, yes.

MR. ZARATE: I have to read what I support.

MR. VERRET: But it really, I just heard, I just learned something, a lot of new things today from Juan but one thing I had never thought about was this idea that's keeping the pot business cash means it's no longer at the first stage of money laundering that we used to think about. It's actually at the integration stage. It's the legit money you're trying to integrate into so it's a, it's moved to a -- keeping it cash moves it to a different stage of the --

MS. GIFFORD: It's a crazy situation.

MR. VERRET: -- money laundering cycle.

MS. GIFFORD: Yeah.

MR. VERRET: That's, I never thought of that.

MR. ZARATE: And it also disconnects from the price. So, Aaron, your point is right if the motivation is price. But if your motivation is placement and leering, you know, the cartels may not care about price. Right. What they want is the ability to hide or to place legitimately and if they have to take a haircut, it's just a cost of doing business.

MR. KLEIN: So I think you're entirely right and one more layer on top of it. The seed to sale licensing and accounting and all the rest, varies state to state. Because

there is no reason to assume that any of these states as they idiosyncratically go down the line are using the same legal requirements that the other states are and so it gets even more confusing.

MR. ZARATE: Well, and not to sort of force a connection back to the Congresswoman's legislation and speech, but it does ultimately come back to ownership and control and beneficial interest here, right. Who owns the operations in California? Who owns the operation in Oregon? We should know that. We should know that.

MR. KLEIN: So I have one more question for the panel before we turn to the audience which is that, you know, thinking about 20 years or 18 years after 9/11, one of the biggest changes is technology. Moore's law remains unbroken. The tech companies are coming up with new innovative ways to solve problems that we never thought of before.

But somehow in banking there seems to be a constraint on adopting these new technologies as it relates to AML. We have talked about some of these aspects legally and regulatorily.

Karen, you served as a regulator and an executive at a tech firm. Kind of what is the problem and is the problem technologists failing to adhere to regulation or is it regulators failing to keep up with technology?

MS. GIFFORD: Oh, you know, I think the politically correct answer to that is that there is faults on both sides and I really used to feel that way strongly. But, you know, at this point I'm going to say this technology has been out for a long time and technologists have been, you know, around and regulators have gotten a chance to get to know them.

And, you know, I feel like at this point, it's a little bit on regulators to move, you know. They -- you know, technologists can sound very combative, at least there's a part of the technology community that can be very oppositional when they talk about regulation. But I just really want to like I would ask regulators to ask themselves are those people really more problematic than bankers?

You know, bankers wear suits and they sound nice and they don't talk about



disruption but there's plenty of very difficult personalities and that group as well and it, the job of the regulatory community is to deal with people and nobody is an angel and nobody is a devil and I think just sort of moving forward in that direction is really on the regulatory and policy community.

You know, I would also say that what I have noticed in the regulatory community a little bit is just like insecurity or fear about learning all this new technology and how it works and, you know, again I would say regulators already work, if they're financial regulators, they're already working in a world of a lot of technology.

They're working in a world of very complex financial instruments and they have found a way forward, they have found a way to deal with that. And this is just one new set of products and one new set of technologies and it, they can deal with it, you know, it's not too hard. So yeah, no, that's where my thinking is right now.

MR. KLEIN: So people in hoodies and people in suits --

MS. GIFFORD: Don't worry about the hoodies. (Laughter)

MR. KLEIN: Go Rodgin.

MR. COHEN: Just one quick point. Since you raised RTP actually I think this has --

MR. KLEIN: Real time payments.

MR. COHEN: Real time payments, a relevance to AML which is if you would have it the information field could actually be quite useful to detecting patterns and would be helpful.

And since you raised it just one more second. If you don't -- if we don't get movement on RTP who is really going to be disadvantaged are the small banks even though they are advocating singly to the Fed to come in. What the Fed has said is we want to come in but five years from now that's not going to be right for the small banks because you are going to have in every not where there is a large bank it can offer its customers RTP and the small banks can't. And this is going to act so much against their interest and against the

interest of their customers in rural America.

MR. KLEIN: So I can't, I have to tell the audience a funny side story. So earlier today Roger was speaking before the American was it --

MR. COHEN: Institute of Certified Public Accountant.

MR. KLEIN: Institute of Public Accountants and you want to talk about an industry that opposed something in their own interest. I worked for Senator Paul Sarbanes and you mentioned I think Enron, I'm going to the old Enron field for a baseball game tomorrow but as you guys know, Enron may have had a little bit of a problem and as a result, Congress many have passed a small accounting reform known as Sarbanes Oxley.

I remember the first group to come in and oppose it was the public accountants. Do you know what industry made the most money off of Sarbanes Oxley? In fact, it was their single largest source of revenue growth was the legislation they fought tooth and nail.

So it's kind of funny how sometimes industry can oppose one thing that turns out to be in their best interest because perhaps bank overdraft fees may be a thing of the past in a few years but there may be new technology layered over that that allows a whole new system to open up. But I think I saw some, I promised some questions. Micah?

QUESTIONER: Thanks, Aaron. Micah Green with (inaudible) Johnson. I guess a question for Rodgin. With all the various siloes of reporting entities and all the various regulators, and I know there is international efforts through FATIF to try to create comedy around the world. Can you, how do you see a utility structure working not only within the United States but across the globe?

MR. COHEN: And it's a very fair question and it's a bit of a walking before you can run. So I think we have got to be able to get it done in the U.S. The real problem globally is going to be privacy and the ability to provide that information into the United States.

And if, you know, I could create the world, I think the U.S. and UK are

closest on that and if we can get an agreement ultimately between the two then it would move into Europe and elsewhere. But that's a problem which I'm not sure is going to be readily soluble.

MR. ZARATE: Aaron, could I just supplement that? I think what is interesting here is the utility model and other variations of kind of the next evolution of AML systems will likely emerge in other jurisdictions before the U.S. In part because I think the regulators as Karen was mentioning are a bit sort of a step behind. Not because they're not smart, not because they're not willing to understand but the -- it's a more ossified system.

Whereas if you look at Singapore for example, Singapore is trying to compete and become the financial center in east Asia and southeast Asia obviously competing with Hong Kong and others. They're looking aggressively to how they can innovate and they've in fact been doing a number of pilots in fact funding pilots in this regard.

I think the same will go for Dubai, I think other banking centers will begin to outpace some of the innovation. I agree with Rodg, ideally you would have the U.S., UK doing this. In fact I think the UK is going to be ahead of us. And it's largely going to be the private sector I think that drives it here first before the regulators and law enforcement gets on board.

MS. GIFFORD: I would just also like to say the point that you make about the discontinuity between England and the U.S. versus Europe with respect to privacy, that's really an issue that technology could go a long way to resolving. There would be ways to keep private, you know, personal information private or housed in, you know, servers in Europe that would resolve a lot of the European issues. Yeah.

MR. VERRET: Well, we can't forget though that the naughty kid in class in this with tax treaties, with these kinds of treaties is China. This is a country that has components that make systematic efforts to steal intellectual property. And that can use information about LLC's about tax issues to piece together things that can help state owned

firms.

You know, that's an issue that's unavoidable I think as you build this out and its similar to the one of the issues I had with the beneficial ownership bill which would give state AG's access. And sometimes, you know, political state AG's go on fishing expeditions against private companies. I mean, it happens. It happens.

QUESTIONER: Thank you. My name is (inaudible). I'm from the IMF. I wanted to ask first of all I wanted to know if financial institutions do share data between themselves on other type of threats such as cyber threats so you can look at the models in this rhythm and perhaps copy to AML, CFT.

But I have a different question. Basically a few of the members of the panel said that they want to keep legitimate transactions in the system and keep the illegitimate transactions out of the system and this is separating equilibrium which could be very different from sector to sector and from state to state and according the location of these financial institutions network. And you ought to get it wrong.

So one is do you prefer one, type one of mistakes that having bad transactions in the system or type two mistakes of having -- excluding good customers from the system and whether the rules should be more flexible to allow each institution or each sector to fine tune the parameters of AML CFT inspections to get this separating equilibrium right.

MR. ZARATE: This is a really interesting and important question because I think it goes to the heart. I like the way you asked it. It goes to the heart of how we think about risk management in the AML space.

And one of the challenges I think that the financial institutions will say is look, you know, the policymakers, the regulators all talk about putting the onus on us to risk rate and to modulate but at the end of the day there, it feels like a zero-tolerance sort of mentality and so there really isn't risk management in the AML space.

When we talk about sort of the evolution we talk about sort of track one in

the current system moving to track two, a more innovative model. You know, a core question is, you know, how much can we live with false negatives, right. What rate of the false positives has to drop? Those are questions that the regulators are grappling with as we speak and it goes right of the heart of your question.

How much will institutions be allowed to inaudible their risk management around financial crime risk and if we can for example reduce false positives by 50 percent because most of the false positive rates in the current system are above 98 percent. Imagine that. If you drop it let's say 50 percent and you have got maybe a rate of three or four percent false negative, is that good? It sounds pretty good. But I don't know, right.

And the regulators are debating that as we speak in trying to figure out what do we -- what markers do we use to validate what a good risk management system looks like with these new technologies. So we are right in the middle of the debate and there is no answer to it yet but you've asked the right question.

MS. GIFFORD: I would also add that it could be a little bit how can I put it? Like the way banks ask those question is not, you know, its narrow to their institution, right. So if they're willing to tolerate, you know, a lot of false negatives and push people out of their bank, then they look better to their regulators and feel safer but, you know, is society safer with a lot of people pushed out of the legitimate banking system and it gives cover to, you know, bad actors if they can just blend in with ordinary people who can't get access to the banking system. So it also matters what like from what perspective are you asking that question.

MR. KLEIN: All right. In the back.

QUESTIONER: Thank you for Brookings having this informal event. I am (inaudible) from the heritage foundation. I want to ask your panelists that if there is any international law or interactive cooperation with other countries that can foster this AML movement or accelerate this anti-laundering policy?

MR. ZARATE: Sure. One of the interesting things about this field and

space is there is an international regime largely driven by the final action taskforce which sets the international norms and practices and then assesses countries now in the fourth round of assessment around the effectiveness of their regimes and there's not only a FATIF body but regional style bodies that lay out the recommendations and the technical requirements.

In fact, FATIF just this past summer laid out in an interpretative note which is a kind of a term of art of kind of an advisory, how to think about the regulation of digital and crypto assets, right. And that now is driving how the international community is debating this. So there is that system.

You also have the Egmont Group of financial intelligence units around the world which are at least purportedly created to share that kind of information within their governments but also with counter party FIU's and there are special agreements to that effect.

And then there's all sorts of sharing between institutions as was referred to earlier. In the U.S. there are, there is legislation 314 A and B of the Patriot Act that allows for sharing between institutions and more aggressive sharing with authorities in the private sector. And so there are different models of that around the world.

But to answer your question simply, absolutely there is an entire regime built around trying to not only have the same norms and principles but to accelerate the kind of information that's shared. A lot of that's being restricted now by data privacy and data nationalization and there is a little bit of tension in that regard.

MR. KLEIN: So for just some good recommendation to FATIF I would commend the Gifford Barr Klein paper which tried to answer some of your questions about type 1 and type 2 errors I think it is safe to say we lean a little more on the inclusion side.

You know, as we close, I want to kind of sum up and give each of you the opportunity because the Brookings stage is a magical place. And so I'm going to give you each a magic wand and you're able to make one legislative change to our AML laws and

one regulatory change. Tell the audience what you would change, what it would result in and why you would prioritize that. J.W. should we start over there and bring it to a close here?

MR. VERRET: All right. Do I have to say Harry Potter magic words while I do it?

MS. GIFFORD: Yes, yes, you do.

MR. VERRET: I would do a couple of things. I would include in addition to the reporting regime part of what makes this regime what it is, is the related criminal regime. I would apply there has been an effort in the past to apply to the criminal law generally more of a CENTR reform so to make CENTR the default unless there is some reason not to make affirmative CENTR the component of a criminal action.

I would apply that to beneficial ownership reporting if it passes over my objection or my suggestion of working with Representative Hill for a compromise. I would look to redesign the system to encourage, to provide incentives for people, bounties. If you can stop the next 9/11 or even if you can help catch the tax fraud or a drug dealer or intermediary for them, there is a bounty in place. A generous bounty system in place for you.

And beyond that, I would apply my magic wand to securities law. I have a list but that's for the next event you invite me to, Aaron.

MR. ZARATE: Aaron, I'll be quick about this. I would say reform of the Bank Secrecy Act that does to things. One reinforces the idea that this is no longer just about following the money to catch the bad guy to help law enforcement but fundamentally about protection of the financial system.

That's what we say from a policy perspective. That's not what's legally required pursuant to the Bank Secrecy Act. What that does is it liberates then the animal spirits to have within that same legislation the ability to say we are going to allow the financial sector and those regulated entities to figure out how best to manage the risk around

all of these risks that we're worried about but you figure out how to do it and the SAR system is part of it but it's not the only part of it and it's not a cornerstone.

On a regulatory, the regulatory complement to that would be the regulators would then provide a safe haven to those institutions that are experimenting with non-SAR like systems using behavioral analysis for example instead of rule-based systems to say look if you discover things in your system that, you know, your old system didn't capture, we are not going to hold to account.

They kind of have said that but there is no legal safe harbor and so what you have are institutions very much unwilling to say oh yeah, we are going to be experimental, we are going to go find things but the problem is it's going to reveal things we should have been doing and our regulators are going to ding us for it. We are going to get in trouble and I could lose my job.

If we are going to innovate, we are going to move to track two, there has to be some degree of safe harbor or allowance.

MS. GIFFORD: Wow. Both super interesting. I guess if I had Harry Potter magic words I, it's hard to choose. But I think what I would do is ask Congress to pass a law that would enable portable digital identity that a regulatory effort to maybe partner with the private sector to come up with a regime of regulations that would get personal information out of the hands of all of like many, many different companies that are trying to manage it now and into a more secure format where it can be managed mostly by the individual who owns it.

And that would also give obviously law enforcement access to personal information when necessary but maybe have far greater access to information relating to like patterns and odd behavior, troublesome behavior that is very hard to track right now.

MR. COHEN: So let me start with my Harry Potter magic word which is the only word I know where the two clauses in the single word are oxy moronic and that's bipartisan. (Laughter) That's what we really do need to be able to do it.



The legislation and regulation both come from the same source and it's what Juan mentioned earlier. It's sections 314 A and B of the Patriot Act.

With respect to legislation, I would like to see A expanded to permit sharing with foreign government authorities if approved by whoever we want to have approved it and on a reciprocal basis.

For 314(b) for the regulatory authorities to make clear that the application of technology to data does not somehow mean sharing of data until a suspicion is formed.

MR. KLEIN: Wow. Well, thank -- join me in thanking the panel of their time today. (Applause)

MS. GIFFORD: Aaron, thank you --

MR. KLEIN: And appreciate everybody.

MS. GIFFORD: -- for doing this.

MR. KLEIN: Have a good day.

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