

Statement of the Honorable Clay Lowery
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Before the U.S. House Committee on Financial Services’
Task Force to Investigate Terrorism Finance
March 1, 2016

Chairman Fitzpatrick, Ranking Member Lynch, and Members of the Task Force, I thank you for the opportunity to testify on Helping the Developing World Fight Terror Finance.

My name is Clay Lowery and I am currently Vice President of Rock Creek Global Advisors, a consulting firm that advises its clients on international economic and financial policy matters. I also serve as a visiting fellow at the Center for Global Development (CGD), and in 2015 – I chaired CGD’s working group on “The Unintended Consequences of Anti-Money Laundering Policies for Poor Countries.” This report was funded through grants to CGD from the Omidyar Network, the Open Society Foundations and the William and Flora Hewlett Foundation. My testimony should be considered my own views and not the views of any of these organizations.

As further background, I served in the U.S. Government from 1994 to 2009, most of it with the Treasury Department but also with the National Security Council and with the Millennium Challenge Corporation. My last few years in government, from 2005 to 2009, I was the Assistant Secretary of International Affairs for the Treasury Department which exercises oversight of the executive branch of U.S. involvement in the IMF and the multilateral development banks.

I am pleased to be testifying alongside Jim Adams who has had a long, distinguished career in development as well as William Wechsler who is an expert on fighting terrorism. Most of all, it is an honor to be next to my former boss and someone I respect very much -- Bob Kimmitt.

In my testimony, I will describe (i) what I see as a conflict in policy goals in which countering terrorist finance policies appear to be having an unintended consequence on poor countries, (ii) some recommendations to improve the situation, and (iii) areas where Congress and this task force could follow up.

Conflict of policy goals

In 2015 – I chaired an international working group for the Center for Global Development consisting of policy, private sector, and academic experts with backgrounds in development, banking, and enforcement. The rationale for our working group was to analyze whether the

implementation and enforcement of anti-money laundering (AML) and countering the financing of terrorism (CFT) policies was impacting poor countries. Our conclusion was a clear yes, and in ways that could undermine the very objectives that these policies were put in place to prevent in the first place.

A very important policy goal of the United States is to prevent finance from getting into the hands of bad actors. The idea of such efforts is to increase the safety of the financial system and to improve our national security. A different, but also important policy goal of the United States is to allow finance to flow in the most efficient and competitive manner possible. The idea of such efforts is to assist with global economic growth and to include even more people in the financial system in a formal and transparent manner.

To me, it is pretty clear that these two legitimate policy objectives have come into conflict, particularly in poorer countries around the world. Those most affected are likely to include the families of migrant workers, small businesses that need to access working capital or trade finance, and recipients of life-saving aid in active-conflict, post-conflict or post-disaster situations.

From a national security perspective, current AML/CFT policies may be self-defeating to the extent that they catalyze finance moving from the formal financial system to the more opaque parts of the system.

Under the current AML/CFT approach, banks are asked to prevent sanctions violations and assess and mitigate money laundering (ML) and terrorist financing (TF) risks, or face penalties. However, regulators sometimes send mixed signals about whether and how banks and other entities should manage their ML/TF risk, which sometimes results in simplistic risk assessment methodologies being applied by these entities. While there may not be clarity in terms of defining the management of those risks, the penalties have increased to the point that taking zero risk may seem like the best option.

By the working group's calculations, in the five-year period from 2010 to 2014 – the number of AML/CFT fines more than doubled while the amount of those fines went from less than \$1 billion in total fines to over \$15 billion. Even putting aside a few headline cases, the fines have still increased over 400% in a very short period of time.

The imposition of heavy fines on some large banks for egregious contraventions of AML/CFT and sanctions laws may very well be legitimate, but it is also clear that both the number and amount of fines could be chilling on many financial institutions that are doing their very best to adhere to the law. While it is not the only factor, it is pretty clear that AML/CFT policies have led banks to adopt an understandably conservative position when working in risky developing countries in areas such as correspondent banking or facilitating remittances. The result includes

financial institutions exiting from providing services to firms, market segments and countries that are seen as higher risk, lower profitability and could become the source of costly future fines, monitorships or even prosecutions.

In essence, financial institutions are engaging in “de-risking” by ceasing in a wholesale fashion to engage in activities that are seen to be higher risk, rather than judging the risks of clients on a case-by-case basis. Individual banks may be acting rationally in not serving certain types of clients, due to a variety of factors. However, the implementation of AML/CFT appears to have created categories of clients whose business cannot justify the associated compliance costs. The financial exclusion of such clients creates yet another obstacle for poverty alleviation and economic growth, especially in poor countries.

The data for this analysis are too weak to make systemic judgments. However, we did observe a number of outcomes potentially driven by AML/CFT policies, such as the de-banking of (i) money transfer organizations (MTOs), (ii) correspondent banking, and (iii) non-profits trying to access banking services in difficult environments. Much of this is catalogued in the report, which is linked to this testimony.¹

For the purposes of the testimony, however, let me focus on remittances. On a global basis, remittance flows to developing countries have risen from being roughly the same as official development assistance (ODA) in 2000 to being over four times that amount today. In other words, financial flows due to remittances are a key source of funds to poor people around the world.

In 2009, the G20 resolved to reduce the costs of remittances by five percentage points within five years. In addition, there have been significant developments in financial innovation, particularly in payments technology. Despite this high-level policy drive and technological developments, however, the G20 goal is not even close to being met – in fact data as of early 2015 would suggest the G20 is over 60% short of its goal, in other words, remittance costs have been reduced by one-to-two percentage points – not five. Why is this?

While data does not allow us to isolate the cause of this failure as being AML/CFT policies, the results from both surveys and anecdotal evidence suggest that they are definitely playing a role. A recent survey by the World Bank has indicated that money transfer companies across a large number of countries are reporting trouble obtaining or retaining bank account access, largely because they were considered to be high risk clients. In some respects, this isn't surprising – a lot of countries with a high dependence on remittance flows are countries considered to be high risk by regulators. In addition, the compliance regimes of many smaller MTOs are weak and don't

¹ <http://www.cgdev.org/sites/default/files/CGD-WG-Report-Unintended-Consequences-AML-Policies-2015.pdf>

follow best practices, although there has been a tendency by regulators to over-generalize in this area.

While we don't yet have firm evidence on impacts, the potential consequences of making remittance flows more difficult and expensive are worthy of our concern – either people who depend on these financial flows for their everyday livelihood will suffer or we will see more and more of these funds chased into the shadows, as desperate people will find less transparent means to move money overseas.

What can we do about it

Assuming the analysis in our report is correct, and other groups – official and non-official – seem to suggest it is, then we should take steps to address it. We still want to meet both policy goals: stop money going to bad actors and allowing finance to flow in a transparent and efficient manner. There is no silver bullet, but there are areas that could improve the situation going forward.

Many of the recommendations in my testimony are borrowed from the CGD report, but I have added my own personal thoughts. The recommendations include actions that can be taken by our government, other national governments, international organizations, international standard setters, and the private sector. In short, we should (1) work in poor countries to assist them with supervision and meeting best practices, (2) assess more rigorously the impact of AML/CFT and sanctions enforcement, (3) obtain and distribute much better data, (4) clarify and strengthen the risk-based approach, and (5) facilitate the lowering of compliance costs.

1. [Improve compliance, increase technical assistance and clarify indicators of lower risk](#)

Compliance procedures at many MTOs must be improved so as to be more effective. At the same time, more needs to be done to recognize those MTOs that do have effective systems in place, including better supervision of MTO sectors at the country level.

- Many MTOs, especially smaller ones, should improve their compliance procedures to ensure money laundering and terrorist financing risks are mitigated effectively and efficiently.
- FATF should provide greater clarity on the likely indicators of lower risk MTOs, and national governments and industry participants should collaborate to reflect this guidance with best practice documents.
- The U.S. and international financial institutions should provide even more technical assistance in as coordinated a way as possible to financial supervisors in countries where the remittances and correspondent banking have been most clearly affected by AML/CFT policies.

2. [Rigorously assess the unintended consequences of AML/CFT and sanctions enforcement at the national and the global level](#)

- Groups such as the Financial Stability Board (FSB)² should conduct a rigorous assessment of the global AML/CFT and sanctions regulatory environment, including the guidance produced by Financial Action Task Force (FATF)³, with a view to reducing unintended consequences.
- FATF should continue to enhance its mutual evaluation methodology to include:
 - A. Displacement of transactions from more into less transparent channels, which are sometimes informal or processed through lower-tier, less compliant institutions
 - B. Risks in the whole economy, rather than just in the formal financial sector
 - C. Risks posed to the important drive toward financial inclusion
 - D. Over-compliance at the national level and in particular sectors

3. Generate better data and share data

In order to assess unintended consequences rigorously, more and better data should be generated through private and public sector efforts.

- The World Bank should make publicly available, both the results and if possible, the underlying anonymized data, from its de-risking survey of banks, MTOs and governments as soon as possible.
- The FSB should direct the World Bank to carry out representative, countrywide surveying of non-profits involved in the delivery of humanitarian assistance, banks and MTOs.
- Government agencies that keep detailed registries of regulated MTOs and non-profits should make available headline statistics about the numbers and nature of such organizations.
- National financial intelligence units, including but not limited to FinCEN, should query financial institutions for data regarding the volume, amounts and types of transactions associated with MTOs, non-profits and banking correspondents.
- On behalf of central banks and private financial institutions; SWIFT, CHIPS, CHAPS, BIS and other entities tasked with managing and collecting data on cross-border transactions and relationships should make available data on bilateral payment flows and the number of correspondent banking relationships between countries.
- National governments should make the data that they are using for risk analyses and regulatory impact assessments available to other jurisdictions and to parties conducting analyses that are demonstrably in the public interest.

² The FSB consists of central banks, finance ministries, and financial regulators from around the world and attempts to coordinate and review the work of international financial regulatory standard setters. The United States is represented by the Federal Reserve, the Treasury Department and the SEC.

³ FATF is the global standard setting body for AML/CFT policies.

4. Strengthen the risk-based approach

- FATF should provide a definition of money laundering and terrorist financing risk for its purposes that is consistent with a standardized definition (as provided by the International Organization for Standardization) and existing private sector definitions of ‘risk’.
- FATF should clarify its thinking regarding transparency and the tradeoff of risk in the formal versus informal sector.
- FATF should further encourage simplified due diligence where it is in the best interests of transparency.

5. Facilitate identification and lower the costs of compliance

National governments, banks and the World Bank should accelerate the adoption of new and existing technology to facilitate lower cost customer identification, know your customer compliance, and due diligence.

- National governments should provide citizens with the means to identify themselves in order to make reliably identifying clients possible for financial institutions and other organizations.
- National governments should ensure that appropriate privacy frameworks and accountability measures support these identification efforts while ensuring the free flow of information related to identifying ML and TF.
- Banks and other financial institutions should redouble their efforts, with encouragement from the FSB and national regulators, to develop and adopt better messaging standards and implement Know Your Customer documentation repositories.
- Banks and other financial institutions should accelerate the global adoption of the Legal Entity Identifier scheme.
- The World Bank should convene all relevant entities to review the possibility of donor-subsidized third party verification for unprofitable clients.

Suggestions for this task force and Congress

On a highly positive note and in just the last few weeks, various official sector entities appear to be moving in ways that are highly consistent with these recommendations. For instance, just this past weekend, the Chairman of the Financial Stability Board (FSB) in a letter to the G20 Finance Ministers and Central Bank Governors explained that the FSB has set up a task force with a number of work streams, including one that is supposed to assist developing countries with capacity building. A little more than a week ago, FATF published a report to begin the process of providing greater clarity for financial remitters. And in just the past few months, IMF staff –

thanks to the leadership of Managing Director Lagarde – have begun to ask about what more can they do to assist countries in gathering data and in improving their supervisory capabilities.

These efforts and hopefully some of the recommendations I noted are all helpful, but it will not reverse what has happened. Many banks that have exited jurisdictions many never return. I commend this Committee’s task force for addressing these issues and have a few suggestions for its own work.

The U.S. is the leading player on AML/CFT issues in the world. In multilateral settings, we are represented at the FSB by the Federal Reserve, Treasury, and the SEC; we are a leader in FATF; and we are the leading funder to the IMF and the World Bank. In its oversight role, Congress should:

- Work with Treasury and State to understand the resources being provided to poor countries to assist them with AML/CFT. How well are those efforts coordinated within the U.S.? With other donors? And with the international financial institutions?
- Ask for an update on progress from Treasury and potentially the Federal Reserve on the work being done by the Financial Stability Board and by the Financial Action Task Force;
- Work with the Federal Reserve and the Office of the Controller of the Currency and the private sector to try to understand if there are differences between senior management and at the examiner level. Financial examiners at the micro level can be, understandably, quite risk adverse even if the officials in Washington are acknowledging that there needs to be a risk-based framework not “zero tolerance for risk”; and
- Receive a briefing on the efforts currently taking place at the IMF and the World Bank.

These are key issues that will require attention as the task force works to help developing countries fight terror finance. Technical assistance is critical, but we also need to understand the problem better, we need to clarify terms and the rules, and we need to try to lower the costs of compliance. In these ways, we will truly be working with developing countries to help all of us meet different policy goals that don’t have to be in conflict.

Thank you and I’m happy to field any questions.