CLOSING THE LAST LOOPHOLE

by

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Abstract

The proliferation of illegitimate capital being spent in the United States remains an economic and national security concern. The American economic system is becoming an innocuous haven for illegitimate capital as 70.6% of criminals convicted of money laundering in the U.S. were American citizens. Such individuals are assisting international criminals with laundering between $800 billion to $2 trillion USD globally. The harm caused by this activity around the world is very evident. When oppressive political leaders are able to amass large amounts of wealth illegally and undetected, citizens living under their dictatorship suffer as these leaders’ exorbitant powers go unchecked. More disturbing are the contracts secured from the U.S. Department of Defense by unnamed companies associated with the Taliban, a radical group which triggered the creation of the PATRIOT Act due to their affiliation with the September 11th attacks. Although banks have been required to have anti-money laundering (AML) provisions since 1970, those involved in money laundering continue to find new, sophisticated ways to mask their activities. A lack of transparency in large financial transactions/purchases, or transactions via virtual asset service providers (VASP), are loopholes many have taken advantage of. Developing a working group of voters, experts, and politicians to discuss the best next steps for strengthening America’s AML efforts is key, as the emphasis on the regulation of digital assets and VASPs is not meant to focus AML efforts entirely on emerging technologies. Instead, it is an example to reinforce the reason why Congress should emend the existing ENABLERS Act, ensuring the bill leaves no room for illicit funds transfers to circumvent federal investigation.

Advised by: Paul Weinstein Jr
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I. Action-Forcing Event

During the fourth quarter of the year 2021, US representatives introduced the ENABLERS Act, which expands institutions and businesses that should be considered financial institutions. This Act was primarily put forth to address the issue of bad actors using the United States as a safe haven for illegitimate capital.

II. Statement of the Problem

The proliferation of illegitimate capital being spent in the United States remains an economic and national security concern. Money laundering involves the redistribution of money earned through illegal activity into property or businesses that hide the origin and owners of these funds. While money laundering cases have decreased by 30.4% since fiscal year 2016, the median amount of illegitimate funds involved in the 755 money laundering cases during 2020 was $301,606 (see Figure 1).
Disappointingly, 70.6% of criminals convicted of money laundering in the U.S. were American citizens.\(^1\)

This could point to a significant national security issue where Americans are assisting international criminals with laundering between $800 billion to $2 trillion USD globally.\(^2\)

Specifically, American citizens have become “enablers”, a term brought up in the recent bi-partisan bill proposed by House Representatives Tom Malinowski (D-New Jersey) and Maria Elvira Salazar (R-Florida). Enablers are defined as individuals or entities that, due to their exemption from due diligence rules for financial transactions, help criminals and/or crooked government officials find legitimate means to integrate illegally acquired funds into ostensibly legal assets. For example, many criminals earning

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money through drug or human trafficking “clean up” their money trail by using this money to purchase land or commercial rental properties.  

According to the United Nations Office on Drugs and Crime (UNODC), “it is [difficult] to estimate the total amount of money that goes through the laundering cycle.” However, the harm caused by this activity around the world is very evident. When oppressive political leaders are able to amass large amounts of wealth illegally and undetected, citizens living under their dictatorship suffer as these leaders’ exorbitant powers go unchecked. A few examples include, but are not limited to the following:

1. President Ilham Aliyev (Azerbaijan) has been accused of suppressing critics of his regime and rigging the so-called democratic 2008 election in his favor, removing the second-term limit after securing his reelection as president. Aliyev also used funds to bribe German politicians to gain support for his violent takeover of the Nagorno-Karabakh region. His family has purchased “$700 million worth of real estate in London” to mask their accumulation of illegitimate funds.

2. President Vladimir Putin (Russia) hired the paramilitary company Wagner Group to recruit mercenaries for his invasion and annexation of Crimea, murder of prisoners of war in Libya, and current attacks on Ukraine. U.S. intelligence reports also confirm that Russia funded social media propaganda and electronic hacking of high-ranking officials’ emails to heavily influence

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the results of America’s 2016 election.\textsuperscript{7} To do this, Putin often relies on the financial support of Russian oligarchs alleged to hide vast wealth abroad in countries like the UK.\textsuperscript{8}

There is a risky misconception that Western democracies such as the United States are not susceptible to corruption via association with these regimes. In his analysis of the 2022 invasion of Ukraine by Russia’s military, economist Paul Krugman states that financial sanctions against the Russian government will only be effective if and when the American government is “willing to take on its own corruption.”\textsuperscript{9} As recently as July 2020, limited proof of identity and/or source of funds was required for those setting up shell companies to invest in various U.S. industries. This is a direct result of state and federal laws either (a) not enforcing the existing money laundering regulations in the PATRIOT Act, or (b) exploiting loopholes that permit money laundering inadvertently. American citizens (i.e. the 70 percent of criminals convicted in 2020 of money laundering crimes) are knowingly engaging with kleptocrats to do business in the real estate and art markets, even if these kleptocrats are known political adversaries of the U.S. government. More disturbing are the contracts secured from the U.S. Department of Defense by unnamed companies associated with the Taliban, a radical group which triggered the creation of the PATRIOT Act due to their affiliation with the September 11th attacks. More than $3 million USD was awarded in these contracts, and a military report later found that these funds were used to purchase bombs and other weapons for terrorist groups. Iran, a country that has also had a contentious

\begin{footnotesize}
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\item \textsuperscript{9} (Krugman, 2022)
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relationship with the U.S. diplomatically, managed to buy and rent property in New York City’s most
e xpensive neighborhoods without penalization.10

III. Background/History

Banks have been required to have anti-money laundering (AML) provisions since 1970. The Bank Secrecy
Act (BSA), signed by President Richard Nixon, was the first iteration of U.S. code that placed
requirements on financial institutions for internal and external audits of their recordkeeping procedures
to ensure compliance with federal AML rules.11 Financial institutions (FIs) are traditionally defined as
private companies with a business model emphasizing the management of monetary transactions (e.g.
financial deposits, currency exchanges, purchasing/selling of investment securities) and handling of
financial instruments (e.g. certificates of deposit, insurance policies). Commercial/Investment banks,
brokerage firms, and insurance companies often fall under the category of FIs.12

A post-September 11th law (the PATRIOT ACT) was designed to put extra scrutiny on AML activities at
FIs in order to prevent the funding of terrorist acts.13 Title III of the PATRIOT Act states that money
laundered from “transnational criminal enterprises” accounted for 2 to 5 percent of global gross
domestic product (GDP) in 2001. In the wake of the World Trade Center, Pentagon, and (subverted)
White House violent attacks conducted by Al-Qaeda, investigations revealed how Osama bin Laden, the
fugitive son of a Saudi billionaire, financed this terrorist operation using laundered money.14 While

2020.
Act.
https://www.investopedia.com/terms/f/financialinstitution.asp
https://www.investopedia.com/terms/p/patriotact.asp
14 Lacey, Kathleen and Barbara Crutchfield George. 2003. “Crackdown on Money Laundering: A Comparative Analysis of the
Feasibility and Effectiveness of Domestic and Multilateral Policy Reforms.” Northwestern Journal of International Law and
funding for Al-Qaeda primarily came from abroad, the principal actors in the September 11th attacks were able to receive wire transfers into U.S.-based bank accounts they used to make purchases leading up to the events.\textsuperscript{15}

To this day, off-shore banking in countries like Panama, the Seychelles and the United States has allowed criminals (including known terrorists) to hide large amounts of funds anonymously. This makes it difficult for intelligence agencies to monitor when and where money is sent to support heinous attacks against the governments they represent. As it was in the case of Al-Qaeda and September 11th, weapons used in terrorist attacks are funded via money obtained through illegal activity.\textsuperscript{16}

Why is money laundering still a pressing economic and national security concern in America? For a number of years, money laundering has almost always required some form of interaction with a FI.\textsuperscript{17} However, as banks and money transfer platforms have fallen under more and more microscopic surveillance, those involved in money laundering need to find new, sophisticated ways to mask their activities. A lack of transparency in large financial transactions/purchases, especially involving real estate, is a loophole many have taken advantage of up until today. Additionally, there are numerous state laws in the United States making it very easy for foreign and domestic investors to incorporate ("shell") companies serving as a front for permissible business transactions, or as lawful fiduciaries carrying out interactions with FIs on behalf of nefarious actors.

Prior to the proposal of the ENABLERS Act in 2021, these entities have not been categorized as FIs and, subsequently, are not forced to comply with AML due diligence requirements. A New York Times investigation uncovered that setting up a shell company in Delaware, Nevada and Wyoming, for


\textsuperscript{16} (World Bank, 2009)

example, is significantly easier and affordable than in most so-called developing countries with less legal infrastructure set up to prosecute money laundering activities. FIs have been forced to spend large amounts of capital to investigate thousands of clients (regardless of the size of their accounts) for legal risks, collecting and analyzing where their customers live/were incorporated, the beneficial owner (i.e. person or persons enjoying the privilege of owning) of companies doing business with them, and the citizenship status of those interfacing with the FIs. This burden, however, has not been placed on the real estate industry, luxury goods industry, and attorneys (under certain circumstances), which are now seen as enablers of money laundering activities (i.e. allowing this illegal activity to perpetuate, despite legislation designed to prevent it).

Why have the due diligence requirements taken so long to apply to the current enablers of these hostile groups? One reason (as Mr. Malinowski points out) is that current loopholes exempt these industry sectors from required due diligence rules that uncover how their clients accumulated the funds used to purchase their products/services. This was an oversight of the BSA, which presumed all illegal funds would eventually make its way through the banking sector. These loopholes can leave unsuspecting, tangential parties (e.g. tenants of a rental property) in vulnerable situations. For instance, Azerbaijan’s Aliyev naming his 11-year old son the landlord of a Michelin-star restaurant and office for Conde Nast is unusual, fiscally imprudent, and a clear indication of a front for illegal activity.

Finally, one could also argue that the current legislative process moves exceptionally slower than strategic and technological advances facilitating money laundering through non-traditional routes.

When it comes to investigating and prosecuting criminals involved in money laundering, 18 US Code §

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19 (Malinowski, 2021)
20 (Patrucic, 2021)
1956/1957, 18 U.S.C. § 20 and 31 C.F.R. § 1010.100 legally require the involvement of the following federal government agencies:

1. the IRS (under the Treasury, and specifically the IRS Criminal Investigation Division)

2. the Department of Justice, namely:
   a. the Money Laundering and Asset Recovery Section (or MLARS, when financial institution is involved);
   b. the Criminal Division (when prosecuting attorneys); and
   c. The U.S. Attorney’s Office (USAO).

The growing cryptocurrency sector allowed criminals to launder up to $8.6 billion USD in 2021 alone.21 These “decentralized finance” (or DeFi) platforms are not adequately regulated by any of the above-mentioned U.S. agencies, leaving them as another legal loophole exempt from AML requirements.22 A crucial component of cryptocurrency is a financial ledger that gives transaction owners nearly complete anonymity via blockchain, which hides a user’s “real-world” name and address by assigning them a public key generated via the blockchain technology.23 Therefore, any comprehensive solution to the enforcement of AML policies is going to require Congress to increase its understanding of the fast-paced evolution of digital money and its involvement in hiding the tracks of illegal activities domestically and internationally.

IV. Policy Proposal

Section 2 of the ENABLERS Act (H. R. 5525) under Part B (“Rulemaking”) should be amended to include a paragraph stating new technologies designed to replace, mimic or transform fiat currency with digital assets must be included in the AML investigations and due diligence policies required for FIs under section 5318(h) of title 31 (United States Code). The goal of this proposal is to regulate the advancement of new technologies used in money laundering activities and effectively see a reduction in illicit money entering and circulating within the U.S. economy. Part V of Public Law 115–97 should also be amended to include provisions for a non-refundable business tax credit offsetting tax liability owed to the IRS in exchange for the costs incurred by FIs (as well as small businesses and/or corporations) to conduct due diligence processes. (A detailed explanation of how the business tax credit would work is included on page 10.) The goal is to incentivize both FIs and currently unregulated enablers to invest in stronger AML internal controls, knowing that the additional capital spent on this measure will be rewarded. The success of this policy will be measured by an increased number of FIs reporting suspicious activity negatively correlated with the median amount of illicit funds laundered annually (based on reports from the U.S. Sentencing Commission).

Those eligible for the proposed business tax credit after demonstrating full compliance with Section 2 of the ENABLERS Act include (as quoted from the bill):

1. “a person engaged in the business of providing investment advice for compensation;”
2. “a person engaged in the trade in works of art, antiques, or collectibles, including a dealer, advisor, consultant, custodian, gallery, auction house, museum, or any other person who engages as a business in the solicitation of the sale of works of art, antiques, or collectibles;”
3. “an attorney, law firm, or notary involved in financial activity or related administrative activity on behalf of another person, a trust or company service provider;”
4. “a certified public accountant or public accounting firm;”
5. “a person engaged in the business of public relations, marketing, communications, or other similar services in such a manner as to provide another person anonymity or deniability;” and
6. “a person engaged in the business of providing third-party payment services, including payment processing, check consolidation, cash vault services, or other similar services designated by the Secretary of the Treasury.”
In sum, the ENABLERS Act should allow wealth management firms, legal advisory firms/consultants, accountants, marketing agents or agencies, real estate agents and/or companies, and software-as-a-service (SaaS) companies (like Square or PayPal) to receive a reduction in taxes owed to the IRS in exchange for providing evidence that they are abiding by rules set forth in Section 2 of the ENABLERS Act.

Further, this proposal recommends also making the following businesses and/or individuals eligible for the recommended non-refundable business tax credit:

1. virtual asset service providers (VASPs), or any legal/natural persons “assisting in the exchange between virtual assets and fiat currencies, exchange between one or more forms of virtual assets, transfer of virtual assets, safekeeping and/or administration of virtual assets or instruments enabling control over virtual assets, and/or participation in and provision of financial services related to an issuer’s offer and/or sale of a virtual asset”;

2. any natural/legal persons providing cryptocurrency payment gateway services;

3. any natural/legal persons receiving payment for products or services via crypto wallets.

The following two metrics should also be used to measure this proposed policy’s effectiveness:

1. **Metric One**: continue to decrease number of money laundering cases by 10 percent annually until total reaches 0 percent (with a target timeframe within 7-8 years);

2. **Metric Two**: increase the number of registered CVC providers to 100 percent, and increase the number of registered CVC providers inspected by 20 percent annually (reaching 100 percent consistently by no later than 2026).

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Metric Two is essential to ensuring the U.S. becomes fully compliant with Recommendation 15 from the FATF on the regulation of new technologies for AML efforts. Both Metric One and Metric Two were extrapolated based on the past trend seen in the number of money laundering cases in FY 2019 and 2020 (a 13 percent decrease then a 23 percent decrease, respectively). Due diligence and AML rules under Section 2 of the ENABLERS Act should go into effect for transactions at a minimum threshold of $1,000 USD for transactions involving digital assets or the use of VASPs, per FATF recommendations.

The President’s FY2023 budget allocated $16.2 billion in discretionary funding towards the Department of Treasury, and it is recommended that this become the baseline budget for implementing the policy proposed in this memo. As of the second month of Q2 FY2022, the Treasury has spent $138,423,039 (~$138 million) USD on salaries and expenses for BSA Administration and Analysis, which means that implementation of the proposed policy may cost at minimum between $1.9 billion USD to $2.2 billion USD over 7-8 years. This equates to 12-14 percent of the entire budget for the Treasury’s current fiscal year alone. Revenue from the Base Erosion and Anti-Abuse Tax (BEAT) is one avenue to make up for any deficit created from the cost of business tax credits awarded to eligible taxpayers/corporations abiding by the ENABLERS Act AML rules. For instance, the BEAT rate will rise from 10 to 12.5 percent by 2026, which equates to approximately $23 billion to $28.8 billion (respectively) if applied to the income earned by U.S. corporations from equities in foreign corporations (during 2021). To control costs, business tax credits for AML compliant individuals and/or corporations may be capped at 2.5 percent of

28 (USASpending.gov, 2022).
taxable income (i.e. the difference between the current 10 percent and future 12.5 percent rate for BEAT).

It is important to note that BEAT only applies to multinationals with gross receipts of $500 million or more. Regardless, the 2.5 percent business tax credit for ENABLERS Act AML regulations can be applied to corporations of all sizes (e.g. small businesses and multinationals alike). For example, an eligible\textsuperscript{31} sole proprietor or limited partnership earning $100,000 of taxable income in one year would receive a business tax credit of $2,500 in exchange for providing evidence of complying with AML requirements as dictated by the ENABLERS Act.

The U.S. Treasury should remain the entity charged with administering this policy since (a) it is already named in the ENABLERS Act as the administering entity and (b) it has the authority to both levy/collect taxes and prosecute financial/tax criminals under U.S. federal law. This combination of law enforcement and tax incentives in this case serves, metaphorically, as a “stick and carrot” policy approach that uses the full force of the Treasury’s prosecutorial power while also reducing the need for it by creating a win-win scenario for enablers and the U.S. government. This approach would go into effect within 90 days of the enactment of the ENABLERS Act (per the suggestion in the bill) or by/after June 30, 2024 (when the bill suggests rules become applicable).

V. Policy Analysis

The ENABLERS Act as-is provides recommendations for expanding the definition of FIs to include non-banking and ancillary parties involved in the exchange of assets for potentially illicitly acquired funds. While this is a commendable start, it does not address advances in the methods criminals can use to make legal financial transactions undetected nor does it provide ways to measure the effectiveness of

\textsuperscript{31} “Eligible” refers to any type of business and/or person listed on pages 8 and 9 of this memo that must legally abide by the ENABLERS Act AML regulations due to the nature of the products or services they offer.
expanding the definition of FIs. The policy proposed in this memo provides tangible and quantifiable solutions to closing regulatory gaps in the Banking Secrecy Act and PATRIOT Act. The previously provided evidence of the U.S. failing to meet FATF compliance standards and the $3 million+ awarded by the U.S. military to terrorist groups (cited on page 4 of this memo) shows that current legislation has not done enough to thwart criminals/terrorists from using America as a safe haven for their illicitly acquired money.

Crypto market regulation is an example of where legislation should go further to stop money laundering in the United States. In theory, suspicious transactions made via cryptocurrency may be flagged under the Bank Secrecy Act if cryptocurrency payment gateways are involved. Companies that create these gateways would fall under Category #6 of the ENABLERS Act due to the nature of their work: they provide a third-party payment service by facilitating transactions between a customer using a crypto wallet, and a vendor receiving payment from said transaction. However, individuals can easily bypass this by completing transactions strictly via personal crypto wallets.

Cryptocurrencies are managed and issued digitally via decentralized peer-to-peer (P2P) networks, unlike fiat money that is printed by government treasuries. This makes cryptocurrency accessible to anyone globally and relatively easily. To access this digital currency, owners operate as “their own bank” by setting up a crypto wallet to access and use funds online. When transactions are made using the latter, blockchain technology is used to encrypt it and, subsequently, keep the owner of the crypto wallet’s activities anonymous.

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This is why one of the advantages of the proposed policy in section IV of this memo is to include audits of cryptocurrency transactions and/or rules that require these transactions to go through regulated payment gateways to reveal the source of each transaction as part of their due diligence processes. Spelling out in clear, direct terms that FIs are legally responsible for identifying the source of payments through new technologies (e.g. those that involve the exchange of cryptocurrency) would remove any ambiguity about the role of FIs in monitoring these activities. This would also remove a method by which money launderers continue to wipe their money trail clean through otherwise legitimate economic activity.

Examining the advantages of the policy authorization tools available for use by the Treasury, and precedents for effectively using them, can show us how realistic it is to execute the policy proposed in Section IV of this memo. This examination will demonstrate that there is an existing legal framework for enforcing these rules without violating the constitutional rights of U.S. citizens or corporations. First, the Enforcement Policy and Administration Program was created under the Clinton Administration as a group of advisors responsible for recommending best practices for carrying out investigations & prosecutions related to (international) finance crimes. The program's past work includes technical training on “asset tracing, asset freezing, and forensic accounting techniques” for Treasury staff.36 Furthermore, the program is largely responsible for the expansion of the Financial Crimes Enforcement Network (FinCEN).37 In the past, FinCEN has been rated highly effective by the Financial Action Task Force (FATF).38

The FATF is an important entity to bring up, since it is also responsible for providing the ratings on countries’ technical compliance with FATF Recommendations versus ratings on the effectiveness in applying recommendations (i.e. how effective countries are in enforcing AML laws). Based on the chart below (with data from 2021), the U.S. is only fully compliant with one of the FATF Recommendations directly related to the amendments to the proposed ENABLERS Act, demonstrating that the current language in the bill (a) does not include enough rules related to the categories listed in the chart below, and/or (b) does not prepare the U.S. government to become fully compliant with every FATF recommendation below.

Figure 2: U.S. Technical Compliance with FATF Recommendations

<table>
<thead>
<tr>
<th>Recommendation</th>
<th>Compliant</th>
<th>Largely Compliant</th>
<th>Non-compliant</th>
<th>Partially Compliant</th>
</tr>
</thead>
<tbody>
<tr>
<td>R.1: Assessing risks &amp; applying a risk-based approach</td>
<td>X</td>
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</tr>
<tr>
<td>R.2: National cooperation and coordination</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>R.3: Money laundering offence</td>
<td></td>
<td></td>
<td>X</td>
<td></td>
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<tr>
<td>R.4: Confiscation and provisional measures</td>
<td></td>
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<tr>
<td>R.5: Targeted financial sanctions related to terrorism and terrorist financing</td>
<td></td>
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<td>X</td>
<td></td>
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<tr>
<td>R.10: Customer due diligence</td>
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</tr>
<tr>
<td>R.15: New technologies</td>
<td></td>
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</tbody>
</table>

Data derived from the FATF’s 4th Round Ratings on Effectiveness and Technical Compliance (produced March 22, 2022). This chart/analysis was created by counting the number of recommendations rated as compliant, largely compliant, non-compliant, or partially compliant using the raw data provided by the FATF.

Additionally, the U.S. is only ranked highly effective for four out of eleven outcomes expected when implementing FATF Recommendations (see Figure 3). According to the FATF, the U.S. does not make it difficult or impossible for money laundering to occur via legal means, nor does it provide sufficient support to due diligence officers to identify the beneficial ownership in financial transactions. The amendments to the ENABLERS Act and Public Law 115–97 mentioned in this memo would improve America’s ratings on these two incompetencies/vulnerabilities highlighted by the FATF.
The U.S. government has taken some first steps toward using law enforcement and the executive branch (i.e. the Cabinet-appointed office of the U.S. Treasury) as its AML policy authorization tool, but this has not resulted in full compliance or efficacy in reducing money laundering in the country. The policy proposal in this memo considers where there is room for improvement and provides direction on how to implement these reforms.

Regarding the U.S. government’s capacity to execute and achieve these policy goals, The ENABLERS Act begins to delineate the policies expressing an ultimate goal of eradicating all loopholes subverting AML efforts in the United States. It must now answer the question of who or what will ensure these policies result in changed behaviors and reduced criminal activity. The ENABLERS Act lists the U.S. Treasury Department (the Treasury) as the main federal office authorized to assign agencies (either at the state or federal level) to enforce AML due diligence rules. There is significant room to provide further
instructions beyond these guidelines, given that the Treasury already possesses the legal power to administer economic sanctions, collect taxes, and “[prosecute] tax evaders, counterfeitors, and forgers.”

Firstly, research shows it to be more prudent to centralize AML tax incentives to reduce disproportionate taxation locally and ensure consistency in the implementation and impact of AML policies (as defined in this memo and the ENABLERS Act) across all 50 states and the District of Columbia. A study completed by the Tax Foundation found that state and municipal governments are grappling with a distortion in their collection of tax income due to local tax incentives designed in such a way that businesses receive “much more in tax subsidies from the state than [they pay] in taxes.” In other words, state and local governments are creating a tax deficit that significantly reduces the amount of revenue available for government-sponsored programs. As a result, state and municipal governments may have less financial resources to allocate not only to existing infrastructure and governing projects but also to the task of enforcing AML rules and regulations at the local level.

The Treasury has the added benefit of supporting government agencies to expand its capacity to flag, identify, investigate, and eventually prosecute persons or entities in violation of the ENABLERS Act AML rules and regulations. Full scope and power of each agency’s involvement in AML investigation and prosecution is delineated within 18 US Code § 1956/1957, 18 U.S.C. § 20 and 31 C.F.R. § 1010.100, and it is recommended that each agency continue operating under the specific guidelines set forth in those laws.

The Treasury, under the council of the Enforcement Policy and Administration Program, has trained banks on flagging “suspicious transactions” using robust due diligence controls arguably to incentivize

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the banks’ compliance with AML laws. The assumption is that banks (or FIs generally) may become more cooperative with these laws if receiving (free) support from the government reduces their risk of being labeled as co-conspirators when a crime is unveiled. The policy proposal presented takes this assumption one step further by involving tax abatement incentives for FIs (including those newly defined in the ENABLERS Act) that demonstrate clear efforts taken to avoid association with suspected money laundering attempts.

Traditionally, tax incentives have been used in the U.S. to stir economic growth and activity. The Brookings Institution notes that “[t]he prevailing model of tax incentives has been to reward a narrow set of business behaviors—namely, the creation of new jobs [and] the retention of jobs under threat” and that “incentives were aligned with some, but not all, of four important inclusive growth principles: invest in people and skills; focus on advanced industries; connect places; boost trade.” Can tax abatement incentivize businesses to invest in comprehensive due diligence on clients’ & investors’ sources of income, just as it has spurred other investments (e.g. for capital equipment) in the past? This depends largely on whether there is any precedent for using this policy authorization tool to persuade people to act more equitably, versus selfishly.

That is why this policy proposal also includes a recommendation for Congress to hire a non-partisan, independent group of analysts to design and carry out a feasibility study prior to June 30, 2024 to ensure the proposed business tax credit model is positioned to create the desired outcome (e.g. Metric Two listed on page 10). A request for bids should be advertised as early as June 2022 to identify and vet

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registered government contractors who may qualify for this opportunity. An expected output for this feasibility study should include further recommendations on tracking the policy’s progress towards meeting Metric One and Two in the proposed time frame.

With increased cybersecurity risks (e.g. via use of cryptocurrency) may come anticipated increased costs for implementing these suggested tools to avert AML activities. It is anticipated that comprehensive efforts would reach a budget of approximately $42 billion nationally for the average U.S. corporation or FI. This is partially why business tax credits are recommended as one policy mechanism by which the ENABLERS Act would be enforced. The business tax credit may be viewed as reducing the financial load that FIs (and relevant corporations) will have to bear in order to remain compliant with AML regulations.

In addition to the tax relief for FIs and/or individuals compliant with AML regulations, a fine may be levied on individuals/institutions that fail to comply (i.e. failing to submit any report or evidence on due diligence processes used to avoid involvement in money laundering activities). Portions from this fine may be used to fund investigations led directly by the Treasury to combat use of enablers to legally hide funds received by illegal means.

The OECD reported that countries such as the Republic of Korea (South Korea) that offer financial incentives for anti-corruption reporting have seen a significant increase in whistleblowing and money laundering cases successfully prosecuted. Between 2014 and 2017, the South Korean government awarded ₩108,200,000 KRW (approximately $97,380 USD in 2017) in rewards to persons who reported financial crimes that resulted in the confiscation of illicit money. The OECD confirmed that this incentive structure enhanced Korea’s AML legal framework and met recommendations prescribed by the OECD in its Phase 3 report on the country. This case study serves as strong evidence that the business tax credit

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proposed in this memo would lead to a reduction in illicit money entering and circulating within the U.S. economy.

However, we may still note that in the wake of the COVID-19 induced slowdown, uncertainty over the economic outlook in the next 7-8 years may be the biggest challenge to prepare for when implementing the proposed policy. Based on a 2020 analysis, the Congressional Budget Office (CBO) predicted that real GDP and real potential GDP will remain stagnant from now (2022) until 2030. Profits earned by corporations domestically are also expected to remain stagnant in that time period. There is no guarantee that another crisis such as the 2020 COVID pandemic will interrupt and erase economic recovery gains made since 2021. Therefore, policymakers should carefully monitor the distribution of the proposed business tax credit to ensure its ability to influence behaviors contributing to Metric One and Two for measuring increasing compliance with AML regulations listed in the ENABLERS Act. If in the future taxable income significantly decreases due to decreased economic activity, it may be necessary to consider whether reducing tax burdens on FIs and corporations risks a dangerous drop in tax revenue collected. This risk assessment is similar to the one illustrated in the Tax Foundation’s analysis of state tax incentives for attracting new businesses.

VI. Political Analysis

On March 9, 2022 President Biden signed an executive order requiring the Treasury to produce an analysis on regulating cryptocurrency. This could suggest that the current administration sees the monitoring and regulation of digital assets as a national security and economic policy priority. This also aligns with your communicated endorsement of such policy analysis where you’ve stated that

46 Loughhead, 2021.
“consumers, investors, and businesses should be protected from fraud and misleading statements regardless of whether assets are stored on a balance sheet or distributed ledger.”\textsuperscript{48} Further, you stated that the rules of cryptocurrency should be based on how digital assets affect people, which is a tangentially related goal of the policy recommendations in this memo. It is also appreciated that you note that it is essential to de-anonymize platforms for the exchange of digital assets so that the government is adequately capable of protecting American citizens from the impact of financial fraud.

House Representatives appear to be split in the middle over the severity of reporting requirements for FIs that handle digital assets. Thirty-five bills have been introduced by Congress in 2021 with language that addresses cryptocurrency and blockchain technology. However, only one proposing rigorous reporting on the beneficial ownership of digital assets passed—the Infrastructure Investment and Jobs Act (H.R. 3684).\textsuperscript{49} Several House Republicans, and Democrats such as Ro Khanna (D-CA)\textsuperscript{50}, argued that broadening the definition and reporting requirements of FIs would “stifle innovation” and take away America’s competitive advantage in the crypto industry. Ultimately, Republicans passed the vote with the language unchanged after moderate Democrats agreed to have $1.75 trillion earmarked for social policy and climate change legislation removed from the bill.\textsuperscript{51}

One obstacle to full bi-partisan support in the House is the argument over the difference between blockchain (developers) and cryptocurrency transmission (e.g. VASPs). For instance, some lawmakers do not want those designing the technology that cryptocurrency operates on to be punished or burdened


for the consequences of criminals using cryptocurrency. Additionally, most House Representatives (namely House Republicans) wanted to vote against H.R. 3684 because they believed it unfairly required crypto miners to produce evidence that they were not involved (knowingly or unknowingly) with criminal activity. To some extent, it is valid to argue that crypto miners should not be included in the list of FIs/enablers required to comply with AML reporting rules. This is mainly because targeting nefarious actors at the mining stage is too late. In this instance, the government should first investigate who is selling crypto mining hardware and ask these vendors to verify where customers acquired the funds to purchase equipment (if the amount spent meets the minimum threshold of $1,000 USD mentioned on page 10 of this memo). In sum, House Republicans would need reassurance that the policy recommendations in this memo do not include crypto miners in its list of regulated entities, and this is a concession that is logical to make.

Influential House Representatives that could be in favor of the policy proposal in this memo include Darren Soto (D-FL), Patrick McHenry (R-NC), Ted Budd (R-NC), and Don Beyer (D-VA). These three alone have garnered significant bipartisan support from their colleagues to co-sponsor similar bills introduced to Congress. Soto co-sponsored the Keep Innovation In America Act (H.R. 6006) introduced by Patrick McHenry (R-NC), which (a) specifies when and how FIs (or parties involved in crypto transactions) should report information on activities and (b) removes these requirements for those lacking the internal capacity to retrieve this information (based on the nature of their businesses or the type of customer information they would readily have access to). This bill is also endorsed by crypto lobbyists and co-sponsored by 12 House Representatives, pointing to a positive sign that any legislation with similar language will pass through the House. Soto also introduced the Cryptocurrency Tax Clarity Act (H.R. 5082) that essentially makes the same recommendations as this policy memo—to list as FIs brokers who

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carries out a transfer of digital assets on behalf of a natural or legal person (e.g. to a crypto wallet, financial account, etc).\textsuperscript{53} Budd introduced bill H.R. 296, which includes financial incentives to those providing information on terrorists’ use of digital assets, a recommendation similar to the business tax credit suggested on page 9 of this memo. Beyer is a sponsor of bill H.R. 4741, which promotes the de-anonymization of beneficial owners of digital assets, a goal of the recommended amendments to the ENABLERS Act and, essentially, an endorsement for proposed policy in this memo.\textsuperscript{54}

It is safe to expect greater bi-partisan support for this memo’s policy recommendations in the House compared to the Senate. Both Senator Ted Cruz (R-TX)\textsuperscript{55} and Senator Tom Emmer (R-MN)\textsuperscript{56} have led Republican outcry over the risk of losing competitive advantage over China’s lax regulation of cryptocurrency. Pat Toomey (R-PA) has also stated he wants any proposed legislation to narrowly define what types of brokers are required to adopt AML reporting policies aligned with the ENABLERS Act. Essentially, Toomey would like to shrink the list of qualified FIs required to perform due diligence and determine beneficial ownership in all financial transactions (whether involving fiat or digital currency).\textsuperscript{57}

Business Insider reported that several Senators (mainly from the Republican party) are opposed to further scrutiny of VASPs or digital assets because many of them own large shares in this market.\textsuperscript{58} This reinforces Krugman’s point made in his New York Times opinion piece: the American government must be ready and willing to demonstrate full transparency in examining whether or not its officials are

\textsuperscript{54} Brett, Jason. 2021
potentially money laundering enablers themselves. Of course, direct or insinuated accusations would not be the best method for incentivizing greater support from dissenters of the ENABLERS Act (or its recommended adjustments). Instead, it would be helpful to point to the Democrats and Republicans reaching across party lines to argue for increased transparency and accountability in the crypto market.

One major example is the collaboration between Jim Risch (R-Idaho), Bill Cassidy (R-LA), and Bob Menendez (D-N.J.) on a bill showing similar concern for use of cryptocurrency to evade AML precautions set up against sanctioned countries and/or “organized criminal organizations”.\(^{59}\) In addition to leveraging this relationship with co-committee members (Risch being on the Committee of Foreign Relations and Cassidy on the Committee on Finance), Menendez’s role as senior member of the Senate Banking, Housing, and Urban Affairs Committee and Senate Finance Committee could prove beneficial in influencing more senators to getting the ENABLERS Act (along with proposed amendments in this memo) passed. Further, Menendez is Chairman of the Subcommittee on Securities, Insurance, and Investment, whose members (like Republican Tim Scott) have endorsed investigations into managing money laundering threats that come from the use of cryptocurrency.\(^{60}\) As it is with the House, the Senate must come to an agreement on how to define FIs and/or brokers charged with providing due diligence reports on beneficial ownership to overcome the hurdle of making changes necessary to achieve the goal of reduced illicit money circulating in the U.S. economy.

Proponents of the policy changes recommended in this memo can tap into the support of influential analysts to solve the FI definition dilemma. In an August 2021 op-ed, Ezra Klein (journalist and co-founder of Vox) argued that at its essence, cryptocurrency is designed to create a “trustless” system in which you never know who is on the other side of any transaction. That design ultimately makes it


inherently dangerous and infrastructure that requires intense scrutiny, even at the risk of overburdening the people involved with innovating the platform. Chainalysis (a blockchain data company) provided insights in a report to the BBC that supports Klein’s argument. In this report, the company demonstrated that money laundering increased by 30 percent from 2020 to 2021 because of the very features that make cryptocurrency innovative—its use of blockchain technology to anonymize transactions.61 Therefore, it may be beneficial for proponents of the ENABLERS Act to quote this company’s analysis when/if they are attempting to win over members of Congress who are resisting regulation of the crypto market.

Additionally, proponents must emphasize the national security implications of refusing to monitor digital asset transactions as carefully as possible. Senators Menendez, Risch, and Cassidy began this conversation with their proposed bill on El Salvador’s adoption of Bitcoin as legal tender. In sum, the bill states that this adoption of the cryptocurrency reduces the effectiveness of U.S. sanctions on the country and its potential trading partners (like China). Essentially, the senators fear that if El Salvador is able to forge a strong trading relationship with other larger economies by accepting cryptocurrency for government activities, it has no incentive to cower under the pressure of the United States. Recently, the U.S. imposed economic sanctions on El Salvador after it accused two of its government officials and Salvadoran President Nayib Bukele of providing “financial incentives” to known gang members in an attempt to quell kidnappings and violence in the country. Effective December 2021, these government officials no longer had access to assets they owned within the U.S. These sanctions bothered Bukele and, based on Menendez’s proposed legislation, may push him to find other viable alternatives to a partnership with America.62 An increased ability to monitor how and where cryptocurrency can be used

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in this instance to empower a potential political adversary to circumvent U.S. foreign policy would hopefully incentivize members of Congress to reconsider relaxing the stipulations required of FIs and corporations to uncover criminal uses of cryptocurrency.

The opinions of American voters and professionals in the financial sector may also influence whether significant support for a revised ENABLERS Act could be secured. For example, while 44% of Americans in support of cryptocurrency as legal tender are ages 25-34, less than half of registered voters fit within this demographic.\(^6\)

Figure 4: Poll of U.S. citizens on the decision to make Bitcoin legal tender

This voting bloc could provide substantial political leverage to members of Congress supporting more government involvement in the cryptocurrency market. This same voting group is also more likely to believe the U.S. government needs greater anti-corruption reforms, which may mean they would lean heavily towards endorsing comprehensive AML regulations if these regulations reduce the number of politicians and power brokers (e.g. high net-worth individuals, corporations, and banks) involved with or enabling financial crimes.

Conversely, 43 percent of baby boomers (“boomers”) “strongly oppose” the use of cryptocurrencies, even as legal tender (i.e. as stablecoins pegged to the U.S. dollar or currency issued directly by the Treasury). Boomers tend to be the more active voter bloc, showing higher election turnout rates than Gen X, millennials and Gen Z voters combined (except for the 2018 midterm elections).

Figure 5: 2020 Election Voter Demographics (By Age)

<table>
<thead>
<tr>
<th>Age Group</th>
<th>United States Citizens</th>
<th>Total Population</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Registered to Vote</td>
<td>Not Registered</td>
</tr>
<tr>
<td>Total</td>
<td>Percent</td>
<td>Percent</td>
</tr>
<tr>
<td>75 and older</td>
<td>77.8</td>
<td>6.9</td>
</tr>
<tr>
<td>65 - 74 Total</td>
<td>79.1</td>
<td>6.8</td>
</tr>
<tr>
<td>45 - 64 Total</td>
<td>75.7</td>
<td>8.9</td>
</tr>
<tr>
<td>25 - 44 Total</td>
<td>70.1</td>
<td>13.1</td>
</tr>
<tr>
<td>18 - 24 Total</td>
<td>59.8</td>
<td>20.3</td>
</tr>
</tbody>
</table>

Source: United States Census Bureau, April 2021

According to a Pew Research Center survey, boomers represent 56 percent of registered Republicans while the majority of registered Democrats (49 percent) are between 18 and 49 years old. Both Republican and Democrat Congress members may be swayed to align their proposed regulations on cryptocurrency with the preferences of their constituents. However, the laissez-faire approach to legislation that some Congressional Republicans favor is in direct opposition to the opinions of their largest political base—voters ages 50 and older.

VII. Recommendations

Congress may consider developing a working group of voters, experts, and politicians to discuss the policy proposals in this memo and come to an agreement on the best next steps for strengthening America’s AML efforts. Participants in this working group may include the recommended anti-corruption groups listed below, as well as a bi-partisan representation of House and Senate members who have sponsored or co-authored similar AML legislation in the past.

Figure 6: List of Anti-Corruption Groups Operating in the U.S.

<table>
<thead>
<tr>
<th>Name of Organization</th>
<th>Mission/Issues</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Accountability Project</td>
<td>Whistleblower protection and anti-retaliation legislative recommendations</td>
</tr>
<tr>
<td>Global Financial Integrity</td>
<td>Curtailing illicit financial flows and promoting effective policy solutions internationally</td>
</tr>
<tr>
<td>RepresentUs</td>
<td>Stopping political bribery and promoting financial transparency laws</td>
</tr>
<tr>
<td>American Society of International Law</td>
<td>Corporate compliance and terrorist financing</td>
</tr>
<tr>
<td>Transparency International</td>
<td>Prosecution of financial crimes, stronger accountability laws, and whistleblower protection</td>
</tr>
<tr>
<td>Blockchain Intelligence Group</td>
<td>Cryptocurrency investigation, law enforcement capacity</td>
</tr>
</tbody>
</table>

Policymakers may also want to consider the results of the IntraFi Network’s Q3 and Q4 surveys of professionals in the banking industry (conducted in 2021). In this survey, opinions about the U.S. Federal Reserve issuing its own digital currency and whether stablecoins should be regulated by federal depository institutions were examined. Thus far, 60 percent of banking professionals are unsure of whether U.S.-issued cryptocurrency is a good idea or something they would support. Further, 69 percent of banking professionals are unsure or unconvinced that stablecoin regulation is appropriate for safety and/or innovation in the cryptocurrency market.

Figure 7: IntraFi Network 2021 Q3 Survey - Banker Perspectives on Cryptocurrency

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The Fed will soon issue a discussion paper analyzing the costs and benefits of offering its own central bank digital currency (CBDC).

Should the Fed offer such a digital asset?

31% No, it could become a competitor to federally guaranteed deposits and the banking system in general

60% Unsure, we need to know more about what form this would take and how it would impact the system

9% Yes, it will speed payments by creating a digital dollar and will foster more innovation in the system

Figure 8: IntraFi Network 2021 Q4 Survey - Banker Perspectives on Stablecoins
In working group conversations with the proposed participating members (see Figure 6), Congress may want to ask representatives of the American Bankers Association whether their members perceive this additional oversight from the government as an additional financial or operational burden. Getting at the crux of the uncertainty or opposition to extended regulation of the crypto market may help determine whether options like the business tax incentive would mitigate the tension rising from the topic of federal supervision. For instance, in a discussion on the business tax credit, members of Congress can ask whether bankers will feel more equipped to monitor and comply with additional AML regulations by investing tax savings into hiring more risk managers, compliance officers, and auditing software for know-your-customer (KYC) processes.

Additionally, publishing op-ed articles provides an opportunity to both educate the general public about the historical issues surrounding the proposed policy amendments in this memo and to engage the general public in a debate on the pros and cons of the recommendations presented. Influential
government-appointed officials such as yourself, or elected officials from Congress may reach out to any of the following publications that have most notably written on the topic of money laundering and DeFi regulation in the past two years: the New York Times, Forbes, and Axios. It may also be beneficial to identify publications reaching a diverse readership to promote inclusion in the public debate. Data shows that African Americans make up 44% of cryptocurrency investors, and 35% of traditional stock investors. Including this population in the conversation is another approach to building voter confidence and political support from Americans who could benefit from understanding the protections and consequences resulting from the ENABLERS Act.

This memo’s emphasis on the regulation of digital assets and VASPs is not meant to focus AML efforts entirely on emerging technologies. Instead, it’s an example to reinforce the reason why Congress should emend the existing ENABLERS Act, ensuring the bill leaves no room for illicit funds transfers to circumvent federal investigation. The U.S. government should recognize that technological innovations in the global financial system are likely to render old ways of governance ineffective and incomplete. Even if the U.S. does not proceed with the introduction of a federally backed crypto coin for use, it should acknowledge the reality of its citizens turning to decentralized currencies to fulfill transactions, and put in place safeguards for this reality to prevent national security issues.

Lastly, the purpose of this memo is to also underscore the involvement of American citizens in facilitating laundering efforts even on behalf of non-U.S. clients. Based on the data presented by the U.S. Sentencing Commission at the start of this memo, the financial incentives for Americans to continue this risk-taking behavior seems to outweigh the negative consequences of being caught and prosecuted for these crimes, given that more than two-thirds of money laundering cases involve U.S. citizens.

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Therefore, it’s strongly recommended that the U.S. government consider ways to make abiding by the law, frankly, more lucrative. This is why the business tax credit is provided as an additional amendment to the existing ENABLERS Act and Bank Secrecy Act. By committing to a 360-degree approach to regulation, AML efforts in the U.S. can comprehensively remove these threats to democracy from the roots, preventing them from persistently germinating and spreading undetected in the future.
Curriculum Vita

Olatunde Ogunlana was born on May 3, 1988 in Lagos, Nigeria. At the age of 6, Olatunde moved to New York City. After graduating high school at Tottenville High, he earned his Bachelor of Science in Business Administration at Wagner College. After college, Olatunde worked as an analyst at PricewaterhouseCoopers, then as a senior associate at the Goldman Sachs Group. Olatunde is currently employed as a Vice President at JPMorgan Chase & Co. His academic and professional interests include economic policy, and public management.