

United States Senate
WASHINGTON, DC 20510

March 29, 2022

The Honorable Janet Yellen
Secretary
U.S. Department of the Treasury
1500 Pennsylvania Ave NW
Washington, DC 20220

The Honorable Gary Gensler
Chair
U.S. Securities and Exchange Commission
100 F Street NE
Washington, DC 20549

Dear Secretary Yellen and Chair Gensler:

We write regarding the disconcerting loophole in the nation's financial regulations that exempts the \$11 trillion private investment industry from anti-money laundering (AML) and countering the financing of terrorism (CFT) obligations. This loophole allows private investment companies like hedge funds and private equity firms, as well as their investment advisers, to accept and manage huge sums of money without asking basic questions about their customers.¹ As a result, many private investment companies and investment advisers are not even aware of the identities of their investors and clients, undermining our anticorruption, counterproliferation, and counterterrorism programs and enabling Russian elites and other criminal actors to evade sanctions and hide and grow their wealth.² Although the Biden Administration has led the world in imposing strong sanctions on Russia following its illegal invasion of Ukraine, the financial secrecy afforded by private investment markets makes complete and consistent enforcement of these sanctions near impossible. As such, we urge the Treasury Department and the Securities and Exchange Commission (SEC) to use your existing statutory authorities to immediately close the AML/CFT loophole for the private investment industry.

AML/CFT programs are essential to American national security and a basic pillar of our financial system. In short, they help to combat money laundering, terrorism, the proliferation of weapons of mass destruction, and other criminal activity by requiring financial institutions to identify their customers, keep records on the source of client funds, report suspicious activity,

¹ FACT Coalition, Global Financial Integrity, and Transparency International U.S. Office, "Private Investments, Public Harm: How the Opacity of the Massive U.S. Private Investment Industry Fuels Corruption and Threatens National Security," December 2021, p. 6, https://thefactcoalition.org/wp-content/uploads/2021/12/TI_Private-Investments-Public-Harm-10.pdf.

² *Id.* at 7; Wall Street Journal, "Sanctions on Russia Put Private Fund Backers Under the Microscope," Ted Bunker and Laura Kreutzer, March 6, 2022, <https://www.wsj.com/articles/sanctions-on-russia-put-private-fund-backers-under-the-microscope-11646586001>.

and monitor account transactions.³ When properly implemented, AML/CFT programs can combat attempts by criminals, terrorists, rogue nations, and sanctioned individuals to conceal their identities (through entities such as shell companies) and prevent them from hiding, investing, and transferring cash illegally.⁴ Information obtained from AML/CFT programs can also provide insight into systemic risks from inbound investment that could entrench and empower foreign kleptocracies or other corrupt regimes.⁵

Nevertheless, for the past two decades, there has been an alarming loophole in AML/CFT requirements for the financial industry. Most of the financial sector—including banks, mutual funds, credit unions, broker-dealers, and even casinos—must have AML/CFT programs.⁶ But thanks in part to a 20-year “temporary exemption” granted by the Treasury Department in 2002, neither unregistered investment companies (including hedge funds, private equity firms, and venture capital firms) nor their investment advisers are subject to federal AML/CFT requirements.⁷ Some private investment vehicles have voluntarily adopted their own programs.⁸ But many have not, allowing corrupt actors to hide their ill-gotten gains in vast segments of the American financial market without scrutiny or public accountability.⁹

The Treasury Department has attempted to end this two-tiered system on several different occasions. In 2002, it sought to require unregistered investment companies to set up AML/CFT programs.¹⁰ In 2003 and 2015, it sought to do the same for certain investment advisers.¹¹ All three efforts, however, ended in either perpetual pendency or the withdrawal of the proposed rules in the face of industry opposition, allowing private investment vehicles to continue to profit from and grow the wealth of criminals, terrorists, and kleptocrats unchecked.¹²

³ Washington Post, “The search for oligarchs’ wealth in U.S. is hindered by investment loopholes,” Todd C. Frankel, March 16, 2022, <https://www.washingtonpost.com/business/2022/03/16/private-equity-regulation-gap>.

⁴ *Id.*

⁵ Atlantic Council, “Defending the United States Against Russian Dark Money,” Anders Åslund and Julia Friedlander, November 2020, <https://www.atlanticcouncil.org/wp-content/uploads/2020/11/Russia-Dark-Money-Printable-PDF.pdf>.

⁶ FACT Coalition, Global Financial Integrity, and Transparency International U.S. Office, “Private Investments, Public Harm: How the Opacity of the Massive U.S. Private Investment Industry Fuels Corruption and Threatens National Security,” December 2021, p. 18, <https://thefactcoalition.org/wp-content/uploads/2021/12/TI-Private-Investments-Public-Harm-10.pdf>.

⁷ 31 C.F.R. § 103.170.

⁸ Washington Post, “The search for oligarchs’ wealth in U.S. is hindered by investment loopholes,” Todd C. Frankel, March 16, 2022, <https://www.washingtonpost.com/business/2022/03/16/private-equity-regulation-gap>.

⁹ *Id.*

¹⁰ U.S. Department of the Treasury, Federal Register Notice, “Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Unregistered Investment Companies,” September 26, 2002, <https://www.federalregister.gov/documents/2002/09/26/02-24145/financial-crimes-enforcement-network-anti-money-laundering-programs-for-unregistered-investment>.

¹¹ U.S. Department of the Treasury, Federal Register Notice, “Financial Crimes Enforcement Network; Anti-Money Laundering Programs for Investment Advisers,” May 5, 2003, <https://www.federalregister.gov/documents/2003/05/05/03-10840/financial-crimes-enforcement-network-anti-money-laundering-programs-for-investment-advisers>; U.S. Department of the Treasury, Federal Register Notice, “Anti-Money Laundering Program and Suspicious Activity Report Filing Requirements for Registered Investment Advisers,” September 1, 2015, <https://www.federalregister.gov/documents/2015/09/01/2015-21318/anti-money-laundering-program-and-suspicious-activity-report-filing-requirements-for-registered>.

¹² Washington Post, “The search for oligarchs’ wealth in U.S. is hindered by investment loopholes,” Todd C. Frankel, March 16, 2022, <https://www.washingtonpost.com/business/2022/03/16/private-equity-regulation-gap>.

Critically, exempting the private investment industry from AML/CFT requirements endangers our national security and poses systemic risks to our financial system. America's private investment market is massive; the \$11 trillion industry would be one of the top ten largest world economies standing alone.¹³ Yet, regulators and the companies themselves have limited insight into the identities of investors in the industry and the nature of their investments, presenting at least three serious problems:

- First, the United States cannot reliably determine how much money in the private investment market comes from illicit actors, whether criminal organizations, terrorists, or sanctioned individuals. As the Federal Bureau of Investigation has noted, the current system is “not adequately designed to monitor and detect threat actors’ use of private investment funds to launder money.”¹⁴
- Second, the United States is less capable of enforcing sanctions against wealthy individuals—including Russian oligarchs and government officials—or even understanding the sanctions’ impact. As a former Treasury official explained, “[w]e simply don’t know what’s out there.”¹⁵
- Third, by granting unfettered, anonymous access to America’s lucrative private financial markets, the United States is enabling and legitimizing foreign corrupt and criminal actors to some extent, without any understanding of how the geopolitical risk associated with doing so may contribute to market instability.

Recent reporting from the *New York Times* underscores the problem. According to the *Times*, Roman Abramovich—a Russian oligarch with close ties to President Vladimir Putin—has invested billions of dollars in American hedge funds and private equity firms over the past twenty years.¹⁶ But because the private investment industry is so “lightly regulated,” and because of “Wall Street’s willingness to ask few questions about the origins of the money,” hedge funds and private equity firms investing Abramovich’s money often had “no inkling about—or interest in discovering” that they were working to enrich the oligarch.¹⁷

The status quo is plainly untenable. If the United States were to sanction Abramovich (as it reportedly may do after the European Union and the United Kingdom froze his assets earlier this month),¹⁸ neither the U.S. government nor the entities handling his secretive investments

¹³ Credit Suisse, “Global wealth databook 2021,” June 2021, p. 130, <https://www.credit-suisse.com/media/assets/corporate/docs/about-us/research/publications/global-wealth-databook-2021.pdf>.

¹⁴ Federal Bureau of Investigation, “Threat Actors Likely Use Private Investment Funds To Launder Money, Circumventing Regulatory Tripwires,” May 2010, p. 1, <https://archive.org/details/fbi-intelligence-bulletin-threat-actors-likely-use-private-investment>.

¹⁵ Washington Post, “The search for oligarchs’ wealth in U.S. is hindered by investment loopholes,” Todd C. Frankel, March 16, 2022, <https://www.washingtonpost.com/business/2022/03/16/private-equity-regulation-gap>.

¹⁶ New York Times, “How One Oligarch Used Shell Companies and Wall Street Ties to Invest in the U.S.,” Matthew Goldstein and David Enrich, March 21, 2022, <https://www.nytimes.com/2022/03/21/business/russia-roman-abramovich-concord.html>.

¹⁷ *Id.*

¹⁸ CNBC, “Treasury Secretary Yellen says Russian oligarch Abramovich ‘could face sanctions’ by U.S.,” Robert Frank, March 25, 2022, <https://www.cnbc.com/2022/03/25/treasury-secretary-yellen-says-russian-oligarch-abramovich-could-face-sanctions-by-us.html>; BuzzFeed News, “Russian Oligarch Roman Abramovich Invested At Least \$1.3 Billion With US Financiers, Secret Records Show,” Tom Warren, Jason Leopold, Anthony Cormier, John

would have a full understanding of where Abramovich has invested his billions in the American financial system, let alone the ability to effectively enforce sanctions against him. Put another way, the AML/CFT regulatory gap threatens to undermine the Biden Administration’s historically robust sanctions against corrupt Russian elites.

In December 2021, the Biden Administration announced its intent to address the AML/CFT loophole for investment advisers and private investment companies. The U.S. Strategy on Countering Corruption commits to “address[ing] deficiencies in the anti-money laundering regime,” stressing the importance of America’s role in “strengthen[ing] global efforts to limit the proceeds of corruption and other illicit financial activity.”¹⁹ In particular, the Administration highlighted two proposals to shore up AML/CFT requirements in the private investment industry: (1) re-examining the 2015 proposed rule that would have imposed anti-money laundering and suspicious activity reporting (SAR) requirements on certain investment advisers and (2) considering whether the rule should “cover private placement funds, including investments offered by hedge funds and private equity firms.”²⁰

We support the Administration’s commitments in this area, and we urge you to act now, given the pressing need to fully enforce sanctions against Russia. Both the Treasury Department and the SEC have a role to play in closing the AML/CFT gap for the private investment industry.²¹ The Treasury Department has the authority under the *Bank Secrecy Act* to impose AML/CFT and SAR requirements on financial institutions.²² The SEC has the authority under the *Investment Advisers Act* to require investment advisers to disclose any records “as necessary and appropriate in the public interest” and “for the assessment of systemic risk.”²³ Pursuant to these authorities, the Treasury Department should immediately promulgate a rule to require investments advisers²⁴ and unregistered investment companies to implement robust AML/CFT programs with beneficial ownership identification, risk evaluations for all investors, suspicious activity reporting to the Financial Crimes Enforcement Network, and ongoing monitoring. And the SEC should revise Form PF to require investment advisers to conduct risk-based customer due diligence, report beneficial ownership information (including information about any

Templon, and Scott Pham, March 16, 2022, <https://www.buzzfeednews.com/article/tomwarren/roman-abramovich-billion-invested-united-states-financiers>.

¹⁹ The White House, “United States Strategy on Countering Corruption,” December 2021, p. 11, <https://www.whitehouse.gov/wp-content/uploads/2021/12/United-States-Strategy-on-Countering-Corruption.pdf>.

²⁰ *Id.* at 22-23.

²¹ The SEC and FinCEN already play a collaborative role in closing the AML/CFT gap for broker-dealers. *See* 31 U.S.C. § 5312(G) & 17 C.F.R. § 240.17a-8.

²² 31 U.S.C. §§ 5312(a)(2)(I), 5312(a)(2)(Y) & 5318.

²³ 15 U.S.C. §§ 80b-4 & 80b-10(c); *cf.* SEC v. Alpine Sec. Corp., 982 F.3d 68 (2d Cir. 2020), *cert. denied* (Nov. 8, 2021).


²⁴ The Treasury Department should sweep broadly with its definition of “investment adviser” to minimize loopholes for exploitation. Covered advisers should include registered investment advisers, investment advisers that work solely with private funds (including private equity, hedge, venture capital, and family office funds or rural business investment companies), and foreign private advisers. FACT Coalition, Global Financial Integrity, and Transparency International U.S. Office, “Private Investments, Public Harm: How the Opacity of the Massive U.S. Private Investment Industry Fuels Corruption and Threatens National Security,” December 2021, p. 37, <https://thefactcoalition.org/wp-content/uploads/2021/12/TI-Private-Investments-Public-Harm-10.pdf>.


“politically exposed person”²⁵ or “senior foreign political figure”²⁶), and disclose the country of origin of each investor, the source of their funds, and an approximate value of the funds invested.

Closing the private investment AML/CFT loophole will help the U.S. government track down the hidden wealth of sanctioned Russian elites and better combat money laundering, terrorism, the proliferation of weapons of mass destructions, and other criminal activity throughout our financial system. Further delay is not an option: the Biden Administration has led the global efforts to sanction Russia after its unprovoked attack on Ukraine, and the Treasury Department and SEC must use all tools available to enforce those sanctions. We ask that you move swiftly to end the AML/CFT loophole, send an explanation of when you plan to start the rulemaking process—and if any barriers exist to start the process—no later than April 12, 2022, and provide us with a briefing on your efforts to do so by April 12, 2022.

Thank you for your attention to this important matter.

Sincerely,


Elizabeth Warren
United States Senator


Sheldon Whitehouse
United States Senator

CC: The Honorable Himamauli Das, Acting Director, Financial Crimes Enforcement Network

²⁵ Financial Action Task Force, “Politically Exposed Persons (Recommendations 12 and 22),” June 2013, p. 3, <https://www.fatf-gafi.org/media/fatf/documents/recommendations/Guidance-PEP-Rec12-22.pdf>.

²⁶ 31 C.F.R. § 1010.605(p). This information would be confidentially filed and used to evaluate systemic risk; it may only be shared under limited circumstances. *See* 15 U.S.C. § 80b-4(b)(8). The SEC might also contemplate reforms to Form ADV that would be consistent with its authority to evaluate AML/CFT risk. *See* 15 U.S.C. § 80b-3(c)(1).