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Testimony Submitted to the U.S. Senate Committee on Banking, Housing, and Urban Affairs on "Stopping the Flow of Fentanyl: Public Awareness and Legislative Solutions"

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Chairman Brown and Ranking Member Scott, and distinguished members of this Committee, thank you for the opportunity to address you today on additional measures needed to combat the international trade in fentanyl and other deadly narcotics. This growing trade has killed hundreds of thousands of Americans, destabilized Mexico and our southern border, and adversely affected our nation's communities and its financial integrity. Significant new tools, including those provided in the Fentanyl Eradication and Narcotics Deterrence (FEND) Off Fentanyl Act (the "FEND Act"), are needed to address it.

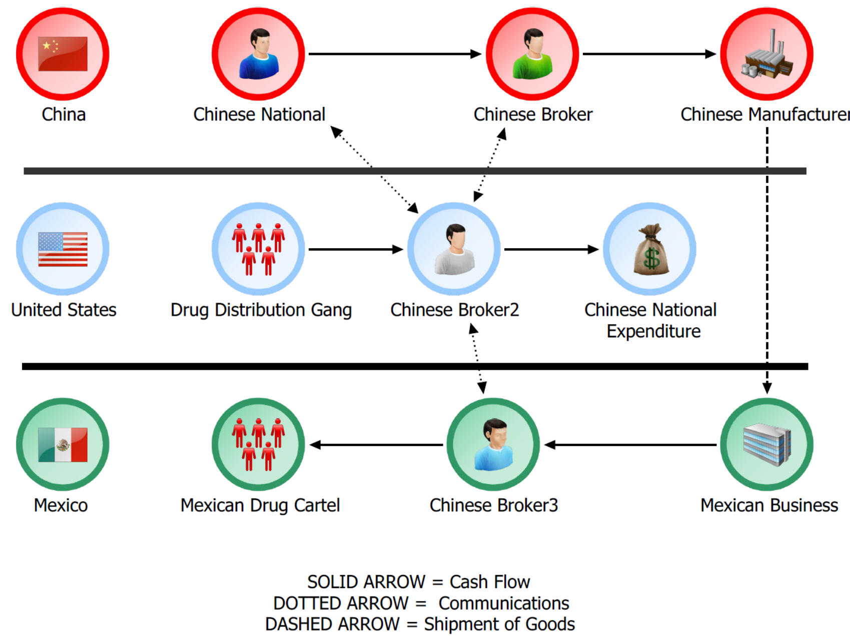
I saw firsthand the damage done by the international trade in narcotics, including fentanyl and other deadly drugs, during a 24-year career as an agent and executive with the U.S. Drug Enforcement Administration ("DEA"). I started off on the front lines targeting leaders of transnational criminal organizations ("TCOs") who were trafficking drugs into the United States and laundering crime proceeds through U.S. financial institutions and trade-based money laundering. I also spent time abroad working with our international partners to increase international collaboration against TCOs and malicious state actors.

In 2018, I was assigned to the DEA's Special Operations Division ("SOD"), where I supervised a team that focused on a new and evolving threat: Chinese Money Laundering Organizations ("CMLOs"). We formed this team because we were receiving reports from the field that Mexican drug cartels and other TCOs were using CMLOs in increasing amounts to launder their cash. Agents in the field who were making arrests of local traffickers reported learning that CMLOs would charge only one to two percent of the amount they were laundering, could deliver funds to the traffickers in their home countries immediately, and could guarantee payment of laundered funds. This was a dramatic change in the operation of the cartels, which historically had used Latin American money launderers to handle the task of repatriating drug proceeds using traditional methods such as the Black Market Peso Exchange and bulk cash smuggling. Those money launderers charged higher rates, required longer turnaround times, and posed greater risk of loss. The CMLO model thus represented a dramatic improvement for TCOs: it allowed them to ship more dangerous drugs into the United States and achieve greater profits from that deadly trade.

What I learned over the next several years while leading this program at SOD led me to conclude that the U.S. law enforcement community and the U.S. financial system needed significant new authority, guidance, and resources to understand and combat the threat. My conclusions have been reinforced since joining Nardello & Co., a global investigative firm, in 2022.

Summary Description of CMLO Activity

To understand how CMLOs have been so successful at laundering drug proceeds and why new tools are needed to combat this threat, it is first important to understand how CMLOs launder funds. Following is a simplified graphical representation of CMLO laundering activity:



Here is how the scheme works:

- Every day in the U.S., proceeds from sales of fentanyl and fentanyl analogues, heroin, cocaine, and other dangerous drugs are generated in the form of bulk U.S. cash. Those proceeds are delivered to a CMLO affiliate so that they can be laundered. For example, a drug distribution gang in New York that owes payment for drugs to a Mexican cartel or other TCO delivers the bulk cash to a Chinese broker affiliated with the CMLO who is located in New York.
- The CMLO then sells the U.S. dollars to Chinese customers who want to spend money in the U.S. Some of these customers cannot transfer funds directly from China because of Chinese capital controls. This money can be used to fund investments, acquire real estate or cars, pay college tuition, and purchase chips at casinos, among other things. Funds can be delivered in cash or in the form of wire transfers or checks from CMLO-affiliated businesses or individuals. These Chinese customers pay another CMLO-affiliated broker in China for the cash they purchase in the U.S.
- Funds received by CMLO-affiliated brokers from customers in China are used to buy goods for export to Mexico or another country where TCOs operate.
- Once those goods arrive in Mexico or another country used by TCOs, they are sold and the proceeds are delivered to another CMLO-affiliated Chinese broker, who has already

advanced the funds to the TCO in its home territory. The CMLOs make money at each stage of the transaction and accomplish all of this quickly and efficiently through *WeChat* or similar communications and financial technology.

What makes this scheme so effective and hard to detect?

- First, it minimizes movement of funds. Dollars don't leave the U.S., pesos don't leave Mexico, and RMB does not leave China.
- Second, it takes advantage of the huge and increasing volume of trade with China, and the existence of capital controls within China, by ensuring a constant stream of customers and making it harder to separate legitimate from illegitimate transactions.
- Third, it uses technology to its advantage, advertising the sale of dollars in Internet chat rooms and communicating and transacting primarily via *WeChat*, an encrypted network that is resistant to surveillance by U.S. law enforcement and that facilitates speed and trust within the CMLO.
- Fourth, it exploits the fact that financial institutions and other domestic recipients of Chinese-origin funds (car dealerships, higher education institutions, real estate brokers, casinos, etc.) are unfamiliar with the way CMLOs operate, hindering their effectiveness in flagging and stopping potential money laundering activity.

That said, the scheme has several potential vulnerabilities that are not being fully exploited but could be with the aid of the FEND Act and other changes. Unlike some traditional money laundering schemes, proceeds never leave the U.S., meaning they can be frozen or seized. In addition, financial institutions, TCOs, and CMLOs maintain detailed transaction data that can be exploited by law enforcement and regulators with the aid of targeting analysts and data scientists.

The FEND Act will help exploit these vulnerabilities in the following ways:

- Enhanced sanctions will make it more difficult for TCOs to operate and launder their crime proceeds.
- An expanded statute of limitations for sanctions violations will provide U.S. authorities with more time to build cases against the most sophisticated TCOs and CMLOs.
- The Treasury Department will be able to quickly place special surveillance and restrictions on financial institutions, transactions, and accounts used by TCOs and CMLOs to facilitate opioid trafficking.
- Regulators will provide additional guidance to financial institutions that will enable them to be more effective in filing Suspicious Activity Reports ("SARs") concerning transactions linked to suspected fentanyl trafficking, and regulators and law enforcement will prioritize investigations into those SARs.
- The law will make more forfeited TCO-linked property available for law enforcement operations.

While each provision is important, providing useful guidance to U.S. financial institutions that may handle TCO-derived funds will be particularly valuable in view of the changing nature of the threat. At Nardello & Co., I am helping the business community understand how TCOs work with

CMLOs to launder funds so that businesses can develop tools to detect and report on this activity when it occurs. Federal guidance should highlight the telltale signs of CMLO activity – including bulk cash transactions, third-party wires and checks for purposes unrelated to the account holders' personal or business activities – and provide clear instructions on when SARs should be filed and what information they should contain. Financial institutions and other potential facilitators also will need to invest more in training and detection in order to ensure their compliance systems are up to the challenge of protecting the integrity of the financial system in the face of this growing threat.

While some additional measures may be outside the scope of this Committee's jurisdiction, I would recommend consideration of two in particular:

- Additional resources should be allocated to combating CMLOs. Investigative resources such as translators, data scientists, and experienced targeting analysts are needed to understand how CMLOs work with TCOs to launder funds, interpret Chinese-language communications, analyze transaction data, and aid enforcement activity. These resources also could be used to support creation of inter-agency task forces targeting TCOs and CMLOs involved in the international opioid trade for prosecution, sanctions, and other international enforcement efforts.
- Currently, U.S. law enforcement lacks a reliable means to intercept financial transaction information and communications over encrypted apps such as *WeChat*, even with a court order supported by probable cause. This makes it much harder for law enforcement operations targeting TCOs and CMLOs to gather evidence critical to holding perpetrators accountable and dismantling the organizations. Serious consideration should be given to developing a lawful means of addressing this matter.

Thank you for your time and consideration. I look forward to answering your questions, and to future discussions with the Committee and its staff about this important issue.