FLOWTRACKER ANALYTICS INC.

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October 6, 2021

The Honorable Ron Wyden
Chairman, U.S. Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510
USA

The Honorable Mike Crapo
Ranking Member, U.S. Senate Committee on Finance
219 Dirksen Senate Office Building
Washington, DC 20510
USA

The Honorable Richard Neal
Chairman, U.S. House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515
USA

The Honorable Kevin Brady
Ranking Member, U.S. House Ways and Means Committee
1102 Longworth House Office Building
Washington, DC 20515
USA

The Honorable Janet Yellen
Secretary, Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220
USA

The Honorable Charles Rettig
Commissioner, Internal Revenue Service
1111 Constitution Avenue Northwest,
Washington, DC 20224
USA

Re: "Introduce Comprehensive Financial Account Reporting to Improve Tax Compliance", in General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals, Department of the Treasury, May 2021.

Subject: A better way to provide banking data to the IRS for compliance analysis

Dear Chairmen Wyden and Neal, Ranking Members Crapo and Brady, Secretary Yellen and Commissioner Rettig:

We expect the US Treasury eventually will be authorized to collect personal banking information in some form to support the goal of enforcing tax compliance. When and if this becomes necessary, we believe the Treasury, Citizens and the Financial Services Industry would be better served by reporting money flows, rather than transactions.

Much like the Statement of Cash Flow reported by corporations, money flows, rather than raw transaction data reporting, could be implemented faster, at less cost, and with lower risk to all parties, without compromising the policy objective of reducing tax non-compliance through analysis of banking activity.

We thank you in advance for your consideration and respectfully request a meeting with your offices to explore the possibility of implementing a better solution.

Issues with banking transaction reporting

We see significant issues arising from the Treasury proposal:

1. False behavior "signals" will be pervasive.

2. Transaction breakdown is impracticable.
3. Implementation and maintenance costs will be high.
4. Privacy and security are serious public concerns.

Please see Appendix 1 for discussion and elaboration of these issues.

A better approach

The Treasury is trying to identify unreported income and over-reported expenses. Internal flows of money between an owner's accounts are irrelevant.

What's needed is a way to separate external money flows from internal banking transactions.

Money flows can be derived and analyzed from account balance "snapshots'' with commercially available software. At the individual account level this analysis segregates:

- money brought into the Institution (aka "new money"),
- money taken out of the Institution (aka "lost money"), and
- internal flows between accounts of the same owner within the Institution.

This provides the Treasury with meaningfully classified money flows, without the need to process data from billions of unwanted internal transactions. Also, the money flow analysis solution can be implemented quickly and easily by individual reporting Institutions, or at national or regional levels (with additional benefits).

Please see Appendix 2 for an outline of how money flow analysis addresses these issues and how it can be implemented both quickly and at minimal cost.

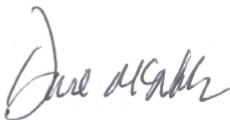
How we can help

We believe there is an urgent need for lawmakers to recognize the problems inherent in the current Treasury proposal, and to explore practical alternatives to achieve the intended goals.

We are proposing for your consideration a cost-effective, proven alternative solution that would avoid many of the issues the Treasury proposal presents to the Industry, Citizens, and the Government.

We look forward to hearing your thoughts and would welcome the opportunity to demonstrate the simplicity and effectiveness of our analytics software solution to you, your team, and your constituents.

Sincerely,



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Appendix 1 - Discussion / elaboration of issues

1. False-positive "signals" will be pervasive

Gross inflows and outflows in personal and business accounts with the same owner would include billions of internal transactions between accounts that have no significance for tax purposes.

Why: Individuals and businesses routinely move money from one account to another within a Financial Institution without incurring any external cash flows. For example, transactions moving money between Certificates of Deposit, Checking/Share Draft, or Savings/Regular Share/Money Market accounts within one owner's relationship are not relevant for tax compliance monitoring.

These internal transactions are extensive. Our research - gleaned from analyzing millions of US banking account holders' behavior over time - shows approximately 30% of all liability account growth and diminishment at any banking institution is funded by the owner's own accounts. These internal movements of money are irrelevant to the IRS.

Consequence: Reporting these "internal" transactions will provide millions of irrelevant transaction events, which the IRS would need to resolve, wasting taxpayer and compliance resources on a massive scale.

2. Transaction breakdown is not practicable

The proposed breakdown of gross money flows by physical cash, transactions with a foreign account, and transfers to and from another account with the same owner is not possible due to structural limitations in most financial recordkeeping systems. Payment transactions can be classified in this fashion, but not all banking transactions can be.

Why: The ability to identify and classify money flows as "new," "lost," or "internal" at the account level has always been an information management challenge in banking. Put simply, the original source of funds flowing through to an ultimate destination account or entity is not captured in most banking recordkeeping systems.

Consumer and business banking routinely involves accumulating funds from various sources and deploying funds to various destinations – there is rarely a one-to-one match. Banking systems record deposits and withdrawals through Demand Deposit/Share accounts (DDA) or internal Suspense accounts regardless of whether the money was sourced from physical cash, a foreign account, an account within the Institution (including other products) or accounts held at another Institution by the same owner.

Funds originating from these various sources are commingled in the DDA account. When funds are disbursed, the commingled money flows from the DDA account to various destinations without any reference to the original source, breaking the source-destination identity chain.

Consequence: As envisioned by the Treasury proposal, the reporting by source and destination breakdown is possible for each individual transaction, but the lack of analysis of end-to-end money flow events will not provide the IRS with meaningful information.

Implementation and maintenance costs will be excessive

The envisioned transactions data would contain sensitive personal information, requiring major investments in data security management practices and infrastructure for both the Treasury and providers of the data to comply with regulations.

It also will require a massive investment in information governance. Transaction and product codes are unique to every Institution, and they change frequently. Dictionaries of institution-specific transaction codes would be necessary to map information provided by institutions to regulatory transaction definitions for comparative analysis. The burden of mapping these unique data codes to a standard scheme will necessarily fall to the reporting Institutions, consuming scarce, highly skilled resources.

Why: As custodians of sensitive and private data, Financial Institutions and other data processors bear ultimate accountability for the safety and security of the Consumer and Business data they process. The Financial Services Industry will need to have access and visibility into the data management practices of the Treasury to fulfill their fiduciary obligations to customers.

Consequence: Audits of the Treasury's data management and governance practices and policies, including how the data is used, will be required by the Financial Services Industry to satisfy their existing obligations to protect Consumer and Business information.

3. Privacy and security are serious public concerns

At the risk of stating the obvious, we note that public reaction to sharing banking information with the Treasury / IRS has been both negative and loud, with consumers and businesses alike worried about the potential for misuse of the data and the potential for data leakage. Money flow information would help to reduce the sense of intrusion and risks of loss or misuse of the data.

These are more political matters than Industry concerns but are indeed an essential consideration in any regulatory proposal.

Appendix 2 - Addressing the issues and implementation

It may be helpful to explain more fully the notion of "money flow analysis" and how it differs from transaction analysis.

Banking transactions are designed to record the movement of money from a single source to a single destination. It often takes many transactions to achieve the desired outcome of a financial decision an account holder makes to meet their changing needs.

For example, a person decides to pay down a HELOC with proceeds of a CD, all within one Institution. To do this the bank records a transaction to redeem the CD, deposits the CD proceeds into a demand deposit account, and finally transfers the funds from the DDA to the HELOC - a minimum of 3 transactions to account for a single financial behavior.

Transactions fragment behavior to accommodate banking recordkeeping systems. Transactions taken in isolation generate false signals. In our example above, it would be easy (and false) to interpret the transactions as a CD cash-out, followed by a large DDA deposit, then a large DDA withdrawal and a large HELOC pay-down. None of those "behaviors" faithfully reflects the actual customer behavior of liquidating the CD to pay down the HELOC.

The solution is to analyze the changes in the customer's balance positions holistically. In our simple example the CD has gone down by an amount equal to the decrease in the HELOC and the DDA is unchanged, so we correctly understand there is a money flow from CD to HELOC.

More complex behaviors require more sophisticated analysis to deal with many-to-many data flow relationships. The required logic to do this has been developed into the FlowTracker software product.

Money flow analysis solves the problems

One of the most significant benefits of using money flows instead of transaction analysis is the data is easy to source – account level spot balances – with no transaction data required. This method improves the usefulness of the information while reducing risk and cost.

Specifically, here is how money flow analysis solves the problems we have outlined in this note:

1. **False behavior signals** – money flow analysis identifies the source-to-destination of money flows, explicitly classifying:
   a. new money (funds brought into the Institution from external sources),
   b. lost money (funds taken out of the Institution), and
   c. internal substitution flows (among products, accounts, and branches belonging to the same account owner within the Institution),

   as types of events by looking at account owner behavior holistically. The fragmented view presented through transaction analysis generates false positive "signals."

2. **Transaction breakdown** – money flow analysis separates internal and external fund flows, overcoming the problem of mapping source to destination at the transaction level, which

banking recordkeeping systems generally cannot support. Payment transactions would still be required to track cash, foreign payments et al.

3. **Implementation and maintenance costs** – simple data (balances, not transactions) and commercially available analysis software greatly reduce the complexity of the solution and significantly reduce the extent of expensive product code and transaction code mapping required to support integration and comparability of data.

4. **Privacy concerns** – money flow information does not require any personal transaction-level data to identify how money flows through the owner's accounts.

In addition to solving these problems, money flow analysis has the added benefit of generating useful information for the management and supervision of Financial Institutions. It can be used as a method for pre-screening AML case follow-ups, as a basis for Sales Planning and Performance Management, and to glean market signals concerning shifts in term preference and liquidity behaviors otherwise not apparent from transaction data analysis.

Implementation at reporting FIs

Software-as-a-service that performs analysis of money flows has already been implemented in several large Credit Unions in the USA. From the start of data sourcing to implementation has a typical duration of 6 weeks, and an operating cost to the Institution of less than $10,000 USD monthly.

Decentralized implementation places the burden of reporting on the Institution but provides a benefit by creating useful management information locally, for the Institution’s use in business operations and risk management contexts. Institutions which have implemented money flow analysis have decided it is a worthwhile investment, even if it's used solely for internal purposes.

Implementation at a national or regional level

Industry Associations and the IRS could implement analysis of money flows at a national or regional level to gain economies of scale. Extending the analysis beyond the boundaries of individual Financial Institutions would reveal:

- money flows of the account owner between Institutions,
- flows within Institutions, and
- extra-territorial money flows

This has the potential to benefit regulatory bodies and the Financial Industry with a rich fact base for analysis and benchmarking of liquidity risk and anti-money laundering event detection.

In addition, we note that countries such as Colombia and Israel have already adopted a national approach to combat money laundering and terrorism financing. The adoption of money flow analysis at a national level in the US could usher in a new era of international financial security.