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BANK SECRECY ACT ENFORCEMENT

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

ON

EFFORTS TO ENSURE COMPLIANCE AND ENFORCEMENT OF THE BANK SECRECY ACT, ENACTED IN 1970, WHICH AUTHORIZES THE SECRETARY OF THE TREASURY TO ISSUE REGULATIONS REQUIRING THAT FINANCIAL INSTITUTIONS KEEP RECORDS AND FILE REPORTS ON CERTAIN FINANCIAL TRANSACTIONS, FOCUSING ON ANTI-MONEY LAUNDERING AND ISSUES CONCERNING DEPOSITORY INSTITUTION REGULATORY OVERSIGHT

JUNE 3, 2004

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BANK SECRECY ACT ENFORCEMENT

THURSDAY, JUNE 3, 2004

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 9:45 a.m., in room SD–538, Dirksen Senate Office Building, Senator Richard C. Shelby (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN RICHARD C. SHELBY

Chairman SHELBY. The hearing will come to order.

The purpose of today's hearing is to examine the record of the Federal Government in enforcing this Nation's laws against money laundering and terrorist financing. The high-profile case of Riggs Bank, which was recently fined $25 million for repeated—I emphasize "repeated"—failures to comply with the Bank Secrecy Act, the basic anti-money laundering statutes requiring the reporting of large cash transactions and suspicious financial activities, has highlighted possible deficiencies in the governmental structure for enforcing these laws.

The Riggs case could be seen as unique. It involved that bank's near monopoly on foreign embassy banking. It involved an oil-rich country for which the movement of large amounts of cash was as routine as writing a check to pay bills is for many Americans. Whatever cultural, political, or economic factors resulted in Riggs' failure to comply with the law, despite repeated assurances to its Federal overseers that it would improve in that regard, this case cannot be seen as unique. As the General Accounting Office will testify later today before this Committee, the problem runs deeper than we may care to admit. There does appear, on the basis of a number of recent money laundering cases, as well as the case of UBS Investment Bank of Switzerland, about which this Committee held a hearing on May 20, to be serious deficiencies on the part of the Federal regulatory agencies vested with the authority and responsibility to enforce this Nation's laws against money laundering.

I mention the UBS case for a reason. In that case, the Federal Reserve Bank of New York, responsible for ensuring that U.S. currency was not being transferred to countries sanctioned for their support of terrorist activities or their poor human rights records, failed to provide adequate oversight of the banks with which it had contracted to serve as depositories of billions of U.S. dollars in cash. The Federal Reserve Bank trusted that the self-generating reports provided it by UBS were an accurate reflection of the latter's conduct. The Fed was wrong, to the tune of $5 billion.

Similarly, the Riggs case showed a deference toward the client financial institution that undermined the integrity of the oversight process. Trust that Riggs would comply not just with the terms of the law, but with the agreements intended to bring it into compliance with the law, proved the undoing of a process that is essential to the war against terrorism. The war against terrorism cannot be won without serious efforts at impeding the very types of criminal activity that seem to be going on or went on at the Riggs Bank, as well as the UBS case. And Riggs, as we all know, is not just about their bank's relationship to the Embassy of Saudi Arabia. As disturbing are the business transactions with the Government of Equatorial Guinea, a country known for its corruption, human rights abuses, and desperately poor population, despite vast oil wealth.

The Riggs case, as well as that of Banco Popular, Delta National Bank and Trust of New York, and others clearly point to underlying problems in the approach of Federal regulatory agencies to properly carry out their mandate to enforce the Bank Secrecy Act.

How long banks are given to comply with the law before the Government acts with sufficient force so as to compel compliance is one of the issues to be addressed here today. Others include the ability and the willingness of the agencies represented here today to execute their enforcement function with regard to money laundering with the same competence with which they execute their apparently more ingrained "safety and soundness" function. Their relationship to each other, to the Financial Crimes Enforcement Network, also represented here today, and to law enforcement and the degree to which information essential for enforcing anti-money laundering laws is shared among themselves in a timely manner. For example, was the FBI informed about cease-and-desist orders, or did it have to read about them in the papers? What about FinCEN? Does the examination process need repair? These are the questions that demand attention here.

Testifying here today and hopefully addressing these questions, are Susan Schmidt Bies, Board of Governors of the Federal Reserve System; John D. Hawke, Comptroller of the Currency and frequent guest here; Donald Powell, the Chairman of the Federal Deposit Insurance Corporation; James Gilleran, Director of the Office of Thrift Supervision; JoAnn Johnson, Chairman of the National Credit Union Administration; and William Fox, Director, Financial Crimes Enforcement Network. After we hear testimony from these officials, we have a second panel comprised of Gaston Gianni, Inspector General of the Federal Deposit Insurance Corporation; and Davi D'Agostino, Director of the Financial Markets and Community Investment Division of the General Accounting Office.

Senator Sarbanes.

STATEMENT OF SENATOR PAUL S. SARBANES

Senator SARBANES. Thank you very much, Mr. Chairman. First of all, I want to say that I strongly share your commitment to very strong oversight by this Committee of the agencies under our jurisdiction and, in particular, this focus on the administration and enforcement of the Bank Secrecy Act.

The President speaks often of the war against terrorism, and again and again people say that an essential part of the war against terrorism is to dry up the financial resources that the terrorist networks gain access to which enable them to carry out their activities. The Bank Secrecy Act is part of that effort, but the effectiveness of the BSA and the priority which bank regulators and the Treasury Department give to its enforcement is regrettably a very open question, underscored by the failures of compliance and regulatory oversight at Riggs Bank and other institutions. Riggs is the most recent one and in the focus.

OCC examiners outlined problems in Riggs' BSA compliance and anti-money laundering procedures as early as 1997. But despite Riggs' well-known special circumstances, in terms of its clients, the examiners failed to discover widespread noncompliance with the Bank Secrecy Act. It was not until late 2002 that OCC examiners began seriously to test transactions to see if the Riggs' program was actually producing results. We now know that it was not.

Throughout much of the same period, Federal counterterrorism and law enforcement officials were involved in investigations involving accounts of some of Riggs' largest customers. And the Federal Reserve Board was conducting parallel oversight because of its jurisdiction over the Riggs holding company and Edge Act subsidiary. It is not clear when the Financial Crimes Enforcement Network, FinCEN, which is said to administer the Bank Secrecy Act and which ultimately issued a concurrent $25 million penalty assessment with the OCC against Riggs, first learned of Riggs' compliance problem. It seems clear that there was no coordinated Federal regulatory effort relating to the audit and investigation of Riggs.

The Riggs situation in and of itself is serious, obviously. But it may reflect a broader structural problem. No one seems to be directly accountable for enforcement of the Bank Secrecy Act. Congress vested authority for the Bank Secrecy Act's administration and enforcement in the Secretary of the Treasury, who has delegated that authority, since 1994, to the Director of FinCEN. The Federal banking agencies examine the compliance of depository institutions with the Bank Secrecy Act, under authority delegated by Treasury. But they also have a separate statutory obligation to examine for BSA compliance procedures, employing a different set of sanctions than the statutory penalties in the Bank Secrecy Act.

The list of agencies involved in potential BSA compliance problems does not end there. Federal enforcement and, now, intelligence agencies—for example, the FBI, the Bureau of Immigration and Customs Enforcement, the Drug Enforcement Administration, the Criminal Investigation Division of the Internal Revenue Service—investigate potential BSA violations in the course of their activities. State bank regulators have their own oversight authority that extends to the Bank Secrecy Act in the case of State-chartered institutions. Different regulators may—in fact, likely will—regulate different parts of increasingly integrated bank holding companies. Treasury, through FinCEN, will become involved in compliance penalties only in a limited number of situations in which cases are referred to it under procedures that, according to testimony we will be receiving today, are more than a decade old.

I am also concerned about the nature of the bank examination procedures themselves in this area. Today's testimony will indicate that the bank examiners review procedures and systems in their money laundering compliance examinations. They rarely test transactions to see if the procedures or systems are working. It is a little bit like going into a room and seeing that the furniture is all in place but not placing any weight on the furniture to see whether it will sustain the stress. It could all be hollow.

I am also concerned about reports that compliance examiners, generally at the OCC, FDIC, and OTS, have been made subordinate to safety and soundness examiners. This would affect not only the Bank Secrecy Act, but also other critical compliance areas, including, of course, consumer protection.

The unfortunate lesson of the Riggs case seems to be that, despite the attention paid to improving the statutory tools given to the Treasury and to law enforcement in the legislation enacted after September 11—this Committee brought forth a title on money laundering which was included in that legislation, and, of course, prior legislation—the Bank Secrecy Act is not really "administered" at all in any coordinated way. Again, no one seems to be responsible for putting the statute into effect.

I hope that today's hearing can force accelerated discussion of these issues and place them at the top of the anti-money laundering and counterterrorism financing agenda.

I also want to get a better sense from our witnesses of how uniformly they are enforcing the BSA and the anti-money laundering laws. It is my understanding that last week, Comptroller Hawke sent a memorandum to the OCC's bank examiners reminding them of their responsibilities in this area, and I look forward to hearing what our other financial regulators are doing in this regard and how seriously they take this issue.

A number of far-reaching proposals are now being made, and the Committee may well have to address them. And, of course, these would involve how authorities are allocated. One proposal is to create a separate Bank Secrecy Act audit and enforcement force at the Treasury. Another would be to create a joint BSA audit authority under the supervision of the banking regulators staffed by experienced examiners whose career ladders call for rotation into the unit for several years and who audit institutions other than those supervised by their home agencies. Another possibility is retaining the present system, but requiring FinCEN, so long as it is administrator of the BSA, to receive the portion of each examination report dealing with Bank Secrecy Act matters, and to participate in the determination of action to take in response to deficiencies.

Another possibility, moving across the range of things, would be to delegate full BSA penalty and administrative authority to the bank regulators together with mandated reporting to Treasury. Another would be to mandate transaction testing and other upgraded examination procedures for BSA examination.

I think it is very clear that the current system is not working the way it should be working. The Fed imposed a $100 million on UBS AG for conducting illegal currency transactions with four countries. Our colleague, Representative Sue Kelly, on the House side, the Chairman of the House Financial Services Oversight Committee,

called this sanction "a mere slap on the wrist." There is very deep concern, obviously, here in the Congress about the effectiveness of our fight against terrorist financing. Our concern also involves organized crime, drug cartels, and so forth. And there is not a sense that the agencies are fully reporting for duty with respect to this important issue.

Mr. Chairman, I look forward to hearing the testimony.

Chairman SHELBY. Thank you, Senator Sarbanes.

Senator Reed.

STATEMENT OF SENATOR JACK REED

Senator REED. Mr. Chairman, I simply want to associate myself with Senator Sarbanes' comments and remarks, and I look forward to hearing the testimony of the witnesses.

Thank you, Mr. Chairman.

Chairman SHELBY. Senator Allard, do you have an opening statement?

STATEMENT OF SENATOR WAYNE ALLARD

Senator ALLARD. I do, Mr. Chairman, have an opening statement. I will just submit it for the record.

Chairman SHELBY. Without objection, it is so ordered.

Senator ALLARD. I would like to thank the panel for taking the time to testify before the Committee and you for holding the hearing.

Chairman SHELBY. Thank you.

All of your written testimony will be made part of the hearing record. We will start with you, Governor Bies.

STATEMENT OF SUSAN S. BIES, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Ms. BIES. Thank you, Mr. Chairman and Senator Sarbanes. I want to thank you for the opportunity to appear before this Committee to discuss the Federal Reserve's participation in efforts to combat money laundering and terrorist financing.

In my remarks today, I will describe for you some of the important steps we are taking to fulfill our supervisory mission, to guide the institutions we supervise, and, in cooperation with the other banking and financial services regulators and the Treasury Department, to make every effort to use our supervisory tools to enhance the banking industry's role in preventing and detecting money laundering and terrorist financing activity. The Federal Reserve's anti-money laundering program is multifaceted. It involves work in the bank supervision area, the applications area, enforcement, investigations, training, and coordination with law enforcement and intelligence communities, as well as rule writing. This morning, I will touch on some of these aspects of the Federal Reserve's anti-money laundering program, but will concentrate on bank supervision efforts and enforcement matters.

The Federal Reserve has long shared Congress' view that financial institutions and their employees are on the front lines of the efforts to combat illicit financial activity. The Federal Reserve believes that the banking organizations it supervises must take every reasonable step to identify, minimize, and manage any risks that

illicit financial activity may pose to individual financial institutions and the banking industry.

It has been our longstanding policy that Federal Reserve supervisors incorporate a Bank Secrecy Act compliance and anti-money laundering program component into every safety and soundness examination conducted by a Federal Reserve Bank. This means that on a regular examination cycle, examiners evaluate whether a banking organization's Bank Secrecy Act and anti-money laundering compliance program is satisfactory and are commensurate with the organization's business activities and risk profiles. Bank Secrecy Act and anti-money laundering compliance has, for years, been an integral part of the bank supervision process at the Federal Reserve. Furthermore, the Federal Reserve's enforcement program has a strong history of addressing both anti-money laundering and safety and soundness problems in formal actions when it becomes necessary.

There is an important correlation between the areas covered by a BSA/AML examination and an institution's overall risk management and internal controls. Bank examiners take into account an organization's enterprise-wide corporate governance mechanisms and how they are applied. The Federal Reserve's bank examiners are able to apply a broad perspective and depth of organizational knowledge to the area of Bank Secrecy Act and anti-money laundering compliance and to coordinate with the examination and analytical staff to ensure that safety and soundness and Bank Secrecy Act and anti-money laundering are integrated and comprehensive. The Federal Reserve has found that there is an important synergy gained by integrating safety and soundness and Bank Secrecy Act/anti-money laundering supervisory processes.

The Federal Reserve focuses significant resources on the prevention and early resolution of deficiencies within the supervisory framework. In cases where examiners have identified a violation of the compliance program requirement, the Federal Reserve is bound by law to take formal enforcement action. The same law requiring us to promulgate rules requiring a compliance program provides that if an institution fails to establish and maintain required procedures, we must issue a formal action requiring the institution to correct the problem.

The Federal Reserve takes this responsibility very seriously and has issued a number of public actions against banking organizations in fulfillment of this statutory mandate. Over the last 3 years, for example, the Federal Reserve has taken approximately 25 formal, public enforcement actions addressing Bank Secrecy Act and anti-money laundering-related matters.

In addition to taking action itself, the Federal Reserve may refer a Bank Secrecy Act-related matter to Treasury's FinCEN for consideration of an enforcement action based on violations of that law.

The Federal Reserve staff coordinates enforcement actions with other regulators or agencies, including in the area of anti-money laundering. If a banking organization's problems involve entities supervised by different regulators, resolution of enterprise-wide problems may involve multiple enforcement actions. For example, the OCC, FinCEN, and the Federal Reserve coordinated their recent enforcement actions against Riggs Bank, National Association;

Riggs National Corporation; and Riggs International Banking Corporation, the national bank's Edge Act subsidiary. The Federal Reserve coordinates its enforcement actions with State banking supervisors on a regular basis, and enforcement actions involving operations of foreign banking organizations may be resolved in cooperation with supervisors abroad. In several recent matters, there was close coordination also with the U.S. Department of Justice.

The Federal Reserve's Bank Secrecy Act and anti-money laundering functions range from supervising and regularly examining banking organizations subject to Federal Reserve supervision for compliance with the Bank Secrecy Act and relevant regulations, to requiring corrective actions for detected weaknesses in their Bank Secrecy Act/anti-money laundering program, to enhancing money laundering investigations by providing expertise to the U.S. law enforcement community, to providing training to U.S. law enforcement authorities and various foreign central banks and government agencies. Over the last 3 years, for example, Federal Reserve experts in anti-money laundering-related matters have participated in special reviews of funds transfers for Federal law enforcement and intelligence authorities, taught classes at FBI and Department of Homeland Security training academies, held seminars for central bank and foreign supervisor authorities in 10 countries, and engaged in discussions on anti-money laundering-related matters at international fora such as the Basel Cross-border Group and the Financial Action Task Force.

Board and Reserve Bank supervisors seek to provide guidance to banking organizations to assist them to fully understand applicable regulatory requirements and what is expected by the regulators. The Federal Reserve views its supervisory role as including initiatives to enhance awareness and understanding by banking organizations under Federal Reserve supervision and by the industry at large.

The Federal Reserve makes its Bank Secrecy Act examination procedures available to the banking industry and updates those procedures by publicly issuing supervision and regulation letters. These letters advise Reserve Bank supervisory staff and the industry about new examination policies and protocols, such as those associated with the USA PATRIOT Act. Federal Reserve staff also speaks regularly before the financial industry and issues sound practice guidance in conjunction with other regulators and Treasury. These initiatives are meant to respond to or anticipate questions that arise regarding anti-money laundering requirements and to help banking organizations' compliance efforts.

The Federal Reserve believes that banking organizations should take reasonable and prudent steps to combat illicit financial activities, such as money laundering and terrorist financing, and to minimize their vulnerability to risks associated with such activity. For this reason, the Federal Reserve's commitment to ensuring compliance with the Bank Secrecy Act continues to be a high supervisory priority. The Federal Reserve has an important role in ensuring that criminal activity does not pose a systemic threat and, as important, in improving the ability of individual banking organizations in the United States and abroad to protect themselves from illicit activities.

Thank you.

Chairman SHELBY. Thank you, Governor Bies.

Mr. Hawke.

STATEMENT OF JOHN D. HAWKE, JR.
COMPTROLLER OF THE CURRENCY
U.S. DEPARTMENT OF THE CURRENCY

Comptroller HAWKE. Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I appreciate the opportunity to discuss the work of the OCC in combating money laundering and enforcing compliance with U.S. laws designed to prevent our financial institutions from falling victim to criminals and terrorists.

For the past 30 years, the OCC has placed great importance on developing policies and procedures designed to ensure that financial institutions have the necessary controls in place and provide the requisite notices to law enforcement to make certain that they do not become vehicles for money laundering. Our examiners are dedicated. Our BSA/anti-money laundering examination techniques are highly regarded. We have strived to keep our exam techniques current and responsive to new developments, and we work cooperatively and successfully with law enforcement. For all these reasons, the situation that we have confronted with Riggs Bank is deeply troubling, and this Committee's keen interest in Riggs is entirely appropriate.

For this reason, I will rely today on my written testimony for a detailed discussion of the components of the OCC's extensive BSA and anti-money laundering program and devote my oral testimony to the Riggs situation.

As I reviewed the record of our oversight of Riggs' Bank Secrecy Act/anti-money laundering compliance during this period, it become clear to me that there was a failure of supervision. We should have been more aggressive in our insistence on remedial steps at a much earlier time. The types of strong formal enforcement action that we ultimately took should have been taken earlier. We should have done more extensive probing and transaction testing of accounts. Indeed, our own BSA exam procedures called for transactional reviews in the case of high-risk accounts, yet until recently that was not done. We failed to appreciate the risks inherent in Riggs' embassy banking business and in certain of the accounts handled by the bank, as well as the significance of the deficiencies in the bank's systems and controls in relation to those risks.

This is not a case where the deficiencies in these systems and controls at Riggs were not recognized, nor was there an absence of OCC supervisory attention to those deficiencies. But in failing to promptly recognize the high-risk nature of the bank's business in this regard, we did not probe as soon or as deeply as we should have. We gave the bank too much time, based on its apparent efforts to fix the problems we had repeatedly noted, before we demanded specific solutions, by specific dates, pursuant to formal enforcement actions.

With this context, allow me to provide a brief review of our recent supervision of Riggs. The specific shortcomings in Riggs' BSA/AML compliance program were known to us as early as 1997. In

our regular and frequent examinations, we repeatedly identified the need for improvement in Riggs' BSA internal audit coverage, its information systems, its internal monitoring processes, its staff training, and its customer due diligence requirements, and we brought those deficiencies to the attention of Riggs management. Each time, we found management to be apparently cooperative and responsive. And because of this attitude, we concluded that Riggs' compliance program was either "satisfactory" or "generally adequate," which led us to continue to rely on various informal supervisory remedies in dealing with the Riggs management.

In the aftermath of the September 11, 2001 tragedies, the OCC conducted a series of antiterrorist financing reviews at our large and high-risk banks. Riggs was included in those targeted exams. The subsequent examination of Riggs ran from January to May 2003 and involved extensive cooperation with law enforcement agencies. It focused on certain suspicious transactions involving the Saudi Embassy relationship and culminated in a July 2003 cease-and-desist order, directing Riggs to undertake a long list of corrective actions.

Yet when we returned to the bank in October 2003, the same pattern surfaced. While progress had been made toward complying with the July C&D order, a new set of problems had become evident, this time relating to the bank's relationship with Equatorial Guinea. Our reaction this time was fundamentally different than before and ultimately led to the assessment of a record $25 million civil money penalty against the bank. We also continue to evaluate whether additional actions are warranted.

Against this background, there are at least three important questions that this Committee might appropriately ask. And I am sure there are more. First, why was there a failure of supervision in the Riggs case? Second, is our record with regard to Riggs symptomatic of shortcomings in our BSA/AML supervision of other national banks? And, third, what is the OCC doing to assure that there will be no recurrence of situations like Riggs?

To address the first two questions, I have directed our Quality Management Division, which reports directly to me and is analogous to an internal IG operation, to conduct a complete, no-holds-barred, top-to-bottom review of our handling of the Riggs situation and to report their findings and recommendations back to me in 90 days. I have also directed QMD to make a more general assessment of the quality of our BSA/AML supervision and to determine whether there are other banks as to which our compliance oversight reflects similar shortcomings. I will be happy to share the QMD report with this Committee when it is completed.

In order to assure that there is no recurrence of the shortcomings evidenced in the Riggs case, I have directed a number of other actions, which are described in my written testimony, to improve our practices and policies and to develop new risk-screening systems and techniques.

I have also instructed our Committee on Bank Supervision, which is comprised of the OCC's senior supervision officials, to communicate with all OCC examination staff to raise their level of alert for suspicious or high-risk accounts and to reemphasize the need for deeper investigation and transaction testing where such

circumstances exist. This communication re-emphasizes the critical importance of our BSA/AML compliance program and the role that program plays in helping to assure that national banks will not be used to facilitate improper transactions.

The Riggs episode reminds us that the Bank Secrecy Act and money laundering issues are not only of extreme importance to national security but they also have huge reputation implications for the banking industry. This heightened awareness, coupled with the many technical and other improvements in the approach to BSA/AML supervision already adopted or contemplated by the OCC and its sister financial regulatory agencies, should strengthen the ability of our financial system to resist those who would use it for improper purposes.

Notwithstanding the Riggs situation, Mr. Chairman, the OCC is committed to doing its part to assure that national banks scrupulously perform their responsibilities under the laws relating to money laundering. We stand ready to work with Congress, with law enforcement, with the other financial regulatory agencies, and with the banking industry to continue to develop and implement a coordinated and comprehensive response to the threat posed to the Nation's financial system by money launderers and terrorists.

Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Powell.

STATEMENT OF DONALD E. POWELL
CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Chairman POWELL. Mr. Chairman, Senator Sarbanes, and Members of the Committee, thank you for this opportunity to discuss how the FDIC, along with the other bank regulatory agencies, addresses our responsibilities under the Bank Secrecy Act and related anti-money laundering and antiterrorism laws.

While my written testimony provides greater detail about the FDIC's effort to prevent money laundering and terrorist financing, I would like to focus my statement today on how the FDIC is seeking to ensure that the American financial system is not misused in a way that supports criminal and terrorist activities and how bank regulators, law enforcement, and the banking industry can work together to address money laundering and terrorist financing.

One of the strongest ways to attack criminal and terrorist activities is to focus on their funding sources and their attempts to use the financial system to further their goals. While legislative and regulatory efforts originally focused on criminals laundering large sums of cash, the events of September 11 expanded our reach to terrorists who seek to use the U.S. banking system to fund their activities.

The FDIC is responsible for examining State-chartered, nonmember banks for compliance with the Bank Secrecy Act and to determine the effectiveness of the financial institutions' anti-money laundering program. While the vast majority of FDIC-supervised institutions are diligent in their efforts to establish, execute, and administer effective Bank Secrecy Act compliance programs, there have been instances where the controls and efforts were lacking. In those cases, we have implemented a range of corrective measures to ensure banks comply with the law.

In cases where an institution's anti-money laundering compliance program has been criticized or in cases where previously identified deficiencies have not been corrected, including significant violations of law, the FDIC will take formal or informal enforcement action. The type of enforcement action pursued by the FDIC against an institution is directly related to the severity of the offense, management's willingness and ability to effectively implement corrective action, as well as the extent to which the program has failed to identify or deter potential money laundering. In addition, the nature of the criticism, the response to prior weaknesses or violation notifications, and the overall risk profile of the institution are factored into the type of supervisory action, as well as any determination to assess civil money penalties.

The FDIC understands that all institutions are at risk. In today's global banking environment, where funds are transferred in an instant and communication systems make services available nationally, even a lapse at a small financial institution outside of a major metropolitan area can have major implications on another location across the Nation. The more difficult it is for criminals and terrorists to gain entry into the American financial system, the more likely it is that they will need to rely on less secure and less efficient means of financing their activities.

Since the passage of the USA PATRIOT Act of 2001, the FDIC has been involved in a number of activities aimed at supporting our efforts to reduce the risk of terrorist financing activities. We participated in the rulemaking process of relevant parts of the USA PATRIOT Act, and we participated in a number of working groups focused on counter-financing of terrorism and the USA PATRIOT Act. In conjunction with this, and in part to address some recommendations identified in a recent inspector general report, the FDIC has undertaken or established a number of initiatives to enhance our enforcement of the Bank Secrecy Act.

First, consistent with the increased importance of the BSA, the additional workload associated with the USA PATRIOT Act and greater emphasis on international efforts to combat terrorism financing, we are dedicating more staff to oversight of our anti-money laundering and PATRIOT Act efforts. Currently, the FDIC has more than 150 Bank Secrecy Act subject matter experts nationwide. The FDIC expects to double this number over the next 18 months.

Second, the FDIC is requiring that all examiners complete additional formal training on anti-money laundering and PATRIOT Act issues by the end of this year. This computer-based training also will be offered to all State banking authorities and other regulators who wish to provide additional training for their staff.

Third, the FDIC is reviewing all written guidance for examiner and industry use to assure that it is current and provides clear direction.

Fourth, beginning this month, in those instances where the State banking authority does not conduct Bank Secrecy Act exams, the FDIC will send an examiner to conduct an examination for BSA and anti-money laundering compliance concurrent with the State authority's safety and soundness examination. While the FDIC reviews BSA compliance each time it examines a State-chartered

nonmember bank, not all States conduct similar examinations. This initiative will ensure that all FDIC-supervised banks are reviewed for money laundering and terrorist financing activity during every examination cycle.

Fifth, the FDIC has centralized the monitoring process for FDIC-supervised banks with serious anti-money laundering program deficiencies. This ensures a consistent supervisory approach is applied on a national basis. In addition, the FDIC recently centralized the process for referring violations to FinCEN, which provides consistency in reporting. These centralization efforts will enable us to analyze historical data internally to identify emerging trends and issues among FDIC-supervised banks.

Sixth, the FDIC will continue its participation in the Bank Secrecy Act Advisory Group, which is a public-private partnership engaged in the evaluation of strategies to detect and prevent money laundering and terrorist financing schemes. These initiatives are underway and ongoing.

There is more we can do. Here are some ideas we are exploring within the FDIC and the broader Government to further buttress our efforts: Work toward a smarter BSA that accomplishes the mission more efficiently through more useful and timely filing by banks; Encourage the use of Section 314 safe harbor language in the law to foster meaningful dialogue between institutions about suspicious transactions; Tear down the wall between industry and Government and foster better dialogues about the broader threats, current criminal and terrorist practices, and about the way institutions' BSA filings are put to use; Enhance and solidify the perception of invulnerability. Any criminal or terrorist should know that if he uses the U.S. banking system to transfer value, he will be caught.

In conclusion, the FDIC is fully committed to preventing the use of the financial system to support criminal or terrorist activities. Only through a strong and comprehensive supervisory response and the continued full commitment of the industry can we create an environment where terrorists know that any attempt to use the American financial system to fund their operations poses an unacceptable risk of discovery.

This concludes my testimony. Thank you.

Chairman SHELBY. Mr. Gilleran.

STATEMENT OF JAMES E. GILLERAN
DIRECTOR, OFFICE OF THRIFT SUPERVISION
U.S. DEPARTMENT OF THE TREASURY

Director GILLERAN. Chairman Shelby, Senator Sarbanes, Members of the Committee, the OTS fully supports the Bank Secrecy Act and the U.S. PATRIOT Act, and we are dedicated to make sure that our agencies and our licensees completely carry out their responsibilities under them.

In the last 10 months, of our 916 institutions we have completed 476 BSA examinations. Of those 476 examinations, we found 167 associations with BSA violations. The number of violations in those associations in total were 342. All of those violations were addressed prior to the completion of our examinations and did not lead to any more formal action since the institutions completely ac-

cepted our findings and made changes immediately. We have 7 actions that have come out of that effort that have been more formal in nature, have resulted in cease-and-desist orders and in civil money penalties. And we have 4 or 5 more that are in process.

To put the number of violations, though, into perspective, 342, in adding up the number of potential violations that are embedded in the OTS and Treasury regulations, they number over 200 for each institution. So the possibility of the number of violations in those approximately 500 examinations was over 100,000 potential violations. So the regulations are extremely detailed and, of course, our examination procedures are appropriately detailed but risk-focused.

We have also participated in trying to conduct educational programs for the industry. We have provided additional training for our staff. We have greatly expanded the number of examiners who are BSA trained. We have halved the interval between BSA examinations from 24 to 36 months to 12-month to 18-month intervals. We have developed and implemented enhanced scoping and examination procedures. We have implemented a new BSA tracking and monitoring information system. We have improved internal controls governing internal data collection. We have bolstered our offsite BSA monitoring programs. We have adopted more robust and stringent enforcement policies. We have implemented the new BSA quality assurance and audit program. And we have improved our internal communications and external communications and coordinated closely with other financial regulatory agencies, Department of the Treasury, and law enforcement.

I await your questions.

Chairman SHELBY. Thank you.

Ms. Johnson.

STATEMENT OF JOANN M. JOHNSON
CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

Ms. JOHNSON. Chairman Shelby, Senator Sarbanes, and Members of the Committee, thank you for the invitation to testify before you today on behalf of the National Credit Union Administration on the enforcement of the Bank Secrecy Act.

Congress enacted the BSA to prevent credit unions and other financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity. NCUA is the regulatory authority that monitors federally insured credit unions for compliance with the BSA.

I am pleased to report to the Committee that federally insured credit unions have a good record of compliance with the requirements of the BSA. Credit unions are also substantially in compliance with Sections 314, Information Sharing, and Section 326, Customer Identification Program, of the USA PATRIOT Act.

At the end of 2003, NCUA insured 9,399 credit unions. Almost 50 percent of federally insured credit unions have assets less than $10 million. These credit unions are less likely to have transactions that trigger the recordkeeping and recording requirements of the BSA. Additionally, approximately one-third of Federal credit unions have a single common bond sponsor. Officials in smaller credit unions often have a more intimate understanding of their members' transactions, which facilitates their compliance with the require-

ments of the BSA. Consequently, money laundering has not been a major problem for credit unions.

Nevertheless, much has changed since the terrorist attacks of September 11. NCUA recognizes that some federally insured credit unions may be targeted by individuals or groups seeking to launder money.

The Federal Credit Union Act requires NCUA to assure BSA compliance in federally insured credit unions. Federally insured credit unions are required to have BSA compliance programs that effectively monitor their daily operations to assure compliance with all applicable rules and regulations.

In fact, the risk-focused examination program used by NCUA examiners and State credit union examiners directs that a review of compliance with the BSA be completed at every examination. All examinations of federally insured credit unions completed by a State regulator are reviewed by NCUA staff. It should be noted, however, that NCUA does not review examinations of privately insured credit unions and does not have enforcement authority for BSA compliance in those credit unions.

During the examination of the 7,500 federally insured credit unions in 2003, NCUA determined that there were 334 violations of the BSA. The violations were in 261 credit unions, representing 3.5 percent of all credit unions examined. The most common violations fell into three categories: Inadequate written policy, 63 percent; inadequate customer identification program, 8 percent; or inadequate currency transaction reporting procedures, 7 percent.

Of the 334 violations, credit union officials working with an examiner, corrected or agreed to correct 99 percent of the violations during the on-site examination.

In instances when violations at a federally insured credit union persist and/or are more severe, NCUA has several options to initiate corrective action. They range from a letter from the NCUA Regional Director to formal administrative action, including conservatorship.

NCUA will use a formal administrative action when necessary to correct BSA violations. This has occurred twice in the recent past. NCUA placed one institution into conservatorship and issued a cease-and-desist order against another.

NCUA has taken numerous initiatives to address BSA compliance in credit unions. These initiatives fall into the following general categories: Examination program, examiner training, compliance examiners, and credit union education.

In addition to on-site reviews of BSA compliance during examinations, NCUA has issued several publications to educate federally insured credit unions on BSA and USA PATRIOT Act compliance.

Looking forward, NCUA is committed to maintaining a dynamic examination program that will assure federally insured credit unions have effective programs in place to minimize the risk of money laundering. NCUA will continue to provide guidance to federally insured credit unions regarding compliance with the BSA.

Again, thank you, Mr. Chairman, for the opportunity to appear before you today on behalf of NCUA to discuss BSA compliance in the credit union industry. I am pleased to respond to any questions

the Committee may have or be a source of any additional information you may require.

Thank you.

Chairman SHELBY. Thank you.

Mr. Fox.

STATEMENT OF WILLIAM J. FOX
DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK
U.S. DEPARTMENT OF THE TREASURY

Mr. FOX. Thank you, Mr. Chairman, Senator Sarbanes, and distinguished Members of the Committee. I appreciate the opportunity to appear before you here today to discuss the role that the Financial Crimes Enforcement Network can and should play in Bank Secrecy Act compliance and enforcement matters. It is truly an honor for me to appear with this distinguished panel. As I stated the last time I appeared before this Committee, we very much appreciate the leadership and commitment and oversight of this Committee and its staff on these important issues that are the focus of today's hearing. I have prepared a statement and have submitted it for the record, and I will keep these remarks very brief.

FinCEN is the delegated administrator of the Bank Secrecy Act. Through that delegation, FinCEN is answerable to the Secretary of the Treasury for ensuring that the ultimate goals of the Act are achieved. While we eagerly accept this responsibility, this responsibility is not ours alone. The distinguished ladies and gentlemen on this panel with me today and the agencies they represent, as well as other agencies such as the Securities and Exchange Commission and the Internal Revenue Service, have been delegated responsibility to examine financial institutions for BSA compliance.

Indeed, presently implementation of the Bank Secrecy Act's regulatory regime involves eight different Federal agencies and three SRO's. This unusual structure is both a strength and a weakness. The weaknesses are obvious and sometimes clearly manifested. To diffuse responsibility across so many bureaucracies can cause, and indeed on occasion has caused, inconsistency in application, lack of clarity on purpose, and, more importantly, a lack of accountability. However, let me submit to you that, if managed properly, this structure can also be a strength because it builds upon the existing expertise and examination functions of the regulators who know their industries best. This structure leverages resources where resources would otherwise be completely insufficient and possibly duplicative, and the current structure exploits the knowledge base, experience, and resources of these disparate regulators who, again, know their industries best.

I view it as FinCEN's responsibility to work with my colleagues at this table to help manage this structure, to build on the strengths our diverse partners bring to the table. In other words, administration of the Bank Secrecy Act means oversight, it means coordination, and it means ensuring consistency of application.

When I appeared before this Committee in April, I outlined a number of challenges I perceived as I came to learn more about FinCEN. In my view, of all of those challenges, there are no challenges as important to FinCEN as the proper and appropriate implementation of the Bank Secrecy Act's regulatory regime. Much of

our work has been and is devoted to the goal of maximizing industry compliance with that regime. We have new leadership of our regulatory team at FinCEN. We have also developed some short-term priorities for FinCEN in this area and on these issues to better understand the industries we regulate, assist our regulator partners in the examination process, and to further enhance our own capabilities to enforce the regulatory regime we have been asked to administer.

We also have several ideas on how to better manage and coordinate the implementation of this regulatory regime on which we will engage our regulatory partners. The specifics of those priorities and the ideas that we have are set forth in my written testimony so I will not recite them here. What I want you to know, Mr. Chairman, is that I clearly understand how important this set of issues is to the success of our country's anti-money laundering and counter-terrorism finance efforts, dare I say it, to our country's security. The implementation of this risk-based system is a delicate matter that demands balance, consistency, and clarity.

For example, the cornerstone of the Bank Secrecy Act, suspicious activity reporting, requires financial institutions to make judgment calls. If we fail in properly implementing this regime, if we get it wrong, the entire system fails. In other words, if as regulators we do not keep our focus on the implementation of appropriate anti-money laundering programs that generate proper reporting, there could be two equally unacceptable outcomes. Compliance, for example, is not about second-guessing individual judgment calls made by financial institutions whether a particular transaction is suspicious. If we go down that path, financial institutions as small "c" conservative institutions will merely file on everything to protect themselves from regulatory risk. If, on the other hand, we are too lax when it comes to ensuring institutions or implementing these programs, proper reporting simply will not be generated. Either scenario represents a failure of implementation, in my view.

Mr. Chairman and distinguished Members of this Committee, you should know that you have my commitment and the commitment of the women and men of FinCEN to do all in our power to ensure the appropriate and robust implementation of this critical regulatory regime. We appreciate this Committee's continued support and focus on these critical issues. Again, I appreciate very much the opportunity to be here today, and hopefully our presence here will add to this important conversation.

I will be happy to answer any questions the Committee may have.

Chairman SHELBY. Thank you. I thank all of you.

We have all heard former President Reagan's statement: "Trust, but verify." What I fear here is that there has been a lot of trust and no verification for many years.

Mr. Hawke, for the record's sake here, would you indicate, the first BSA compliance issue at Riggs, when it was noted by an OCC examiner? And when was final action taken with respect to the particular BSA compliance problems, in other words, the gap there, beginning to the end?

Comptroller HAWKE. I have reviewed the record back to 1997, Mr. Chairman, and in 1997, we noted certain shortcomings in their compliance program.

Chairman SHELBY. What did you do about it?

Comptroller HAWKE. First of all, we graded their program "satisfactory," which in retrospect was clearly not warranted in view of——

Chairman SHELBY. In other words, you did not do anything.

Comptroller HAWKE. No. We told them that they had to make certain improvements in their Bank Secrecy Act compliance. They went through the motions of making those changes, and as we came back——

Chairman SHELBY. Did you go through the motions of checking them, too?

Comptroller HAWKE. We did. In subsequent examinations, we found that they had not fully complied, and we continued to push them to do it.

Chairman SHELBY. What did you do about it when you knew they had not complied? Nothing?

Comptroller HAWKE. As I said in my oral statement, Mr. Chairman, we did not take swift enough and strong enough action.

Chairman SHELBY. Could you just for a minute discuss the procedures for routine Bank Secrecy Act examinations? Just give us a scenario.

Comptroller HAWKE. We have about 40 full-time Bank Secrecy Act compliance examiners and a team of about three specialists in the Washington headquarters who set policies. In our large banks, Bank Secrecy Act compliance is a regular part of the ongoing responsibilities of the resident teams at those large banks. In those banks where we do not have full-time resident teams, Bank Secrecy Act compliance is part of their regular on-site examination.

Chairman SHELBY. How many, if you could quantify—and if you cannot do it here, do it for the record—violations did you pick up at Riggs? There had to be a lot of them.

Comptroller HAWKE. There were plenty of violations at Riggs.

Chairman SHELBY. Over many, many years, right?

Comptroller HAWKE. At the beginning of the process, the violations were inadequate control systems, inadequate training, and the like. As we developed further familiarity with that program, it was clear that the violations included failure to file suspicious activity reports in situations where they were called for.

Chairman SHELBY. Would it be fair to say that the scrutiny of the BSA was in name only? In other words, there is not a lot of verification, there is not a lot of compliance? Seven years' worth of violations and nothing really happened.

Comptroller HAWKE. I am not sure I would characterize it quite that way.

Chairman SHELBY. Close to it?

Comptroller HAWKE. I think the problem, Mr. Chairman, was not that we were not identifying shortcomings in their compliance program. We were. We were insufficiently robust in assuring that they were correcting those——

Chairman SHELBY. In other words, you did not do anything about it, just plain English.

Is that right?

Comptroller HAWKE. We did not take swift enough action or strong enough action.

Chairman SHELBY. Okay. If we know this has gone on at Riggs under your supervision, as you are the Comptroller of the Currency, how many other hundreds of thousands, perhaps, of exam reports in your files which document serious and unaddressed BSA compliance issues at national banks throughout the country? Does that concern you?

Comptroller HAWKE. It certainly is an appropriate question. I do not have any reason to think that Riggs represents a systemic problem. But I have directed——

Chairman SHELBY. But you do not know that.

Comptroller HAWKE. I have directed our Quality Management Division to make exactly that kind of inquiry and to report back to me on it.

Chairman SHELBY. Mr. Hawke, in addition to the Saudi and Equatorial Guinea accounts, Riggs held numerous other foreign accounts, including what many characterize as what we would call high-risk by FinCEN and OFAC. They include, among others, Burma, Cuba, the Sudan, Iraq, Iran, Syria, and Nigeria. If Riggs' BSA/AML internal controls were so deficient, which is a given, should we be concerned, in other words, should you be concerned that many of these other embassy and special interest accounts could suffer similar inadequacies and violations?

Comptroller HAWKE. That is certainly a concern, and we have been addressing that concern in a number of ways over the last year and a half.

Chairman SHELBY. Will you give us a report to the Committee on what you have done, especially in these particular ones we have raised here?

Comptroller HAWKE. I would be happy to, Mr. Chairman.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

Mr. Fox, you are the Administrator of the Bank Secrecy Act. Is that correct?

Mr. FOX. Yes, sir.

Senator SARBANES. When did FinCEN learn of the problems at Riggs Bank?

Mr. FOX. I believe the first we learned of the problems at Riggs Bank from the Comptroller's office was in June 2003.

Senator SARBANES. June 2003?

Mr. FOX. I believe, yes.

Senator SARBANES. Well, now, we just heard in response to the questions from Chairman Shelby that the Comptroller's office, as I understand Mr. Hawke's answer—and he can correct me—had identified shortcomings at Riggs as early as 1997. Is that correct?

And the first you knew as the Administrator of the Bank Secrecy Act, that there were such shortcomings, was when in 2003?

Mr. FOX. June 2003, Senator. That is what I am told. I was not there at FinCEN at the time, but that is what I am told.

Senator SARBANES. You are the Administrator of this Act. Do you not think there is something amiss when these shortcomings are being identified and you are not told about it?

Mr. FOX. I actually think, sir, that we have a responsibility to engage our regulator partners to make sure that this communication is occurring on a regular and consistent basis.

Senator SARBANES. Am I to take it from that answer that to your perception the same possibility would exist with respect to the other agencies? There is no established reporting procedure which lets you, as the Administrator of the Bank Secrecy Act, know at a fairly early point that these regulators have discovered deficiencies in the workings of their financial institutions with respect to the Bank Secrecy Act?

Mr. FOX. What I have found, Senator, since I have been there, is that communication occurs on an ad hoc basis, and I believe that that is not a wise course to follow. I believe that it should be routinized and we should have better, more established, consistent channels of communication if we are going to administer the Act effectively and efficiently.

Senator SARBANES. Let me ask the panel: When was the last time those on the panel, the regulators, including the Administrator of the Bank Secrecy Act, from the Treasury, Mr. Fox, met together to discuss and review programs and policies for coordination of the application of the Bank Secrecy Act?

Mr. FOX. Sir, we had a meeting. I believe it was as recently as last month. It might be the month before. I can get you the exact date if you like. We have a group that we call affectionately, the SAR owners group, which includes all of the bank regulators, the functional regulators, and we met for an afternoon at FinCEN, and discussed just a number of issues that relate to this.

Senator SARBANES. And this included the people at this table?

Mr. FOX. No, sir. It was their staff that handled these types of issues for them.

Senator SARBANES. Let us take it a level above you and go to the Secretary of the Treasury. Are you the administrator by delegation from the Secretary of the Treasury?

Mr. FOX. Yes, sir.

Senator SARBANES. When was the last time, Ms. Bies, that you and these other top regulators here, and the Secretary of the Treasury—although if he sent Mr. Fox, I will accept that for the moment—met in order to discuss Bank Secrecy Act matters?

Ms. BIES. Senator, I have not had such a meeting. I am not aware whether any of the other governors have. I can follow up on that and let you know.

Senator SARBANES. Are you the governor that is the point person——

Ms. BIES. I chair the Committee on Supervision Regulation, so it would be—I would probably be the one, and I have not had such a meeting at that level.

Senator SARBANES. Mr. Hawke.

Comptroller HAWKE. I am not aware of any meeting during my tenure, Senator Sarbanes, of principals to discuss Bank Secrecy Act matters.

Senator SARBANES. Mr. Powell.

Chairman POWELL. Two meetings, Senator. First of all, Vice Chairman Reich met with Mr. Fox about, I am guessing, 3 to 4 weeks ago to discuss this particular issue. Then I met with——

Senator SARBANES. Four weeks ago?

Chairman POWELL. Three to 4 weeks ago. I met with the Secretary of the Treasury within the last 10 days. Among other things, we talked about BSA.

Senator SARBANES. Now, that was just between you and them though. It was not a general meeting of the regulators?

Chairman POWELL. It was not a general meeting.

Senator SARBANES. It seems to me that you all might presumably learn something from one another in this arena.

Mr. Gilleran.

Director GILLERAN. FinCEN is involved in all 7 of our cease-and-desist orders that have culminated from our examinations in the last year, and our people have met with FinCEN on several occasions in a formal way. I myself have not participated personally.

Senator SARBANES. Ms. Johnson.

Ms. JOHNSON. I am not aware of a formally organized meeting that may have been attended by Former Chairman Dollar and then by myself.

Senator SARBANES. Is it an outlandish idea to think that a coordinated meeting of the regulators and FinCEN with respect to the Bank Secrecy Act on some periodic basis would be a good idea?

Chairman POWELL. It is a good idea, Senator.

Comptroller HAWKE. I completely agree, Senator. I think sharing information and experiences at the principal level would be very useful.

Senator SARBANES. Mr. Chairman, I have other questions, but my time is up, and I will yield.

Chairman SHELBY. We have another round.

Senator Reed, thank you for your indulgence.

Senator REED. Thank you, Mr. Chairman, and thank you for your testimony, ladies and gentlemen.

Mr. Hawke, why were criminal charges not brought in this matter with respect to Riggs? Is there a provision to allow criminal charges?

Comptroller HAWKE. Senator Reed, Riggs is a matter of ongoing investigation, and I think I need to be rather circumspect in talking about what may be coming out of the ongoing discussions relating to Riggs.

Senator REED. Fine. There is a general question you might also want to be circumspect. That is, the motivation behind these violations, which are rampant over many years. It would be one thing if it was just inattention or, lax recordkeeping. It would be something else if it was just designed to avoid regulation to induce business, and a third category, obviously, if there was some malign motive of cooperating with people who are criminals or worse. I do not know if you want to comment on that?

Comptroller HAWKE. Yes, I would like to comment on that, Senator, because Riggs was not an unsophisticated country bank. They were a long-established, significant bank in the Nation's Capital. As I look back over the record and ponder the same kind of question that you have raised, it seems to me that there was an inherent tension involved in Riggs' business objective, which was essentially to monopolize the embassy banking business. They had 95 percent of the embassies in Washington, 50 percent of the embas-

sies in London, and they put a very high degree of importance on that business. But that was a very high-risk business from a Bank Secrecy Act point of view. There was an inherent conflict, an inherent tension between that business objective and the responsibility for robust compliance with the Bank Secrecy Act.

Senator REED. Thank you.

Governor Bies, there is another related case, and that is UBS Investment Bank of Switzerland with respect to the extended custodial inventory program. A $100 million fine, I presume a civil fine?

Ms. BIES. Yes, it was a civil fine, yes, sir.

Senator REED. Is there any contemplation of criminal charges?

Ms. BIES. I think I again need to be circumspect around that right now while we continue to get the full information.

Senator REED. Let me pose the same question I posed to Mr. Hawke. What is your sense of the motivation, given there are a range of motives and some of them are, none of them are acceptable, but some are more serious and sinister than others.

Ms. BIES. Again, I do not want to comment on the motives. The only thing I will comment is that when you have collusion to manage the information that comes to the Federal Reserve, there is some kind of intent, and that also the collusion made it difficult for us to detect it, and as a result of this we are looking; we have already changed procedures, and we are going in to test those procedures in the future to try to see if there is a way we could have detected this despite the collusion.

Senator REED. Thank you, Governor Bies.

Mr. Gilleran, the GAO report, at least my understanding of it, suggests that in a survey of 986 thrifts from January 2000 to October 2002, they discovered BSA violations at 180, which seems to be almost 20 percent. That causes you concern?

Director GILLERAN. It certainly does, and we have responded to that report, and we are appreciative of their comments in this area, and we have adjusted our system accordingly. We have improved our information system and that period of time was prior to the USA PATRIOT Act, and the focus of course now is much greater, but I think that review was a good one for us, and we are now presently being reviewed by the GAO also in the same area. I think outside reviews are helpful.

Senator REED. Thank you. The obvious question that I will just pose to the panel, is there any legislative authority that you need in addition to the existing statutes to better coordinate, better implement, and better enforce? I say that because I spend time on the Armed Services Committee also and we spend a lot of hours on the war, on terror and threats to the Nation. And you might have a more decisive role in frustrating attacks against America than many of our uniformed officers, if you can control the monies.

Ms. Johnson.

Ms. JOHNSON. Senator, there is one area that NCUA would have interest in. The Exam Parity Act of 1998 gave NCUA authority to perform examinations of third-party vendors, and the Act contained a sunset provision, and that authority expired in December 31, 2001. The other regulators do have that indefinite examination authority over third-party vendors, and that may be helpful.

Senator REED. Thank you.

Comptroller HAWKE. Could I just add something, Senator Reed?

Senator REED. Yes, sir.

Comptroller HAWKE. The legal requirements that we as regulators enforce are very far-reaching and very demanding. They go essentially, though, to process, to the maintenance of control systems, to training, to the maintenance of compliance officers, to the filing of currency transaction report, and the filing of suspicious activity reports.

I think those statutes provide a very strong framework for the regulators to assure, if they are carrying out their responsibilities properly, that the banks, which have the primary information about transactions, are doing their job in identifying who their customers are, knowing what kinds of transactions are going through their accounts, and filing all the appropriate reports. It is the job of law enforcement to take the output of that process and to determine whether there are actual money laundering transactions or terrorist financing transactions that are going through the system.

I think that the statutory framework is strong and adequate if we fulfill our responsibilities and the banks fulfill theirs in meeting the requirements to have the right kind of controls, to have the right kind of systems, and to do the right kind of reporting.

Senator REED. Thank you.

Thank you, Mr. Chairman.

Chairman SHELBY. Thank you, Senator Reed.

Director GILLERAN. Just to respond further to Senator Reed, in my written statement I have made some recommendations for increased communications and better flow of information from law enforcement back to the institutions we regulate, because I think one of the problems here is the institutions do not know to what end a lot of the information that they are providing results in, and I think that would help them to better focus on a problem if they had more feedback.

At the same time I would like to see, and I think my fellow regulators agree, that we should have a working group set up at the Federal Financial Institution Council focusing on Bank Secrecy Act, and I would like to have FinCEN be part of that. I think that is the appropriate forum under which we can all communicate.

But I think enhanced communication of information is very important in this process.

Senator REED. Thank you, Mr. Chairman.

Chairman SHELBY. Mr. Hawke, as I understand it from talking with you yesterday, if someone withdraws, we will just use $1 million, at Riggs Bank, $1 million in cash. And the bank files a notice of that with you, with the transaction report. Is there a second step that has to be done dealing with the Bank Secrecy Act? In other words, is it a two-step process? Would that be a little suspicious, $1 million?

Comptroller HAWKE. I think a $1 million cash transaction would inherently raise——

Chairman SHELBY. Should have set off an alarm somewhere at the Comptroller of the Currency if you had known.

Comptroller HAWKE. It should have set off alarms at the bank, which is the first place that the transaction would be noticed.

Chairman SHELBY. Unless the bank perhaps was maybe not filing that second report? Was it incumbent upon them to file two reports, one the transaction itself, the withdrawal?

Comptroller HAWKE. There are statutory and regulatory standards that define the circumstances for filing suspicious activity reports, and it is the bank's obligation in the first instance to make sure that they are filing suspicious activity reports where there is a suspicious transaction.

Chairman SHELBY. So it is a two-step process, was it not? That is what I am getting at.

Comptroller HAWKE. That is right.

Chairman SHELBY. The first one they file, and they did file, as I understand?

Comptroller HAWKE. That is right.

Chairman SHELBY. But they did not file the suspicious activity report, although in some cases there is $1 million in cash withdrawn; is that correct?

Comptroller HAWKE. That is correct.

Chairman SHELBY. Mr. Fox, I know there is an ongoing investigation, but it suggests to me maybe there is a conspiracy or something going on at Riggs. They file one report and do not file the others, you know, something is going on in the bank. Does that trigger anything with you?

Mr. FOX. Senator, I agree that $1 million cash transaction generally should set off alarms, and I think it does at most institutions if such transactions occur. I really cannot comment on what——

Chairman SHELBY. I know, not on an ongoing investigation.

Mr. FOX. Yes, sir.

Chairman SHELBY. Mr. Hawke, as you fully confident as we speak today, after looking back in the Comptroller of the Currency's Office, that your examiners fully understand the significance of BSA compliance? We know they understand the safety and soundness compliance, which is important.

Comptroller HAWKE. Senator, if they do not understand it today, we have a very serious problem. I think they do. We have emphasized it repeatedly. We are in the process of revising our examination handbook for Bank Secrecy Act. I directed our Committee on Bank Supervision to send out a very strong message to all of our examination personnel to reemphasize the importance of Bank Secrecy Act compliance and the need for transaction testing and the need to be extremely cautious and sensitive about identifying transactions that raise questions.

Chairman SHELBY. Governor Bies, how many cases, if any, has the Federal Reserve referred to FinCEN in the past year?

Ms. BIES. Total number of cases I may have to get back to you, sir.

Chairman SHELBY. I heard it was zero, that it was no referrals.

Ms. BIES. No, that is not true. That is not true. We have a good working relationship. We have the history of the 25 cases I cited. We actually referred cases to FinCEN, and in some cases they took formal action.

Chairman SHELBY. Will you furnish that to the Committee?

Ms. BIES. We will get you a list, yes, sir.

Chairman SHELBY. What criteria is used in determining whether to refer a case to FinCEN from let us say the Board of Governors of the Fed?

Ms. BIES. When we go in and do the testing as part of the examination procedure, we will look at the facts that we find and determine the violations. Sometimes also, I want to emphasize that the tests we perform, since they are samples, we may not detect the errors, but that is why it is so important we work with FinCEN and law enforcement because like in Banco Popular, they gave us a heads up on particular customers that we could then target for this testing, and were able to work with them to prove the case. So the information sharing is critical with law enforcement, both Department of Justice as well as FinCEN, to make sure we are effective jointly, because together we can find more than individually working.

Chairman SHELBY. Mr. Fox, do you recall any referrals from the Federal Reserve to FinCEN?

Mr. FOX. Senator, I would like to get back to you with that number, particularly based on the Governor's comments. I just would like to get back and make sure we do not leave anything incorrect.

Chairman SHELBY. That what you told us before is right?

Mr. FOX. Yes.

[Laughter.]

I want to be right, sir.

Chairman SHELBY. Mr. Fox, has FinCEN ever encountered resistance from bank regulators to the kind of communication you believe is essential to your mission of law enforcement?

Mr. FOX. Sir, since I have been an FinCEN, absolutely not. In fact, one of the gratifying things that has occurred for me since I have been at FinCEN, since December 2003, is the willingness of the staff of the regulators to engage in this way.

I think we are working on these issues and working on them hard, and I think this is getting better. That is my perception. I cannot speak about the past.

Chairman SHELBY. To all you as regulators, since September 11, 2001, what has changed? Have you become more aware of the importance of terrorist financing and so forth? In other words, what have you done since September 11, 2001?

Comptroller HAWKE. Mr. Chairman, I think that the awareness of not only the regulators, but also everybody in Government has been significantly heightened since September 11. There are a number of supervisory actions that we have taken in this area including horizontal reviews of all of our large bank compliance programs, as well as many of the mid-size bank compliance programs. As I said before, we have revised our examination procedures, and our examination handbook. We are creating a database of SAR's. We are redoing a lot of things that have commended themselves to us because of the awareness that came from September 11.

Chairman SHELBY. Mr. Hawke, is there written guidance for examiners on when to refer violations to FinCEN? I would ask Mr. Powell and Mr. Gilleran the same question.

Comptroller HAWKE. I believe there are referral guidelines, Mr. Chairman, and those guidelines generally provide for referral of systematic serious violations to FinCEN.

Chairman SHELBY. Would this be true of the Board of Governors?

Ms. BIES. Yes, sir.

Chairman SHELBY. Mr. Powell, the FDIC?

Chairman POWELL. Yes, sir. May I comment on your earlier question?

Chairman SHELBY. Absolutely.

Chairman POWELL. Obviously, I think there is a heightened awareness. We have dedicated more personnel. We have adopted new policies, and new procedures. Training is intensified. Let me make a couple of comments.

I think policies, controls, oversight, testing, training are terribly important. I think it is important, in the line of questioning, that we fill in the box and that we make the appropriate reference to law enforcement. All those are critically important. But I do not think it is as important as the culture or the oversight of management. I think until management is committed, including the regulatory agencies——

Chairman SHELBY. At the top.

Chairman POWELL. It is a mindset, a proactive commitment. The procedures are important, but not like the attitude in our culture at the top.

Chairman SHELBY. Governor Bies.

Ms. BIES. Mr. Chairman, I would like to echo what Mr. Powell just said, and to emphasize that at the Federal Reserve, one of the things we really focus on in terms of the quality assurance around our examination procedures is when we do find breaks in controls, that we take it very seriously and go back and say, what could we have done better, and improve it.

For example, after Banco Popular, we went back and made significant changes in the way we were reviewing money laundering, the Bank Secrecy Act, and have put those changes in place.

For the USA PATRIOT Act for those different parts of it where the required rules have been issued, we have already drafted new examination procedures. They are out in pilot, being actively tested by our examination force now to make sure they will be effective and have the intended results. We will adjust them if they do not get the results we are expecting. We just view this as a continuous process that every one of these events reminds us there are new ways that people are finding to use the banking system for illicit purposes, and whenever we find another way it is done, it is our job to respond promptly and make sure that is added to the arsenal of information that our examiners have out in the field to deal with this promptly.

Chairman SHELBY. Mr. Fox, how can you be sure that the banking regulators are referring violations to you under consistent criteria; how do you do that?

Mr. FOX. Mr. Chairman, I think we have an agreement that was signed in 1990, or it may even have been signed before FinCEN became a bureau, certainly before it became the Administrator of the Act. Sir, that agreement needs to be revisited and along with our colleagues at the table here we need to come up with some pretty set criteria and guidelines so that we are all working from the same page.

But I think again, sir, I would answer your question directly in saying that the best thing that we can do is engage these regulators. They are doing, from our perspective, very good work out there, and I think it is our responsibility to keep, if anything, maybe even be annoying at times, to keep reminding them that this is important and that we need to communicate and we need to do this in a right way. I think that is the best and most effective way to do it under this current system.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. Thank you very much, Mr. Chairman.

I have to say to the panel, I do not perceive a sense of urgency in dealing with this matter. I appreciate that the bank regulators have had a traditional focus on safety and soundness. And I understand that if something went wrong with safety and soundness, we would have you in here at the table and saying, "Why did you not meet your mission? Here we have had a breakdown in safety and soundness and it is affecting the whole financial system."

But these compliance questions are important as well. Now, some of them involve a lot of consumer protection and I am not going to move over into that arena, although that is an arena that I think is quite important, and I think there has been a tendency on the part of the regulatory agencies not to give it appropriate focus and attention and importance. But Bank Secrecy Act compliance could well go to some basic question of our Nation's security.

The Army announced today that they are going to keep thousands of active duty and reserve soldiers who are nearing the end of their volunteer service commitments, they are going to keep them in and have them serve an entire tour overseas. So it is really being transformed from a voluntary service into mandatory service. Now, the Army is under a lot of stress, which is resulting in this, but I mean, in a sense, emergency measures are being taken all over the place.

And dealing with money laundering and terrorist financing is of critical importance. Now, we did not pay enough attention to it before. We had drug cartels, we had crime syndicates using money laundering and so forth. Great resistance. The Justice Department came to us, when we did the USA PATRIOT Act and wanted this title and a lot of the authorities which previously they had not been able to obtain. It is clear why.

Some banking institutions come to us and say that clients are moving to off-shore jurisdictions because they have to go through these procedures here. Apparently they want to move hot money, and they go somewhere else in order to try to do it, which of course leads to the question of who is responsible for interacting in order to curb what is being done in other jurisdictions.

But we have to devise a way for compliance to have a higher status, and I am trying to figure out how that can be done while at the same time, you can continue to ensure safety and soundness. Let me ask a couple of questions.

First of all, I take it from the responses we have already received that the Treasury Secretary, interacting with the head regulators who are here today, could establish periodic meetings to consider the application of the Bank Secrecy Act and how to enhance its enforcement with respect to all of the financial institutions; is that

correct? We do not have to pass legislation in order for that to happen; is that correct?

[Witnesses nodded affirmatively.]

I also gather most people think it is a good idea. I see everyone nodding.

Mr. Fox, would you go back and tell Treasury Secretary Snow of this conversation we had here and see if we can get such a first meeting underway and then subsequent meetings to follow up? I mean, there is a lot of exchange that can take place here that I think will enhance the application of the Act. This is an important matter—I keep coming back to it—in the fight against terrorism.

Mr. FOX. You have my word, sir, I will do that. I agree with you.

Senator SARBANES. Yes, okay.

Now, I want to ask about the subordination of the compliance function at the various agencies to the safety and soundness examiners. The Fed maintains separate Safety and Soundness and Compliance Divisions, and that seems to me to give an extra impetus or focus to compliance and enables the development of enhanced expertise in that arena. I mean, the Safety and Soundness people have plenty to do in and of itself, and I think if you put the Compliance people under them, you may have a bit of a problem or maybe you will have quite a big problem.

Now, as I understand it, the Compliance examiners at the other agencies have now been placed under the Safety and Soundness structure; is that correct?

Director GILLERAN. That is not true at the OTS.

Senator SARBANES. It is not true at the OTS?

Director GILLERAN. No.

Senator SARBANES. You have a separate Compliance Division?

Director GILLERAN. No, we have cross-trained, and therefore we see no distinction between Compliance and Safety and Soundness. We think that Compliance is part of Safety and Soundness. We have cross-trained our people so that they are completely able to do the compliance work, as well as safety and soundness work. We think that is the proper way to both train people and to carry out the examination process.

Senator SARBANES. Mr. Powell.

Chairman POWELL. Ours is separate, as you know, Senator. But one comment. I want to be sure I do not mislead you. BSA is part of the safety and soundness exam at the FDIC, and the reason for that is that we believe our BSA people should be trained more than in just the compliance effort, understand the bank operations, the assets and the liabilities. We found that terrorists sometimes get loans and just do not pay them back. So the BSA is part of the safety and soundness examination. The examiner are uniquely and specially trained. As I mentioned in my testimony, we have specialists. We have 150 of them at the FDIC that do nothing but the BSA work.

Senator SARBANES. Well, with respect to both of you, does this response also apply to the other laws in which you have a compliance responsibility?

Chairman POWELL. No, sir. We have specialists in compliance that are specialists in consumer laws and other related compliance laws.

Senator SARBANES. Are they under the safety and soundness people?

Chairman POWELL. They are under the Division of Supervision and Consumer Protection. We have a safety and soundness section, and we have a compliance section.

Senator SARBANES. And the OCC?

Comptroller HAWKE. I do not think it is accurate, Senator Sarbanes, to say that compliance supervision has been subordinated to safety and soundness supervision. We have, as the other agencies do, specialists in the compliance area, and each one of our banks has an examiner in charge. The examiner-in-charge of each of the 24 largest banks is responsible for all aspects of supervision of that bank. He will have Safety and Soundness people reporting to him, he will have Compliance people, he will have Asset Management people and IT people all reporting to him. So, at the top of the pyramid, with respect to any one of our large banks, there is a single point of accountability who will have responsibility both for safety and soundness and compliance.

One other point, Senator Sarbanes, the nature of the responsibilities that we have in the Bank Secrecy Act compliance area is procedural and process-oriented, very much the same as the nature of the responsibilities we have in the safety and soundness area. Our examiners look at the adequacy of systems, the adequacy of controls, the adequacy of training. It is the same kind of methodology that is brought to bear on the safety and soundness side. So there is a great deal of similarity between the two disciplines.

Senator SARBANES. Well, now, as I understand it, the OCC recently realigned its compliance organizational structure; is that correct?

Comptroller HAWKE. We did not really realign it. We eliminated an intermediate level of management and replaced them with compliance experts in that chain of command.

Senator SARBANES. Well, now in the directive sent out by your Deputy Comptroller for Compliance, where they say you are going to "closely align our Compliance Program with our Safety and Soundness Program," and then you move the Compliance field examiners to report to the ADC's in the field offices. That is a change.

Comptroller HAWKE. Right. That is with respect to the community banks. With respect to the large banks, as I described, it is the examiner-in-charge of the large bank who has the consolidated responsibility for all aspects of supervision: safety and soundness, compliance——

Senator SARBANES. And then let me go on. That same memo says, and I am concerned about this, "Given the changes that are occurring in the banking industry, we anticipate that the number of field compliance specialists and ADC's at the Band 7 level will in the future exceed the volume of traditional compliance work at that level. Therefore, we are offering buyouts to the Compliance examiners and Compliance ADC's who occupy Band 7 positions."

Now, at a time when the OCC seems to be taking on more compliance responsibilities, both Bank Secrecy and Consumer Protection, it is not quite clear to me how you can be buying out your Compliance examiners, in terms of meeting your responsibilities.

Comptroller HAWKE. We are not reducing the number of Compliance people that we have in the organization as a whole, Senator Sarbanes, and we are trying to promote, as Chairman Powell and Director Gilleran indicated, the broadening of the expertise of our examiners, generally.

Senator SARBANES. Let me ask, do you have——

Comptroller HAWKE. We do not intend to reduce the number of Compliance examiners.

Senator SARBANES. Then, that has not happened? You are not buying out Compliance examiners?

Comptroller HAWKE. No. I am not sure which memo you are reading from, Senator.

Senator SARBANES. It was a notice sent in March 2004 by Ann Jaedicke, Deputy Comptroller for Compliance.

Comptroller HAWKE. We put out a memo in May 2004, describing what was going on with respect to compliance, and we made very clear in that memo that we do not intend to reduce the number of Compliance examiners.

Senator SARBANES. Could you furnish us a copy of that memo.

Comptroller HAWKE. Yes, sir. I would be happy to.

Ms. BIES. Senator Sarbanes, can I respond to the comment? I did not have a chance.

The one thing I would like to point out, in the Federal Reserve System, we created, in 1993, at the Board level, a group, an officer who was really responsible for all of the BSA and anti-money laundering supervision, and we have expanded that group as need has occurred over the last few years.

The reason we have specialists within Supervision and Regulation at the Board is to help design the policies and help us identify when there are weaknesses that need to be addressed out in the field exams. Within the Reserve Banks, which is where our examiners reside, is each of the 12 Reserve Banks, the examiners are part of the supervisory group within that Reserve Bank.

But these, as we have gone from just money laundering with criminal activity to now bank secrecy, where you are involving maybe activities that go through legitimate funding sources that end up in terrorist hands, it gets more and more difficult to identify the sources of funding. And so one of the things we are trying to do is to work aggressively with law enforcement to help identify back to the banks where there are particular cases, whether they need to do follow-up.

So it is really a team effort. It is identifying policy and procedures at the Board level, using that to strengthen the activities in the Reserve Banks, and then work in the field by the examiners also giving us indications back up to the top where the supervisory process needs to change. But it is integrated within the overall supervision for the Bank Secrecy Act anti-money laundering. It is all within our supervisory responsibility of the Division of Banking Supervision and Regulation.

Senator SARBANES. That is very helpful. Thank you.

Chairman SHELBY. Is there a set number of warnings that a financial institution receives, Mr. Hawke? In other words, is there a number of years that generally pass between an initial warning regarding a BSA compliance and imposition of a penalty?

Comptroller HAWKE. No, not at all, Senator. I think that is an issue that has to be decided in each case. Clearly, in the Riggs case, we gave them too much latitude over too long a period of time.

Chairman SHELBY. Trusted them too much?

Comptroller HAWKE. Well, it is not so much that we trusted them too much. We were insufficiently——

Chairman SHELBY. Wait a minute now. Are you saying you did not trust them? I thought you told me before, and others have said, that a lot of the relationship with a bank is trust.

Comptroller HAWKE. In the Riggs case, it was not a question of our trusting the management. We saw things that needed to be fixed. We told them that they had to be fixed. Where we were guilty of a shortfall in not coming in robustly and soon enough.

Chairman SHELBY. There was no follow-through, in other words, by the Comptroller of the Currency's Office, basically; is that correct?

Comptroller HAWKE. The follow-through was not strong enough early enough.

Chairman SHELBY. Well, did it exist at all?

Comptroller HAWKE. We eventually——

Chairman SHELBY. No, I mean from 1997 until recently, did it exist?

Comptroller HAWKE. Eventually, it did. In 2003, we issued a cease-and-desist order. We waited too long to do that.

Chairman SHELBY. Six years.

Comptroller HAWKE. We should have taken stronger action earlier. There is no question about that.

Chairman SHELBY. Chairman Powell, briefly, the Hudson United Bank Corporation, one of the most recent BSA-related cease-and-desist order involves the Hudson United Bank of New Jersey. Would you briefly walk us through the history of this case. What was the FDIC's role in determining what measures would be taken in responding to information pointing to Hudson's failure to comply with the Bank Secrecy Act? What was your agency's assessment of Hudson's risk prior to detection of its failure to comply with the Bank Secrecy Act?

Chairman POWELL. I am not sure I can answer those, specifically, Mr. Chairman, but I can tell you that I have been briefed on that particular issue within the last 30 days. I think our people were very aggressive in assessing the enforcement action against that particular institution, after findings that had occurred over the last 12 to 24 months.

Chairman SHELBY. Mr. Fox, in the past here, in the Committee, and Senator Sarbanes has been here longer than I have, and this is my 18th year, but I can tell you in the past we have addressed the issue of regulatory forbearance as it related to the solvency of bank safety and soundness.

We learned the hard way right here, and the regulators learned, too, that when regulators let banks that were in trouble get by, when those banks later failed, it cost the U.S. taxpayers billions and billions of dollars.

What is your view with respect to the dangers of regulatory forbearance in BSA compliance cases?

Mr. FOX. Oh, it cannot even enter the conversation, Mr. Chairman. I believe that the information collected under the Bank Secrecy Act is absolutely critical to the security of our country.

Chairman SHELBY. That is right.

Mr. FOX. And I will tell you something that I hope is heartening. It has been my perception, since I have been at FinCEN, I have not seen any such regulatory forbearance among these regulators, but I do not think we could ever be in a situation where we would allow something like that to happen.

Chairman POWELL. Senator, I think the bank regulators——

Chairman SHELBY. Chairman Powell.

Chairman POWELL. I am concerned, to some extent. I think that bank regulators and the industry we supervise recognize this is national security. Safety and soundness is one issue, but this is equal or superior to safety and soundness—the national security of this country. And I think there is heightened oversight on the BSA.

Chairman SHELBY. A high priority.

Chairman POWELL. Absolutely. I think bankers, I would not underestimate the seriousness of the BSA enforcement. It is a national security issue. It is lives and deaths. The other is dollars. And I think, clearly, our resolve is very strong that we enforce the Bank Secrecy Act.

Chairman SHELBY. But when there is a 6-year lapse there, that is more than troubling.

Senator Sarbanes, do you have any other comments?

Senator SARBANES. I do not think so.

Chairman SHELBY. I want to thank the panel, all of you, for your time and your participation. We have a number of questions for the record, and we have some Members that are tied up in other hearings, and we will keep the record open for that.

Mr. Fox, all of you, thank you very much.

Senator SARBANES. Mr. Chairman, I think, as they depart, we should leave them with a message that this is a matter which, I presume, the Committee intends to follow very closely, given its importance.

Chairman SHELBY. Absolutely. We have no choice in our oversight, as we know. This is important, and we are expecting Mr. Fox, and we believe that he is going to be working with you very, very closely regarding this.

Mr. FOX. We welcome that oversight, Mr. Chairman, Senator Sarbanes. Thank you.

Chairman SHELBY. Thank you very much, all of you.

Our second panel will be Gaston Gianni, Jr., Inspector General, the Federal Deposit Insurance Corporation, and Ms. Davi D'Agostino, Director, Financial Markets and Community Investments, General Accounting Office.

I want to welcome the second panel. We appreciate your forbearance here today. We had some very important witnesses here, as you people know well.

Mr. Gianni, we will start with you. Your written testimony has been made part of the record. And without objection, you proceed as you wish.

STATEMENT OF GASTON L. GIANNI, JR.

INSPECTOR GENERAL

FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. GIANNI. Thank you, Mr. Chairman.

Mr. Chairman, Senator Sarbanes, and Members of the Committee, I am pleased to testify before you today. We appreciate and thank the Committee for its interest in gaining a greater understanding of how Government is combatting terrorist financing and money laundering.

What I would like to do is just briefly summarize my testimony, having it included for the record.

By way of perspective, the FDIC Chairman's testimony indicated that FDIC has conducted almost 11,000 Bank Secrecy examinations since 2000. Over the past several years, in line with our responsibilities under the Inspector General Act, my office has conducted three audits that address the FDIC's efforts to design and implement a supervisory program to examine institutions' compliance with provisions of the Bank Secrecy and then more recently the USA PATRIOT Act.

Overall, these audits identified that the Corporation has taken steps to implement a risk-focused approach to examinations. However, improvements were needed. I am pleased to report to you this morning that the Corporation has corrective actions completed or in process to address all of our recommendations.

We issued our first report, the "Examination Assessment of Bank Secrecy Compliance Act," in March 2001 and concluded that, first, examiners did not adequately document their Bank Secrecy examination planning and procedures; second, examiners did not consistently document the work they performed in risk-scoping as required by the Corporation; and, last, the examiners were not taking full advantage of the information that was available at FinCEN.

We made recommendations to enforce the documentation requirements and to make fuller use of the information at FinCEN.

We issued our second report in September 2003, related to our review of whether FDIC had developed and implemented adequate procedures to examine financial institutions' compliance with the USA PATRIOT Act. We focused on Title III of the Act, which addressed anti-money laundering measures and currency crimes and protection.

The Division of Supervision and Consumer Protection had advised the FDIC-regulated institutions of the new Title III requirements in cases where the Department of the Treasury had issued final rules implementing Title III provisions, but had not established guidance for their examiners. The Corporation was either coordinating the issuance of uniform procedures with an interagency steering committee or waiting for Treasury to issue additional final rules. This delay was of particular concern for Title III provisions addressing money laundering deterrents and verification of customer identification.

Again, we recommended that FDIC issue interim guidance and procedures and then work closely with their interagency counterparts to ensure timely issuance of final guidance.

Our most recent audit related to Bank Secrecy focused on actions taken by FDIC in its supervisory capacity to ensure that FDIC-supervised institutions implemented effective corrective actions to BSA violations.

Of the over 5,600 institutions that the FDIC supervised during the time period of our audit, which would cover the time period of 1997 through the year 2003, approximately 47 percent of the institutions had been cited at least one time for a BSA violation. Those violations included citations for not complying with Treasury requirements, as well as the FDIC's policies and procedures as to how a program is supposed to be developed.

In those institutions where violations were cited, 458—approximately 17 percent—had been cited for repeat Bank Secrecy violations. Our audit results raised concerns related to four general areas: The extent of regulatory action on significant and repeat violations; the consistency of reporting of deficiencies and violations; the timing of follow-up and corrective actions taken by the institutions; and then handling of those referrals to the Department of the Treasury.

Our audit showed a high rate of significant and repeat violations, many of which were not subject to regulatory actions. Our sample included 27 institutions with repeat violations. Of those 27 institutions, 17—63 percent—were not subject to regulatory action for their repeat violations, although other supervisory efforts such as follow-up correspondence to bank management and visitations may have been in progress. Of the 10 institutions that were subject to regulatory actions, only one was subject to a cease-and-desist order and the other 9 were subject to informal actions.

Not all Bank Secrecy deficiencies that the Corporation's examiners described in their reports were cited as violations in the reports and tracked in the FDIC information systems. Such deficiencies may receive less attention from bank management or in FDIC's follow-up system.

In many instances, the Corporation followed up or pursued regulatory action for certain violations before the next examination or received evidence from bank management, FinCEN, or others that the violation had been corrected.

However, for nearly one-third of the 82 reports that we reviewed, examiners waited until the next examination to follow up on some or all of the Bank Secrecy violations.

In some cases, more than 1 year, and up to 5 years, passed before bank management took corrective action that was effective or before the FDIC applied regulatory actions. About two-thirds of the violations sampled took longer than 1 year to correct.

FDIC's policy of alternating examinations with State regulatory agencies also contributed to this time lag. Specifically, 45 of the 72 exam reports that we reviewed from State regulatory agencies did not address Bank Secrecy compliance. These were the institutions that had violations. We reviewed the State reports. They did not cite any specific information regarding the Bank Secrecy violations. Therefore, the FDIC could not rely on those exams. Consequently, follow-up by the FDIC did not occur until the next examination; generally, 2 to 3 years after the violations were initially filed.

While many institutions had been cited for BSA violations, there were only 34 referrals to the Treasury Department during this period. Most of these referrals were made by one FDIC regional office. We determined that when a referral to the Treasury Department had been made, Treasury had taken action.

Based on our work and in light of the increased Congressional interest in BSA compliance and emphasis on national security concerns, we have made recommendations that the Corporation reevaluate and update its examination guidance to help ensure adequate examiner follow-up and timely corrective action by bank management; discuss and update the referral policy with the Treasury Department; encourage State coverage of Bank Secrecy Act compliance; and develop alternative procedures to compensate for the lack of State coverage.

Looking ahead, Mr. Chairman, there are key questions that FDIC should consider in conjunction with the Treasury Department and the other financial regulators as it looks to improve the Bank Secrecy program.

First, is risk-scoping Bank Secrecy examinations and follow-up still the most effective approach to uncovering money laundering and terrorism financing?

Second, are the policies and procedures for reporting certain cash transactions and Bank Secrecy violations to the Treasury Department, some of which date to the early 1990's, currently effective?

And, last, is the information reported to FinCEN by financial institutions and regulators effectively evaluated and does it ultimately result in timely preventive actions?

Mr. Chairman, we appreciate the opportunity to participate in these hearings. We are prepared to assist in addressing these issues and have additional audits planned in this area.

I would be pleased to answer any questions that you may have.

Chairman SHELBY. Thank you.

Ms. D'Agostino.

STATEMENT OF DAVI M. D'AGOSTINO, DIRECTOR FINANCIAL MARKETS AND COMMUNITY INVESTMENT U.S. GENERAL ACCOUNTING OFFICE

Ms. D'AGOSTINO. Thank you, Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee.

I am very pleased to be here today before you and along with the FDIC IG on this panel to discuss a number of issues concerning Federal regulators' oversight of banks, thrifts and credit unions for Bank Secrecy Act or BSA compliance, and our ongoing work for this Committee on this matter.

Several recent cases imposing large civil money penalties on depository institutions have increased attention on industry compliance with, and Government enforcement of, the BSA. My oral summary will focus on, one, selected recent enforcement actions taken against depository institutions for BSA violations, and two, the scope and approach of our ongoing work that we are doing for this Committee on BSA examinations, violations identified and the various levels of enforcement and penalties imposed for them.

First, in the last few years and as recently as last month, the financial regulators, FinCEN and the Courts have taken actions

against a number of depository institutions for significant BSA violations. Recent enforcement actions show that various types of depository institutions have had BSA violations. These actions also raise the issue of the timeliness of the identification of the BSA violations and the enforcement actions taken by the regulators. For example, an individual who was later convicted of money laundering offenses had apparently deposited $21 million in cash at Banco Popular de Puerto Rico, between 1995 and 1998. The bank had not investigated or reported this activity to FinCEN or to law enforcement until 1998, years after the suspicious activity had taken place.

In 1999, the bank's regulator expanded its examination scope for BSA compliance based on information it received from law enforcement. Its findings then led to Justice, FinCEN, and the bank regulator, imposing penalties and entering into a deferred prosecution agreement with the bank. These actions were all taken for violating the BSA's suspicious activity reporting requirement.

More recently Riggs Bank was assessed a $25 million civil money penalty for BSA violations including the failure to maintain an effective BSA compliance program and failure to monitor and report large transactions involving foreign embassies. Although OCC, Riggs' regulator, testified yesterday and again today that they had identified the problems early on, apparently as early as 1997, and used supervisory measures in efforts to get improvement at the bank, these efforts in this case proved to have limited effect.

In 2003, OCC deemed the bank to be systemically deficient and the bank entered into a consent order. In 2004, when the bank still was not in full compliance, they were assessed the penalty.

In recent years, we have issued a number of reports dealing with regulatory oversight of AML activities, anti-money laundering activities, of financial institutions, and my written statement that has been submitted for the record goes into more detail on those. Our statement also highlights some of the work done by the IG's, the Inspectors General, on which we are relying quite heavily to help us get up the curve to do the massive amounts of work that we are doing for you in your most recent December request.

Our current work is actually the most comprehensive review we think that we have done at GAO on BSA issues. In that work our primary objectives are to determine first, how the five regulators' risk-focused examinations assess BSA compliance; second, the extent to which the regulators identified BSA and AML violations and take supervisory actions; and third, the consistency of BSA compliance examination procedures and the interpretation of violations across the regulators.

To answer these questions we plan to review the reliability of the data systems that the regulators use to track the violations themselves. As FDIC's IG's work has pointed out, there are some problems with the systems and what data is included and not included by the examiners in the database that is used.

Second, from the samples we plan to pull from all of the regulators of BSA compliance examinations over a 4-year period, we plan to analyze the work papers, and this will allow us to determine the following things: The areas the exams did and did not cover, the nature of BSA violations identified, whether or not the

regulators somehow curtailed their BSA compliance exams, and the basis for the decisions to do so. We are also going to be tracking the supervisory actions taken to correct violations that have been identified, and we will examine the ramifications, if any, of Treasury not delegating authority to the bank regulators to assess BSA compliance penalties as mandated by statute in 1994.

We are also in the process of putting together a picture of the statutory authorities, the players and the layers of types of violations and enforcement actions, and the penalties, including when they are civil and when they are criminal. I hear a lot of confusion at each of these hearings that we are monitoring over the spring over what is a deficiency versus what is a violation? What is a recordkeeping violation versus a program violation? We hope to sort through all of that and review when certain kinds of penalties make sense. We are working with Justice, the bank regulators and Treasury to try to tease that out and make some sense of it as well as wade through all of the various legislation and authorities that are in place.

With that said, Mr. Chairman, Ranking Member Sarbanes, I will conclude my statement and will answer any questions you have of us.

Chairman SHELBY. The General Accounting Office has prepared a number of reports on money laundering and terrorist financing over the years. Do you believe that there are systemic problems that resulted in Riggs case being unaddressed for so many years? You heard the testimony earlier. You know the case. A lot of years.

Ms. D'AGOSTINO. Yes. It did seem to go on for quite some time. From the pieces that we are putting together from the testimonies of the OCC representatives, it appears that OCC was trying to "push on a string" at Riggs with the bank's management, and when you push on a string, you don't get resistance and you don't make progress. It seems as if it did last a long time.

Whether or not it is systemic, I do not think that we can say today. We hope that our work for the Committee will provide some insight into that question.

Chairman SHELBY. Would you say it is lack of due diligence then?

Ms. D'AGOSTINO. OCC was aware and trying to work with the bank's management.

Chairman SHELBY. Well, they were trying, but were they——

Ms. D'AGOSTINO. They were pushing on the string.

Chairman SHELBY. I love your phrase.

Ms. D'AGOSTINO. Yes. And it is very frustrating.

Chairman SHELBY. You have tried to push one, have you not?

Ms. D'AGOSTINO. Yes, sir.

Chairman SHELBY. Senator Sarbanes.

Senator SARBANES. I want to follow up the Chairman's question right there on whether there was a problem with the system. In the Banco Popular case which you cited, there eventually was a settlement in that case, correct?

Ms. D'AGOSTINO. There was a deferred prosecution. It was one of the early uses by Justice, I think, of this interesting tool.

Senator SARBANES. But the settlement agreement indicated, and I am now quoting from it, "During the period of 1995 through 1998,

the Federal Reserve, through the Federal Reserve Bank of New York, conducted four examinations of Banco Popular. These examinations did not contain any criticism of Banco Popular's BSA compliance policies or procedures." And apparently they only noticed it when the Fed got a tip from a Federal law enforcement official, and ordered a special targeted examination of the bank.

I ask the Chairman if I could ask that question right now.

Chairman SHELBY. You can.

Senator SARBANES. Because it follows up exactly on his point. I mean there is something wrong. The system is not working right, is it?

Ms. D'AGOSTINO. It is not working swiftly from the appearance of these two cases, and I think the FDIC IG's work indicates it can take a long time to go through the supervisory process of trying to take informal and formal supervisory action, sometimes without much effect.

Yet at the same time—again—there is much we do not know, because we are still doing our work. For example, we do not know to what extent informal supervisory actions have been effective and timely. So, I think by starting with these cases which are very enlightening, we still may be missing the whole picture. Some of the things that we can learn by looking at more closed cases for the Committee, is how this layering of authorities, layering of players, and interaction between bank regulators and law enforcement, fits together and works—not only where it breaks down but also where it may work well. That is what we hope to get at in our systematic review of the regulators' data and through sampling exams for the Committee.

Chairman SHELBY. Mr. Gianni, how could the FDIC better use its supervisory and enforcement authority, which they have a lot there, to address BSA violations? Is BSA violations deemed an important mission at the FDIC, and if not, why not?

Mr. GIANNI. I think after today's hearing, I believe it is a priority within the Corporation. I think that clearly the work of my office would lead me to say that the examiners, the evidence would show that the examiners were in fact identifying problems. The issue became what happened after the identification? How hard did we push to get the problems resolved? What was the management support? This morning, Chairman Powell said that if you do not have the culture and you do not have the tone at the top, if I might use a phrase, to say that this is important, you tend to try to go after the approach that will have the least impact in disrupting the relationship with the institution. So you take the least aggressive action first. And if they do not follow through on that, then you go up a step. That takes time. Then if they do not take action on the second time, you go up to the last or cease and desist.

So it takes time to go through this process of increased regulatory action. I think we need to, the Corporation needs to reexamine at that.

Chairman SHELBY. Is it troubling to both of you that in the Riggs situation, the second report that I talked about later was almost always ignored, the BSA, bank suspicious activity report? They filed the transaction report, but they did not do the other one.

Ms. D'AGOSTINO. The SAR.

Chairman SHELBY. Is that troubling?

Ms. D'AGOSTINO. Yes, it is. Although we do know from our previous work, that banks spend a lot of time doing their own investigation before they put together one of these reports. And again, I am not familiar with all of the facts and circumstances surrounding, for example, the Saudi account case, and whether or not this activity was unusual or suspicious for the Saudi account. It could have been routine that they pulled and moved millions of dollars in and out every day from their accounts. We just do not know enough about it.

Chairman SHELBY. But you are studying it closely.

Ms. D'AGOSTINO. We are. We are watching it every day. We are not going to be able to get all the details until cases are closed, and so that makes our job a little more difficult.

Chairman SHELBY. How often are banks, ma'am, examined? In other words, have the regulators adhered to their examination cycle with respect to the Bank Secrecy Act enforcement?

Ms. D'AGOSTINO. We have not gotten that far yet in our work, but we will include this question in our scope.

Chairman SHELBY. Is that not an important question?

Ms. D'AGOSTINO. Sure. How often do they go in and look at BSA compliance?

Chairman SHELBY. Will you be addressing this in your ongoing study at the General Accounting Office?

Ms. D'AGOSTINO. Sure. That will be one of many factors.

Chairman SHELBY. Mr. Gianni.

Mr. GIANNI. Mr. Chairman, I can report that the Corporation, is complying with the statute of ensuring that banks are examined at least every 18 months, and in some cases every year.

Chairman SHELBY. What about information sharing with regard to the Federal Deposit Insurance Corporation? If you just briefly tell the Committee the normal process which by FDIC information, the way they work the Bank Secrecy Act compliance, is shared with the other agencies like Treasury and anybody else.

Mr. GIANNI. There are a number of committees and groups that address bank secrecy type issues. I do not think there is a comprehensive process in place currently to share the information as it relates to bank secrecy and to pull all of this information together to see whether there are trends, anomalies, or issues that need to be addressed.

I think first of all, all of the information that we accumulate within the Corporation is not passed on to FinCEN, and so with FinCEN's greater responsibility and the will to bring the regulators together, I think it is a good first step that the Committee has achieved. The parties can begin to better share information to see whether information that is housed within the FDIC is similar to information that is housed in one of the other regulatory agencies. Again, it is not unlike what is going on between the CIA and the FBI now as it relates to our intelligence sharing.

Chairman SHELBY. But it is very important in both instances to share information.

Mr. GIANNI. I would agree with you, sir, and I think what happened, sir, is that when September 11 tragically occurred, we had a sea change of priorities within our country, and we had the pas-

sage of the USA PATRIOT Act, but I believe that the risks associated to that, or potential risks associated to that were underestimated by the bank regulators. It is now being recognized that it is a part of our national defense, and I believe that the regulators will have the will and commitment to step up and to address these issues in a unified manner.

Chairman SHELBY. Both of you, you at the FDIC as Inspector General, and you at the General Accounting Office are continuing to work in this area. What are some of the steps you are into?

Ms. D'AGOSTINO. One of our major efforts relates to assessing the systems that each regulator has and the separate sets of data that are housed in their own IT units. We are going to have to go through all of them—luckily FDIC has done some work ahead of us on that—and try to get a good fix on what kind of data are and are not included. We will design our work around the systems and the data available within them, and check the reliability of them.

That is what we are involved in right now. It is basically an audit within an audit, to see how reliable the information is before we use it to report to you information and analysis. That is a big piece of our undertaking for the Committee.

Again, we are looking at the authorities and the penalties and how it all works in practice.

Chairman SHELBY. Thank you.

Mr. GIANNI. Mr. Chairman, I think we are going to work closely with the GAO. We do not want to duplicate. We want to try to identify how we can complement the GAO in its efforts to try to address the request from the Committee.

There are several areas where I think that we could make a contribution. Clearly, I think that this practice of risk focusing might be appropriate for the initial go-round, but risk focusing for follow-up action may not be the appropriate way. So, we need to think a bit more about risk scoping and how that applies to bank secrecy.

Second, I think clearly the agencies are concerned about regulatory burden. Having said that, we have to think through how we have gone about implementing the various laws and regulations, and to see whether there may be a streamlined way of still accomplishing the legislative objectives that were set out by the Congress, yet, doing it in a much more efficient way. The Corporation has a process working with the other regulators to look at that.

The last thing I would like to talk about is—it was raised this morning—I think I would like to look at the Hudson case to see the similarities that might exist, and just pursue that from an intellectual standpoint to see if there are some lessons learned that we might be able to help the Corporation on.

Chairman SHELBY. You are in a position to do that.

Mr. GIANNI. Yes, I am, sir.

Chairman SHELBY. And I hope you will. To both of you, will you hopefully finish your work in this area before the year is out? This is just June 1. I know it is a big undertaking, but it is an important and timely undertaking. You cannot put a calendar day on it.

Ms. D'AGOSTINO. We have not yet committed to a date to the Committee for issuing our final report. We are considering whether there might be ways where we could report on an interim basis on

different pieces of this fairly large request you have made of us, so that you do not have to wait so long to receive our results.

Chairman SHELBY. Sure. We appreciate that.

Could you both briefly expand on comments regarding the vulnerability of the risk-based approach to the oversight process? For example, when you determine what constitutes suspicious activity, is that pretty subjective? You have criteria to go by, you have to have something that triggers something at the regulatory agencies?

Mr. GIANNI. There are certainly guidelines out that have been written to help the examiners, but it is judgment. It comes down to judgment. When you have judgment being made——

Chairman SHELBY. Critical evaluation of something.

Mr. GIANNI. It is a critical judgment. When you have those types of critical judgments being made within a framework, it is important to make sure those judgments get reviewed not only on an individual basis, but also on a collective basis to see if there are areas where we can help refine the guidance, further improve the guidance, so stronger and better judgments are made in the future.

Chairman SHELBY. Do you believe that the regulatory structure we have today, if used diligently, would be sufficient in the future, or do we need to look somewhere else?

Mr. GIANNI. I personally think that the bank regulators, working together, can accomplish what needs to get accomplished.

Chairman SHELBY. Is the Riggs case a wake-up call and some of the others, hopefully?

Mr. GIANNI. I believe Riggs is a wake-up call, as well as the fact that the Committee has seen fit to have oversight. I personally do not underestimate the power of Ccongressional oversight.

Chairman SHELBY. Do you have a comment?

Ms. D'AGOSTINO. I agree with the FDIC IG. I think training and keeping up to date on the most current approaches by the money launderers and terrorist financiers, and anything that law enforcement could help put together to better inform the examiners would be useful too. But I am not sure that structure is the only issue. I do think that the leadership, the oversight, and that tone at the top, as Mr. Gianni pointed out, are very important in keeping attention properly focused on AML.

Chairman SHELBY. You both have your hands full, but we appreciate the job you are doing and the attitude that you have, and we will have you back before the Committee.

Thank you very much for the work and your commitment.

Ms. D'AGOSTINO. Thank you.

Mr. GIANNI. Thank you, Mr. Chairman.

Chairman SHELBY. The hearing is adjourned.

[Whereupon, at 12:10 p.m., the hearing was adjourned.]

[Prepared statements, response to written questions, and additional material supplied follows:]

PREARED STATEMENT OF SENATOR WAYNE ALLARD

I would like to thank Chairman Shelby for holding this hearing to examine the enforcement of the Bank Secrecy Act. Since 1970, the Bank Secrecy Act has been an important tool the Government uses to combat money laundering and the financing of terrorism. This statute has taken on even more significance through the USA PATRIOT Act as the international monetary system has been manipulated by terrorists. The Act requires all financial institutions to maintain records and file reports that are used in criminal, tax, or regulatory investigations and proceedings. Seeing that these requirements are met is a daunting task, yet critical to the ultimate safety of people around the world.

The Committee has held three oversight hearings on terror financing this year, which I believe have helped initiate significant improvements to the existing counterterror finance programs within the Treasury Department. I look forward to today's discussion on the specific procedures on how suspicious activities and transactions are detected, and more particularly, how they are dealt with when they are found. That is where there have been problems in recent months and it is vital that we determine how to catch money launderers in a timely fashion. An effective way to track down terrorists is by tracing their financial transactions, and so I look forward to progress made in this area.

I would like to thank our witnesses for coming to testify and look forward to hearing how your offices enforce the Bank Secrecy Act.

PREPARED STATEMENT OF SENATOR JIM BUNNING

Thank you Mr. Chairman for holding this very important oversight hearing and I would like to thank all of our witnesses here today.

Like many Americans, I was very surprised to hear the reports out of Iraq of our soldiers finding large sums of U.S. currency in a country that our Nation has imposed sanctions upon. I was even more surprised to find out that the cash was traced directly to the New York Federal Reserve. I was somewhat relieved to find out the New York Fed did nothing wrong in this particular instance, though I am concerned some of our allies were skirting our sanctions. However, when the Fed investigated the cash in Iraq, they uncovered many serious problems in the Extended Custodial Inventory Program. The program, which was set up to ensure a supply of currency and recover and replace worn out currency, showed some very disturbing abuses. UBS, who ran the program in Switzerland, falsified documents and sent currency to countries on our sanctions list.

Equally disturbing were the reports of the Riggs bank scandal. Riggs was skirting Bank Secrecy Act procedures, and moving large sums of cash without making Suspicious Activity Reports or SAR's. SAR's are not something that are that obscure. They were even mentioned on an episode of the Sopranos. Surely a banker would know to file them. The only conclusion could be that the SAR's were knowingly not filed. The OCC has recently fined Riggs $25 million. But I am very concerned why the Riggs scandal lasted as long as it did. And I want to make sure this type of problem does not happen again.

There seemed to be a lapse in oversight by the regulators in both of these cases. I am glad all of the regulating agencies are represented today so we can find out their take on the Bank Secrecy Act and the USA PATRIOT Act and if they believe any of their regulated institutions are involved in similar practices. I would like to know, if the Fed and OCC, without jeopardizing any possible investigations, can you tell us if there are any other similar problems out there on the horizon in the other institutions you regulate.

I would also like to know from all of you, what you think of the Bank Secrecy Act and the USA PATRIOT Act. Should they be expanded or contracted. Where and how can they be improved? Do they need to be tweaked or overhauled? We must make sure we are making the best use of our resources to ensure we are doing whatever we can to choke off the financial lifeblood to terrorists. We can and must do better. Too much is at stake.

Once again, thank you Mr. Chairman for holding this hearing and I thank our witnesses for testifying today. Hopefully we can get to the bottom of this.

PREPARED STATEMENT OF SUSAN S. BIES

MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

JUNE 3, 2004

Mr. Chairman, thank you for the opportunity to appear before the Senate Committee on Banking, Housing, and Urban Affairs to discuss the Federal Reserve's participation in efforts to combat money laundering and terrorist financing. The Federal Reserve and the other Federal financial institutions supervisory agencies play a critical role in these efforts, and the Federal Reserve is actively engaged in a number of initiatives to refine and strengthen examination protocols in this area and to effectively deploy resources to prevent, identify, and address problems at the banking organizations supervised by the Federal Reserve.

In my remarks today, I will describe for you some of the important steps we are taking to fulfill our supervisory mission, to guide the institutions we supervise, and, in cooperation with the other banking and financial services regulators and the Treasury Department, to make every effort to use our supervisory tools to enhance the banking industry's role in preventing and detecting money laundering and terrorist financing. The Federal Reserve's anti-money laundering program is multifaceted. It involves work in bank supervision, applications, enforcement, investigations, training, coordination with the law enforcement and intelligence communities, and rule writing. This morning, I will touch on some of these aspects of the Federal Reserve's anti-money laundering program, but will concentrate on bank supervision efforts and enforcement matters.

I would like to begin with a few words about the Federal Reserve's supervisory philosophy in this area. The Federal Reserve has long shared Congress's view that financial institutions and their employees are on the frontline of the effort to combat illicit financial activity. The Federal Reserve believes that the banking organizations it supervises must take every reasonable step to identify, minimize, and manage any risks that illicit financial activity may pose to individual financial institutions and the banking industry. Accordingly, the Federal Reserve has required the financial institutions it supervises to put in place appropriate controls and risk management mechanisms, and has also devoted extensive resources to issuing guidance on legislative and regulatory requirements and sound banking practices, as well as to coordinating supervisory efforts with other agencies. In addition, the Federal Reserve uses its enforcement authority, where necessary, in the event that serious problems or risks cannot be satisfactorily addressed in the supervisory process.

Supervisory Strategy and Procedures for Anti-Money Laundering and Counter Terrorist Financing

It has been our longstanding policy that Federal Reserve supervisors incorporate a Bank Secrecy Act compliance and anti-money laundering program component into every safety and soundness examination conducted by a Reserve Bank. This means that on a regular examination cycle, examiners seek to determine if a banking organization's Bank Secrecy Act (BSA) and anti-money laundering (AML) compliance programs are satisfactory and are commensurate with the organization's business activities and risk profiles. Examinations are conducted at the State member banks, bank holding companies, Edge Act corporations, and U.S. branches and agencies of foreign banks supervised by the Federal Reserve. Every Reserve Bank has BSA/AML specialists and coordinators on its staff, and, since the late 1980's, the Board has had an anti-money laundering program in its supervision division overseen by a senior official. Simply put, Bank Secrecy Act and anti-money laundering compliance has for years been an integral part of the bank supervision process at the Federal Reserve. Furthermore, the Federal Reserve's enforcement program has a strong history of addressing both anti-money laundering and safety and soundness problems in formal actions, where necessary. While the number of actions may fluctuate somewhat from year to year, the Federal Reserve's exercise of its enforcement authority has been consistently strong and timely.

The Federal Reserve supervision process includes both on-site examinations and off-site surveillance and monitoring. The Federal Reserve generally conducts an on-site examination of each bank it supervises once every 12 to 18 months, and at each examination staff reviews the institution's anti-money laundering procedures and its compliance with the Bank Secrecy Act, as amended by the USA PATRIOT Act and new Treasury regulations. For large, complex banking organizations, the safety and soundness examination process is continuous, and anti-money laundering and BSA compliance is incorporated into examinations conducted throughout the year. The Federal Reserve always includes BSA/AML examinations in the supervisory strategy for every banking organization we supervise.

A key component of anti-money laundering examinations is the institution's compliance with the BSA compliance program requirement. The Federal Reserve and the other Federal banking agencies have compliance program requirements for institutions they supervise. In general, the rules require a bank to establish, maintain, and document a program that includes:

- a system of internal controls to ensure ongoing compliance with the BSA,
- independent testing of the bank's compliance with the BSA,
- training of appropriate bank personnel, and
- the designation of an individual responsible for coordinating and monitoring day-to-day compliance with the BSA.

The Federal Reserve works to ensure that the banking organizations we supervise understand the importance of having in place an effective anti-money laundering program. When a Reserve Bank conducts a BSA/AML examination of a banking organization under its supervision, the four components of the program establish the framework for the examination. To properly evaluate the effectiveness of a banking organization's anti-money laundering program, the Federal Reserve has developed comprehensive examination procedures and manuals, and regularly provides training for its examiners. The BSA/AML examination procedures are currently under revision to reflect newly issued regulations under the USA PATRIOT Act.

The Federal Reserve's BSA examinations are risk-focused. While a "core" BSA examination is required of all banking organizations, risk-focused procedures allow examiners to apply the appropriate level of scrutiny to higher-risk business lines, where necessary, and alleviate burden where high-risk products or customers are not present. In other words, a small State member bank with a low-risk customer base receives a considerably different and less burdensome BSA/AML examination than a large, complex banking organization with international operations.

The Examination Process

During every safety and soundness examination of banking organizations under Federal Reserve supervision, bank examiners specially trained in BSA requirements review the institution's previous and current compliance with the BSA. Examiners first determine whether the institution has included BSA/AML procedures in all of its operational areas, including retail operations, credit, private banking, and trust, and has adequate internal control procedures to detect, deter and report money laundering activities, as well as other potential financial crimes. As part of such an examination, bank examiners also review an institution's fraud detection and prevention capabilities, and its policies and procedures for cooperating with law enforcement (whether through responding to subpoenas, acting on information requests under Section 314 of the USA PATRIOT Act, or otherwise).

Our supervision policy guidance in this area requires that examiners also conduct a review of the databases of Suspicious Activity Reports (SAR's) and Currency Transaction Reports (CTR's) to determine if the banking organization that is about to be examined has filed such reports and that they appear complete and timely. Examiners are not doing this to count the number of SAR's and CTR's, to compare their findings against other institutions, or to base any criticisms solely on a numerical count, but rather to make sure, for example, that the bank or U.S. branch of a foreign bank understands its obligations in this critical area and has taken steps to fulfill its responsibilities by filing timely and accurate reports with law enforcement and bank regulators.

The on-site examination begins as a review of the institution's written compliance program and documentation of self-testing and training, as well as a review of the institution's system for capturing and reporting certain transactions pursuant to the Bank Secrecy Act, including any suspicious or unusual transactions possibly associated with money laundering or other financial crimes. Transaction testing is generally conducted to verify these systems.

In those instances where there are deficiencies in the BSA/AML program, including failures to adequately document self-testing or training, obvious breakdowns in operating systems, or failures to implement adequate internal controls, the Federal Reserve's examination procedures require examiners to conduct a more intensified second-stage examination that would include the review of source documents and expanded transaction testing, among other steps.

There is an important correlation between the areas covered by a BSA/AML examination and an institution's overall risk management and internal controls. Thus, bank examiners take into account an organization's enterprise-wide corporate governance mechanisms and how they are applied. The Federal Reserve's bank examiners are able to apply a broad perspective and depth of organizational knowledge to the area of BSA/AML and to coordinate with examination and analytic staff to

ensure that the safety and soundness and BSA/AML examinations are integrated and comprehensive. The Federal Reserve has found that there is an important synergy gained by integrating the safety and soundness and BSA/AML supervisory processes.

Enforcement Actions

The Federal Reserve focuses significant resources on the prevention and early resolution of deficiencies within the supervisory framework. When problems are identified at a banking organization, they are typically communicated to the management and directors in a written report. The management and directors are requested to address identified problems voluntarily and to take measures to ensure that the problems are corrected and will not recur. Most problems are resolved promptly after they are brought to the attention of a banking organization's management and directors.

In some instances, however, examiners identify problems relating to anti-money laundering measures that are pervasive, repeated, unresolved by management, or otherwise of such serious concern that use of the Federal Reserve's enforcement authority is warranted. If the problem does not require a formal action, the Reserve Banks have the authority to take informal, nonpublic supervisory action, such as requiring the adoption of an appropriate resolution by an institution's board of directors or the execution of a memorandum of understanding between an institution and the Reserve Bank.

When informal action will not suffice, the Federal Reserve has authority to take formal, public enforcement action to compel the management and directors of a banking organization to address anti-money laundering and BSA compliance problems. These actions include written agreements, cease-and-desist orders, and civil money penalties, and are legally enforceable in court. These actions are not delegated to the Reserve Banks, and are undertaken only with the concurrence of the Board's General Counsel and the Board's Director of the Division of Banking Supervision and Regulation. Because these actions are public, they can have a significant impact on a banking organization, particularly one that is a public company. In determining whether formal action is appropriate, Federal Reserve staff considers all relevant factors, including the nature, severity, and duration of the problem, the anticipated resources and actions necessary to resolve the problem, and the responsiveness of the directors and management.

In cases where examiners have identified a violation of the compliance program requirement, the Federal banking agencies are bound by law to take formal enforcement action. The same law requiring the banking agencies to promulgate rules requiring the four-part compliance program that I discussed earlier provides that if an institution fails to establish and maintain the required procedures, or if it has failed to correct any previously identified problem with the procedures, then the agency *must* issue a formal action requiring the institution to correct the problem. The Federal Reserve takes this responsibility very seriously and has issued a number of public actions against banking organizations in fulfillment of this statutory mandate. Federal Reserve staff exerts every effort to ensure that this statute is implemented consistently, and Board staff acts as a central coordinator for the examination and enforcement staff at the different Reserve Banks. Over the past 3 years, for example, the Federal Reserve has taken approximately 25 formal, public enforcement actions addressing BSA/AML-related matters. Actions have been taken against large banking organizations as well as smaller ones—the one constant is that the examination process identified regulatory violations in the organizations' compliance programs that, under the law, mandated the supervisory actions.

In addition to taking action itself, the Federal Reserve may refer a BSA-related matter to Treasury's Financial Crimes Enforcement Network (FinCEN) for consideration of an enforcement action based solely on BSA violations, rather than a program failure or issues relating to safety and soundness. Treasury has delegated to the Federal financial banking agencies the authority to examine for BSA compliance those institutions they normally examine for safety and soundness; however, Treasury has not delegated the authority to take an enforcement action, such as the assessment of a fine, for violations of the Bank Secrecy Act.

Federal Reserve staff coordinates enforcement actions with other regulators or agencies, including in the area of anti-money laundering. If a banking organization's problems involve entities supervised by different regulators, resolution of enterprise-wide problems may involve multiple enforcement actions. For example, the Office of the Comptroller of the Currency (OCC), FinCEN, and the Federal Reserve coordinated their recent enforcement actions against Riggs National Corporation; Riggs Bank, N.A.; and Riggs International Banking Corporation, the bank's Edge Act subsidiary, to ensure consistency and concurrent resolution of open issues. The Federal

Reserve coordinates enforcement actions with State banking supervisors on a regular basis, and enforcement actions involving operations of foreign banking organizations may be resolved in cooperation with supervisors abroad. In several recent matters, there was close coordination with the U.S. Department of Justice as well.

The Applications Process

Before I describe some more aspects of the Federal Reserve's supervisory process, let me touch on a very important component of the Federal Reserve's anti-money laundering process—the processing of applications and notices filed with the Board. The Federal Reserve has had a longstanding practice of considering an applicant's compliance with anti-money laundering laws in evaluating various applications, including bank mergers and acquisitions of insured depositories by bank holding companies as well as applications filed by foreign banks to establish U.S. banking offices under the Foreign Bank Supervisory Enhancement Act. The USA PATRIOT Act included a provision memorializing our practice in the application area and required the Board to take into account the effectiveness of an applicant's BSA compliance program when it considers applications under various laws.

Under our longstanding protocols as well as the new law, every application matter considered by the Federal Reserve includes a BSA/AML compliance-related component whereby staff has to make specific judgments regarding an applicant's compliance with the law in this important area. While I cannot, of course, comment on specific cases, I can report to you that Board staff has on some recent occasions advised banking organizations considering expansion or other activities requiring the filing of applications with the Federal Reserve to concentrate instead on their BSA/AML programs. While not the full equivalent of an enforcement action, I am sure that you can appreciate the fact that every banking organization that is seeking or planning on seeking Federal Reserve approval of an application makes every effort possible to ensure that its anti-money laundering program is considered to be fully satisfactory by examiners and that any deficiencies that may be identified are addressed as expeditiously as possible. The applications process gives the Board a strong tool in the BSA/AML area.

Guidance to Banking Organizations

Turning back to the Federal Reserve's normal supervision process, Board and Reserve Bank supervisors seek to provide guidance to banking organizations to assist them to fully understand applicable regulatory requirements and what is expected by the regulators. While financial institutions are, of course, fully responsible for their own compliance, the supervisors play an important role in ensuring that regulatory requirements are correctly understood and uniformly applied. This is particularly true in areas such as compliance with new regulations promulgated since the USA PATRIOT Act.

The Federal Reserve views its supervisory role as including initiatives to enhance awareness and understanding by examiners throughout the Federal Reserve System, by banking organizations under Federal Reserve supervision, and by the financial industry at large. To promote a full understanding of anti-money laundering requirements, the Federal Reserve issues Supervision and Regulation letters, which are used to advise Reserve Bank supervisory staff, supervised institutions, and the banking industry about policy matters; provides on-going training to examiners; speaks regularly before the financial industry; and issues guidance in conjunction with other regulators and Treasury. These initiatives are meant to respond to or anticipate questions that arise regarding anti-money laundering requirements. The Federal Reserve is keenly aware of the resources that anti-money laundering and counter-terrorist financing requirements demand of financial institutions and believes that it is our duty to assist them in meeting their obligations.

Federal Reserve Resource Commitment

The Federal Reserve's BSA/AML function ranges from supervising and regularly examining banking organizations subject to Federal Reserve supervision for compliance with the BSA and relevant regulations, to requiring corrective action for detected weaknesses in BSA/AML programs, to enhancing money laundering investigations by providing expertise to the U.S. law enforcement community, and to providing training to U.S. law enforcement authorities and various foreign central banks and government agencies. Over the past 3 years, for example, Federal Reserve experts in BSA/AML-related matters have participated in special reviews of funds transfers for Federal law enforcement and intelligence authorities, taught classes at FBI and Department of Homeland Security training academies, held seminars for central bank and foreign supervisory authorities in over 10 countries, including Botswana, Mexico, Russia, and the United Arab Emirates, and engaged in

discussions on AML-related matters at international fora such as the Basel Cross-border Group and the Financial Action Task Force on Money Laundering (FATF).

Over the course of the past 10 plus years, the Federal Reserve's anti-money laundering program has grown dramatically. From a senior official at the outset assigned to coordinate the Federal Reserve's BSA activities in the late 1980's, to the creation and staffing in early 2004 of a new section within the Board's Division of Banking Supervision and Regulation dedicated solely to anti-money laundering efforts (the Anti-Money Laundering Policy and Compliance Section), the Federal Reserve continues to commit a growing number of its resources to BSA/AML compliance. In 1993, the Federal Reserve System began the practice of designating a senior examiner at each of the 12 Reserve Banks to serve as a Bank Secrecy Act coordinator for the BSA examiners at that Reserve Bank. The number of senior BSA examiners throughout the System has grown tremendously, particularly since the enactment of the USA PATRIOT Act and the increasing complexity of BSA examinations. The web of BSA examiners throughout the Federal Reserve System is brought together through a direct communication channel with the Board's AML Policy and Compliance Section. This communication is an important tool for gathering examination experiences and providing consistent guidance throughout the Federal Reserve System.

By any standard, the Federal Reserve has taken a leadership role in the U.S. Government's and international banking and regulatory community's anti-money laundering efforts.

Supervisory Coordination

Due to the complexity of financial institutions today, it is imperative that the Federal Reserve coordinate with a long list of agencies on issues tied to the Bank Secrecy Act. First, the Federal Reserve views the Department of the Treasury and FinCEN as important partners due to their leadership role in administering the Bank Secrecy Act. In addition, for a number of complex financial institutions, the Federal Reserve shares supervisory and regulatory responsibilities with the OCC, Federal Deposit Insurance Corporation, and the Office of Thrift Supervision at the Federal level, with the banking agencies of the various States, and with foreign banking authorities for the international operations of U.S. banks and the operations of foreign banks in the United States.

This network of partners requires a high degree of coordination. The regulatory authorities communicate constantly regarding BSA-related matters. For example, among bank regulators, there are a number of electronic systems in place that allow secure access to examination information. This allows regulators to monitor the status of organizations under their direct or indirect purview. It is also the Federal Reserve's practice to notify relevant functional regulators when a supervisory action may have impact on an institution subject to their supervision.

In addition, bank regulators collaborate in the development of consistent examination procedures and examiner training. The USA PATRIOT Act required a surge of rulemaking activity, and the Federal Reserve and its regulatory colleagues continue to advise Treasury as it completes this important work.

Law Enforcement Coordination

The Federal Reserve routinely coordinates with Federal and state law enforcement agencies with regard to potential criminal matters, including anti-money laundering and financial crime activities. This coordination may occur when the Federal Reserve takes action to address matters that are also addressed in a criminal proceeding, when the financial condition of a bank is affected by a criminal matter, or when law enforcement draws on Federal Reserve staff expertise in its investigative work. The Federal Reserve maintains open channels of communication with law enforcement, whether through interagency working groups or through informal staff level contacts.

Conclusion

The Federal Reserve believes that banking organizations should take reasonable and prudent steps to combat illicit financial activities such as money laundering and terrorist financing, and to minimize their vulnerability to risks associated with such activity. For this reason, the Federal Reserve's commitment to ensuring compliance with the Bank Secrecy Act continues to be a high supervisory priority. The Federal Reserve has an important role in ensuring that criminal activity does not pose a systemic threat, and, as important, in improving the ability of individual banking organizations in the United States and abroad to protect themselves from illicit activities.

Thank you again for inviting me today to explain the Federal Reserve's work in this important area.

PREPARED STATEMENT OF JOHN D. HAWKE, JR.

COMPTROLLER OF THE CURRENCY

U.S. DEPARTMENT OF THE TREASURY

JUNE 3, 2004

Introduction

Chairman Shelby, Ranking Member Sarbanes, Members of the Committee, I appreciate the opportunity to appear before you today to discuss the challenges we at the Office of the Comptroller of the Currency (OCC)—and other financial institution regulators—face in combating money laundering in the U.S. financial system, and how we are meeting those challenges. I will also address the enforcement actions in this area we have recently taken against Riggs Bank N.A.

As the regulator of national banks, the OCC has long been committed to the fight against money laundering. For more than 30 years, the OCC has been responsible for ensuring that the banks under its supervision have the necessary controls in place and provide requisite notices to law enforcement to assure that those banks are not used as vehicles to launder money for drug traffickers or other criminal organizations. The tragic events of September 11 have brought into sharper focus the related concern of terrorist financing. Together with the other Federal banking agencies, the banking industry, and the law enforcement community, the OCC shares the Committee's goal of preventing and detecting money laundering, terrorist financing, and other criminal acts and the misuse of our Nation's financial institutions.

The cornerstone of the Federal Government's anti-money laundering (AML) efforts is the Bank Secrecy Act (BSA). Enacted in 1970, the BSA is primarily a recordkeeping and reporting statute that is designed to ensure that banks and other financial institutions provide relevant information to law enforcement in a timely fashion. The BSA has been amended several times, most recently through passage of the USA PATRIOT Act in the wake of the September 11 tragedy. Both the Secretary of the Treasury, through the Financial Crimes Enforcement Network (FinCEN), and the Federal banking agencies, have issued regulations implementing the BSA, including regulations requiring all banks to have a BSA compliance program, and to file reports such as suspicious activity reports (SAR's) and currency transaction reports (CTR's).

Due to the sheer volume of financial transactions processed through the U.S. financial system, primary responsibility for compliance with the BSA and the AML statutes rests with the Nation's financial institutions themselves. The OCC and the other Federal banking agencies are charged with ensuring that the institutions we supervise have strong AML programs in place to identify and report suspicious transactions to law enforcement, and that such reports are, in fact, made. Thus, our supervisory processes seek to ensure that banks have systems and controls in place to prevent their involvement in money laundering, and that they provide the types of reports to law enforcement that the law enforcement agencies, in turn, need in order to investigate suspicious transactions that are reported.

To accomplish our supervisory responsibilities, the OCC conducts regular examinations of national banks and Federal branches and agencies of foreign banks in the United States. These examinations cover all aspects of the institution's operations, including compliance with the BSA. Our resources are concentrated on those institutions, and areas within institutions, of highest risk. In cases of noncompliance, the OCC has broad investigative and enforcement authority to address the problem.

Unlike other financial institutions, which have only recently become subject to compliance program and SAR filing requirements, banks have been under such requirements for years. For example, banks have been required to have a BSA compliance program since 1987, and have been required to file SAR's (or their predecessors) since the 1970's. Not surprisingly, most banks today have strong AML programs in place, and many of the largest institutions have programs that are among the best in the world. There are now approximately 1.3 million SAR's in the centralized database that is maintained by FinCEN. While the USA PATRIOT Act further augmented the due diligence and reporting requirements for banks in several key areas, one of its primary objectives was to impose requirements on nonbanking institutions that had long been applicable to banks.

The OCC's efforts in this area do not exist in a vacuum. We have long been active participants in a variety of interagency working groups that include representatives of the Treasury Department, law enforcement, and the other Federal banking agencies. We also work closely with the FBI and other criminal investigative agencies, providing them with documents, information, and expertise on a case-specific basis.

In addition, when we are provided with lead information from a law enforcement agency, we use that information to investigate further to ensure that BSA compliance systems are adequate.

We continue to work to improve our supervision in this area and we are constantly revising and adjusting our procedures to keep pace with technological developments and the increasing sophistication of money launderers and terrorist financers. For example, along with the other Federal banking agencies, the OCC recently developed examination procedures to implement several key sections of the USA PATRIOT Act, and we expect to be issuing a revised version of our BSA Handbook by year end. We have also recently initiated two programs that will provide stronger and more complete analytical information to assist our examiners in identifying banks that may have high money laundering risk. Specifically, we are developing a database of national-bank filed SAR's with enhanced search and reporting capabilities, and we also are developing and will implement nationwide, a new risk assessment process to better identify high-risk banks. Additionally, we are exploring with FinCEN and the other banking agencies better ways to use BSA information in our examination process to better identify risks and vulnerabilities in the banking system.

Recent events surrounding Riggs Bank N.A. have heightened interest in how the banking agencies, and the OCC in particular, conduct supervision for BSA/AML compliance. Together with FinCEN, the OCC recently assessed a record $25 million civil money penalty (CMP) against Riggs Bank N.A. The OCC also imposed a supplemental cease-and-desist (C&D) order on the bank, requiring the institution to strengthen its controls and improve its processes in the BSA/AML area. Along with the C&D order we issued against the bank in July 2003, these and other actions we have taken have greatly reduced the bank's current risk profile.

However, with the benefit of hindsight, it is clear that the supervisory actions that we previously took against the bank were not sufficient to achieve satisfactory and timely compliance with the BSA, that more probing inquiry should have been made into the bank's high risk accounts, and that stronger, more forceful enforcement action should have been taken sooner. While we do not believe that Riggs is representative of the OCC's supervision in the BSA/AML area, we are nonetheless taking a number of steps to guard against a repeat of this type of situation. In this regard, I have directed that our Quality Management Division commence a review and evaluation of our BSA/AML supervision of Riggs and make recommendations to me on several issues concerning our approach to and the adequacy of our BSA/AML supervision programs generally, and particularly with respect to Riggs.

Background and Legal Framework

In 1970, Congress passed the "Currency and Foreign Transactions Reporting Act" otherwise known as the "Bank Secrecy Act" (BSA), which established requirements for recordkeeping and reporting by private individuals, banks, and other financial institutions. The BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments into or out of the United States or being deposited in financial institutions. The statute sought to achieve that objective by requiring individuals, banks, and other financial institutions to create a paper trail by keeping records and filing reports of certain financial transactions and of unusual currency transfers. This information then enables law enforcement and regulatory agencies to pursue investigations of criminal, tax, and regulatory violations.

The BSA regulations require all financial institutions to submit various reports to the Government. The most common of these reports are: (1) FinCEN Form 104 (formerly IRS Form 4789)—Currency Transaction Report (CTR) for each payment or transfer, by, through or to a financial institution, which involves a transaction in currency of more than $10,000; and (2) FinCEN Form 105 (formerly Customs Form 4790)—Report of International Transportation of Currency or Monetary Instruments (CMIR) for each person who physically transports monetary instruments in an aggregate amount exceeding $10,000 into or out of the United States. Bank supervisors are not responsible for investigating or prosecuting violations of criminal law that may be indicated by the information contained in these reports; they are, however, charged with assuring that the requisite reports are filed timely and accurately.

The Money Laundering Control Act of 1986 precludes the circumvention of the BSA requirements by imposing criminal liability for a person or institution that knowingly assists in the laundering of money, or who structures transactions to avoid reporting. It also directed banks to establish and maintain procedures reasonably designed to assure and monitor compliance with the reporting and recordkeeping requirements of the BSA. As a result, on January 27, 1987, all Federal

bank regulatory agencies issued essentially similar regulations requiring banks to develop procedures for BSA compliance. The OCC's regulation requiring that every national bank maintain an effective BSA compliance program is set forth at 12 CFR § 21.21 and is described in more detail below.

Together, the BSA and the Money Laundering Control Act charge the bank regulatory agencies with:

- overseeing banks' compliance with the regulations described, which direct banks to establish and maintain a BSA compliance program;
- requiring that each examination includes a review of this program and describes any problems detected in the agencies' report of examination; and
- taking C&D actions if the agency determines that the bank has either failed to establish the required procedures or has failed to correct any problem with the procedures which was previously cited by the agency.

The Annunzio-Wylie Anti-Money Laundering Act, which was enacted in 1992, strengthened the sanctions for BSA violations and the role of the Treasury Department. It contained the following provisions:

- a so-called "death penalty" sanction, which authorized the revocation of the charter of a bank convicted of money laundering or of a criminal violation of the BSA;
- an authorization for Treasury to require the filing of suspicious-transaction reports by financial institutions;
- the grant of a "safe harbor" against civil liability to persons who report suspicious activity; and
- an authorization for Treasury to issue regulations requiring all financial institutions, as defined in BSA regulations, to maintain "minimum standards" of an AML program.

Two years later, Congress passed the Money Laundering Suppression Act, which primarily addressed Treasury's role in combating money laundering. This statute:

- directed Treasury to attempt to reduce the number of CTR filings by 30 percent and, to assist in this effort, it established a system of mandatory and discretionary exemptions for banks;
- required Treasury to designate a single agency to receive SAR's;
- required Treasury to delegate CMP powers for BSA violations to the Federal bank regulatory agencies subject to such terms and conditions as Treasury may require;
- required nonbank financial institutions to register with Treasury; and
- created a safe harbor from penalties for banks that use mandatory and discretionary exemptions in accordance with Treasury directives.

Finally, in 2001, as a result of the September 11 terror attacks, Congress passed the USA PATRIOT Act. The USA PATRIOT Act is arguably the single most significant AML law that has been enacted since the BSA itself. Among other things, the USA PATRIOT Act augmented the existing BSA framework by prohibiting banks from engaging in business with foreign shell banks, requiring banks to enhance their due diligence procedures concerning foreign correspondent and private banking accounts, and strengthening their customer identification procedures. The USA PATRIOT Act also:

- provides the Secretary of the Treasury with the authority to impose special measures on jurisdictions, institutions, or transactions that are of "primary money-laundering concern;"
- facilitates records access and requires banks to respond to regulatory requests for information within 120 hours;
- requires regulatory agencies to evaluate an institution's AML record when considering bank mergers, acquisitions, and other applications for business combinations;
- expands the AML program requirements to all financial institutions; and
- increases the civil and criminal penalties for money laundering.

The OCC and the other Federal banking agencies have issued two virtually identical regulations designed to ensure compliance with the BSA. The OCC's BSA compliance regulation, 12 CFR § 21.21, requires every national bank to have a written program, approved by the board of directors, and reflected in the minutes of the bank. The program must be reasonably designed to assure and monitor compliance with the BSA and must, at a minimum: (1) provide for a system of internal controls to assure ongoing compliance; (2) provide for independent testing for compliance; (3) designate an individual responsible for coordinating and monitoring day-to-day compliance; and (4) provide training for appropriate personnel. In addition, the implementing regulation for Section 326 of the USA PATRIOT Act requires every bank adopt a customer identification program as part of its BSA compliance program.

The OCC's SAR regulation, 12 CFR § 21.11, requires every national bank to file a SAR when they detect certain known or suspected violations of Federal law or suspicious transactions related to a money laundering activity or a violation of the BSA. This regulation mandates a SAR filing for any potential crimes: (1) involving insider abuse regardless of the dollar amount; (2) where there is an identifiable suspect and the transaction involves $5,000 or more; and (3) where there is no identifiable suspect and the transaction involves $25,000 or more. Additionally, the regulation requires a SAR filing in the case of suspicious activity that is indicative of potential money laundering or BSA violations and the transaction involves $5,000 or more.

OCC'S BSA/AML Supervision

The OCC and the other Federal banking agencies are charged with ensuring that banks maintain effective AML programs. The OCC's AML responsibilities are coextensive with our regulatory mandate of ensuring the safety and soundness of the national banking system. Our supervisory processes seek to ensure that institutions have compliance programs in place that include systems and controls to satisfy applicable CTR and SAR filing requirements, as well as other reporting and recordkeeping requirements to which banks are subject under the BSA.

The OCC devotes significant resources to BSA/AML supervision. The OCC has nearly 1,700 examiners in the field, many of whom are involved in both safety and soundness and compliance with applicable laws including the BSA. We have over 300 examiners onsite at our largest national banks, engaged in continuous supervision of all aspects of their operations. In 2003, the equivalent of approximately 40 full time employees were dedicated to BSA/AML supervision. The OCC also has three full-time BSA/AML compliance specialists in our Washington DC headquarters office dedicated to developing policy, training, and assisting on complex examinations. In addition, the OCC has a full-time fraud expert in Washington DC, who is responsible for tracking the activities of offshore shell banks and other vehicles for defrauding banks and the public. These resources are supplemented by dozens of attorneys in our district offices and Washington DC headquarters office who work on compliance matters. In 2003 alone, not including our continuous large bank supervision, the OCC conducted approximately 1,340 BSA examinations of 1,100 institutions and, since 1998, we have completed nearly 5,700 BSA examinations of 5,300 institutions.

The OCC monitors compliance with the BSA and money laundering laws through its BSA compliance and money laundering prevention examination procedures. The OCC's examination procedures were developed by the OCC, in conjunction with the other Federal banking agencies, based on our extensive experience in supervising and examining national banks in the area of BSA/AML compliance. The procedures are risk-based, focusing our examination resources on high-risk banks and high-risk areas within banks. During an examination, examiners use the procedures to review the bank's policies, systems, and controls. Examiners test the bank's systems by reviewing certain individual transactions when they note control weaknesses, have concerns about high-risk products or services in a bank, or receive information from a law enforcement or other external source.

In 1997, the OCC formed the National Anti-Money Laundering Group (NAMLG), an internal task force that serves as the focal point for all BSA/AML matters. Through the NAMLG, the OCC has undertaken a number of projects designed to improve the agency's supervision of the BSA/AML activities of national banks. These projects include the development of a program to identify high-risk banks for expanded scope BSA examinations and the examination of those banks using agency experts and expanded procedures; examiner training; the development of revised examination procedures; and issuance of policy guidance on various BSA/AML topics.

Over the years, the NAMLG has had many significant accomplishments including:

- publishing and updating numerous guidance documents, including the Comptroller's BSA Handbook, extensive examination procedures, numerous OCC advisories, bulletins and alerts, and a comprehensive reference guide for bankers and examiners;
- providing expertise to the Treasury Department and the Department of Justice in drafting the annual U.S. National Money Laundering Strategy;
- providing expertise to the Treasury Department, FinCEN and the other Federal banking agencies in drafting the regulations to implement the USA PATRIOT Act; and
- developing state-of-the-art training programs for OCC and other Federal and foreign regulatory authorities in training their examiners in BSA/AML supervision.

To deploy its resources most effectively, the OCC uses criteria developed by NAMLG that targets banks for expanded scope AML examinations. Experienced examiners and other OCC experts who specialize in BSA compliance, AML, and fraud are assigned to the targeted examinations. The examinations focus on areas of identified risk and include comprehensive transactional testing procedures. The following factors are considered in selecting banks for targeted examinations:

- locations in high-intensity drug trafficking areas (HIDTA) or high-intensity money laundering and related financial crime areas (HIFCA);
- excessive currency flows;
- significant international, private banking, fiduciary or other high-risk activities;
- unusual suspicious activity reporting patterns;
- unusual large currency transaction reporting patterns; and
- fund transfers or account relationships with drug source countries or countries with stringent financial secrecy laws.

The program may focus on a particular area of risk in a given year. For example, our 2005 targeting program will focus on banks that have significant business activity involving foreign money services businesses. In prior years, our targeting focus has been on banks that have significant business activity in private banking, offshore banking, and lines of business subject to a high risk of terrorist financing.

Other responsibilities of the NAMLG include sharing information about money laundering issues with the OCC's District offices; analyzing money laundering trends and emerging issues; and promoting cooperation and information sharing with national and local AML groups, the law enforcement community, bank regulatory agencies, and the banking industry.

NAMLG has also worked with law enforcement agencies and other regulatory agencies to develop an interagency examiner training curriculum that includes instruction on common money laundering schemes. In addition, the OCC has conducted AML training for foreign bank supervisors and examiners two to three times per year for the past 4 years. Over 250 foreign bank supervisors have participated in this training program. Recently, the World Bank contracted with the OCC to tape our international BSA school for worldwide broadcast. The OCC has also partnered with the State Department to provide AML training to high-risk jurisdictions, including selected Middle Eastern countries. And we consistently provide instructors for the Federal Financial Institutions Examination Council schools, which are now patterned after the OCC's school. In total, the OCC's AML schools have trained approximately 550 OCC examiners over the past 5 years.

OCC'S ENFORCEMENT AUTHORITY

Effective bank supervision requires clear communications between the OCC and the bank's senior management and board of directors. In most cases, problems in the BSA/AML area, as well as in other areas, are corrected by bringing the problem to the attention of bank management and obtaining management's commitment to take corrective action. An OCC Report of Examination documents the OCC's findings and conclusions with respect to its supervisory review of a bank. Once problems or weaknesses are identified and communicated to the bank, the bank's senior management and board of directors are expected to promptly correct them. The actions that a bank takes, or agrees to take, to correct deficiencies documented in its Report are important factors in determining whether more forceful action is needed.

OCC enforcement actions fall into two broad categories: Informal and formal. In general, informal actions are used when the identified problems are of limited scope and magnitude and bank management is regarded as committed and capable of correcting them. Informal actions include commitment letters, memoranda of understanding, and matters requiring board attention in examination reports. These generally are not public actions.

The OCC also may use a variety of formal enforcement actions to support its supervisory objectives. Unlike most informal actions, formal enforcement actions are authorized by statute, are generally more severe, and are disclosed to the public. Formal actions against a bank include C&D orders, formal written agreements and CMPs. C&D orders and formal agreements are generally entered into consensually by the OCC and the bank and require the bank to take certain actions to correct identified deficiencies. The OCC may also take formal action against officers, directors and other individuals associated with an institution (institution-affiliated parties). Possible actions against institution-affiliated parties include removal and prohibition from participation in the banking industry, CMP's, and C&D orders.

In the BSA area, the OCC's CMP authority is concurrent with that of FinCEN. In cases involving systemic noncompliance with the BSA, in addition to taking our

own actions, the OCC refers the matter to FinCEN. In the case of Riggs Bank, the OCC and FinCEN worked together on the CMP against the bank.

In recent years, the OCC has taken numerous formal actions against national banks to bring them into compliance with the BSA. These actions are typically C&D orders and formal agreements. The OCC has also taken formal actions against institution-affiliated parties who participated in BSA violations. From 1998 to 2003, the OCC has issued a total of 78 formal enforcement actions based in whole, or in part, on BSA/AML violations. During this same time period, the OCC has also taken countless informal enforcement actions to correct compliance program deficiencies that did not rise to the level of a violation of law.

SIGNIFICANT BSA/AML ENFORCEMENT ACTIONS

The OCC has been involved in a number of cases involving serious BSA violations and, in some cases, actual money laundering. Some of the more significant cases involved the Bank of China (New York Federal Branch), Broadway National Bank, Banco do Estado de Parana (New York Federal Branch), and Jefferson National Bank. There are also dozens of other examples where the OCC identified significant money laundering or BSA non-compliance, took effective action to stop the activity, and ensured that accurate and timely referrals were made to law enforcement.

Bank of China, New York Federal Branch

In May 2000, OCC examiners conducting a safety and soundness examination discovered serious misconduct on the part of the branch and its former officials, including the facilitation of a fraudulent letter of credit scheme and other suspicious activity and potential fraud and money laundering. The misconduct, which resulted in significant losses to the branch, was subsequently referred to law enforcement. In January 2002, the OCC and the Peoples' Bank of China entered into companion actions against the Bank of China and its United States-based Federal branches. The bank's New York branch agreed to pay a $10 million penalty assessed by the OCC and the parent bank, which is based in Beijing, agreed to pay an equivalent amount in local currency to the People's Bank of China, for a total of $20 million. The OCC also required that the branch execute a C&D order which, among other things, required it to establish account opening and monitoring procedures, a system for identifying high risk customers, and procedures for regular, ongoing review of account activity of high risk customers to monitor and report suspicious activity. The OCC also took actions against six institution-affiliated parties.

Broadway National Bank, New York, New York

In March 1998, the OCC received a tip from two separate law enforcement agencies that this bank may be involved in money laundering. The OCC immediately opened an examination which identified a number of accounts at the bank that were either being used to structure transactions, or were receiving large amounts of cash with wire transfers to countries known as money laundering and drug havens. Shortly thereafter, the OCC issued a C&D order which shut down the money laundering and required the bank to adopt more stringent controls. The OCC also initiated prohibition and CMP cases against bank insiders. In referring the matter to law enforcement, we provided relevant information including the timing of deposits that enabled law enforcement to seize approximately $4 million and arrest a dozen individuals involved in this scheme. The subsequent OCC investigation resulted in the filing of additional SAR's, the seizure of approximately $2.6 million in additional funds, more arrests by law enforcement, and a referral by the OCC to FinCEN. In November 2002, the bank pled guilty to a three count felony information that charged it with failing to maintain an AML program, failing to report approximately $123 million in suspicious bulk cash and structured cash deposits, and aiding and assisting customers to structure approximately $76 million in transactions to avoid the CTR requirements. The bank was required to pay a $4 million criminal fine.

Banco do Estado de Parana, Federal Branch, New York, N.Y (Banestado)

In the summer of 1997, the OCC received information from Brazilian Government officials concerning unusual deposits leaving Brazil via overnight courier. The OCC immediately dispatched examiners to the branch that was receiving the majority of the funds. OCC examiners discovered significant and unusually large numbers of monetary instruments being shipped via courier into the Federal branch from Brazil and other countries in South America, as well as suspicious wire transfer activity that suggested the layering of the shipped deposits through various accounts with no business justification for the transfers. The OCC entered into a C&D order with the Federal branch and its head office in Brazil in January 1998 that required controls over the courier and wire transfer activities and the filing of SAR's with law enforcement. The OCC also hosted several meetings with various law enforcement

agencies discussing these activities and filed a referral with FinCEN. Shortly thereafter, the Brazilian bank liquidated the branch. In May 2000, the OCC assessed a CMP against the branch for $75,000.

Jefferson National Bank, Watertown, New York

During the 1993 examination of this bank, the OCC learned from the Federal Reserve Bank of New York that the bank was engaging in cash transactions that were not commensurate with its size. OCC examiners subsequently discovered that several bank customers were depositing large amounts of cash that did not appear to be supported by the purported underlying business, with the funds being wired offshore. The OCC filed four criminal referral forms (predecessor to the SAR) with law enforcement pertaining to this cash activity and several additional criminal referral forms pertaining to insider abuse and fraud at the bank. The OCC also briefed several domestic and Canadian law enforcement agencies alerting them to the significant sums of money flowing through these accounts at the bank. Based upon this information, law enforcement commenced an investigation of these large deposits. The investigation resulted in one of the most successful money laundering prosecutions in U.S. Government history. The significant sums of money flowing through the bank were derived from cigarette and liquor smuggling through the Akwesasne Indian Reservation in northern New York. The ring smuggled $687 million worth of tobacco and alcohol into Canada between 1991 and 1997. The case resulted in 21 indictments that also sought the recovery of assets totaling $557 million. It also resulted in the December 1999 guilty plea by a subsidiary of R.J. Reynolds tobacco company and the payment of a $15 million criminal fine. The four criminal referral forms filed by the OCC in the early stages of this investigation were directly on point and pertained to the ultimate ringleaders in the overall scheme. These money laundering cases were in addition to the C&D order entered into with the bank, the prohibition and CMP cases that were brought by the OCC, and the insider abuse bank fraud cases that were brought by law enforcement against some of the bank's officers and directors. Seven bank officers and directors were ultimately convicted of crimes.

OCC COOPERATION WITH LAW ENFORCEMENT AND OTHER AGENCIES

As the above cases illustrate, combating money laundering depends on the cooperation of law enforcement, the bank regulatory agencies, and the banks themselves. The OCC participates in a number of interagency working groups aimed at money laundering prevention and enforcement, and meets on a regular basis with law enforcement agencies to discuss money laundering issues and share information that is relevant to money laundering schemes. For example, the OCC is an original member of both the National Interagency Bank Fraud Working Group and the Bank Secrecy Act Advisory Group. Both of these groups include representatives of the Department of Justice, the FBI, the Treasury Department, and other law enforcement agencies, as well as the Federal banking agencies. Through our interagency contacts, we sometimes receive leads as to possible money laundering in banks that we supervise. Using these leads, we can target compliance efforts in areas where we are most likely to uncover problems. For example, if the OCC receives information that a particular account is being used to launder money, our examiners would then review transactions in that account for suspicious funds movements, and direct the bank to file a SAR if suspicious transactions are detected. The OCC also provides information, documents, and expertise to law enforcement for use in criminal investigations on a case-specific basis.

The OCC has also played an important role in improving the AML and terrorist financing controls in banking throughout the world. For the past several years, the OCC has provided examiners to assist with numerous U.S. Government-sponsored international AML and terrorist financing assessments. We have a cadre of specially trained examiners that has provided assistance to the Treasury Department and the State Department on these assessments in various parts of the world, including South and Central America, the Caribbean, the Pacific-rim nations, the Middle East, Russia, and the former Eastern Bloc nations. In this regard, the cadre has participated in terrorist financing investigations, assessed local money laundering laws and regulatory infrastructure, and provided training to bank supervisors.

The OCC is also providing direct assistance to the Coalition Provisional Authority (CPA) of Iraq. Four OCC examiners are currently working in Iraq as technical assistance advisers to the CPA's Ministry of Finance and helping their counterparts at the Central Bank of Iraq develop a risk-based supervisory system tailored to the Iraqi banking system. The OCC examiners are assisting in the development of a law addressing money laundering and terrorist financing that is close to enactment by

the CPA, the drafting of new policy and examination manuals to implement this law, and they are providing extensive AML training to Iraqi bank regulators.

Post-September 11 Activities and the Implementation of the USA PATRIOT Act

In the immediate aftermath of the September 11 terror attacks, the OCC participated in a series of interagency meetings with bankers sponsored by the New York Clearinghouse to discuss the attacks and their impact on the U.S. economy and banking system, and provided guidance to the industry concerning the various requests from law enforcement for account and other information. The OCC was also instrumental in working with the other banking agencies to establish an electronic e-mail system for law enforcement to request information about suspected terrorists and money launderers from every financial institution in the country. This FBI Control List system was in place five weeks after September 11 and was the precursor to the current system established under Section 314(a) of the USA PATRIOT Act, which is now administered by FinCEN. At the same time, the OCC established a secure emergency communications e-mail system for all national banks through the OCC's BankNet technology.

In October 2001, Congress passed the USA PATRIOT Act. The OCC has been heavily involved in the many interagency work groups tasked with writing regulations to implement the USA PATRIOT Act over the past few years. To date, these work groups have issued final rules implementing Sections 313 (foreign shell bank prohibition); 319(b) (foreign correspondent bank account records), 314 (information sharing), and 326 (customer identification). The OCC was also involved in drafting the interim final rule implementing Section 312 (foreign private banking and correspondent banking).

The OCC took the lead in developing the current 314(a) process for disseminating information between law enforcement and the banks. The OCC worked with the interested regulatory and law enforcement agencies, and drafted detailed instructions to banks concerning the 314(a) process and the extent to which banks are required to conduct record and transactions searches on behalf of law enforcement. The OCC also took the lead in drafting a frequently asked questions (FAQ's) document to provide further guidance as to the types of accounts and transactions required to be searched, when manual searches for this information would be required, and the timeframes for providing responses back to law enforcement. Under the new procedures, 314(a) requests from FinCEN are batched and issued every two weeks, unless otherwise indicated, and financial institutions have two weeks to complete their searches and respond with any matches.

Throughout this process, the OCC continually assisted FinCEN in maintaining an accurate electronic database of 314(a) contacts for every national bank and Federal branch, provided effective communications to the industry through agency alerts concerning the 314(a) system, and participated in quarterly interagency meetings with fellow regulators and law enforcement agencies to ensure that the process was working effectively and efficiently.

The OCC also took the lead in drafting the interagency Customer Identification Program (CIP) regulation mandated by Section 326 of the USA PATRIOT Act, which mandates the promulgation of regulations that, at a minimum, require financial institutions to implement reasonable procedures for: (1) verifying the identity of any person seeking to open an account, to the extent reasonable and practicable; (2) maintaining records of the information used to verify the person's identity, including name, address, and other identifying information; and (3) determining whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to the financial institution by any government agency. The OCC is also the primary drafter of interagency FAQ's concerning the implementation of the CIP rules. A second set of interagency FAQ's will be issued shortly.

In order to assess USA PATRIOT Act implementation by the industry, in the summer of 2002, the OCC conducted reviews of all of its large banks to assess their compliance with the regulations issued under the USA PATRIOT Act up to that time, and to evaluate the industry response to terrorist financing risk. Although, at that time, many of the USA PATRIOT Act regulations had not yet been finalized, we felt it was important to ascertain the level of bank compliance with and understanding of the new requirements. The purpose of these reviews was to discern the types of systems and controls banks had in place to deter terrorist financing, and follow up with full-scope AML exams in institutions that had weaknesses. As a result of these reviews, the OCC was able to obtain practical first hand knowledge concerning how banks were interpreting the new law, whether banks were having problems implementing the regulations or controlling terrorist financing risk, and which banks needed further supervision in this area.

On October 20, 2003, the OCC issued interagency examination procedures to evaluate national bank compliance with the requirements of Section 313 and 319(b), and Section 314 of the USA PATRIOT Act. The procedures were designed to assess how well banks are complying with the new regulations and to facilitate a consistent supervisory approach among the banking agencies. OCC examiners are now using the procedures during BSA/AML examinations of the institutions under our supervision. The procedures allow examiners to tailor the examination scope according to the reliability of the bank's compliance management system and the level of risk assumed by the institution. An interagency working group is currently drafting examination procedures concerning Section 326 of the USA PATRIOT Act. The OCC is also the primary drafter of these procedures and we expect that they will be issued shortly.

OCC OUTREACH AND INDUSTRY EDUCATION

As previously stated, the primary responsibility for ensuring that banks are in compliance with the BSA lies with the bank's management and its directors. To aid them in meeting this responsibility, the OCC devotes extensive time and resources to educating the banking industry about its obligations under the BSA. This has typically included active participation in conferences and training sessions across the country. For example, in 2002 the OCC sponsored a nationwide teleconference to inform the banking industry about the USA PATRIOT Act. This teleconference was broadcast to 774 sites with approximately 5,400 listeners.

The OCC also provides guidance to national banks through: (1) industry outreach efforts that include roundtable discussions with bankers and industry wide conference calls sponsored by the OCC; (2) periodic bulletins that inform and remind banks of their responsibilities under the law, applicable regulations, and administrative rulings dealing with BSA reporting requirements and money laundering; (3) publications, including the distribution of comprehensive guide in this area entitled Money Laundering: A Banker's Guide to Avoiding Problems; (4) publication and distribution of the Comptroller's BSA Handbook which contains the OCC's BSA examination procedures, and the Comptroller's Handbook for Community Bank Supervision which provides guidance on BSA/AML risk assessment; and (5) periodic alerts and advisories of potential frauds or questionable activities, such as alerts on unauthorized banks and FinCEN reporting processes. In addition, senior OCC officials are regular participants in industry seminars and forums on the BSA, the USA PATRIOT Act, and related topics.

CURRENT SUPERVISORY INITIATIVES

The OCC uses somewhat different examination approaches depending largely on the size of the institution and its risk profile. In large banks (generally total assets of $25 billion) and mid-size banks (generally total assets of $5 billion), OCC examiners focus first on the bank's BSA compliance program. These banks are subject to our general BSA/AML examination procedures that include, at a minimum, a review of the bank's internal controls, policies, procedures, customer due diligence, SAR/CTR information, training programs, and compliance audits. We also evaluate BSA officer competence, the BSA program structure, and the bank's audit program, including the independence and competence of the audit staff. While examining for overall BSA compliance, examiners typically focus on suspicious activity monitoring and reporting systems and the effectiveness of the bank's customer due diligence program.

Additional and more detailed procedures are conducted if control weaknesses or concerns are encountered during the general procedures phase of the examination. These supplemental procedures include:

- transaction testing to ascertain the level of risk in the particular business area (for example, private banking, payable upon proper identification programs (PUPID), nonresident alien accounts, international brokered deposits, foreign correspondent banking, and pouch activity) and to determine whether the bank is complying with its policies and procedures, including SAR and CTR filing requirements;
- evaluation of the risks in a particular business line or in specific accounts and a determination as to whether the bank is adequately managing the risks;
- a selection of bank records to determine that its recordkeeping processes are in compliance with the BSA.

For community banks (generally total assets under $5 billion), examiners determine the examination scope based on the risks facing the institution. For low-risk banks, examiners evaluate changes to the bank's operations and review the bank's BSA/AML compliance program. For banks with higher risk characteristics and weak controls, additional procedures are performed, including review of a sample of high-

risk accounts and additional procedures set forth above. Examiners also perform periodic monitoring procedures between examinations and conduct follow-up activities when significant issues are identified.

USE OF CTR AND SAR DATA IN THE EXAMINATION PROCESS

All banks are required by regulation to report suspected crimes and suspicious transactions that involve potential money laundering or violate the BSA. In April 1996, the OCC, together with the other Federal banking agencies, and FinCEN, unveiled the SAR system, SAR form, and database. This system provides law enforcement and regulatory agencies online access to the entire SAR database. Based upon the information in the SAR's, law enforcement agencies may then, in turn, initiate investigations and, if appropriate, take action against violators. By using a universal SAR form, consolidating filings in a single location, and permitting electronic filing, the system greatly improves the reporting process and makes it more useful to law enforcement and to the regulatory agencies. As of December 2003, banks and regulatory agencies had filed over 1.3 million SAR's, with national banks by far the biggest filers. Nearly 50 percent of these SAR's were for suspected BSA/money laundering violations.

The OCC also uses the SAR database as a means of identifying high-risk banks and high-risk areas within banks. Year-to-year trend information on the number of SAR's and CTR's filed is used to identify banks with unusually low or high filing activity. This is one factor used by the OCC to identify high-risk banks. Examiners also review SAR's and CTR's to identify accounts to include in the examination sample. Accounts where there have been repetitive SAR filings or accounts with significant cash activity in a high-risk business or inconsistent with the type of business might be accounts selected for the sample.

Riggs Bank Enforcement Actions

As previously mentioned, the OCC and FinCEN recently assessed a $25 million CMP against Riggs Bank N.A. for violations of the BSA and its implementing regulations, and for failing to comply with the requirements of an OCC C&D order that was signed by the bank in July 2003. Also, in a separate C&D action dated May 13, 2004 to supplement the C&D we had issued in July 2003, the OCC directed the bank to take a number of steps to correct deficiencies in its internal controls, particularly in the BSA/AML area. Among other requirements in this separate action, the OCC directed the bank to:

- Ensure competent management. Within 30 days, the board of directors must determine whether management or staff changes are needed and whether management skills require improvement.
- Develop a plan to evaluate the accuracy and completeness of the bank's books and records, and develop a methodology for determining that information required by the BSA is appropriately documented, filed, and maintained.
- Adopt and implement comprehensive written policies for internal controls applicable to the bank's account relationships and related staffing, including the Embassy and International Private Banking Group. Among other requirements, the policies must mandate background checks of all relationship managers at least every 3 years and must prohibit any employee from having signature authority, ownership, or custodial powers for any customer account.
- Develop and implement a policy that permits dividend payments only when the bank is in compliance with applicable law and upon written notice to the OCC.
- Adopt and implement an internal audit program sufficient to detect irregularities in the bank's operation, determine its level of compliance with applicable laws and regulations and provide for testing to support audit findings, among other requirements.

These actions were based on a finding that the bank had failed to implement an effective AML program. As a result, the bank did not detect or investigate suspicious transactions and had not filed SAR's as required under the law. The bank also did not collect or maintain sufficient information about its foreign bank customers. In particular, the OCC found a number of problems with the bank's account relationship with foreign governments, including Saudi Arabia and Equatorial Guinea. Riggs failed to properly monitor, and report as suspicious, transactions involving tens of million of dollars in cash withdrawals, international drafts that were returned to the bank, and numerous sequentially numbered cashier's checks. The OCC will continue to closely monitor the corrective action that the bank takes in response to the order and we are prepared to take additional actions if necessary.

These actions are the most recent of a series of escalating supervisory and enforcement reactions to ongoing deficiencies in Riggs BSA/AML compliance program. Since this matter involves an open bank and open investigations, there are limita-

tions on what can be said without disclosing confidential supervisory information and potentially compromising future criminal, civil and administrative actions. With that caveat, we have tried to set out below a summary of our supervision of this institution in the BSA/AML area, dating back to 1997.

The OCC first identified deficiencies in Riggs' procedures several years ago. Beginning in the late 1990's, we recognized the need for improved processes at Riggs and for improvements in the training in, and awareness of, the BSA's requirements and in the controls over their BSA processes. Prior to September 11, the OCC visited the bank at least once a year and sometimes more often to either examine or review the Bank's BSA/AML compliance program.

Over this timeframe OCC examiners consistently found that Riggs' BSA compliance program was either "satisfactory" or "generally adequate," meaning that it met the minimum requirements of the BSA, but we nonetheless continued to identify weaknesses and areas of its program that needed improvement in light of the business conducted by the bank. We addressed these weaknesses using various informal, supervisory actions. Generally, this involved bringing the problems to the attention of bank management and the board and securing their commitment to take corrective action.

During this period, it was clear that the bank's compliance program needed improvement but we determined that the program weaknesses did not rise to the level of a violation of our regulation or pervasive supervisory concern. The OCC identified problems with the bank's internal audit coverage in this area, its internal monitoring processes, and its staff training on the BSA and customer due diligence requirements. Repeatedly, management took actions to address specific OCC concerns but, as is now clear, the corrective actions being taken often were not sufficient to achieve the intended results. The bank was continually taking steps to respond to OCC criticisms, but failed to take action on its own to improve its overall compliance program, especially with regard to high-risk areas. Due to the lack of an effective and proactive management team, additional weaknesses and deficiencies were continually identified by the OCC over this time period, but bank follow-up on these weaknesses ultimately proved to be ineffective and the problems continued longer than they should have.

As various changes occurred in the regulatory expectations for banks relative to BSA compliance and related issues over this period of time, our scrutiny of the bank was adjusted accordingly. For example, when the Financial Action Task Force and FinCEN identified "uncooperative" countries, we conducted an examination at Riggs that specifically focused on account relationships with those countries and determined that the bank did not have extensive transaction activity with any of the countries on the list. In addition, Treasury issued its guidance on "politically exposed persons" in January 2001, and, as a result, the OCC's focus on the risks associated with the Riggs' embassy banking business began to increase and our supervisory activities were heightened accordingly. However, at that time, the Kingdom of Saudi Arabia was not viewed as a country that posed heightened risk of money laundering or terrorist financing, and Equatorial Guinea had just begun to reap the financial benefits of the discovery of large oil reserves in the mid-1990's.

After September 11, the OCC escalated its supervisory efforts to bring Riggs' compliance program to a level commensurate with the risks that were undertaken by the bank and we believed that we were beginning to see some progress in this regard. In fact, the bank was beginning the process of a major computer system conversion that would address many of the shortcomings in the existing information systems that the bank was relying on. Unfortunately, bank management had to adjust the timeline repeatedly. This caused significant delays in the implementation date, pushing it from the original target of year-end 2002 to September 2003. Thus, the bank was not able to fulfill many of the commitments that it made to the OCC to correct our concerns pertaining to their BSA compliance program. Also, as previously mentioned, the OCC conducted a series of anti-terrorist financing reviews at our large or high-risk banks, including Riggs, in 2002. As a result of these reviews and other internal assessments, plus published accounts of suspicious money transfers involving Saudi Embassy accounts, our concerns regarding Riggs BSA/AML compliance were heightened. Thus, we commenced another examination of Riggs in January 2003.

The focus of the January 2003 examination was on Riggs' Embassy banking business, and, in particular, the accounts related to the Embassy of Saudi Arabia. Due to its Washington DC location, its extensive retail branch network, and its expertise in private banking, Riggs found embassy banking to be particularly attractive and had developed a market niche. In fact, at one time, 95 percent of all foreign embassies in the United States, and 50 percent of the embassies in London conducted their banking business with Riggs. The OCC's examination lasted for approximately

5 months and involved experts in the BSA/AML area. The findings from the January 2003 examination formed the basis for the July 2003 C&D order entered into with the bank. The OCC also identified violations of the BSA that were referred to FinCEN.

During the course of the 2003 examination, the OCC cooperated extensively with investigations by law enforcement into certain suspicious transactions involving the Saudi Embassy relationship. These transactions involved tens of millions of dollars in cash withdrawals from accounts related to the Embassy of Saudi Arabia; dozens of sequentially numbered international drafts that totaled millions of dollars that were drawn from accounts related to officials of Saudi Arabia, and that were returned to the bank; and dozens of sequentially numbered cashier's checks that were drawn from accounts related to officials of Saudi Arabia made payable to the accountholder. There was regular contact with the FBI investigators throughout this examination. We provided the FBI with voluminous amounts of documents and information on the suspicious transactions, including information concerning transactions at the bank that the FBI previously was not aware of. The OCC also hosted a meeting with the FBI to discuss these documents and findings. Throughout this process we provided the FBI with important expertise on both general banking matters, and on some of the complex financial transactions and products that were identified.

The July 2003 C&D order directed the bank to take a number of steps to correct deficiencies in its internal controls in the BSA/AML area and to strongly consider staffing changes. Among other requirements in this action, the OCC directed the bank to:

- Hire an independent, external management consultant to conduct a study of the Bank's compliance with the BSA, including, training, SAR monitoring, and correcting deficiencies and conduct a risk assessment for compliance with the BSA throughout the bank.
- Evaluate the responsibilities and competence of management. In particular, the consultant's report to the board of directors must address, among other things, the responsibilities and competence of the bank's BSA officer, and the capabilities and competence of the supporting staff in this area. Within 90 days, the board of directors must determine whether any changes are needed regarding the bank's BSA officer and staff;
- Adopt and implement detailed policies and procedures (including account opening and monitoring procedures) to provide for BSA compliance and for the appropriate identification and monitoring of high risk transactions;
- Ensure effective BSA audit procedures and expansion of these procedures. Within 90 days the board of directors must review and evaluate the level of service and ability of the audit function for BSA matters provided by any auditor; and
- Ensure bank adherence to a comprehensive training program for all appropriate operational and supervisory personnel to ensure their awareness and their responsibility for compliance with the BSA.

The OCC began its next examination of the bank's BSA compliance in October 2003. The purpose of this examination was to assess compliance with the C&D order and the USA PATRIOT Act, and to review accounts related to the Embassy of Equatorial Guinea. It was clear from this examination that the bank had made progress in complying with the order and in improving its AML program. Another notable accomplishment was the successful implementation of the long planned system upgrade that significantly improved the information available to bank staff and management to monitor account activity and identify suspicious activity. Notwithstanding, there were significant areas of noncompliance noted by our examination. The examiners found that, as with the Saudi Embassy accounts, the bank lacked sufficient policies, procedures, and controls to identify suspicious transactions concerning the bank's relationship with Equatorial Guinea. These transactions involved millions of dollars deposited in a private investment company owned by an official of the country of Equatorial Guinea; hundreds of thousands of dollars transferred from an account of the country of Equatorial Guinea to the personal account of a government official of the country; and over a million dollars transferred from an account of the country of Equatorial Guinea to a private investment company owned by the bank's relationship manager. The findings from this examination, as well as previous examination findings, formed the basis for the OCC's recent CMP and C&D actions.

In retrospect, as we review our BSA/AML compliance supervision of Riggs during this period, we should have been more aggressive in our insistence on remedial steps at an earlier time. We also should have done more extensive probing and transaction testing of accounts. Our own BSA examination procedures called for

transactional reviews in the case of high-risk accounts, such as those at issue here, yet until recently, that was not done at Riggs in the Saudi Embassy and the Equatorial Guinea accounts. Clearly, the types of strong formal enforcement action that we ultimately took should have been taken sooner. This is not a case where the deficiencies in the bank's systems and controls were not recognized, nor was there an absence of OCC supervisory attention to those deficiencies. But we failed to sufficiently probe the transactions occurring in the bank's high-risk accounts and we gave the bank too much time, based on its apparent efforts to fix its own problems, before we demanded specific solutions, by specific dates, pursuant to formal enforcement actions. As described below, we have reevaluated our BSA/AML supervision processes in light of this experience and we will be implementing changes to improve how we conduct supervision in this area. I have also directed that our Quality Management Division undertake an internal review of our supervision of Riggs. These steps are outlined more fully below.

IMPROVEMENTS UNDERTAKEN TO IMPROVE BSA/AML SUPERVISION

While we believe our overall supervisory approach to BSA/AML compliance has been rigorous and is working well, we are committed to ongoing evaluation of our approaches to BSA/AML compliance and to appropriate revisions to our approach in light of technological developments, and the increasing sophistication of money launderers and terrorist financers, as well as to address aspects of the process where shortcomings were evidenced in the Riggs situation. Recent and current initiatives include the following:

- As previously mentioned, together with the other Federal banking agencies, we recently developed revised examination procedures for several key sections of the USA PATRIOT Act and we expect to be issuing a revised version of our BSA Handbook by the end of the year.
- We plan to develop our own database of national bank-filed SAR's with enhanced search and reporting capabilities for use in spotting operational risk including in the BSA/AML area. This database will be compatible with the OCC's supervisory databases and enable us to: (1) generate specialized reports merging SAR data with our existing supervisory data, (2) sort SAR information by bank asset size and line of business, and (3) provide enhanced word and other search capabilities.
- We are developing and will implement nationwide, a new risk assessment process to better identify high-risk banks. This system uses standardized data on products, services, customers, and geographies to generate reports that we will use to identify potential outliers, assist in the allocation of examiner resources, and target our examination scopes (for example, particular products or business lines).
- We are exploring with FinCEN and the other agencies better ways to use BSA information in our examination process, so that we can better pinpoint risks and secure corrective action. Upon completion of FinCEN's BSA Direct initiative (currently under development), the OCC will have direct access, as opposed to dial-in access, to the SAR database. We expect that this direct access system will allow us to make better and more effective use of FinCEN's SAR database.
- We are also exploring how we can systematically capture BSA/AML criticisms in examination reports so that we can track situations where no follow-up formal action has been taken.
- Our Committee on Bank Supervision also has sent an alert to remind and reinforce for OCC examination staff the need to recognize accounts and transactions that appear to be anomalous or suspicious or that have other characteristics that should cause them to be considered high-risk in nature, and to conduct additional transaction testing and investigation in such situations.

In addition, specifically with regard to Riggs, I have directed our Quality Management Division to immediately commence a review and evaluation of our BSA/AML supervision of Riggs. This review will include an assessment of whether we took appropriate and timely actions to address any shortcomings found in the bank's processes and in its responses to matters noted by the examiners, and the extent and effectiveness of our coordination and interaction with other regulators and with law enforcement. I have also asked for recommendations for improvements to our BSA/AML supervision and our enforcement policy with regard to BSA/AML violations.

Conclusion

The OCC is committed to preventing national banks from being used, wittingly or unwittingly, to engage in money laundering, terrorist financing, or other illicit activities. We stand ready to work with Congress, other financial institution regulatory agencies, law enforcement agencies, and the banking industry to continue to develop and implement a coordinated and comprehensive response to the threat posed to the Nation's financial system by money laundering and terrorist financing.

PREPARED STATEMENT OF DONALD E. POWELL

CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

JUNE 3, 2004

Mr. Chairman, Senator Sarbanes, and Members of the Committee, thank you for this opportunity to discuss how the Federal Deposit Insurance Corporation, along with the other bank regulatory agencies, addresses our responsibilities under the Bank Secrecy Act (BSA) and related anti-money laundering and antiterrorism laws.

My testimony begins with a brief history of the BSA and an overview of the work the FDIC is doing under the law. I also will outline the current initiatives that the FDIC is undertaking to foster a culture more focused on the effective supervision of banks for compliance with BSA and related laws, and to provide assistance to law enforcement agencies. Finally, I will discuss some broader ideas related to the way bank regulators, law enforcement, and the banking industry can work together to address money laundering and terrorist financing.

Background and Evolution of BSA

The Bank Secrecy Act, which was enacted in 1970, authorizes the Secretary of the Treasury (Treasury) to issue regulations requiring that financial institutions keep records and file reports on certain financial transactions. Treasury's authority includes specifying filing and recordkeeping procedures and designating the businesses and types of transactions subject to these procedures. As part of its overall responsibility and authority to examine banks for safety and soundness, the FDIC is responsible for examining State-chartered, nonmember financial institutions for compliance with the BSA. This is consistent with Treasury's delegation of its authority under the BSA to the financial regulatory agencies for determining compliance with the Treasury's Financial Reporting and Recordkeeping regulations.

The original purpose of the BSA was to prevent banks from being used to conceal money derived from criminal activity and tax evasion. A process of filing various reports, including currency transaction reports (CTR's), was established and proved highly useful in criminal, tax, and regulatory investigations and proceedings. Banks are required to report cash transactions over $10,000 using the CTR. The information collected in the CTR can provide a paper trail for investigations of financial crimes, including tax evasion and money laundering, and has led to convictions and asset forfeiture actions.

Although the BSA has been in effect for over 30 years, numerous revisions and amendments have been made to enhance the notification and investigation of financial crimes. The Money Laundering Control Act, which was enacted in 1986 to respond to the increase in money laundering activity related to narcotics trafficking, was the first major expansion of the BSA. The Money Laundering Control Act criminalized money laundering and prohibited the structuring of transactions to avoid the filing of CTR's. Additionally, at that time, banks reported suspicious transactions by marking the "Suspicious" box on the CTR and also filing a Report of an Apparent Crime form (criminal referral) with the bank's primary regulator and law enforcement agencies.

Over the years, additional laws and amendments were passed to define how financial institutions share information relating to apparent money laundering activities with law enforcement. These laws included: the Annunzio-Wylie Money Laundering Suppression Act of 1992, which replaced the criminal referral form with the suspicious activity report (SAR) to be used for apparent money laundering activities; the Money Laundering Suppression Act of 1994, which liberalized the rules for using CTR exemptions; and the Money Laundering and Financial Crimes Strategy Act of 1998, which focused on improving cooperation and coordination among regulators, law enforcement, and the financial services industry.

The focus of the BSA was escalated further in the wake of the September 11, 2001, terrorist attacks against the United States with passage of the Uniting and Strengthening America by Providing Appropriate Tools to Restrict, Intercept, and Obstruct Terrorism Act of 2001, otherwise known as the USA PATRIOT Act. Title III of the USA PATRIOT Act expands the BSA beyond its original purpose of deterring and detecting money laundering to include terrorist financing in the United States. One of the new provisions requires financial institutions to conduct due diligence on customer accounts through a Customer Identification Program (CIP). The CIP requires institutions to maintain records, including customer information and methods used to verify customers' identities.

In 1990, the Financial Crimes Enforcement Network (FinCEN) was established in Treasury to administer the BSA and provide a government-wide, multisource intelligence and analytical network. In October 2001, the USA PATRIOT Act elevated the status of FinCEN within Treasury and emphasized its role in fighting terrorist

financing. In addition to administering the BSA, FinCEN is responsible for expanding the regulatory framework to other industries (such as insurance, gaming, securities brokers/dealers) vulnerable to money laundering, terrorist financing, and other crimes.

Evolution of 314(a) Requests

Shortly after the attacks on September 11, the Federal Bureau of Investigation provided a confidential listing (Control List) of suspected terrorists to the Federal banking agencies. The Federal banking agencies provided the list to financial institutions to check their records for any relationships or transactions with named suspects. Financial institutions reported positive matches to the Federal Reserve Bank of New York which, in turn, passed the information to the appropriate law enforcement agency. Based upon this information, law enforcement authorities would subpoena the reporting bank for relevant information needed to assist in their investigation. The initial Control List primarily consisted of suspects, supporters, and material witnesses of the ongoing investigation of the September 11 attacks.

Section 314 of the USA PATRIOT Act requires FinCEN to establish a formal mechanism for law enforcement to communicate names of suspected terrorists and money launderers that are under investigation to financial institutions on a regular basis. The implementing regulations mandate that financial institutions receiving names of suspects search their account and transaction records for potential matches and report positive results to FinCEN in the manner and time frame specified in the request. This new information sharing system, referred to as "314(a) Requests," replaced the Control List.

Every FinCEN 314(a) request is certified and vetted as a valid and significant terrorist/money laundering investigation through the appropriate law enforcement agency prior to being sent to a financial institution. Law enforcement agencies maintain that this new system is an effective, successful tool in their investigations.

Information provided to the FDIC from FinCEN, showing the initial results of the program, indicate some successes. From February 18, 2003, through November 25, 2003, agencies have processed 188 law enforcement requests. Of these cases, 124 were related to money laundering and 64 cases were related to terrorism or terrorist financing. There were 1,256 subjects of interest in these investigations. Of these, financial institutions responded with 8,880 matches, resulting in the discovery or issuance of the following:

- 795 new accounts identified;
- 35 new transactions;
- 407 grand jury subpoenas;
- 11 search warrants;
- 29 administrative subpoenas/summons; and
- 3 indictments.

The FDIC plays a particularly active role in ensuring that the 314(a) program runs effectively by maintaining point of contact information for FDIC-supervised and national banks. By properly maintaining this information, the FDIC ensures that banks are able to act on 314(a) requests in the timeliest fashion.

The 314(a) requests should not be confused with the list published by the Department of the Treasury's Office of Foreign Assets Control (OFAC). The Section 314(a) request pertains to suspects and material witnesses to significant terrorist/money laundering investigations, and is confidential. Further, the names are subject to a one-time search of bank records, and banks are not required by law to terminate account relationships. The OFAC list is a public list which contains names of individuals, organizations and countries against whom the United States has instituted sanctions. Financial institutions must have a formal process for regular searches of records and transactions against updated OFAC lists.

Although the Section 314(a) requests have improved our ability to identify possible money laundering or terrorist financing activity, other provisions of Section 314 may be underutilized or could be improved. For example, under Section 314(b), there is a safe harbor for bankers to discuss suspect transactions with other banks that are counterparties in a transaction. It appears that only 10 percent of insured financial institutions use this safe harbor even though it creates an opportunity to gain a better understanding of, and develop additional information about, questionable transactions before they are reported. In addition, under Section 314(a), financial institutions generally have a 14-day window to report a positive "hit." This timeframe should be evaluated to determine whether this permissible reporting delay is realistic since the information may not be received until well after criminal activity occurs. As law enforcement, bank regulators and the industry gain experi-

ence with the USA PATRIOT Act, we must continually evaluate its implementation to ensure that it is as effective as possible.

Responsibilities of the FDIC to Facilitate BSA Compliance

All FDIC-supervised institutions are required to establish and maintain procedures designed to assure and monitor compliance with the requirements of the BSA. Section 326.8 of the FDIC's rules and regulations requires that all FDIC-supervised institutions maintain BSA compliance programs that include controls, training, and independent testing necessary to assure that effective programs are in place.

In addition to examining State-chartered, nonmember banks for compliance with the BSA and underlying regulations, the FDIC is required to make periodic reports regarding violations of Treasury's financial recordkeeping rules to the Treasury. The purpose of the BSA examination is to determine the effectiveness of a financial institution's anti-money laundering program. Specifically, every BSA examination focuses on the oversight provided by a bank's senior management and its respective Board of Directors, as well as the system of controls put in place to identify reportable transactions, prepare CTR's, monitor the purchase and sales of monetary instruments and electronic funds transfer activities, comply with the OFAC laws and regulations, administer information sharing requirements under Section 314(a) of the USA PATRIOT Act, administer the Customer Identification Program, and report suspicious activities. Although the BSA regulations do not prescribe the frequency with which BSA compliance should be reviewed, examination procedures for BSA compliance are included within the scope of FDIC safety and soundness examinations. Since 2000, the FDIC has conducted almost 11,000 BSA examinations.

The FDIC is the primary Federal regulator of approximately 5,300 insured financial institutions holding total assets of almost $1.7 trillion. The majority of FDIC-supervised institutions are small and located outside a Metropolitan Statistical Area (MSA),[1] in less-densely populated areas. To effectively supervise BSA compliance at State nonmember banks, the FDIC has adopted a risk-focused approach. An institution's level of risk for potential money laundering determines the necessary scope of the BSA examination. For example, an examiner might consider an institution with the following characteristics to have a low money-laundering risk: located in a rural area; not located in a high-risk money laundering and related financial crimes area (HIFCA);[2] small asset size; small deposit base; known and stable customer base; stable management and employee base; and relatively few CTR's.

On the other hand, an institution located in a HIFCA or engaged in particularly risky business lines will receive significantly more scrutiny under the FDIC's risk-focused compliance examinations due to their elevated risk profiles. Current HIFCA designations for money laundering are assigned to the MSA's of New York City, Los Angeles, Chicago, San Francisco, and Miami. HIFCA's also include the Mexican borders with Texas and Arizona as well as San Juan, Puerto Rico. Financial institutions located in a HIFCA, or that have certain characteristics that may indicate a greater risk of money laundering or related vulnerabilities, undergo an expanded-scope BSA examination. These examinations include extensive transaction testing designed to validate management's compliance with BSA and anti-money laundering regulations.

Regardless of the risk profile of a particular institution, the FDIC understands that all institutions are at risk of being utilized to facilitate money laundering and terrorist financing. In today's global banking environment where funds are transferred instantly and communication systems make services available nationally, even a lapse at a small financial institution outside of a major metropolitan area can have significant implications in another location across the Nation. The more difficult it is for criminals and terrorists to gain entry into the American financial system, the more likely it is that they will need to rely on less secure and less efficient means of financing their activities.

While it has been our experience that the vast majority of FDIC-supervised institutions are diligent in their efforts to establish, execute, and administer effective

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[1] The Office of Management and Budget defines an MSA as an area with either a minimum population of 50,000 or a Census Bureau-defined urbanized area with a total population of at least 100,000. MSA's comprise one or more counties and may include one or more outlying counties that have close economic and social relationships with the central county. An outlying county must have a specified level of commuting to the central counties and also must meet certain standards regarding metropolitan character. For example, the Washington, DC MSA extends from Frederick, Maryland, to Fredericksburg, Virginia, and includes two counties in West Virginia.

[2] HIFCA is a term used in the Money Laundering and Financial Crimes Strategy Act of 1998 as a means of concentrating law enforcement efforts at the Federal, State, and local levels in high intensity money laundering zones.

BSA compliance programs, there have been instances where controls and efforts were lacking. In those cases, the FDIC implements a range of corrective measures to ensure that banks comply with the law. Generally, weaknesses noted in BSA compliance have been technical in nature and have not resulted in the facilitation of money laundering or terrorist financing activities. Usually, bank management is responsive to correcting the deficiencies within the normal course of business. In cases where significant deficiencies are cited during a BSA examination, bank management is required to address such deficiencies in a written response to the FDIC that outlines the corrective action proposed and establishes a timeframe for implementation.

In cases where an institution has been lax in administering its BSA compliance program and failed to correct previously identified deficiencies, including significant violations of law, the FDIC has procedures to obtain commitments from bank management to correct the deficiencies. The procedures generally require some type of formal or informal enforcement action. The FDIC can also utilize its authority to assess civil money penalties against an institution for noncompliance with BSA. In addition, significant violations are referred to FinCEN, in accordance with the BSA, which also has the authority to assess civil money penalties for noncompliance with the BSA.

The FDIC believes in a flexible supervisory approach using technical guidance, moral suasion, and a gradual escalation of enforcement action as appropriate. However, a more aggressive supervisory approach may be necessary to effect correction when a greater risk for money laundering exists within an institution due to willful noncompliance with the BSA and/or the absence of an effective BSA program. The type of enforcement action pursued by the FDIC against an institution is directly related to the severity of the offense, management's willingness and ability to effectively implement corrective action, as well as the extent to which the program has failed to identify and/or deter potential money laundering. Additionally, the nature of the criticism, the response to prior weaknesses or violation notifications, and the overall risk profile of the institution are factored into the type of supervisory action. When weaknesses are identified at institutions that have a high BSA risk profile, such as those located within a HIFCA, the FDIC has been aggressive in taking formal supervisory action. In addition, the FDIC has the authority to remove and/or prohibit an individual from the banking industry for deliberate or negligent actions related to money laundering.

FDIC Efforts to Thwart Money Laundering and Terrorist Financing Activities

In order to identify money laundering and terrorist financing activity, it is important to know the differences between the two activities. Money laundering generally involves the following factors:

- Profit is the motivation;
- "Dirty money" is laundered;
- Funds are derived from the crime;
- Large sums of money are involved (generally);
- Shell companies and offshore centers are frequently used;
- Complicated structures are created often requiring attorney or trustee involvement;
- Assets are purchased with illicit funds, then sold, thereby converting to "clean" cash; and
- Use of official or counterfeit bank checks or wire transfers.

Terrorist financing differs as it generally involves the following factors:

- Ideology is the motivation;
- Both "clean money" and "dirty money" are laundered;
- Funds are often derived from donations and crime;
- Both large and small sums of money are involved;
- Banks and money exchanges (including alternate value transfer systems) are used;
- Charities and front operations are used; and
- Funding sometimes derives from government "state sponsorship."[3]

These distinctions between money laundering and terrorist financing are important when evaluating suspicious bank transactions.

[3] State sponsorship can be described as implicit or explicit action or funding by a government to endorse terrorist activity.

The FDIC examines CTR's and SAR's to determine, in part, a bank's compliance with the BSA. Examiners analyze an institution's volume and trend in CTR and SAR filings to assist in risk scoping the examination. For example, increases in the volume of CTR's filed may be the result of deposit growth, the elimination of exempted businesses, or increases in retail or other high-risk customers. Decreases may be caused by the failure of the bank to file CTR's, an increase in the number of exempted businesses, the elimination of retail and/or other high-risk customers, or structuring transactions to avoid reporting requirements.

Increases in the number of SAR's filed may be due to an increase in high-risk customers, entry into a high-risk market or product, or an improvement in the bank's method for identifying suspicious activity. Decreases may be the result of deficiencies in the bank's process for identifying suspicious activity, the closure of high-risk or suspicious accounts, personnel changes, or the failure of the bank to file SAR's.

When appropriate, examiners conduct transaction testing during a BSA examination to determine if reportable transactions have been captured on the bank's system and if a CTR was filed. In the case of a structured transaction, an examiner will determine if a SAR was filed. As part of the CTR and SAR validation process, an examiner may also note if the SAR reports fraud and/or insider abuse which is closely linked to money laundering and other illicit acts. Also, examination staff may use SAR's as a basis for further evaluation of the conduct of insiders who may eventually be removed and/or banned from the banking industry under Section 8(e) of the Federal Deposit Insurance Act.

Since 2001, the FDIC has issued 30 formal enforcement actions against 25 financial institutions and three individuals to address severely deficient BSA compliance efforts and/or ineffective anti-money laundering controls. These actions include 25 Orders to Cease and Desist, three Orders of Prohibition which ban individuals from participating in the banking industry and two Civil Money Penalty Assessments against related entities in the amount of $7,500,000. Fourteen of the 25 Cease and Desist Orders were issued in response to severe and/or chronic BSA-related deficiencies that exposed those institutions to a high vulnerability of possible money laundering activity.

The FDIC also has effectively utilized informal actions such as bank board resolutions and memoranda of understanding to strengthen the BSA compliance efforts of its supervised institutions under appropriate circumstances. The informal actions also put the bank's board of directors on notice of their responsibility to ensure BSA compliance. Since 2001, FDIC-supervised institutions have entered into 53 informal actions with BSA-related provisions.

FDIC Participation in Interagency Working Groups

The FDIC participates in numerous interagency working groups formed for the purpose of drafting risk-based revisions to the BSA, required by the USA PATRIOT Act, and developing interpretive guidance for the financial services community. The FDIC has worked actively with Treasury and the financial regulators in developing regulations and guidance to implement the USA PATRIOT Act. For many years, the FDIC has worked with the Treasury, FinCEN and the other banking agencies in setting international standards, developing policies, and implementing best practices to combat money laundering and, more recently, terrorist funding as part of the nation's anti-money laundering regime.

The FDIC also participates in the Bank Secrecy Act Advisory Group, which is a public-private partnership devoted to the discussion of money laundering schemes, enforcement of anti-money laundering laws, and remedies for making all reporting processes more efficient. The BSA Advisory Group has 43 members with representatives from all bank regulatory agencies; law enforcement; the securities, insurance, and gaming industries; and the banking industry. The BSA Advisory Group and its subcommittees are currently evaluating all aspects of the BSA (implementing rules and reporting requirements) and developing recommendations to make these areas more efficient.

International Outreach Programs

The FDIC believes that strong governance of foreign banking programs reduces opportunities for money laundering and increases the ability to identify sources of terrorist financing. The FDIC actively participates in working groups and technical assistance missions sponsored by the Departments of State and Treasury to assess vulnerabilities to terrorist financing activity worldwide and to develop and implement plans to assist foreign governments in enforcement efforts directed toward financial crimes. To facilitate its commitment to these assignments, the FDIC identified a group of 22 examiners and attorneys who have received specialized training

in identifying money laundering and terrorist financing. Over the past 2 years, several of these individuals and others have worked with over 62 countries to provide technical assistance and training, meeting with supervisory and law enforcement representatives, senior prosecutors, and financial intelligence unit directors, and assisting in the development of foreign-directed BSA training programs. In all cases, the foreign officials from these countries ranging from Caribbean to European to Middle Eastern war-torn countries expressed interest in the FDIC's anti-money laundering examination programs and our progress in implementing PATRIOT Act provisions. Some of these countries have a myriad of issues and concerns with regulatory compliance and secrecy laws. Further, through participation on the Basel Committee, the FDIC has assisted in the evaluation and issuance of international guidelines on money laundering.

In addition, the FDIC provided substantial assistance to the Department of the Treasury in drafting the anti-money laundering/antiterrorist financing rules for the Iraqi Coalition Provisional Authority in Baghdad. The comprehensive framework was drafted for the new Iraqi government to implement and conform to international standards.

Current Initiatives

Since the passage of the USA PATRIOT Act in 2001 (which augments the BSA to address the risk of terrorist financing activities), the FDIC has been involved in a number of activities, including: implementing rules and interpretive guidance, incorporating changes into examination procedures, training examiners, and participating in industry outreach sessions. The agency participated in the rulemaking process of relevant parts of the USA PATRIOT Act and has participated in a number of working groups focused on counter-financing of terrorism and the USA PATRIOT Act. In conjunction with these activities, and, in part, to address some recommendations identified in a recent FDIC Office of Inspector General report, we have undertaken a number of initiatives to enhance the FDIC's enforcement of the BSA.

Upgrading Staff

Consistent with the increased importance of the BSA, the additional workload associated with the USA PATRIOT Act, and greater emphasis on international efforts to combat terrorism, the FDIC has taken additional steps to ensure that these areas receive increased attention. The FDIC is dedicating more staff to its Special Activities Section, which oversees the nationwide implementation and coordination of the FDIC's BSA, anti-money laundering, and PATRIOT Act efforts. Additionally, the FDIC is designating and training additional BSA subject matter experts. The FDIC expects to double its number of BSA experts over the next 18 months. Currently, the FDIC has more than 150 BSA experts nationwide. Multiple experts are assigned to offices that examine several institutions having characteristics that may indicate greater money laundering or related vulnerabilities.

Additional Training

In an effort to increase the level of BSA expertise in the field, the FDIC is requiring all examiners to complete additional formal training on BSA anti-money laundering and PATRIOT Act issues by year-end 2004. This computer-based training also will be offered to all State banking authorities and other regulators who wish to provide additional training for their staff. As a supplement to the required additional training, the FDIC is participating in the planning and development of anti-money laundering training for examiners that is sponsored by the Federal Financial Institutions Examination Council.

Updating Examiner Guidance

The FDIC continues to reevaluate and modify as necessary all BSA anti-money laundering and antiterrorism examination and industry guidance to ensure the incorporation of changes resulting from passage of the USA PATRIOT Act. This effort involves reviewing all written guidance for examiner and industry use, working with other bank regulators and Federal law enforcement in assessing the guidance and using conferences and other public forums to communicate any changes required by banks for compliance with the law.

Improving State Examinations

The FDIC has an alternating examination program with most State banking departments. In this program, the FDIC and State authorities alternate, or conduct every other examination, accepting or using the other agency's examination findings to meet mandatory examination cycle requirements. While the FDIC reviews BSA

compliance each time it examines a State-chartered, nonmember bank, not all States conduct similar examinations.

Beginning this month, in those instances where a State banking authority does not conduct Bank Secrecy Act exams, the FDIC will send an examiner to conduct an examination for BSA and anti-money laundering compliance concurrent with the State authority's safety and soundness examination. This initiative will ensure that all FDIC-supervised banks are reviewed for money laundering and terrorist financing activity during every examination cycle. Conducting a BSA examination concurrent with the State's safety and soundness examination is expected to reduce the regulatory burden upon the financial institution by scheduling both events simultaneously rather than multiple examinations conducted during a given year.

In addition, 10 sTates have committed to beginning BSA-examinations in 2004. The FDIC will assist those States as necessary with training to facilitate thorough state evaluations of BSA compliance.

Improving Reporting

The FDIC has centralized the monitoring process for FDIC-supervised banks with serious BSA, anti-money laundering and antiterrorist financing program deficiencies. This allows senior Washington Office personnel to confer with regional staff to ensure that a consistent supervisory approach is applied on a national basis. In addition, the FDIC recently centralized the process for referring BSA violations to FinCEN which provides consistency in reporting. These centralization efforts also will enable the FDIC to analyze historical data internally to identify emerging trends and issues among FDIC-supervised banks.

In order to provide more information to financial institutions and the general public, a section of the FDIC's external website is devoted to the Bank Secrecy Act, anti-money laundering and counter-financing of terrorism issues.

Improving Government and Industry Coordination

While there has been marked improvement in information sharing among Government agencies in recent years, communication between Government entities and the banking industry could be improved. Current communication tends to be limited to requests for information and responses to those requests. We should also create a better dialogue between the industry, the regulators, and law enforcement about how our banking system can be used for nefarious purposes. We should continue to work to eliminate any barriers that exist between Government and the industry to foster more seamless communication about both the broader context and potential threats. In my view, these efforts would help us detect and deter the use of the financial system by criminals and terrorists.

Conclusion

The FDIC believes that a vigilant BSA, anti-money laundering and antiterrorist financing supervisory program requires that appropriate supervisory actions be taken to support compliance with Treasury and FDIC regulations and guidance. Proper supervision of banks to ensure that they maintain effective programs creates an environment where terrorists know that any attempt to use the American financial system to fund their operations pose an unacceptable risk of discovery.

The FDIC diligently enforces the BSA by establishing a comprehensive supervisory approach that includes conducting thorough BSA compliance examinations and ensuring an appropriate supervisory approach when BSA concerns exist in FDIC-supervised institutions. In addition, the FDIC is proactive in addressing recent changes to the BSA by incorporating those rules into examiner and industry guidance, providing various forms of examiner and industry training and outreach sessions, and assisting in global anti-money laundering and antiterrorist financing efforts.

The FDIC is fully committed to preventing the use of the financial system to support criminal or terrorist activities. Highly trained bank examiners are a major resource in this fight that cannot be easily duplicated. They are in every bank in the country, they are able to identify suspicious relationships and transactions and they have the power to dig deeply into the facts when warning flags are raised. While the current system is not perfect, we should approach reforms carefully to ensure that they do not duplicate resources and expertise that already exist and do not inadvertently interfere with the achievement of the goals that we all share.

This concludes my testimony. I would be happy to answer any questions and would like to thank the Committee for providing this opportunity to discuss the FDIC's role in enforcing the Bank Secrecy Act and assisting the overall effort to fight money laundering and terrorist financing activity.

PREPARED STATEMENT OF JAMES E. GILLERAN

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U.S. DEPARTMENT OF THE TREASURY

JUNE 3, 2004

Introduction

Good morning, Chairman Shelby, Senator Sarbanes, and Members of the Committee. Thank you for the opportunity to testify at today's hearing on the Bank Secrecy Act (BSA), as amended by the USA PATRIOT Act. My testimony provides an overview of the BSA and OTS's compliance responsibilities under the BSA and Home Owners' Loan Act (HOLA), describes our work to implement the USA PATRIOT Act and strengthen oversight of the BSA, and reports on the state of thrift compliance with the BSA and on how OTS responds to failures and deficiencies to comply with the Act. My statement also explains requirements for thrifts to file suspicious activity reports (SAR's), and summarizes an ongoing GAO audit of the agency on BSA implementation by OTS.

OTS fully supports the goals and objectives of the BSA and the USA PATRIOT Act through policies, programs, and regulatory, supervisory, and enforcement initiatives. We have examiners who are well trained and experienced in reviewing thrifts for compliance with the BSA and the USA PATRIOT Act. Our examiners know the institutions we regulate well and are well-positioned to identify and correct BSA problems. The average OTS examiner has over 16 years of experience.

Our examiners have been using updated BSA examination procedures since October of last year. We have strengthened our oversight by issuing internal guidance to our examiners and external guidance to the depository institutions. We have also developed and provided substantial new training programs for our staff over the last 2 years, and increased the number of examiners who have been trained in BSA requirements and have developed proficiency in this area.

The number of OTS examiners capable of conducting BSA reviews has increased by over 80 examiners, or by approximately 75 percent from 2001 to the present. We now have more than 190 examiners trained in BSA compliance issues, and we will continue to train staff and add expertise to our examination corps in this area in the coming year. We also shortened the examination cycle for BSA reviews since 2001, from a 2 to 3 year cycle to a 12 to 18 month examination cycle, or more frequently if circumstances require.

In addition, our field personnel communicate on a regular, on-going basis with OTS senior managers. Through frequent industry contact and ongoing supervision, OTS continually monitors industry BSA compliance efforts. We frequently consult with individual thrifts on their BSA compliance programs, such as reviewing changes in key personnel, unusual activity, or anomalous transactions that might warrant a field visit.

In our experience, the most effective way to uncover BSA and USA PATRIOT Act deficiencies is through the ongoing examination process. Violations are usually discovered in fissures within an institution's programs, controls or operations. Uncovering weaknesses in an institution's BSA compliance program requires experienced examiners who are familiar with the ongoing operations of the particular institutions they oversee as well as how various banking transactions are typically structured, industry best practices, and depository institution operations, generally.

BSA compliance review is necessarily risk-focused—the review is tailored to consider the potential risk of money laundering or terrorist financing in different business lines. Our examiners have broad exposure to an institution's entire business operation: Its organizational structure, business activities, normal range of transactions, risk management practices, the quality of its management, and its internal control environment. Our examinations and follow-up reviews enable us to monitor corrections and improvements in, and ongoing compliance with BSA/AML requirements. Knowledge of, and familiarity with each institution's risk profile puts OTS in the best position to effectively monitor the BSA compliance programs and activities of the institutions we regulate.

Background of the Bank Secrecy Act and Compliance Overview

The Bank Secrecy Act (BSA), enacted in 1970, requires financial institutions to file certain currency and monetary instrument reports and maintain certain records for possible use in criminal, tax, and regulatory proceedings. The BSA's purpose is to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity. Accordingly, the BSA requirements result in a paper trail of the activities of money launderers serving the inter-

ests of terrorists, drug traffickers, and other elements of white collar and organized crime.

Congress has amended the BSA several times over the years to strengthen its anti-money laundering (AML) and counter-terrorism financing purposes. The most recent, and perhaps most significant, set of amendments is found in Title III of the USA PATRIOT Act. The USA PATRIOT Act adopted strong and far-reaching requirements intended to prevent, detect, and prosecute terrorism, terrorist financing, and international money laundering. It has resulted in several new regulations that have a direct impact on a thrift's BSA/AML compliance program.

Since its enactment, OTS has worked vigorously and diligently to implement the USA PATRIOT Act. As detailed below, OTS has been actively involved in crafting regulations implementing various provisions of the USA PATRIOT Act,[1] and in issuing related guidance and examination procedures. OTS has been examining and working with the institutions we regulate to ensure compliance not only with the letter of the law, but also the spirit of its intended purpose.

OTS's BSA Oversight Responsibilities

The Home Owners' Loan Act (HOLA) authorizes OTS to require thrifts to comply with the BSA and provides very broad enforcement authority to compel this objective.[2] The HOLA mandates that OTS issue regulations requiring thrifts to adopt BSA compliance procedures. At each examination we conduct, OTS reviews the required procedures, documents its findings and describes any significant problems in the examination report. When a thrift fails to establish and maintain the required procedures, or fails to correct previously identified problems, our examiners and field supervisors are instructed to take enforcement action against the institution. In addition to the HOLA, we have enforcement authority under the Federal Deposit Insurance Act (FDIA), which also imposes AML recordkeeping requirements on thrifts and other insured depository institutions.[3]

To discharge our responsibilities under the HOLA and FDIA, OTS issued a BSA regulation that requires compliance with specific components of the BSA.[4] Our regulation also requires thrifts to comply with the Department of the Treasury's BSA regulations,[5] including requirements for Customer Identification Programs (CIP's), internal controls, testing for BSA compliance, and employee training on BSA/AML and related issues.

OTS has also adopted a suspicious activity report (SAR) regulation that requires thrifts to file a SAR with FinCEN and the appropriate Federal law enforcement agencies when it detects a "known or suspected violation of Federal law or a suspicious transaction related to a money laundering activity or a violation of the [BSA]."[6] These requirements are described in more detail later in this testimony.

While OTS has broad enforcement authority to correct a deficiency or BSA violation, choosing the appropriate supervisory response involves the careful balancing of a wide range of factors and the informed exercise of professional judgment and discretion.

In our experience, the most effective way to resolve most BSA/AML compliance program deficiencies is as part of the overall examination process. We routinely require thrifts to undertake corrective action in the course of an examination. Addressing issues within the examination framework often results in a thrift promptly implementing necessary corrective action, and makes for fast and effective changes that we can immediately review. We believe that our examiners are in the best position to uncover problems with a thrift's BSA/AML compliance program and to resolve them quickly with management. The relationship between the institutions we regulate and our examiners is extremely constructive.

It is our experience that most institutions appreciate the importance of BSA and the USA PATRIOT Act, and are committed to the concepts, goals, and objectives of these laws. We continue to work with thrift institutions to ensure that they have a strong, independent testing and verification process in place. Numbers bear out this contention. Since July of last year, we addressed BSA/AML compliance program deficiencies at 167 thrifts. Some of these deficiencies were self-reported by the institutions, but the vast majority were identified during OTS examinations. The com-

[1] This statement references three sets of regulations. These are OTS's BSA rule at 12 CFR § 563.177; Treasury's BSA regulation at 31 CFR Part 103, which applies to savings associations; and the interagency USA PATRIOT Act regulations, which are a part of Treasury's BSA rule in Part 103, which apply to a wide range of financial institutions, including thrifts.

[2] HOLA § 5(d)(6).

[3] FDIA § 21.

[4] 12 CFR § 563.177.

[5] 12 CFR Part 103.

[6] 12 CFR § 563.180.

bination of self-reporting and issues identified in examinations uncovered 342 BSA violations at these institutions, mostly of Treasury's BSA regulations at 31 CFR Part 103. In all cases, management either agreed with the examiner's recommendation and moved promptly to implement changes to fix the problem, or completed the recommended corrective action before the examination was completed.

When the examination approach fails to resolve a BSA problem or issue, OTS can take enforcement action under FDIA Section 8 against a thrift and its related entities for engaging in an unsafe or unsound practice or violating a law, regulation, condition imposed in writing, or written agreement. Under this authority, OTS may (i) issue cease-and-desist orders, (ii) issue removal, suspension, and prohibition orders, and/or (iii) impose civil money penalties.

OTS Implementation of the USA PATRIOT Act

KEY PROVISIONS OF THE USA PATRIOT ACT

OTS often, in coordination with FinCEN and the other Federal banking agencies (FBA's), has participated in numerous initiatives to issue regulations, policy guidance, and examination procedures to implement the USA PATRIOT Act. For example, OTS issued an extensive staff summary of the USA PATRIOT Act in March 2002.[7] This document informs institutions of the requirements of the Act and provides information on its implementation. In particular, it discusses the USA PATRIOT Act in three sections, as follows:

- The first section describes USA PATRIOT Act requirements that are applicable to all thrift institutions and that were effective immediately or in the near term, such as the information sharing requirements and the requirement that a financial institution produce records relating to its BSA/AML compliance program or its customers within 120 hours of a request from the appropriate FBA.
- The second section describes the new enhanced due diligence procedures for thrifts that engage in private banking or maintain foreign correspondent accounts.
- The third section discusses USA PATRIOT Act provisions of general interest, such as the authorization for Treasury to impose special measures with respect to particular institutions, jurisdictions, accounts, or transactions and the requirement that each thrift have a Customer Identification Program (CIP).

OTS also issued a USA PATRIOT Act Update in August 2002.[8] The update included important guidance on the new CIP requirements, information sharing with law enforcement, and new due diligence requirements for foreign correspondent accounts and private banking accounts. The update noted that OTS would begin reviewing for compliance with the provisions when the new regulations became effective, and urged institutions to carefully review the new regulations and their preambles, and implement the new procedures as required.

Customer Identification Programs

The new CIP requirements, issued on May 9, 2003, by the Treasury Department, the FBA's, the SEC, and the CFTC, set forth procedures for verifying the identity of anyone who opens an account, and requires institutions to maintain records to verify a customer's identity, and to determine whether the customer appears on any list of known or suspected terrorists or terrorist organizations. An institution's CIP must include risk-based procedures designed to enable the institution to form a reasonable belief that it knows the identity of its customers. OTS has been examining institutions for CIP compliance since the requirements went into effect on October 1, 2003.

Simultaneous with the issuance of the new CIP rules, OTS issued two additional pieces of guidance.[9] *Customer Identification Programs: A Staff Summary and Answers to Questions* (the CIP Summary) (copy attached); and *USA PATRIOT Act Preparedness Checkup: A Framework for Achieving Compliance with the New USA PATRIOT Act Regulations* (the Checkup) (copy attached).

The CIP Summary, the first guidance issued by a regulatory agency about the new CIP rules, alerted thrifts to the specific requirements of the new rules. The CIP Summary also specifies exactly what OTS is looking for when reviewing a thrift's CIP, and addresses important questions about the CIP rules.

The CIP Summary describes the types of accounts covered by the rule, who is a "customer" for purposes of the rules, and the specific requirements that a thrift's CIP must meet. The CIP Summary also:

[7] OTS Notice: OTS Staff Summary of USA PATRIOT Act (March 20, 2002) (copy attached).
[8] Chief Executive Officer (CEO) Letter 166 (August 5, 2002) (copy attached).
[9] CEO Letter 175 (May 9, 2003) (copy attached).

- Notes the four pieces of identifying information that a thrift must obtain from a customer who opens a new account;
- Indicates the methods (both documentary and nondocumentary) by which a thrift can verify the identifying information;
- Discusses the recordkeeping requirements of the new rules;
- Highlights the requirements about checking Government lists of suspected terrorists or money launderers;
- Notes that thrifts must be in compliance with the new rules beginning October 1, 2003; and
- Emphasizes that OTS would begin examining for compliance during all examinations beginning on or after October 1, 2003.

The Checkup was issued the same day as the new rules and the CIP Summary. It remains the only checklist form of guidance about preparing for USA PATRIOT Act implementation issued by a regulatory agency. In the Checkup, OTS encouraged institutions to "ADApT" their current BSA/AML program to the new USA PATRIOT Act requirements:

- Analyze their current program;
- Develop a comprehensive BSA/AML program, which includes a CIP that address all of the thrift's business lines;
- Apply the revised program throughout the thrift's day-to-day operations; and
- Test the new program through internal audits and testing to ensure that the program is functioning as intended.

The Checkup lists several questions a thrift should ask as it ADApTs to the new USA PATRIOT Act requirements. For instance, when *Analyzing* its current program, a thrift should consider, among other things, how its business operations expose it to money laundering or terrorism financing risks. When *Developing* its new, enhanced BSA/AML program, a thrift should take a number of steps, including ensuring that the program addresses each of the new regulatory requirements and identify business operations that might require enhanced scrutiny.

When *Applying* its new program, a thrift should ask itself whether staff is informed of the new requirements, whether appropriate customer identification information collection and verification practices are taking place, and whether private banking accounts and foreign correspondent accounts are being handled correctly. Finally, when a thrift *Tests* the new program, the Checkup provides a number of factors for the thrift to review, including ensuring that internal audits or compliance reviews identify shortcomings in the BSA/AML compliance program and seek prompt corrective action, and determining whether staff and service provider implementation of the new regulatory requirements is keeping pace with the thrift's operational needs. Our examiners are instructed to explore all of these issues when examining an institution's USA PATRIOT Act compliance.

In January 2004, OTS, along with the other FBA's, the SEC, and the CFTC, issued another importance piece of guidance, "frequently asked questions" (FAQ's) to help explain the final CIP rule.[10] That document begins with a general description of the CIP requirements and emphasizes that a bank's CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The FAQ's note that it is critical that each bank develop procedures to account for all relevant risks, including those presented by the types of accounts maintained by the bank, the various methods provided to open accounts, the type of identifying information available, and the bank's size, location, and type of business or customer base.

The FAQ's also make clear that specific minimum requirements in the rule, such as the four basic types of information to be obtained from each customer, should be supplemented by risk-based verification procedures, where appropriate, to ensure that the bank has a reasonable belief that it knows each customer's identity.

The document also answers a number of common questions about the CIP rules, such as whether loans purchased from a car dealer are "accounts" (No) and whether a person who becomes a co-owner of an existing deposit account is a "customer" (Yes). The FAQ's also consider whether a bank's foreign subsidiaries are subject to the rule (No) and whether a bank may keep copies of documents provided to verify a customer's identity even though not required to do so (Yes). The agencies are currently working on a second set of FAQ's on the CIP requirements, which are now circulating for approval at the agencies and will be issued soon.

[10] CEO Letter 188 (January 8, 2004) (copy attached).

Information Sharing

Section 314 of the USA PATRIOT Act encourages cooperation and information sharing among financial institutions, regulators, and law enforcement. OTS has actively participated in developing and implementing these requirements.

On September 26, 2002, Treasury issued a final rule implementing the new information sharing requirements. In response to industry concerns about the regulatory burden of the requests for information, and after consulting with OTS and the other FBA's, on November 26, 2002, Treasury placed a moratorium on information requests from law enforcement. Treasury subsequently streamlined the process and lifted the moratorium in February 2003. Since then, institutions have been responding to requests for information from law enforcement.

Last October, OTS alerted thrifts to new examination procedures to review thrift compliance with the new requirements,[11] and we incorporated the new procedures into our overall BSA examination procedures. Those procedures include a review of the institution's procedures for promptly responding to law enforcement requests for information, documentation of any positive match with the requests, and copies of any vendor confidentiality agreements regarding services rendered pursuant to the requests. Examiners are also instructed to review copies of any SAR's filed related to the information sharing process, as well as to review an institution's analysis or documentation where a SAR was considered, but not filed.

OTS also participates in quarterly meetings with FinCEN, the regulators, and representatives of law enforcement to discuss and further refine the information sharing process. Those meetings allow law enforcement to provide feedback to the regulators about how the information sharing process is working and for regulators to convey to law enforcement the views of financial institutions on how to improve the process. Items of discussion have included a breakdown of positive responses by type of financial institution and regulator, proposed enhancements to the various forms used in the process, and development of a secure, encrypted network to facilitate the exchange of information between law enforcement and financial institutions.

Foreign Shell Banks, Requests for Bank Records, and Summons Authority

OTS has also issued specific guidance on the USA PATRIOT Act provisions banning correspondent accounts for foreign shell banks, requiring financial institutions to produce records related to anti-money laundering compliance within 120 hours of an examiner's request, and providing that Treasury or the Attorney General may issue a subpoena or summons to any foreign bank that maintains a correspondent account in the United States and may request the bank to produce records related to that account, including records maintained abroad.

Treasury, through FinCEN and after consultation with OTS and the other FBA's, issued a final rule implementing these new requirements on September 26, 2002. Last October, OTS alerted thrifts to the new examination procedures to review thrift compliance with the new requirements.[12] Under those procedures, examiners are to evaluate an institution's policies and procedures for foreign correspondent accounts to determine whether they address the minimum requirements specified in the regulation, such as the responsible party for gathering the necessary information and the process for identifying foreign correspondent accounts. The procedures also require an examiner to, based on a risk assessment, sample foreign correspondent accounts, review the collection of requisite information and obtain any customer due diligence or other relevant information related to those accounts. We have incorporated those new procedures into our overall BSA examination procedures.

Other Significant USA PATRIOT Act Provisions

OTS also participates in a number of other ongoing working groups and projects related to specific provisions of the USA PATRIOT Act. For instance, Treasury consults with OTS, among others, when considering whether to impose special measures on a jurisdiction, institution, class of transactions, or type of account that the Department finds is of "primary money laundering concern." To date, Treasury has imposed special measures on Nahru, Burma, and two Burmese banks, and has just issued a proposal to do so with regard to a bank in Syria.

OTS has been involved in developing new regulations implementing the USA PATRIOT Act requirements that financial institutions have specific due diligence procedures, including enhanced due diligence procedures, for correspondent accounts for foreign financial institutions or private banking accounts for non-U.S. persons.

[11] CEO Letter 183 (October 20, 2003) (copy attached).
[12] CEO Letter 183 (October 20, 2003) (copy attached).

On July 23, 2002, Treasury, after consulting with OTS and the other FBA's, issued an interim rule imposing the Section 312 requirements on banks and thrifts. Treasury is drafting a final regulation implementing Section 312, and routinely consults OTS.

EXAMINATION PROCEDURES AND GUIDANCE

In preparation for the October 1, 2003, compliance deadline for the new CIP requirements, OTS updated its entire BSA examination program. This revision included updating existing procedures and adding new sections to address specific USA PATRIOT Act requirements. We trained our examiners on the new procedures in mid-September 2003, and our examiners have been using the new procedures for all BSA examinations that commenced since October 1, 2003. Examiner reaction has been positive, with the examiners' general perception that most institutions are taking the necessary steps to comply with the new USA PATRIOT Act requirements. After extensive field testing, we are in the final stages of formally incorporating the new procedures in our OTS Examination Handbook.

Under our comprehensive examination approach, many more examiners are now trained on conducting BSA examinations, which has expanded our capabilities immensely. We continually discuss and cover BSA and USA PATRIOT Act examination issues at staff conferences, examiner team meetings, and examiner education initiatives. In addition to our September 2003 training on the new procedures, we have included BSA/USA PATRIOT Act discussions in our Compliance I, Compliance II, and Advanced Compliance examiner schools. We provided internal training on the new BSA/USA PATRIOT Act requirements at our National Applications Staff Conference in May 2003 and our National Compliance Training for Senior Management program in June 2003. We also provide online and CD–ROM study guides and training modules for our examiners.

We actively participate in training programs and industry conferences throughout the country. Besides the guidance we have issued directly to institutions, we have participated in numerous interagency BSA/USA PATRIOT Act seminars and town meetings with industry representatives in all of our Regions. We also participated in BSA/USA PATRIOT Act discussions at various officer and director conferences, such as the FDIC's Regional Directors conference, and numerous trade association conferences. These include conferences sponsored by America's Community Bankers, the California Bankers Association, the Chicagoland Bankers Association, the Florida Bankers Association, the Georgia Community Bankers Association, the Heartland Community Bankers, the Iowa Bankers Association, Iowa Community Bankers and Iowa Independent Bankers Association, the Maryland Bankers Association, the Missouri Bankers, the North Carolina Bankers Association, the Suncoast Bankers Compliance Association, and the Wisconsin Community Bankers, among others.

In implementing the new USA PATRIOT Act requirements and in examining thrifts for compliance under the new BSA procedures issued last October, OTS also has had the benefit of several recommendations made by the Treasury Department's Inspector General, who conducted an audit of OTS's enforcement actions taken for BSA violations. That audit report, issued September 23, 2003, and which covered the period January 2000 through October 2002, made certain recommendations to further enhance OTS's supervisory process and data collection efforts.

In response to these recommendations, OTS has issued both external and internal supplemental guidance on BSA/AML compliance programs and the enforcement of BSA obligations. This past March, OTS issued a regulatory bulletin that discusses OTS's authority under the BSA, details the specific regulatory and statutory requirements applicable to thrift operations in this area, and sets out general enforcement guidelines that OTS will follow for violations of the regulatory and statutory requirements.[13]

The bulletin also lists the special factors that OTS will consider when determining the appropriate enforcement action for BSA/AML violations, including the following:

- Whether the thrift has adequately corrected BSA/AML violations noted in a prior Report of Examination (ROE);
- Whether the thrift's BSA/AML compliance has deteriorated since violations were noted in the prior ROE, or there has been inordinate delay in making meaningful progress in addressing the violations;
- Whether the violations in fact constitute, or reflect a material risk of, money laundering, terrorist financing, or structuring to avoid reporting requirements; and

[13] Regulatory Bulletin 18–6 (March 31, 2004) (copy attached).

- Whether the thrift identified the weaknesses itself through its BSA testing, audit, or self-evaluation efforts and the thrift has independently instituted timely and adequate corrective action.

On April 5, 2004, we issued to our examiners new internal guidance elaborating on certain features of the regulatory bulletin. That guidance identifies specific BSA/AML violations that must be noted in examination reports, unless the thrift adequately corrects the violations during the examination period. The internal guidance provides further instruction on when a thrift will be considered to have "adequately corrected" a violation. The internal guidance also specifies that all institutions, regardless of asset size, must have BSA compliance programs that address all the regulatory requirements and are appropriate to the BSA/AML risks attributable to the thrift's risk factors, operational complexity, and market circumstances. Finally, the internal guidance provides more detailed instructions to examiners on documenting BSA/AML violations in the appropriate OTS database.

The guidance on entering BSA violations data into OTS's new database is part of an ongoing, multiyear project to enhance and update our examination reporting database that was begun in January 2000. The update, now completed, encompasses all examination areas, including examination of a thrift's BSA compliance program. Not only does our enhanced database enable OTS to more closely monitor a thrift's compliance as well as industry trends and areas of interest, but also the data it is producing verifies our conviction that the most effective way to resolve deficiencies in a thrift's BSA/AML compliance program is during the examination process.

Finally, also as suggested by the Inspector General, we have enhanced our supervisory review of the BSA examination process. Specifically, to assure BSA violation data accuracy, each examiner-in-charge is now responsible for ensuring that BSA violations are entered into the data system correctly. This is often supplemented with a second level review and each region will conduct periodic quality assurance reviews to further ensure accurate data entry. We have drafted procedures for including BSA examinations and the integrity of system data entry in our ongoing Examination Quality Assurance reviews. Those reviews are designed to test compliance with OTS's national standards for BSA examinations, including those discussed in the new guidance. The initial review of examinations completed in the first quarter of calendar year 2004 will commence in the third quarter.

ASSESSMENT OF THRIFT COMPLIANCE WITH THE BSA; OTS ENFORCEMENT

The effective date for the updated procedures to conduct BSA examinations, October 1 of last year, coincides with the effective date for the most recent USA PATRIOT Act regulation, the CIP rules. Although we have been using these new procedures only a short time, we have received preliminary feedback from examiners and supervisors in the field.

That feedback is generally positive. We believe that the thrift industry, in general, is complying with the BSA and USA PATRIOT Act requirements. As in most areas of bank supervision, however, we continue to identify areas of weakness in some thrift institutions. We also periodically uncover significant problems at a small number of institutions. In these situations, we move quickly and forcefully to correct violations. We believe that our record of risk-based supervisory response to identified institutional weaknesses places OTS in an excellent position for ensuring that the thrift industry continues to meets its BSA/AML obligations.

We have identified some recurring problems related to basic BSA/AML requirements at some smaller institutions that have fewer resources to devote to compliance issues. The problems we see in these smaller thrifts are normally the same types we saw even prior to the USA PATRIOT Act. They generally involve the more administratively intensive requirements of the BSA program elements. For example, some smaller thrifts have inadequate training programs or fail to conduct an annual audit of the BSA compliance program that is fully independent.

Generally speaking, smaller thrifts engaged in typical mortgage lending and FDIC-insured deposit taking in a local community tend to be exposed to a lower risk of money laundering as a result of the traditional nature of their operations. They tend to know their customers, have geographically limited operations, offer few or no international banking or private banking products and services, and conduct more streamlined, traditional banking operations focused on narrow, longstanding markets (normally mortgage lending). Even small institutions, however, are not free from the risk of money laundering activities and our reviews take that fact into consideration.

The BSA compliance program at a small thrift—which still should be risk-based—need not be as elaborate as a program at a large, international financial institution. While a BSA compliance program must include all regulatory components, how each component is satisfied can vary depending on the operational risk presented by a

particular institution's business. We have made clear to the industry and our examiners that all thrifts, regardless of size, must have BSA compliance programs that address all regulatory requirements and are appropriate to the BSA risks attributable to their operational complexity and market circumstances.

OTS has backed up that message by issuing a number of formal enforcement orders to ensure that savings associations comply fully with the requirements of the BSA. For example, in October 2003, OTS issued a comprehensive cease-and-desist order to a savings association requiring that it develop and implement effective BSA and AML programs, including procedures to ensure that SAR's and CTR's are filed as required by law. OTS also fined the institution $175,000 for its past violations. OTS is closely monitoring the institution's compliance with the order.

In another example, OTS recently issued a cease-and-desist order against an institution that had several problems with its BSA/AML compliance program. Those problems included failing to monitor large cash transaction activity in several commercial accounts, failing to file SAR's, and failing to file CTR's. Examinations also revealed weaknesses in the required BSA training programs. The cease-and-desist order required the thrift to strengthen its BSA compliance program, with particular attention to its CTR filing obligation and ensuring that its designated BSA officer had sufficient resources to perform BSA responsibilities on a day-to-day basis.

In all, since we started using our new examination procedures last October, we have issued seven formal enforcement orders for BSA violations, including cease-and-desist orders, civil money penalties, and supervisory agreements. We also use the examination process to informally resolve a host of BSA/AML compliance issues. As I noted, since last July, we identified 167 thrifts with deficiencies in their BSA/AML compliance programs—all of the institutions either agreed to implement changes and moved promptly to do so, or completed the recommended corrective action before the completion of their examination. Finally, we are actively investigating several other possible violations of the BSA by thrifts, which may result in the issuance of other enforcement orders.

INTERAGENCY WORKING GROUPS AND COMMITTEES

Cooperation with our fellow agencies is always important, and it is particularly crucial in the anti-money laundering context. Money laundering and the financing of terrorism are truly global issues, cutting across a wide range of business activities, financial institutions, and international boundaries. The continuing fight against money laundering and terrorism demands coordinated, consistent efforts on both the national and international level.

OTS and our Federal banking agency counterparts largely work hand-in-hand in this effort. I have already mentioned the number of USA PATRIOT Act-related working groups and regulatory projects to which OTS, as well the other Federal banking agencies, have contributed. Many of those projects continue, as the agencies, always in a concerted way, provide guidance and examination standards to the industry. A good example of such a continuing effort is the ongoing work to issue a second set of frequently asked questions about the Customer Identification Program rules.

OTS also participates in the Bank Secrecy Act Advisory Group (BSAAG). The BSAAG is a unique collection of representatives from law enforcement, regulators, and the private sector charged with responsibility for advising the Secretary of the Treasury on matters relating to the administration of the BSA. With the USA PATRIOT Act's expansion of the types of entities subject to anti-money laundering program requirements, the BSAAG's membership has also recently expanded to include representatives from a wide variety of new industries, such as automobile dealers, life insurance companies, and money service businesses.

Along with the other Federal banking agencies and representatives from a number of law enforcement agencies, OTS is a member of the Bank Fraud Working Group. This forum enables participants to share information, and cooperate in identifying individuals engaged in fraud and trends involving fraudulent activities.

Even outside the formal working group context, cooperation between the Federal banking agencies on BSA/AML matters is consistent and long-standing. For instance, OTS cooperates with FinCEN and law enforcement agencies when matters of mutual interest are uncovered in OTS examinations or reviews. OTS and FinCEN have worked together to investigate and remedy BSA violations through the issuance of parallel enforcement actions. OTS also has frequently assisted law enforcement agencies investigating possible criminal misconduct and has, on occasion, made its examiners available as testifying experts before grand juries.

OTS'S BSA RESOURCES WEBPAGE AND HOTLINE

To make information about the Bank Secrecy Act and USA PATRIOT Act easily accessible by thrifts and other interested parties, OTS maintains a page on its internet site with links to all the documents referred to in this testimony, including those related to CIP and other USA PATRIOT Act requirements, SAR's, and recent announcements. The webpage also includes links to FinCEN and to the Office of Foreign Asset Control (OFAC). The OTS's BSA webpage can be accessed through OTS's Internet site at *www.ots.treas.gov.* OTS also maintains a USA PATRIOT Act hotline for thrifts to call with questions about their BSA responsibilities.

Suspicious Activity Reports (SAR's)

For many years, the BSA has authorized the Department of the Treasury to require any financial institution to report suspicious transactions relevant to possible statutory or regulatory violations. Even before the FBA's issued SAR regulations in 1996, thrifts and other depository institutions were required to file criminal referral and suspicious transactions reports. The USA PATRIOT Act did not change the basic SAR requirement.

OTS's SAR regulations require a thrift to file a SAR when it detects a "known or suspected violation of Federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act."[14] To reduce regulatory burden on filers, depository institutions, and other filers submit SAR's only to an IRS data center that maintains a unified SAR database on behalf of FinCEN and the FBA's. FinCEN presently is testing a system to permit direct, secure on-line filing of SAR's. Currently, some filers still submit paper reports. Others deliver information electronically on tape or disk, which delays its inclusion in the database by approximately 1 month. When fully implemented, electronic filing will greatly improve the usefulness of the SAR database for regulators and law enforcement agencies.

Because the SAR database contains highly confidential information of known or suspected criminal activities, on-line access is restricted to the FBA's, certain other state and Federal agencies, and to law enforcement agencies, such as the FBI and the Secret Service. Banks and thrifts may not disclose a SAR or its contents, and the banking agencies do not share SAR information with non-SAR users.

From 1996 through 2003, financial institutions filed nearly 1.3 million SAR's. SAR's related to thrifts account for less than 10 percent of all SAR's. The total number of SAR's filed each year has grown significantly. For the 9 months of 1996 after the SAR requirements took effect, there were 52,069 SAR's filed. For 2003, this had grown to 288,343. Nearly half of all SAR's filed since 1996 have related to BSA and money laundering violations. Check fraud is a distant second, with nearly 12 percent.

OTS staff members review SAR's each month for possible enforcement action and to coordinate with law enforcement investigations. In addition, in preparing to conduct a periodic examination of a thrift, examiners review the SAR's that relate to the thrift, and during the examination determine whether there is an ongoing problem that must be addressed.

SAR's are valuable tools. For instance, information in SAR's allows FinCEN to identify emerging trends and patterns associated with financial crimes, which is vital to law enforcement agencies and provides valuable feedback to regulators and financial institutions. Here at OTS, information in thrift-filed SAR's has resulted in a number of enforcement orders, including cease and order orders and prohibition orders.

General Accounting Office Review

The General Accounting Office (GAO) has recently initiated two new reviews in this area. One involves a review of the implementation of the anti-money laundering provisions of the USA PATRIOT Act by the banking agencies and others. GAO specifically plans to review (i) the status of implementing the customer identification program and information sharing provisions, (ii) agency procedures for assessing compliance and enforcement, (iii) efforts to educate the industry about the new regulations, and (iv) the extent to which the agencies have revised and applied examination guidance.

The other review relates to BSA examinations and enforcement for depository institutions. GAO intends to study (i) how the banking agencies audit for BSA compliance, (ii) the number and nature of BSA violations since the late 1990's, (iii) how BSA violations are identified and addressed, (iv) consistency of BSA examinations, interpretation, and enforcement across the agencies, (v) the adequacy of the agen-

[14] 12 CFR § 563.180.

cies' resources for BSA examinations and the new USA PATRIOT Act requirements, and (vi) the role of the Treasury Department in the agencies' examination programs and enforcement efforts.

Much of this testimony addresses what OTS has accomplished in the areas to be covered by the GAO reviews. We are working to provide GAO with the preliminary information they have requested and look forward to assisting them in their efforts in any way we can.

OTS Recommendations to Enhance Existing BSA/USA PATRIOT Act Efforts

We have identified several areas for consideration that we believe would enhance the existing BSA and USA PATRIOT Act efforts and initiatives. These are:

- Establishing better communications among the FBA's, FinCEN, the banking industry and law enforcement, particularly with respect to systemic BSA violations and developing trends. We encourage such exchanges of information through several means, including advisories, guidance, meetings and personal communications.
- Enhancing the flow of information between law enforcement and depository institutions. The information sharing process should be a two-way street. In order to review account records that might relate to terrorist financing, financial institutions need as much identifying information as law enforcement can provide. Additonally, law enforcement needs responses to its inquiries as quickly as possible from depository institutions. The FBA's can substantially assist in facilitating the collection and exchange of this vital information.
- Improving FBA coordination and BSA/AML awareness and training via a more formalized procedure within the Federal Financial Institutions Examination Council (FFIEC). This includes improving communications among the FBA's and FinCEN regarding known schemes to evade BSA/AML laws, as well as having FinCEN supplement BSA training programs within the FFIEC so that all the FBA's and FinCEN are consistent in the application of BSA/AML standards.

Conclusion

We have always taken our responsibility to oversee compliance with the BSA seriously. The original focus of the BSA was to prevent criminal money laundering activities. Since the events of September 11, 2001, and the enactment of the USA PATRIOT Act, the focus of the BSA has expanded to include the war against terrorism.

OTS has redoubled its efforts under the BSA and the new USA PATRIOT Act requirements. We have:

- Helped educate the thrift industry through a variety of mechanisms;
- Provided additional training for staff;
- Greatly expanded the number of examiners who are reviewing BSA and USA PATRIOT Act compliance on an on-going basis;
- Halved the interval between BSA examinations;
- Developed and implemented enhanced scoping and examination procedures;
- Implemented a new BSA tracking and monitoring information system;
- Improved internal controls governing data collection, examination, and enforcement activities;
- Bolstered off-site BSA monitoring programs;
- Adopted more robust and stringent enforcement policies;
- Implemented a new BSA Quality Assurance audit program; and
- Improved internal communications and external communications and coordination with other regulatory agencies, Treasury, and law enforcement.

These actions collectively demonstrate our vigorous and diligent efforts to ensure maximum compliance with the intent and purpose of both the BSA and the USA PATRIOT Act. There is still more to be done. We pledge our continued efforts, look forward to your observations on these issues and await your questions.

PREPARED STATEMENT OF JOANN M. JOHNSON

CHAIRMAN, NATIONAL CREDIT UNION ADMINISTRATION

JUNE 3, 2004

Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, thank you for the invitation to testify before you on behalf of the National Credit Union Administration (NCUA) on the enforcement of the Bank Secrecy Act (BSA).

Congress enacted the BSA to prevent credit unions and other financial institutions from being used as intermediaries for the transfer or deposit of money derived

from criminal activity. NCUA is the regulatory authority that monitors federally insured credit unions for compliance with the BSA.

Supervision of BSA Compliance in the Credit Union Industry

I am pleased to report to the Committee that historically federally insured credit unions have a good record of compliance with the requirements of the BSA. Credit unions are also substantially in compliance with Sections 314 (Information Sharing) and 326 (Customer Identification Program) of the USA PATRIOT Act.

At the end of 2003, NCUA insured 9,399 credit unions. Almost 50 percent of federally insured credit unions are small with assets less than 10 million dollars. The smaller credit unions are less likely to have transactions that trigger the recordkeeping and recording requirements of the BSA. Additionally, approximately one-third of Federal credit unions have a single common bond sponsor. Officials in smaller credit unions and single common bond credit unions often have a more intimate understanding of their members' transactions, which facilitates their compliance with the requirements of the BSA. Consequently, money laundering has not been a major problem for credit unions.

Nevertheless, much has changed since the terrorist attacks of September 11. There is increased recognition that denying terrorists the ability to launder funds through the Nation's financial system is an essential part of winning the war on terrorism. NCUA recognizes that as some federally insured credit unions increase in asset size, offer more complex financial services, and expand their fields of membership, the possibility increases that they may be targeted by individuals or groups seeking to launder money. NCUA is mindful of our responsibility in this area.

The Federal Credit Union Act requires NCUA to assure BSA compliance in federally insured credit unions. Our responsibility is to ensure that all federally insured credit unions comply with applicable regulatory requirements and have effective programs in place to minimize the risk that they will be used to launder money. Federally insured credit unions are required to have BSA compliance programs that effectively monitor their daily operations to assure compliance with all applicable rules and regulations.

To assure compliance, during each examination of a federally insured credit union, examiners review BSA compliance programs. In fact, the risk-focused examination program used by NCUA examiners and State credit union examiners directs that a review of compliance with the BSA be completed at every examination. (In the one State that does not use NCUA's risk-focused examination program, their examination program directs a comparable review of BSA compliance.) While this review is mandated by the Federal Credit Union Act, the design of the review and our extensive examiner education in this area result from NCUA's recognition of the important role of credit unions in preventing both money laundering and the financing of terrorism.

In addition to NCUA's risk-focused examination program, NCUA has jointly participated with our fellow regulators and the Financial Crimes Enforcement Network (FinCEN) on a number of regulations designed to implement provisions of the USA PATRIOT Act. Also, NCUA is represented on the Bank Secrecy Act Advisory Group and the National Bank Fraud Working Group. And, as a member of the Federal Financial Institutions Examination Council (FFIEC), we work with other regulators to develop effective examiner education in this area and provide guidance on best practices to financial institutions.

Among the 9,369 natural person credit unions, 3,593 are State-chartered, federally insured institutions and have a State supervisory authority as their primary regulator. In accordance with its responsibility under the Federal Credit Union Act, NCUA reviews BSA compliance each time it conducts a credit union examination. In State-chartered, federally insured credit unions where the State regulator conducts the examination, the State examiner reviews for BSA compliance. All examinations of federally insured credit unions completed by a state regulator are reviewed by NCUA staff. It should be noted, however, that NCUA does not review examinations of privately insured credit unions and does not have enforcement authority for BSA compliance in those credit unions.

During examinations, NCUA reviews the federally insured credit union's operations to assure that policies and procedures are in place for credit union staff to file Suspicious Activity Reports (SAR's) relating to money laundering. Consolidated reports received from FinCEN concerning SAR filings are provided to NCUA regional staff and examiners to assist in the examination process of the BSA.

In 2003, NCUA examined over 4,400 Federal credit unions and jointly participated with the State regulators in over 600 examinations of state-chartered federally insured credit unions. In addition, State regulators examined approximately 2,500 federally insured credit unions. During those examinations, NCUA deter-

mined that there were 334 violations of the BSA. The violations were in 261 credit unions, representing 3.5 percent of credit unions examined. The most common violations fell into three categories—inadequate written policy (63 percent), inadequate customer identification program (8 percent), or inadequate currency transaction reporting procedures (7 percent).

When an examiner identifies a violation of the BSA, immediate resolution of the violation is sought. Of the 334 violations, credit union officials, working with an examiner, corrected or agreed to correct 99 percent of the violations during the onsite examination. Based on the severity of the violation, the examiner will establish supervision plans to ensure corrective action.

In instances when violations at a federally insured credit union persist and/or are severe, NCUA has several options to initiate corrective action. They range from a letter from the NCUA Regional Director to formal administrative action including conservatorship. During 2003, NCUA Regional Directors issued one letter to a credit union that failed to have a BSA compliance program and entered into one Letter of Understanding and Agreement with credit union officials to ensure resolution of a multitude of problems from a failure to understand requirements of the BSA.

NCUA will use a formal administrative action when necessary to correct BSA violations. This has occurred twice in the recent past. NCUA placed one institution into conservatorship and issued a cease-and-desist order against another. The first instance involved a credit union with multiple violations; NCUA placed the institution into conservatorship, removing the board of directors and senior operational management. NCUA then installed new management to correct deficiencies in internal controls and compliance programs. When systemic problems had been corrected, NCUA entered into a written agreement with the credit union committing the institution to a rigorous compliance program. Approximately 10 months after imposing the conservatorship, NCUA returned operations of the credit union to its members.

In the other instance, NCUA issued a cease-and-desist order to correct deficiencies in a credit union's BSA program. NCUA required a review of past transactions using an acceptable independent auditor and a commitment to file appropriate documentation regarding discovered violations. The credit union also agreed to retain a BSA compliance expert to evaluate its BSA program and to provide weekly education to all its employees in this area.

NCUA Initiatives

The enforcement of the BSA and its related rules has been and remains a priority for NCUA. NCUA has taken numerous initiatives to address BSA compliance in credit unions. These initiatives fall into the following general categories:

- Examination Program
- Examiner Education
- Compliance Examiners
- Credit Union Education

NCUA adopted a risk-focused examination program in 2002. Under this program, each credit union's examination is based on the examiner's analysis of risk for that particular institution. There are three mandatory procedures in the risk-focused examination program, one of which is the completion of the questionnaire on compliance with the BSA. The mandatory questionnaire was updated last year to incorporate recent provisions of the USA PATRIOT Act.

NCUA educated all Federal examiners (approximately 600) for the implementation of the risk-focused examination and provided a specific session on BSA compliance. Additionally, BSA compliance is addressed in core training for all NCUA examiners. State examiners also attend NCUA compliance training sessions.

NCUA participates with the other FFIEC agencies in developing and delivering training in this area. We have worked with our fellow regulators to develop guidance for the industry in implementing new USA PATRIOT Act regulations.

The NCUA Examiner's Guide provides examiners with guidance in their review of a federally insured credit union's compliance with the BSA. To ensure a field focus on compliance with the USA PATRIOT Act, an updated version of the Examiner's Guide and the BSA questionnaire incorporating recent regulatory changes was issued to staff.

In conjunction with the implementation of the risk-focused examination, NCUA has designated almost 30 compliance subject matter examiners. These examiners are called upon to assist in the examination of federally insured credit unions that exhibit a more complex operation or higher risk in compliance areas. Intensive training on the BSA (including the USA PATRIOT Act) was conducted at NCUA's November 2003 Consumer Compliance Conference. Both Federal and state exam-

iners attended the class. In 2002, we also provided a day-long session on the BSA for the compliance examiners.

In addition to on-site reviews of BSA compliance during examinations, NCUA has issued several publications to educate federally insured credit unions on BSA and USA PATRIOT Act compliance:

- October 2001—Issued Letter to Credit Unions, 01–CU–18, NCUA Request Relating to Information Pertaining to the Terrorist Attacks
- April 2002—Issued Regulatory Alert 02–RA–02, USA PATRIOT Act Regulation to Improve Information Sharing
- September 2002—Issued Letter to Credit Unions 02–CU–14, Detection of Terrorist Financing
- March 2003—Issued Regulatory Alert 03–RA–03, USA PATRIOT Act Section 314(a) Information Requests
- May 2003—Issued Regulatory Alert 03–RA–07, Final USA PATRIOT Act Regulations on Customer (Member) Identification
- October 2003—Issued Letter to Credit Unions 03–CU–16, Bank Secrecy Act Compliance
- February 2004—Issued Regulatory Alert 04–RA–04, USA PATRIOT Act Section 326: FAQ's for Customer Identification Program (CIP) and Enclosure

Currently, NCUA is finalizing an update to its Compliance Self-Assessment Guide designed to assist federally insured credit unions in complying with regulations. With our focus on the BSA and USA PATRIOT Act, in October 2003 we issued this draft section to credit unions (attached). The guide highlights key requirements of the BSA and can be used as a quick reference tool for federally insured credit unions.

Working with federally insured credit unions to ensure accurate point of contact information for Section 314 requests of the USA PATRIOT Act, NCUA revised its quarterly Call Report to capture point of contact information in March 2003. All credit unions must provide point of contact information each quarter.

NCUA's website (*www.ncua.gov*) is designed to provide easy access for federally insured credit unions to obtain a SAR form along with information on the proper filing of the form. This facilitates the ability of a credit union to file prompt reports.

Looking forward, NCUA is committed to maintaining a dynamic examination program that will assure federally insured credit unions have effective programs in place to minimize the risk of money laundering. NCUA will continue to provide guidance to federally insured credit unions regarding compliance with the BSA.

Conclusion

Again, thank you, Mr. Chairman, for the opportunity to appear before you today on behalf of NCUA to discuss BSA compliance in the credit union industry. I am pleased to respond to any questions the Committee may have or to be a source of any additional information you may require.

PREPARED STATEMENT OF WILLIAM J. FOX

DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK
U.S. DEPARTMENT OF THE TREASURY

JUNE 3, 2004

Chairman Shelby, Senator Sarbanes, and members of the Committee, I appreciate the opportunity to appear before you to discuss the role that the Financial Crimes Enforcement Network (FinCEN) can and should play in Bank Secrecy Act compliance and enforcement matters. As I noted the last time I appeared before this Committee, we are indebted to the Committee for its leadership and commitment to furthering the efforts of our Government generally, and FinCEN in particular, to understand, detect and prevent money laundering and terrorist financing through the administration of the Bank Secrecy Act regulatory regime.

As the delegated administrator of the Bank Secrecy Act, FinCEN bears responsibility for ensuring that it is implemented to achieve the ultimate goals of the Act—the institution of measures across the financial industry to prevent money laundering, terrorist financing and other financial crime, and the creation of records and reports highly useful to criminal, tax, regulatory, and counter-terrorism intelligence activities. While we eagerly accept this responsibility, we discharge it in large measure through the Federal functional regulators and the Internal Revenue Service, who have been delegated responsibility to examine for Bank Secrecy Act compliance.

The Bank Secrecy Act regulatory system is unique in that its implementation involves 8 different Federal agencies. This unusual structure is both the Bank Secrecy Act's strength and its weakness. It is a strength because it builds on the existing expertise and examination functions of the regulators who know their industries best. It is a weakness because of the risk inherent in such fragmentation and potential for lack of accountability.

Within this structure, FinCEN's task is to build on these strengths while simultaneously addressing the weaknesses. FinCEN, as the fulcrum must ensure that all those responsible are guided by the same interpretive principles and apply them in a consistent manner through a continuing dialogue among the regulators, the regulated industry, and law enforcement.

My statement today outlines our role in this process and highlights the ways in which I think we can improve this process.

Background

By virtue of a delegation order from the Secretary of the Treasury and a statute passed as part of the USA PATRIOT Act, FinCEN is charged with the responsibility of administering the regulatory regime of the Bank Secrecy Act. Among other things, we issue regulations and accompanying interpretive guidance; collect, analyze and maintain the reports and information filed by financial institutions under the Bank Secrecy Act; make those reports and information available to law enforcement and regulators; and ensure financial institution compliance with the regulations through enforcement actions aimed at applying the regulations in consistent manner across the financial services industry. FinCEN also plays an important role in analyzing the Bank Secrecy Act information collected to support law enforcement, identifying strategic money laundering and terrorist financing trends and patterns, and identifying Bank Secrecy Act compliance issues.

FinCEN was created as an office within Treasury in 1990. Its original mission was focused on analysis—both tactical and strategic—of data collected under the Bank Secrecy Act along with other financial data. Treasury's Office of Financial Enforcement (OFE) was originally responsible for the administration of the Bank Secrecy Act regulatory regime. In 1994, Treasury merged OFE into FinCEN and delegated the responsibility to administer the regulatory regime to FinCEN. Treasury sought to link the analytical functions with the administration of the regulatory regime that dictated the information that financial institutions were required to record and report. Adding responsibilities for administering the regulatory regime strengthened and expanded FinCEN's analytical and intelligence abilities.

COMPLIANCE EXAMINATION

While FinCEN is responsible for ensuring compliance with the Bank Secrecy Act regulatory regime, FinCEN does not itself examine financial institutions for compliance. Instead, FinCEN taps the resources and expertise of other Federal agencies and self-regulatory organizations by relying on these agencies to conduct compliance exams, through delegations of authority that largely predated FinCEN. Examination responsibility has been delegated to other Federal regulators as follows:

- Depository Institutions—The Board of Governors of the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration have been delegated authority to examine the depository institutions they regulate for Bank Secrecy Act compliance.
- Securities Broker-Dealers, Mutual Funds, and Futures Commission Merchants/Introducing Brokers—FinCEN has delegated examination authority to the Securities and Exchange Commission and the Commodity Futures Trading Commission, and relies on their self-regulatory agencies (such as the NASD, the NYSE, and the NFA) to examine these entities for compliance.
- Other Financial Institutions—The Internal Revenue Service (Small Business/Self-Employed Division) has been delegated responsibility for examining all other financial institutions subject to Bank Secrecy Act regulation for compliance, including, for example, depository institutions with no Federal regulator, casinos, and Money Services Businesses (MSBs).

Even in the absence of examiners, FinCEN has an important role in supporting the examination regime created through our delegations. FinCEN's role involves providing prompt Bank Secrecy Act interpretive guidance to regulators, policy makers and the financial services industry, and ensuring the consistent application of the Bank Secrecy Act regulations across industry lines, most notably through the rulemaking process and subsequent guidance. We promote Bank Secrecy Act compliance by all financial institutions through training, education and outreach. We support the examination functions performed by the other agencies by providing them

access to information filed by financial institutions in suspicious activity reports, currency transaction reports, and other Bank Secrecy Act reports. We also facilitate cooperation and the sharing of information among the various financial institution regulators to enhance the effectiveness of Bank Secrecy Act examination and, ultimately, industry compliance.

FinCEN has played a more robust role with the Internal Revenue Service to develop an examination regime for the many categories of businesses that are newly subject to anti-money laundering regulation. For example, we have worked extensively with the Internal Revenue Service to improve their examination procedures and capabilities for money services businesses,[1] including providing training, reviewing exam procedures and the setting of priorities and goals. Finally, although done only to a limited extent now, we do provide some assistance with examination targeting and prioritization.

ENFORCEMENT

FinCEN has retained the authority to pursue civil enforcement actions against financial institutions for noncompliance with the Bank Secrecy Act and the implementing regulations. Under the Bank Secrecy Act, FinCEN is empowered to assess civil monetary penalties against, or require corrective action by, a financial institution committing negligent or willful violations.

Generally, FinCEN identifies potential enforcement cases through (1) referrals from the agencies examining for Bank Secrecy Act compliance; (2) self-disclosures by financial institutions; and, (3) FinCEN's own inquiry to the extent it becomes aware of possible violations. Referrals from the examining agencies are regularly made to FinCEN. It should be noted that under Title 12, the banking regulators have authority to enforce certain regulations that fall under that statute as well as under the Bank Secrecy Act, such as the requirement that depository institutions have anti-money laundering programs. In addition, the Internal Revenue Service has authority to enforce certain Bank Secrecy Act requirements including the IRS/FinCEN Form 8300 reporting for nonfinancial trades and businesses, and the Report of Foreign Bank and Financial Accounts by individual and entities.

Efforts to Enhance Bank Secrecy Act Compliance

Much of our work within FinCEN is devoted to the goal of maximizing industry compliance with the Bank Secrecy Act regulatory regime. But as the complexity of the regulatory regime, and the obligations imposed, continue to grow, our efforts must grow as well. Below, my statement outlines my priorities within FinCEN, in the short-term, to better enable us to assist the regulators in the examination process and further enhance our own capabilities to enforce the regulatory regime. I also have included a few ideas to consider as we look for ways to further enhance Bank Secrecy Act compliance and examination consistency.

SHORT-TERM GOALS

As I have explained previously, we are in the process of realigning FinCEN to position ourselves to better fulfill our mission. As part of this, we will be restructuring our regulatory section to focus resources and create efficiencies around the functions of Bank Secrecy Act examination and enforcement:

Creation of an Examination Program Office

Within FinCEN's regulatory office, we will create a new program office devoted solely to the Bank Secrecy Act examination function. Currently, the affected substantive program area handles examination related issues on an ad-hoc basis. For example, individuals responsible for the Money Services Business program have taken a primary role in working with the Internal Revenue Service to develop and enhance their examination regime. The new structure will consolidate all examination support functions and better enable FinCEN to provide the necessary support to regulatory agencies conducting Bank Secrecy Act compliance exams. As an initial priority, FinCEN plans to focus on assisting the Internal Revenue Service in its examination function, particularly in light of the new regulations that FinCEN has and will issue to bring thousands of additional businesses under the Bank Secrecy Act anti-money laundering program provision.

[1] Under the Bank Secrecy Act and FinCEN's implementing regulations, any person or group of persons doing business in the United States in one of the following capacities is defined as a money services business (MSB): currency dealers or exchangers; check cashers; issuers, sellers, or redeemers of travelers' checks, money orders, or stored value; and money transmitters.

Dedication of Analytical Resources to Compliance Support and Examination Targeting

We will also be providing specific analytical support to our Examination Office. Our analysts will exploit the Bank Secrecy Act and other data to identify, review and, through the Examination Office, refer anomalies involving specific financial institutions to the appropriate regulator for review and examination. They will use the information to assist the regulators in examination targeting by identifying high-risk financial institutions or problem compliance areas to help the regulators prioritize and direct examination resources. The analysts will also work toward identifying new and emerging vulnerabilities that should be addressed through the examination process. We intend to work closely with the regulators in this process.

Renewed Focus and Resources to Provide Interpretive Guidance

As the complexity of the Bank Secrecy Act regulatory regime grows, so does the need for interpretive guidance. As part of our reorganization, we are placing a renewed focus and resource commitment on the provision of guidance, both in the form of more comprehensive guidance documents as well as more immediate responses to specific inquiries. With respect to the former, we intend to begin the process of issuing staff commentaries to the various provisions of the Bank Secrecy Act. This will involve close consultation with the regulators. Separately, we look to leverage existing and develop additional industry experts to provide prompt guidance to specific questions as they arise, especially during the course of an examination. This will also require our working with the regulators to ensure that they know what mechanisms are available through which such guidance can be obtained.

Review Enforcement Referral Guidelines and Reporting Requirements

To improve the Bank Secrecy Act civil enforcement process, FinCEN intends to review the utility of developing updated guidelines to assist the Federal banking agencies, Internal Revenue Service and other agencies, as appropriate, in determining how and when to refer matters involving significant, alleged violations of the Bank Secrecy Act to FinCEN for consideration of civil money penalties. Currently, upon discovery of significant Bank Secrecy Act deficiencies during examination cycles, the Federal banking agencies, Internal Revenue Service and the Securities and Exchange Commission rely on a memo predating the creation of FinCEN on such matters. If appropriate, we will work closely with the regulators to revise these guidelines.

In addition, the regulations delegating Bank Secrecy Act examination authority to the banking regulators provide that periodic reports shall be made, in a form and timeframe prescribed by Treasury. By memorandum, dated June 6, 1979, Treasury prescribed the form and timing of the periodic reports to be received from the banking regulators, including the number of apparent Bank Secrecy Act violations discovered during the examination process. However, since its inception such reporting has been sporadic and it has not proved helpful. As a result, FinCEN plans on reviewing the utility of receiving periodic reports, in a mutually agreed to format, to better enable FinCEN to review Bank Secrecy Act compliance and examination findings on a national basis across agency lines; such as, for example, reporting of remedial actions undertaken by financial institutions as a result of consent orders, memorandum of understanding, board resolution, supervisory letter, or other enforcement mechanisms.

MSB Compliance

A top priority for FinCEN is the prevention of the financing of terrorism. One aspect of achieving this goal is finding better ways to provide information to the regulated community to better identify potential terrorist activity. One area of particular focus in this regard will be money services businesses. Money services businesses continue to require more attention and resources, and FinCEN will undertake an initiative to educate segments of this industry most vulnerable to terrorist abuse of their financial services. These segments include small businesses that typically offer money remittance services, check cashing, money orders sales, and informal value transfer systems. Working with our colleagues in law enforcement, we hope to enhance our outreach programs to include training on how terrorists have and may continue to use money services businesses; the reason for and importance of the registration requirement; and the importance of complying with the anti-money laundering compliance program, reporting and recordkeeping requirements of the Bank Secrecy Act, especially suspicious activity reporting. In fact, suspicious activity reporting for money services businesses should be streamlined by permitting the use of a simplified form to file, which we are currently developing.

IDEAS FOR ENHANCED COORDINATION

Coordination among the regulators, industry, and law enforcement is the lynchpin of effective Bank Secrecy Act compliance. Since the passage of the USA PATRIOT Act, cooperation has only improved. On our side, we have developed a much closer working and collaborative relationship with the regulators on all aspects of Bank Secrecy Act administration. This has been reflected in the process of developing the new regulations, conducting outreach and training for the industry, and focusing on specific compliance issues. Indeed, provisions of the Act such as the customer identification section required that FinCEN and the regulators issue regulations jointly.

With respect to examinations, last month the Bank Secrecy Act Advisory Group formed a subcommittee devoted to identifying ways to better ensure examination consistency among the various regulatory agencies and industries. Representatives from industry, the regulatory agencies, and law enforcement will participate. This subcommittee is yet another vehicle through which FinCEN and the regulators can address the range of examination issues with the common goal of enhancing compliance on a national basis.

In this context and elsewhere, we will all have to identify creative ways to facilitate continued cooperation. Some ideas that I hope to explore with my colleagues include:

Identification of Common Compliance Deficiencies

Better identification of compliance issues revealed through the examination process on an interagency scale is an essential aspect of enhancing the overall effectiveness of the Bank Secrecy Act regulatory regime. FinCEN could serve a key role in facilitating that process by encouraging the regular sharing of common compliance deficiencies uncovered by the regulators. Summaries of deficiencies identified in financial institutions will expose areas to be addressed, interpretive questions to be answered, or even inconsistencies with the regulations themselves. Based on this information, FinCEN and the regulators would be able to focus its outreach and guidance efforts on emerging, possibly systemic problem areas affecting one or more financial industries. Similarly, regulators would be able to better focus their examination resources on such areas. This data would also enhance the ability of FinCEN and the regulators to target their examinations and develop strategic examination goals across industry lines.

Continued Collaboration on Examination Procedures

To varying degrees, FinCEN has provided input into the development of examination procedures for the banking regulators and the Internal Revenue Service. In fact, FinCEN is working with Internal Revenue Service now to revise its Bank Secrecy Act Examination Manual, which guides the conduct of Bank Secrecy Act examinations and is used as a training template for Bank Secrecy Act examiners. This is an important way in which FinCEN can communicate our examination priorities to the regulators and better ensure a consistent examination process by the various agencies. We have also begun to participate on a limited scale, resources permitting, as observers in exams performed by our regulatory partners.

Joint Examiner Training

As a complement to the established mechanisms through which the regulators train their examiners, we will explore joint training opportunities that will afford FinCEN the opportunity to supplement the training provided with programs specifically targeted toward our Bank Secrecy Act compliance goals, including the possibility of our participating in multiagency anti-money laundering training at the Federal Financial Institution Examination Counsel.

We have done such training already. For example, FinCEN has conducted joint training of Internal Revenue Service examiners on various Title 31 and USA PATRIOT Act requirements in recent IRS Examiner training classes. FinCEN also will be conducting training at an upcoming meeting of Internal Revenue Service supervisory level personnel who have Bank Secrecy Act examination responsibility. By training at the supervisory level (training-the-trainer), FinCEN can leverage its limited resources to help ensure that IRS Bank Secrecy Act supervisory personnel deliver the appropriate message concerning the content of Bank Secrecy Act exams to the Internal Revenue Service field exam staff.

Conclusion

Mr. Chairman, we appreciate your Committee's continued support in our efforts to ensure the effectiveness of Bank Secrecy Act examination and enforcement programs. This concludes my remarks. I will be happy to answer your questions.

PREPARED STATEMENT OF GASTON L. GIANNI, JR.

INSPECTOR GENERAL, FEDERAL DEPOSIT INSURANCE CORPORATION

JUNE 3, 2004

Mr. Chairman, Ranking Member Sarbanes, and Members of the Committee, I am pleased to testify before you today as you conduct this hearing on the Federal financial regulatory agencies' enforcement of the Bank Secrecy Act (BSA). We appreciate and thank the Committee for its interest in gaining a greater understanding of how the Government is combating terrorist financing and money laundering. The Committee, the regulators, and our office clearly have a mutual interest in assuring the public that the best possible efforts are made to deter such dangerous and illegal activities.

Today, I will present a historical perspective on the Bank Secrecy Act and discuss the BSA-related work my office has done over the past several years. I will also offer our views on the challenges that the Congress and the financial regulators face going forward in this critical area.

The Bank Secrecy Act of 1970

The Bank Secrecy Act of 1970 requires all financial institutions to maintain appropriate records and to file certain reports that are used in criminal, tax, or regulatory investigations and proceedings. The BSA's implementing regulation, 31 CFR Part 103, is also used to aid law enforcement agencies in the investigation of suspected criminal activity such as illegal drug activities, income tax evasion, and money laundering by organized crime. The BSA consists of two parts—Title I, Financial Recordkeeping, and Title II, Reports of Currency in Foreign Transactions.

- Title I authorizes the Secretary of the Treasury (Treasury Department) to issue regulations requiring institutions to maintain certain records related to financial transactions.
- Title II directs the Treasury Department to prescribe regulations governing the reporting of certain transactions by and through financial institutions in excess of $10,000. A financial institution must file a Currency Transaction Report (CTR) with the Treasury Department for each cash transaction over $10,000 or multiple cash transactions by an individual in 1 business day or over a period of days aggregating over $10,000. The BSA also requires financial institutions to file Suspicious Activity Reports (SAR) with the Treasury Department when suspected money laundering activity, terrorist financing, or other BSA violations occur, such as the use of shell entities, check kiting, or embezzlement.

BSA Requirements for FDIC-Supervised Institutions

The FDIC is currently the primary Federal regulator for approximately 5,300 financial institutions. In that role, the Corporation has implemented rules and regulations in addition to those issued by the Treasury Department that require each FDIC-supervised institution to develop and administer a BSA program to ensure compliance with the BSA and 31 CFR Part 103. Institutions' BSA programs should include:

- a written BSA program approved by the institution's board of directors,
- a system of internal controls to assure ongoing compliance,
- independent testing for compliance with the BSA and 31 CFR Part 103 to be conducted by bank personnel or an outside party,
- designation of individual(s) responsible for coordinating and monitoring compliance with the BSA, and
- training in BSA requirements for appropriate personnel.

Examination Authority and Procedures

Although the Treasury Department has overall authority for BSA enforcement and compliance, its regulations delegate authority to financial institution regulatory agencies, including the FDIC, to examine financial institutions for compliance. In this capacity, the FDIC has authority to (1) examine the institutions it supervises for compliance with the BSA, (2) refer BSA violations to the Treasury Department, and (3) impose regulatory actions for BSA violations. The FDIC is also required by the Federal Deposit Insurance Act (FDI Act) to:

- prescribe regulations requiring insured depository institutions to establish and maintain procedures reasonably designed to ensure and monitor compliance with the BSA,
- review such procedures during their examinations of these institutions, and
- enforce compliance with the BSA monetary transaction recordkeeping and report requirements.

The Division of Supervision and Consumer Protection (DSC) at the FDIC is responsible for promoting the safety and soundness of FDIC-supervised institutions, and examining financial institutions' compliance with applicable laws and regulations such as the BSA.

According to the Chairman's testimony for today's hearing, the FDIC has conducted almost 11,000 BSA examinations since 2000.

COMMUNICATION AND TRAINING

The FDIC has taken steps to ensure that its supervised financial institutions and examiners are aware of BSA requirements and that its examinations of financial institutions include a review of BSA requirements. The FDIC also issues regulations, Financial Institution Letters, and other guidance to the financial institutions that it supervises; updates Corporation examination and training materials; and ensures that DSC examiners are adequately trained to monitor BSA compliance.

RISK-FOCUSED EXAMINATION PROCEDURES

DSC requires examiners to use risk-focused examination procedures to assess BSA compliance. To accomplish this, examiners may use (1) core procedures that are considered during the basic review, (2) expanded procedures that are used to target concerns identified during the basic review, and (3) impact analyses to assess the seriousness of identified deficiencies. To assess the impact of deficiencies identified during the basic and expanded reviews, examiners determine whether BSA violations and weaknesses:

- are serious and indicate the need for civil money penalties,
- necessitate referrals to law enforcement agencies,
- necessitate a cease-and-desist order for cases in which a mandatory BSA compliance program was not established or maintained, or other supervisory action to correct prior noncompliance, and
- affect the safety and soundness of the institution.

When Violations Should Be Referred to the Treasury Department

According to referral guidelines issued by the Treasury Department's Office of Financial Enforcement in October 1990, the Treasury Department has a zero tolerance level for violations of the BSA but recognizes that BSA violations are of a varying nature. The guidelines state, "Because the determination process often is subjective, sound examiner judgment and experience also are required." To assist with the determination process for referrals to the Treasury Department, the guidelines instruct examiners to "assess all of the facts and circumstances surrounding the violations," including whether:

- the violations represent an isolated incident caused by human error;
- the deficiencies are indicative of significant noncompliance with the BSA and/or systemic weaknesses in the institution's BSA compliance program;
- the types and nature of the violations are serious;
- the violations are the result of blatant, willful, or flagrant disregard for BSA requirements;
- there is a pattern of noncompliance with one or more sections of the regulations;
- the violations result from inadequate policies, procedures, or training programs; and
- the violations result from a nonexistent or seriously deficient compliance program.

DSC procedures require examiners to use the Treasury Department's guidelines to determine when a referral is appropriate.

The Treasury Department or the FDIC can take Regulatory Actions when BSA Violations are Identified

Failure by a financial institution to comply with the BSA can result in regulatory sanctions by either the Treasury Department or the FDIC. The BSA and its underlying regulations give the Treasury Department the authority to assess civil money penalties for violations and to authorize criminal prosecution. The FDIC is required to report all identified BSA violations and to refer violations that warrant penalties to the Treasury Department's Financial Crimes Enforcement Network (FinCEN). The FinCEN was established to administer BSA and provide a government-wide, multisource intelligence and analytical network. Such referrals, however, do not preclude the FDIC from taking regulatory action when BSA violations are identified. For example, as cited in 12 U.S.C. 1818(s), the FDIC shall issue a cease-and-desist order to any FDIC-supervised institution that fails to establish and maintain appropriate BSA procedures or to correct any previously reported problem with the procedures.

The Corporation has reported that, since 2001, it has issued 30 formal enforcement actions against 25 financial institutions and 3 individuals to address BSA violations—25 of these actions were cease-and-desist orders. Regulatory action, however, also includes informal actions such as bank board resolutions or memorandums of understanding to facilitate corrective action(s) from bank management. Since 2001, the Corporation reports that FDIC-supervised institutions have entered into 53 informal actions with BSA-related provisions. Finally, the FDIC often uses other supervisory actions such as correspondence and follow-up visitations or examinations to promote compliance with BSA and implementing guidance.

BSA became a Higher Priority after the Events of September 11

Prior to the tragic events of September 11, 2001, BSA had played a significant role in preventing banks and other financial service providers from being used as intermediaries for, or to hide the transfer or deposit of, money derived from criminal activity associated with organized crime and international drug traffickers. BSA became more of a national priority following September 11.

THE USA PATRIOT ACT

In October 2001, the Congress enacted the United and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001—the USA PATRIOT Act. This Act expanded the Treasury Department's authority initially established under the BSA to regulate the activities of U.S. financial institutions, particularly their relations with individuals and entities with foreign ties. Provisions of the USA PATRIOT Act augmented the BSA money laundering provisions, making it a useful tool in tracing terrorist financing activities. The Act also elevated the status of FinCEN within the Treasury Department and emphasized its role in fighting terrorist financing. In addition to administering the BSA, FinCEN is responsible for expanding the regulatory framework to other industries (such as insurance and securities brokers and dealers) vulnerable to money laundering, terrorist financing, and other crimes.

FDIC'S POST-SEPTEMBER 11 INITIATIVES

DSC has been proactive in the development and issuance of interagency examination guidance and has participated in working groups led by the Federal Financial Institutions Examination Council to develop and implement examiner training related to the enforcement of BSA and USA PATRIOT Act provisions. Additionally, DSC has organized and participated in numerous outreach programs intended to inform and educate the banking industry of USA PATRIOT Act compliance requirements. Further, DSC has indicated that it has been involved in various interagency and joint law enforcement initiatives, including:

- participation in the Financial Action Task Force's (FATF) Working Group on International Financial Institutions Issues, which establishes international anti-money laundering standards;
- participation in the Basel Committee decisionmaking process in reviewing the "Know Your Customer" risk management report;
- participation in working groups and technical assistance missions sponsored by the Departments of State and Treasury, which are designed to assess vulnerabilities to terrorist financing activity worldwide and to develop and implement plans to assist foreign governments concerning these issues; and
- serving as point-of-contact liaison between FinCEN and FDIC-supervised institutions in the USA PATRIOT Act Section 314(a) terrorist-subject biweekly searches.

FDIC OIG Work that Addresses BSA-Related Issues

My office has conducted three audits that address the FDIC's efforts to design and implement a supervisory program to examine institutions' compliance with provisions of the BSA and the more recently enacted USA PATRIOT Act. The first two audits addressed FDIC examiners' planning and conduct of BSA examinations and the Corporation's implementation of policies and procedures stemming from USA PATRIOT Act requirements. They were both conducted as part of our responsibility to provide coverage of the FDIC's supervision activities. The third and most recent audit primarily focused on supervisory actions taken by the FDIC to ensure institutions implement effective corrective action to address BSA violations. This audit was initiated in response to interest expressed by staff of the Subcommittee on Oversight and Investigations, House Committee on Financial Services.

Overall, these audits identified that the Corporation had taken steps to implement a risk-focused examination program for BSA. However, improvements were needed to ensure that institutions were fully complying with, and the FDIC was effectively enforcing provisions of, the Act.

I will now discuss more details of each audit, with the focus being on our findings and recommendations and the FDIC's corrective actions to address them.

EXAMINATION ASSESSMENT OF BANK SECRECY ACT COMPLIANCE

By way of background, in the wake of a much-publicized Bank of New York money laundering scandal in 1999, the question of whether the BSA and its implementation were effective gained renewed interest from the legislative and executive branches of the Federal Government. Of particular note, the Departments of Treasury and Justice jointly issued a revised National Money Laundering Strategy in March 2000 assigning responsibility for implementing parts of the strategy to bank regulatory agencies, including the FDIC, to enhance efforts to prevent money laundering. The regulatory agencies were specifically tasked with reviewing existing examination procedures, and where necessary, revising, developing, and implementing new examination procedures that would ensure anti-money laundering supervision is risk focused. In light of the interest and new requirements, we conducted an audit in 2000 to determine the extent to which the FDIC's examiners reviewed FDIC-regulated institutions' compliance with the BSA during the course of safety and soundness examinations.

In March 2001, we issued Audit Report No. 01–013, Examination Assessment of BSA Compliance. In the report, we concluded that examiners did not adequately document their BSA examination planning or procedures. In general, there was little justification for the examiners' decisions to omit or include procedures based on their evaluation of risk at the institutions being reviewed. Similarly, after completing the risk-scoping process, examiners did not consistently document the work they performed as required by the Corporation's Manual of Examination Policies. As a result, we could not always determine the extent to which examiners reviewed institutions' compliance with BSA provisions. We also found that examiners could have improved examination planning by taking full advantage of the FinCEN databases that contain information on CTR's and SAR's. At the time of our report, one region was compiling this information in a report and disseminating it to examiners. The report showed whether institutions had significant changes in the volume of SAR and CTR filings since the previous examination and could be used to determine whether the scope of the BSA examination should be expanded.

We recommended that management (1) reinforce risk focusing guidance for BSA examinations and ensure that documentation requirements for examination planning and procedures were followed and (2) require that all FDIC regions provide examiners with CTR and SAR information for the purpose of planning BSA examinations. Management implemented these recommendations.

FDIC'S IMPLEMENTATION OF THE USA PATRIOT ACT

As discussed earlier, the USA PATRIOT Act broadened authority and required regulations to combat money laundering that were already established under the BSA to facilitate the prevention, detection, and prosecution of international money laundering and the financing of terrorism. Our review of the FDIC's implementation of the USA PATRIOT Act focused on Title III of the Act, which is entitled the International Money Laundering Abatement and Anti-terrorist Financing Act of 2001. Title III includes provisions related to (1) international counter-money laundering and related measures, (2) BSA amendments and related improvements that supplement the United States' authority to detect money laundering provided under the BSA, and (3) currency crimes and protection.

The objective of our audit was to determine whether the FDIC had developed and implemented adequate procedures to examine financial institutions' compliance with the USA PATRIOT Act. We issued our final report on the audit entitled The FDIC's Implementation of the USA PATRIOT Act, Audit Report No. 03–037, on September 5, 2003. We concluded that DSC's existing BSA examination procedures covered certain USA PATRIOT Act, Title III requirements. In addition, DSC had advised FDIC-regulated institutions of the new requirements in cases in which the Treasury Department had issued final rules implementing the Title III provisions. However, DSC had not issued guidance to its examiners for those provisions requiring new or revised examination procedures because DSC was either coordinating the issuance of uniform procedures with an interagency steering committee or waiting for the Treasury Department to issue final rules. This delay in issuing examination guidance was of particular concern when the Treasury Department had issued final rules for Title III provisions addressing money laundering deterrents and verification of customer identification. We noted that timely issuance of examiner guidance would have helped ensure institutions' full compliance with USA PATRIOT Act provisions sooner.

We recommended that the FDIC: (1) issue interim examination procedures for those sections for which the Treasury Department has already issued final rules and (2) work with its interagency counterparts to issue examination guidelines concurrently with the Treasury Department's issuance of final rules for institutions' implementation of Title III provisions. The FDIC concurred with both recommendations and took responsive corrective action. More specifically, the FDIC issued interim BSA examination procedures in August 2003, which included steps for reviewing institution compliance with applicable provisions of the USA PATRIOT Act and in October 2003, issued the final examination guidelines developed in consultation with the other financial institution regulators.

While not the result of our audit, FDIC has also trained its bank examination staff on the USA PATRIOT Act and incorporated BSA and Anti-Money Laundering topics into one of its core examination schools. Also, the FDIC is working with the other Federal banking regulators and the Conference of State Bank Supervisors to revise examiner training programs to incorporate provisions of the USA PATRIOT Act. Furthermore, the FDIC has reported changing its application review program to consider prohibitions against certain types of relationships with financial institutions, particularly foreign shell banks. The Corporation has also amended its policies to consider the effectiveness of an insured depository institution's anti-money laundering activities—including those of overseas branches—when evaluating a proposed merger transaction.

SUPERVISORY ACTIONS TAKEN FOR BANK SECRECY ACT VIOLATIONS

Our most recent audit related to the BSA was done in response to interest expressed by the staff of the Subcommittee on Oversight and Investigations, House Committee on Financial Services. The audit focused on actions taken by the FDIC in its supervisory capacity to ensure that FDIC-supervised institutions implement effective corrective action to address BSA violations. Our audit results in this case raised concerns related to four general areas:

- Extent of Regulatory Action on Significant and Repeat Violations
- Consistency of Reporting of Deficiencies and Violations
- Timing of FDIC Follow-Up and Corrective Actions on BSA Violations
- Handling of Filings and Referrals to the IRS and Treasury Department

Audit Took Approach Consistent with Prior Treasury OIG Report on BSA

Our audit approach was modeled after a report issued by the Department of the Treasury OIG entitled OTS: Enforcement Actions Taken for Bank Secrecy Act Violations, Report No. OIG–03–095, dated September 23, 2003. The objectives of the Treasury OIG audit were to determine:

- whether the Office of Thrift Supervision took timely and sufficient supervisory enforcement actions against thrifts with substantive BSA violations;
- enforcement actions, when taken, adequately addressed all substantive BSA violations identified by examiners;
- OTS's systems to track and monitor BSA examinations results were accurate and reliable.

The Treasury OIG determined that greater use of forceful and timely enforcement sanctions were warranted for BSA violations; enforcement actions were not always taken timely or were not always thorough for substantive BSA violations;[1] and BSA examination data errors existed in OTS' automated system used to monitor the results of all examinations, including BSA.

The objective of our audit was to determine whether the FDIC adequately follows up on BSA violations reported in examinations of FDIC-supervised financial institutions to ensure that they take appropriate corrective action. The scope of our audit included examinations conducted by the FDIC or State regulatory agencies, and examinations in which the FDIC participated in a joint capacity with State regulatory agencies from January 1, 1997 through September 30, 2003.

The FDIC Had Cited a Significant Number of Institutions for BSA Violations

Of the 5,662 financial institutions that the FDIC supervised (on average) during the time period covered by our audit, 2,672 institutions (approximately 47 percent) had been cited for at least one BSA violation. Those violations included citations for not complying with the Treasury Department's Financial Recordkeeping and Reporting Requirements, that is, filing CTR's, and not adequately implementing BSA com-

[1] The Treasury OIG defined substantive BSA violations as those that resulted from the failure to develop and implement a BSA program with the basic BSA minimum requirements and the nonfiling of CTR's and SAR's.

pliance programs as required by the FDIC's Rules and Regulations. Of those 2,672 institutions, 458 (approximately 17 percent) had been cited for repeat BSA violations.

Audit Shows High Rate of Significant and Repeat Violations, Many of Which Were Not Subject to Regulatory Action

We selected a random sample of institutions with violations for detailed review. The random sample consisted of 22 institutions selected from the 8 DSC regional or area offices, and another 19 institutions consisted of a judgmental sample of institutions with repeat violations for a total of 41 institutions reviewed. We determined that

- 35 of the 41 institutions (86 percent) were cited for violations related to the Treasury Department's financial recordkeeping and reporting requirements as prescribed in 31 CFR Part 103, and
- 29 of the 41 institutions (71 percent) were cited for deficient BSA compliance programs that did not meet the minimum requirements of the FDIC Rules and Regulations.

Regarding violations of the Treasury Department's Regulations at 31 CFR Part 103, these financial institutions were most frequently cited for failing to: File CTR's for nonexempted transactions over $10,000; maintain records on sales of monetary instruments of $3,000 through $10,000; furnish information required in CTR's, file CTR's timely, or retain CTR's for 5 years; and treat multiple transactions totaling over $10,000 as a single transaction.

With respect to the FDIC's Rules and Regulations Section 326.8, the 41 financial institutions in our sample were most frequently cited for lack of independent testing of BSA compliance; failure to develop or implement an adequate BSA compliance program; inadequate system of internal controls for BSA compliance; and failure to provide adequate BSA training.

We also determined that 27 of the 41 institutions had repeat BSA violations. Of those 27 repeat institutions, 17 institutions (63 percent) were not subject to regulatory action for their repeat violations, although other supervisory efforts such as follow-up correspondence to bank management and visitations may have been in progress. Of the 10 institutions that were subject to regulatory action, only 1 was subject to a cease-and-desist order.[2] DSC policy states that repeat violations cannot be tolerated and that cease-and-desist orders should be initiated in such cases.

In addition, Section 8(s) of the FDI Act states that, "If the appropriate Federal banking agency determines that an insured depository institution . . . has failed to correct any problem with the [BSA] procedures . . . which was previously reported . . . by such agency, the agency shall issue an order . . . requiring such depository institution to cease-and-desist from its violation . . .." In response to our audit, the FDIC concluded that it was not required to issue cease-and-desist orders in the case of every repeat BSA violation. The Corporation believes that enforcement authority always involves some element of discretion, including consideration of the nature of the violation and supervisory judgment as to how best to address the violation. As part of its response to our report, the Corporation provided a legal opinion by its General Counsel that addresses Congress's intent in Section 8(s). The opinion stated that:

> The absence of a mandate to bring a cease-and-desist action to address every violation of Section 8(s) or the regulations does not imply that the alternative is to take no action. To the contrary, the statutory intent must be to take an appropriate corrective action based upon the severity of the problem, the risk it poses, and the bank's willingness to comply expeditiously.

We concur with the Counsel's guidance. However, as noted previously, our audit identified cases where DSC had not taken regulatory action to address repeat violations of BSA requirements.

FDIC's Reporting and Follow-Up On BSA Violations

For the 41 banks in our sample, we reviewed 82 reports of examination that cited apparent and often multiple BSA violations. We noted that not all BSA deficiencies described in DSC's examination reports were cited in the violations section of the reports and tracked in the FDIC's information system. For 25 (30 percent) of the 82 reports, DSC waited until the next examination to follow up on some or all of the BSA violations, and corrective actions to address cited violations often took more

[2] The FDIC imposed a regulatory action for one institution that did not have repeat violations bringing the total number of regulatory actions taken for the sample we reviewed to 11.

than 1 year. Also, DSC's regional offices took various approaches to handling violations related to the filing of CTR's and to referring bank violations to the Treasury Department. Finally, we found that while many institutions had been cited for BSA violations, there were few referrals to the Treasury Department during the audit period, and most were made by one FDIC region.

Inconsistencies in Describing Deficiencies and Citing Violations

In reviewing DSC's reports of examination, we observed several instances of BSA deficiencies described in the reports but not cited in the Violations of Laws and Regulations section of the reports. On the other hand, we also noted instances of BSA deficiencies similar to those described that were cited as violations. Deficiencies that are described in the reports of examination but not cited as violations may receive less attention from bank management or in follow-up by DSC. According to DSC officials, the examiners exercise judgment in determining the significance of BSA concerns. That judgment includes determining whether the weaknesses constitute:

- apparent violation of laws or regulations, meriting inclusion in the violations section of the examination report, or
- noncompliance with DSC guidelines, meriting only mention in the report as matters for bank management's attention, which may be sufficient to eliminate concern.

Follow-up and Correction of Violations Was Not Always Timely

DSC's process for following up on violations cited in reports of examination includes:

- a request for the report to be considered in the bank's next board meeting, with a record of actions taken entered into the minutes;
- a request for bank management to provide a response indicating the actions taken to eliminate each cited violation or deficiency; and
- follow-up of the corrective actions at the next examination.

For the institutions included in our sample, we checked how often and by what method DSC followed up on whether corrective actions had been taken. We considered evidence related to DSC's follow-up actions or the banks' corrective actions, as well as information from the Treasury Department. As a result of our analysis of the process and our review of the 82 reports that cited apparent BSA violations, we found that:

- For 20 reports, DSC followed up or pursued regulatory action for certain violations before the next examination, including additional correspondence, visitations, and regulatory actions such as bank board resolutions, memorandums of understanding, or cease-and-desist orders.
- For 42 reports, DSC received evidence from bank management, Treasury's FinCEN, or the Internal Revenue Service (IRS) that certain violations had been corrected before the next examination, and in many of these instances, corrective action took place before the examination was completed.
- For 25 reports, DSC waited until the next examination to assess the adequacy of bank corrective actions for certain violations.[3]

We also observed that DSC regional and field offices exercised wide discretion in deciding whether and when to follow up on the violations or take regulatory action. In some cases, more than 1 to 5 years passed before (1) bank management took corrective action that was effective to prevent repeat violations or (2) DSC applied regulatory actions to address continuing violations. As shown below, about two-thirds of the violations took longer than 1 year to correct.

[3] Note that the numbers do not total 82 because DSC used different follow-up actions for some examination reports that cited multiple violations.

Time Taken to Address BSA Violations

LENGTH OF TIME FOR ACTION	NUMBER OF INSTITUTIONS*
12 months or less	27
13 months–24 months	13
25 months–36 months	16
37 months–48 months	10
49 months–60 months	1
More than 60 months	8

*The number of institutions will exceed the 41 sampled institutions because the length of time varied for institutions with multiple BSA violations.
Source: OIG analysis of ViSION data and review of evaluation reports and supplemental information provided by DSC for the 41 sampled institutions.

DSC officials stated that follow-up on BSA violations often occurs at the next FDIC examination rather than between examinations. Although the FDIC can conduct visitations between regularly scheduled examinations, we identified only a few visitations based on information provided by DSC that addressed BSA violations.

Generally, the FDIC alternated examinations of the sampled institutions with State regulatory agency examinations for those institutions. However, 45 of the 72 examination reports we reviewed from state regulatory agencies did not specifically address BSA compliance. Therefore, the FDIC could not rely on those examinations to determine whether bank management took corrective actions to address previously cited violations or to identify any new BSA violations. Consequently, follow-up by the FDIC on some previously cited BSA violations did not occur until the next FDIC examination—generally 24 to 36 months after the violations were initially identified. This delay in ensuring that BSA violations are corrected could result in additional or continued BSA violations and could hinder the detection of criminal activity.

Handling of Violations Related to CTR's

We also noted variations in the handling of violations related to CTR's. While conducting examinations, examiners identified instances in which financial institutions had improperly exempted customers from currency transaction reporting requirements or otherwise failed to file CTR's. According to DSC guidance, CTR's must be filed with the IRS within 15 days following the date of the transaction (25 days if the financial institution files electronically). For those institutions that did not file CTR's within the specified timeframe, FinCEN requests that examiners have bank officials request permission to backfile CTR's. DSC regional offices did not handle violations related to the backfiling of CTR's in a consistent manner. Some offices required the institutions to request permission to backfile, while other offices allowed the institutions, in cases that involved one or two CTR's, to file without requesting permission to backfile.

Handling of Referrals to the Treasury Department

DSC referrals of bank violations to the Treasury Department were infrequent. According to information provided by DSC, while 2,672 institutions were cited for violations, there were only 34 referrals made from January 1, 1997 through December 31, 2003, and most of these referrals were made by one DSC regional office. DSC officials added that, since the Treasury Department has access to FDIC information on BSA violations through a shared information system, further reporting is not required. The Treasury Department sometimes requests copies of applicable examination reports based on its analysis of the violations. The following actions have resulted from the referrals made by the FDIC from January 1, 1997 through December 31, 2003

- 27 institutions received cautionary letters or letters of warning from the Treasury Department,
- 1 institution received a civil money penalty,
- 3 referrals were resolved by other means, and
- 3 referrals were still open.

In summary, the Treasury Department took action when referrals were made but, in our assessment, FDIC only did so infrequently.

Report Recommends Strengthening Guidance Related to BSA Monitoring and Follow-Up Processes

We concluded in our report that the FDIC had adequately followed up on some BSA violations to ensure bank management has taken appropriate corrective action. However, more could be done to better ensure that prompt and effective actions are taken by bank management to ensure compliance with BSA regulations.

In light of the increased Congressional interest in BSA compliance and emphasis on national security concerns, we recommended that the Corporation:

- reevaluate and update its examination guidance to help ensure adequate examiner follow-up and timely corrective action by bank management;
- discuss and update the referral policy with the Treasury Department; and
- encourage State coverage of BSA compliance, and develop alternative processes to compensate for the lack of State coverage of BSA compliance.

FDIC Management Agreed with Recommendations and Is Taking Steps to Improve Its BSA Program

DSC management agreed with our recommendations. DSC had taken steps to initiate a reevaluation and update of its guidance, with interagency cooperation, to address formal supervisory actions, follow-up actions, citation of apparent violations, and recordkeeping and backfiling of CTR's. DSC also agreed to work with the FDIC Legal Division to clarify and update, as necessary, enforcement action guidance on BSA.

Further, DSC management agreed to pursue clarification of referral procedures with the Treasury Department. Finally, DSC agreed to focus on strengthening processes to address variations in the State examination coverage of BSA and believed doing so would increase the consistency and reliability of the follow-up to its BSA examinations.

Looking Ahead

Mr. Chairman, the goal of identifying and cutting off terrorist funding is an essential one. The Government's success in accomplishing that goal is dependent upon collecting and analyzing necessary information, and disseminating and sharing that information among appropriate law enforcement and regulatory agencies. To that end, the Congress passed the BSA, and later, the USA PATRIOT Act, to establish requirements and coordination mechanisms for creating this free flow of information. While the FDIC has been a leader in many initiatives aimed at complying with these two Acts, we found and the Corporation has acknowledged it can do more. In light of the knowledge we have gained since September 11 and more recent terrorist threats, there are key questions that the FDIC should consider, in conjunction with the Treasury Department and the other financial regulators, as it looks to improve its BSA program.

- Is risk-scoping BSA examinations and follow-up still the most effective approach to deterring money laundering and terrorist financing?
- Are the policies and procedures for reporting certain cash transactions and BSA violations to the Treasury Department, some of which date to the early 1990's, currently effective?
- Is the information reported to FinCEN by financial institutions and regulators effectively evaluated and does it ultimately result in timely preventive actions?

Mr. Chairman, we appreciate the opportunity to participate in this hearing. We are prepared to assist in addressing these issues and have additional audits planned in this area to help ensure that financial institutions, through efficient and effective supervision by the FDIC, will remain vigilant in implementing BSA programs that assist in preventing money laundering and terrorism. I would be pleased to answer any questions the Committee may have at this time.

United States General Accounting Office

GAO

Testimony
Before the U.S. Senate Committee on Banking, Housing, and Urban Affairs

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ANTI-MONEY LAUNDERING

Issues Concerning Depository Institution Regulatory Oversight

Statement of Davi M. D'Agostino, Director
Financial Markets and Community Investment

GAO-04-833T

Highlights

Highlights of GAO-04-833T, a report to the Chairman, Senate Committee on Banking, Housing and Urban Affairs

Why GAO Did This Study

The U.S. government's framework for preventing, detecting, and prosecuting money laundering has been expanding through additional pieces of legislation since its inception in 1970 with the Bank Secrecy Act (BSA). The purpose of the BSA is to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity and to provide a paper trail for law enforcement agencies in their investigations of possible money laundering. The most recent changes arose in October 2001 with the passage of the USA PATRIOT Act, which, among other things, extends anti-money laundering (AML) requirements to other financial service providers previously not covered under the BSA. GAO was asked to testify on its previous work and the ongoing work it is doing for the Senate Committee on Banking, Housing, and Urban Affairs on the depository institution regulators' BSA examination and enforcement process.

www.gao.gov/cgi-bin/getrpt?GAO-04-833T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Davi M. D'Agostino at (202) 512-8678 or dagostinod@gao.gov.

June 3, 2004

ANTI-MONEY LAUNDERING

Issues Concerning Depository Institution Regulatory Oversight

What GAO Found

In recent years, GAO has issued a number of reports dealing with regulatory oversight of anti-money laundering activities of financial institutions. In 1998, GAO issued a report regarding Treasury's Financial Crimes Enforcement Network's (FinCEN) role in administering the BSA, which updated information on civil penalties for BSA violations. One focus was the Secretary of the Treasury's 1994 mandate to delegate the authority to assess civil money penalties for BSA violations to federal banking regulatory agencies. GAO noted that this delegation had not been made and said that FinCEN was concerned that bank regulators may be less inclined to assess BSA penalties and may prefer to use their non-BSA authorities under their own statutes.

Also in 1998, GAO reported on the activities of Raul Salinas, the brother of the former President of Mexico. Mr. Salinas was allegedly involved in laundering money from Mexico, through Citibank, to accounts in Citibank affiliates in Switzerland and the United Kingdom. GAO determined that Mr. Salinas was able to transfer $90 - $100 million between 1992 and 1994 by using a private banking relationship structured through Citibank New York in 1992 and effectively disguise the funds' source and destination, thus breaking the funds' paper trail.

In 2001, GAO issued a report on changes in BSA examination coverage for certain securities broker-dealers. At the time, there was no requirement that all broker-dealers file Suspicious Activity Reports (SARs); however, broker-dealer subsidiaries of depository institutions and their holding companies were required to file SARs and were examined by banking regulators for compliance. GAO determined that with the passage of the 1999 Gramm-Leach-Bliley Act, these broker-dealers were no longer being examined to assess their compliance with SAR requirements. However, with the passage of the USA PATRIOT Act and the issuance of a final rule that was effective on July 31, 2002, all broker-dealers were required to report such activity.

GAO is currently studying the depository institution regulators' BSA examination and enforcement process for the Senate Committee on Banking, Housing, and Urban Affairs. The objectives include determining how the regulators' risk-focused examinations assess BSA compliance, the extent to which the regulators identify BSA and AML violations and take supervisory actions, and the consistency of BSA compliance examination procedures and interpretation of violations across regulators. GAO plans to determine whether and to what extent regulators curtailed BSA compliance examinations and the bases for these decisions. GAO plans to track supervisory actions taken to correct violations identified. GAO will also examine the ramifications, if any, of the lack of delegation of authority to assess BSA compliance penalties by Treasury to the banking regulators, as mandated by statute. GAO will meet with government and industry officials to gain their perspective on the BSA compliance examination process.

United States General Accounting Office

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to be here today to discuss a number of issues concerning federal depository institution regulators' oversight of financial institutions for Bank Secrecy Act (BSA) compliance and our ongoing work for this committee on this matter.[1] The U.S. government's framework for preventing, detecting, and prosecuting money laundering has been expanding through additional pieces of legislation since its inception in 1970 with the Bank Secrecy Act.[2] The purpose of the BSA is to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity and to provide a paper trail for law enforcement agencies in their investigations of possible money laundering. Over the years, the BSA has evolved into an important tool to help deter money laundering, drug trafficking, terrorist financing, and other financial crimes. The most recent changes arose in October 2001 with the passage of the USA PATRIOT Act, which, among other things, contains expanded provisions to prevent, detect, and prosecute terrorist financing and international money laundering at depository institutions and extends anti-money laundering (AML) requirements to other financial service providers previously not covered under the BSA.[3]

Congress amended the BSA in 1994 to require federal financial banking regulators to develop enhanced examination procedures and training to improve the identification of possible money-laundering schemes at financial institutions under their supervision.[4] Federal banking regulators regularly assess compliance with BSA and related AML requirements during safety and soundness or compliance examinations using examination procedures that are consistent with their overall risk-focused examination approach. Under the risk-focused approach, those activities

[1]The term "federal banking regulators" in this testimony refers collectively to federal regulators of depository institutions, including banks, thrifts, and federally chartered credit unions. The federal banking regulators are the Federal Deposit Insurance Corporation (FDIC), Board of Governors of the Federal Reserve System (Federal Reserve), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and Office of Thrift Supervision (OTS).

[2]Currency and Foreign Transactions Reporting Act, Pub. L. No. 91-508, 84 Stat. 1305(1970).

[3]Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act. Pub. L. 107-56, 115 Stat. 272(2001).

[4]The Money Laundering Suppression Act of 1994, Pub. L. 103-325, 108 Stat. 2243(1994).

judged to pose the highest risk to an institution are to receive the most scrutiny by examiners.[5] In examining depository institutions for BSA compliance, the regulators' examination procedures are to serve as a tool for determining whether depository institutions (1) have developed AML programs and procedures to adequately detect, deter, and report unusual or suspicious activities possibly related to money laundering; and (2) comply with the technical recordkeeping and reporting requirements of the BSA.

The regulators also have a variety of enforcement tools to address noncompliance. They can take increasingly formal supervisory actions that range from moral suasion or informal discussions with the institution's management to written agreements, civil money penalties, and cease and desist orders.

The recent imposition of several large civil money penalties on depository institutions has increased concern about industry compliance with and government enforcement of the BSA. My statement today will focus on the banking regulators' approach for ensuring compliance with BSA and AML program requirements. Specifically, I will discuss (1) recent enforcement actions taken against depository institutions for BSA violations, (2) inspectors general reports assessing the regulators' examination work and enforcement activities, and (3) issues raised in some of our past work on money laundering and ongoing work on BSA examinations and enforcement for the Committee.

To address these objectives, we reviewed consent orders and other documents pertaining to selected enforcement actions, recent Department of the Treasury (Treasury) and Federal Deposit Insurance Corporation (FDIC) Office of Inspector General reports, past GAO reports, and documents related to our ongoing BSA work for this Committee.

Summary

In the last few years and as recently as last month, the financial regulators and the courts have taken actions against a number of depository institutions for significant BSA violations. Recent enforcement actions show that various types of depository institutions—including banks,

[5] U.S. General Accounting Office, *Risk-Focused Bank Examinations: Regulators of Large Banking Organizations Face Challenges,* GAO/GGD-00-48 (Washington, D.C.: January 24, 2000).

thrifts, and credit unions—have had BSA violations. These enforcement actions also raise the issue of the timeliness of the identification of BSA violations and enforcement actions taken by the regulators. For example, in 2000, Banco Popular de Puerto Rico was charged with violating the BSA's suspicious activity reporting requirement, paid a civil money penalty of over $20 million, and received a deferred prosecution. In this case, an individual who was later convicted of money laundering offenses had deposited over $21 million at this bank, but the bank had not investigated nor reported this activity to law enforcement until several years after the suspicious activity had begun. The bank's regulator expanded its examination scope for BSA compliance four years after the deposits began. More recently, Riggs Bank was assessed a $25 million civil money penalty for BSA violations including failure to maintain an effective BSA compliance program and failure to monitor and report large transactions involving foreign embassies. Although Riggs' regulator deemed the bank to be systemically deficient in 2003 and the bank entered into a consent order, the bank was not in full compliance with the consent order in 2004 and was subsequently assessed the penalty.

Recent reports of the Treasury's and Federal Deposit Insurance Corporation's Offices of the Inspector General (FDIC IG) assessing the regulators' examination work and enforcement activities have raised questions about potential gaps in the consistency and timeliness of the regulators' activities to monitor and follow-up on BSA violations. For example, in its March 2004 report the FDIC IG concluded that FDIC needed to strengthen its follow up processes for BSA violations.

In recent years, we have done work addressing money laundering issues regarding a variety of activities and financial institutions, such as securities broker-dealers, private banking, and Russian entities. We are currently studying the depository institution regulators' BSA examination and enforcement process for this committee. Our primary objectives are to determine how the regulators' risk-focused examinations assess BSA compliance, the extent to which the regulators identify BSA and AML violations and take supervisory actions, and the consistency of BSA compliance examination procedures and interpretation of violations across regulators. We plan to determine whether and to what extent regulators curtailed BSA compliance examinations and the bases for these decisions. We also plan to, among other things, track supervisory actions taken to correct violations identified.

Background

The Financial Recordkeeping and Currency and Foreign Transactions Reporting Act, commonly referred to as the Bank Secrecy Act, passed by Congress in 1970, requires that financial institutions file certain currency and monetary instrument reports and maintain certain records for possible use in criminal, tax, and regulatory proceedings. As a result, the BSA helps to provide a paper trail of the activities of money launderers for law enforcement officials in pursuit of criminal activities.

Congress has amended the BSA a number of times to increase the effectiveness of the regulators' efforts. For example, the initial BSA reporting system did not include provisions for separate money laundering charges against those who had not satisfied reporting requirements. Thus, Congress enacted the Money Laundering Control Act of 1986, which made money laundering a criminal offense separate from any BSA reporting violations.[6] This act created criminal liability for individuals or entities that conduct monetary transactions knowing that the proceeds involved were obtained from unlawful activity and made it a criminal offense to knowingly structure transactions to avoid BSA reporting. The 1986 act also directed the regulators (1) to issue regulations that require the financial institutions subject to their respective jurisdiction "to establish and maintain procedures reasonably designed to assure and monitor the compliance of such institutions;" (2) to review such procedures during the course of each examination of such financial institutions; (3) to issue cease and desist orders to ensure compliance with the requirements; and (4) to assess civil money penalties for failure to maintain such compliance procedures.[7]

In 1992, Congress increased the penalties for institutions and their employees who violate the BSA and authorized the regulators to take additional supervisory actions for such violations. More specifically, the Annunzio-Wylie Anti-Money Laundering Act authorized the federal banking regulators to revoke an institution's charter if it was convicted of money laundering and, in certain circumstances, to issue removal and prohibition orders against individuals charged with BSA offenses. As

[6] 18 U.S.C. §§ 1956, 1957.

[7] Amendments to banking statutes authorized the regulators to review institutions' BSA compliance procedures during examinations and take supervisory actions for noncompliance. Section 8(s) of the Federal Deposit Insurance Act (12 U.S. C. § 1818 (s)), Subsection 5(d) of the Homeowners Loan Act of 1933 (12 U.S.C. § 1464 (d)(6), and Section 206 of the Federal Credit Union Act (12 U.S.C. 1786(q)).

authorized by this act, in 1996, Treasury issued a rule requiring that banks and other depository institutions use a Suspicious Activity Report (SAR) form to report activities involving possible money laundering. Institutions file these forms with the Financial Crimes Enforcement Network (FinCEN) at Treasury.

Congress amended the BSA again in 1994, with The Money Laundering Suppression Act, to require that financial regulators develop enhanced examination procedures and training to improve identification of money-laundering schemes at financial institutions under their supervision. Accordingly, the federal banking regulators adopted a core set of examination procedures to determine whether an institution has the necessary system of internal controls, policies, procedures, and auditing standards to assure compliance with the BSA and implementing regulations. The procedures also require examiners to review an institution's internal audit function, procedures, selected workpapers, records, reports, and responses. Based on the results, examiners may conclude the examination or continue with expanded procedures, which might include transaction testing and review of related documentation. This act also directed the Secretary of the Treasury to delegate to appropriate federal banking regulatory agencies the authority to assess civil penalties for BSA violations. In May 1994, the Secretary delegated this authority to FinCEN but, to date, this delegation has not been made to the banking regulators.

In October 2001, Congress again amended the BSA through passage of the USA PATRIOT Act, specifically through Title III of this act. The passage of the USA PATRIOT Act was prompted, in part, by the September 11, 2001, terrorist attacks in Washington, D.C. and New York City, which in turn enhanced awareness of the importance of combating terrorist financing through the U.S. government's AML efforts. Title III expanded the scope of the BSA to include organizations not previously covered, such as securities brokers, insurance companies, and credit card system operators. Among Title III's provisions are requirements that financial institutions covered by the act:

- Establish and maintain AML programs;
- Identify and verify the identity of customers who open accounts;
- Exercise due diligence and, in some cases, enhanced due diligence with respect to all private banking and correspondent accounts;

- Conduct enhanced scrutiny with respect to accounts maintained by or on behalf of foreign political figures or their families; and
- Share information relating to money laundering and terrorism with law enforcement authorities, regulatory authorities, and financial institutions.

Title III also added activities that can be prosecuted as money laundering crimes and increased penalties for activities that were money laundering crimes prior to enactment of the USA PATRIOT Act. Examination procedures of the federal banking regulators are expected to conform to PATRIOT Act amendments to the BSA and regulations issued by the Treasury.

Recent Actions Taken against Depository Institutions for BSA Violations Highlight Deficiencies in AML Programs at Some Institutions

In the last few years and as recently as last month, the federal banking regulators and the courts have taken actions against a number of depository institutions for significant BSA violations. In addition to deficiencies at the institutions themselves, issues raised in these cases included the timeliness of the identification of BSA violations and enforcement actions taken by the regulators. To illustrate, I will discuss three different cases at three different types of depository institutions.

Banco Popular de Puerto Rico

In the first case, a bank was charged with BSA violations of suspicious activity report requirements and received a deferred prosecution.[8] In 2000, the U.S. Department of Justice (Justice) charged Banco Popular de Puerto Rico, a bank subsidiary of a diversified financial services company serving Puerto Rico, the United States, and Latin America, with failing to file SARs in a timely and complete manner—in violation of the BSA.[9] According to Justice, from 1995 through 1998, an individual, who was later convicted of money laundering offenses, deposited approximately $21.6 million in cash into an account at Banco Popular. Justice indicated that a number of branch employees were aware of the suspicious activity, but that the bank failed to investigate the account for over 2 years from the date the account

[8]A deferred prosecution is a legal procedure whereby the prosecution for an offense is deferred pending completion of corrective action.

[9]Title 31 USC 5318(g)(1) and 5322(b).

was opened, and also did not report the suspicious activity to FinCEN until 1998 as required by the BSA.

Although the Federal Reserve Bank of New York (FRBNY) conducted four examinations of Banco Popular from 1995 through 1998, the examinations, based on procedures used at the time, did not contain any criticism of the bank's BSA compliance policies or procedures. In 1999, 4 years after the individual first began laundering an undetermined amount of money through Banco Popular, FRBNY expanded the scope of the bank's regularly scheduled safety and soundness examination as a result of information it received from a U.S. Customs Service drug investigation. Based on AML compliance problems identified during the examination, FRBNY developed a supervisory strategy that led to a written agreement containing numerous remedial actions. Banco Popular also entered into a deferred prosecution agreement with Justice, FinCEN, and the Federal Reserve; and agreed to a civil money penalty of over $20 million.

Polish and Slavic Federal Credit Union

In another instance, FinCEN assessed penalties against a credit union for currency transaction reporting violations. In January 2000, FinCEN assessed civil money penalties of $185,000 against the Polish and Slavic Federal Credit Union, located in Brooklyn, New York, for willful failure to file Currency Transaction Reports (CTR) and improperly granting an exemption from CTR filings in violation of the BSA.

FinCEN determined that between 1989 and 1997, the Polish and Slavic Federal Credit Union willfully failed to file numerous CTRs for currency transactions in amounts greater than $10,000.[10] FinCEN also reported that the credit union, through the actions of its former management and board of directors, improperly exempted one customer from CTR filings. The customer, the former chairman of the credit union's board of directors and owner of a travel agency and money remitter business, did not qualify for the CTR filing exemption, according to FinCEN. The remitter made over 1,000 currency deposits in excess of $10,000 but no CTRs were filed. FinCEN further reported that the credit union, through its former general manager and former board, failed to establish and maintain (1) an adequate level of internal controls for BSA compliance, (2) an effective

[10] 31CFR. $103.22 requires depository institutions to file CTRs for currency transactions of $10,000 or more.

BSA compliance program, (3) BSA training for credit union employees, and (4) an effective internal audit function.

NCUA, the regulator of the Polish and Slavic Federal Credit Union, took a series of enforcement actions against the credit union beginning in January 1997 to compel compliance with the BSA. However, FinCEN's report also indicates that NCUA's enforcement actions began about 8 years after the violations began. In April 1999, NCUA removed the credit union's board of directors and imposed a conservatorship based on the credit union's failure to establish adequate internal controls, including controls for BSA compliance.

Riggs Bank N.A.

Last month, OCC and FinCEN assessed a $25 million civil money penalty against Riggs Bank, N.A. for numerous BSA violations, including failure to maintain an effective BSA compliance program and to monitor and report transactions involving millions of dollars by the embassies of Saudi Arabia and Equatorial Guinea in Washington, D.C.

Since 1987, OCC has required each bank under its supervision to establish and maintain an AML compliance program and specified four elements that banks were required to satisfy.[11] However, FinCEN reported that Riggs was deficient in all four elements required by the AML regulation. FinCEN found that Riggs willfully violated the suspicious activity and currency transaction reporting requirements and the AML program requirements of the BSA. Specifically, Riggs failed to establish and maintain an effective BSA compliance program because it did not provide (1) an adequate system of internal controls to ensure ongoing BSA compliance, (2) an adequate system of independent testing for BSA compliance, (3) effective training for monitoring and detecting suspicious activity, and (4) effective monitoring of BSA compliance by the BSA officer.

In July 2003, OCC entered into a consent order with Riggs, in which Riggs was directed to, among other things, correct AML internal control deficiencies and referred the Riggs case to FinCEN. According to a Riggs' filing with the Securities and Exchange Commission, in April 2004, OCC classified Riggs as being in a "troubled condition" for failing to fully

[11]The AML regulation, 31CFR §103.120, requires at a minimum that a BSA compliance program provide for a system of internal controls to ensure compliance, independent testing for compliance, training for appropriate personnel, and a designated individual responsible for day-to-day monitoring of BSA compliance.

comply with the July 2003 consent order. Due to additional BSA violations by Riggs National Corporation (the bank's holding company), in May, OCC and the Federal Reserve, respectively, issued a supplemental consent order and a cease and desist order, requiring extra corrective actions. OCC and FinCEN cited the corporation for deficiencies in risk management and internal controls. Although OCC deemed Riggs to be systemically deficient in 2003 and the bank entered into a consent order with OCC, Riggs was not in full compliance with the consent order in 2004 and was subsequently assessed the penalty.

In addition to the three cases discussed above, published reports of BSA violations at other banks have increased concerns about bank noncompliance with the BSA and timely oversight and enforcement by the federal banking regulators. For example, in 2003, the Department of Homeland Security's Bureau of Immigration and Customs Enforcement (ICE) reported that the Delta National Bank & Trust Company pled guilty in U.S. District Court to charges that it failed to file a SAR in connection with a transaction made in 2000 between two accounts at the bank. As part of the plea agreement with the government, the bank agreed to forfeit $950,000. In 2002, Broadway National Bank pled guilty to three felony charges for failing to report suspicious banking activity in the 1990s, according to ICE. The prosecutors determined that more than $120 million was illegally moved through the bank. The bank was fined $4 million.

Inspectors General Reports Highlight Areas of Improvement Needed in the BSA Examination Process

Recent Treasury and FDIC IG reports assessing the regulators' examination work and enforcement activities have raised questions about potential gaps in the consistency and timeliness of the regulators' monitoring and follow-up on BSA violations.

Treasury's Office of IG

The Treasury's IG issued a report in 2003 on BSA violations at depository institutions and has a number of related audits in its fiscal year 2004 work plan. In September 2003, the Treasury IG issued a report on its review of OTS enforcement actions taken against thrifts with substantive BSA violations. Among its findings, the report stated that examiners found substantive BSA violations at 180 of the 986 thrifts examined from January 2000 through October 2002. OTS had issued written enforcement actions against 11 of the 180 thrifts; however, in 5 of these actions, the IG reported

that enforcement actions did not address all substantive violations found, were not timely, or were ineffective in correcting the thrifts' BSA violations. The IG further reported that among 68 sampled cases, OTS relied on moral suasion and thrift management assurances to comply with the BSA. In 47 cases (69 percent), thrift management took the corrective actions, but in the other 21 cases (31 percent), thrift management was nonresponsive. BSA compliance worsened at some of the 21 thrifts, according to the IG.

The IG made several recommendations including that OTS assess the need for additional clarification or guidance for examiners on when to initiate stronger supervisory action for substantive BSA violations and time frames for expecting corrective actions from thrifts. OTS concurred and stated that supplemental examiner guidance would be provided for the first quarter of 2004.

The IG's fiscal year 2004 annual plan lists several related audit projects including an assessment of OTS' BSA examinations, including the new requirements under the USA PATRIOT Act.

FDIC IG

I am pleased to be on a panel with the FDIC Inspector General and would like to highlight some of his office's work to illustrate issues recently raised regarding BSA examinations and enforcement. For example, in March 2001, the IG reported on its review of the FDIC Division of Supervision and Consumer Protection assessment of financial institutions' compliance with the BSA. Among the IG's findings were that FDIC did not adequately document its BSA examinations work; as a result, the IG was unable to determine the extent to which examiners reviewed regulated institutions' compliance with the BSA during safety and soundness examinations.

The IG made several recommendations, including that FDIC reemphasize to examiners and ensure that they follow (1) specific guidance related to the documentation requirements of scoping decisions, procedures, and conclusions reached during the pre-examination process when risk-focusing BSA examinations; and (2) policy and instructions on how to adequately document BSA examination decision factors and procedures. With regard to both recommendations, FDIC stated it would reemphasize its existing policies and guidance, specifically those policies requiring examiner responses to all of the BSA core decision factors at each examination. FDIC also stated that it had made revisions to its BSA examination module.

In September 2003, the IG reported on its audit of FDIC's implementation of examination procedures to address financial institutions' compliance with provisions of Title III of the USA PATRIOT Act. The IG concluded that FDIC's existing BSA examination procedures covered the AML subject areas required by the act to some degree and that its Division of Supervision and Consumer Protection had advised FDIC-regulated institutions of the new requirements. However, the IG reported that, for a number of reasons, the division had not issued guidance to its examiners on the act's provisions that required new or revised examination procedures. One of the report's recommendations was that the division issue interim examination procedures for those sections of the USA PATRIOT Act for which Treasury had issued final rules. The division agreed with the recommendation.

In March 2004, the IG issued a report on its work to determine whether the FDIC adequately followed up on BSA violations reported in examinations of FDIC-supervised financial institutions to ensure that they take appropriate corrective action. Among the IG's findings was that, in some cases, BSA violations were repeatedly identified in multiple examination reports before bank management took corrective action or FDIC took regulatory action to address the repeat violations. The IG concluded that FDIC needs to strengthen its follow-up processes for BSA violations and recommended that FDIC's Division of Supervision and Consumer Protection (1) reevaluate and update examination guidance to strengthen monitoring and follow-up processes for BSA violations and (2) review its implementation process for referring violations to Treasury. The IG noted that FDIC has initiatives underway to reassess and update its policies and procedures. Although it did not concur with all of the IG's findings, in its response, FDIC concurred with the recommendations.

GAO's BSA and AML Examinations and Enforcement Work

In recent years, we have done work addressing money laundering issues within the context of different activities and financial institutions such as securities broker-dealers, Russian entities, and private banking. We have also reviewed FinCEN's regulatory role.

Past Reports

In 1998, we issued two reports regarding FinCEN's role in administering the BSA.[12] In both of these reports, we discussed the Secretary of the Treasury's mandate to delegate the authority to assess civil penalties for BSA violations to federal banking regulatory agencies and noted that this delegation had not been made. One purpose of this work was to update information on civil penalties for BSA violations. We reported that one of the issues under discussion at the time was whether violations would be enforced under BSA provisions or under the banking regulators' general examination powers granted by Title 12 of the U.S. Code. At that time, FinCEN officials told us that they were concerned that the banking regulators might be less inclined to assess BSA penalties and instead use their non-BSA authorities under their own statutes.

Also in 1998, we reported on the activities of Raul Salinas, the brother of the former President of Mexico.[13] Mr. Salinas was allegedly involved in laundering money from Mexico, through Citibank, to accounts in Citibank affiliates in Switzerland and the United Kingdom. We determined that Mr. Salinas was able to transfer $90 - $100 million between 1992 and 1994 by using a private banking relationship structured through Citibank New York in 1992 and effectively disguise the funds' source and destination, thus breaking the funds' paper trail. The funds were transferred through Citibank Mexico and Citibank New York to private banking investment accounts at Citibank London and Citibank Switzerland.

In October 2000, we reported on our work on suspicious banking activity indicating possible money laundering conducted by certain corporations that had been formed in the state of Delaware for unknown foreign individuals or entities.[14] We first identified an agent that together with a related company created corporations for Russian brokers and established bank accounts for those corporations. We also reviewed SARs filed by three banks concerning transactions by corporations formed by this agent for Russian brokers. We then determined that from 1991 through early

[12]U.S. General Accounting Office, *Money Laundering: FinCEN Needs to Better Communicate Regulatory Priorities and Time Lines*, GAO/GGD-98-18 (Washington, D.C.: Feb. 6, 1998); and *Money Laundering: FinCEN Needs to Better Manage Bank Secrecy Act Civil Penalty Cases*, GAO/GGD-98-108 (Washington, D.C.: June 15, 1998).

[13]U.S. General Accounting Office, *Private Banking: Raul Salinas, Citibank, and Alleged Money Laundering*, GAO/OSI-99-1 (Washington, D.C.: Oct. 30, 1998).

[14]U.S. General Accounting Office, *Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities*, GAO-01-120 (Washington, D.C.: Oct. 31, 2000).

2000, more than $1.4 billion in wire transfer transactions was deposited into over 230 accounts opened at two U.S. banks—Citibank and Commercial Bank. More than half of these funds were wired from foreign countries into accounts at Citibank and over 70 percent of the Citibank deposits for these accounts were wire-transferred to accounts in foreign countries. Further, both of these banks had violated BSA requirements regarding customer identification. We concluded that these transfers raised concerns that the U.S. banking system may have been used to launder money.

In 2001, we issued a report on changes in BSA examination coverage for certain securities broker-dealers.[15] At the time, there was no requirement that all broker-dealers file SARs; however, broker-dealer subsidiaries of depository institutions and their holding companies were required to file SARs and were examined by banking regulators for compliance. We determined that with the passage of the 1999 Gramm-Leach-Bliley Act, these broker-dealers were no longer being examined to assess their compliance with SAR requirements, although they were being examined for compliance with reporting currency transactions and other requirements Treasury had specifically placed on broker-dealers. However, with the passage of the USA PATRIOT Act and the issuance of a final rule that became effective on July 31, 2002, all broker-dealers were required to report such activity.

Ongoing Work

In December 2003, the Chairman and Ranking Member of this Committee requested that we conduct a review of the regulators' BSA examination procedures and enforcement actions. In requesting this work, you cited the Treasury and FDIC IG work that I discussed above. Among the major questions you raised were:

- How do the regulators design, target, and conduct BSA compliance examinations, including for the added provisions of the USA PATRIOT Act?
- How many BSA violations have federal banking regulators identified and taken action on over a several year time period?

[15] U.S. General Accounting Office, *Money Laundering: Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers Ceased*, GAO-01-474 (Washington, D.C.: Mar. 22, 2001).

- What consequences do the regulators' risk-focused examinations have for identification and enforcement of BSA violations?
- What differences, if any, are there between enforcement of the BSA through the regulators' general safety and soundness authorities and enforcement of the BSA under the terms of the BSA itself?
- Are BSA violations consistently interpreted among the regulators, Treasury, and depository institutions?
- How do BSA violations come to the attention of the regulators and what other agencies are involved in resolving the violations?
- What is the relationship between Treasury and the banking regulators in shaping examination policy and subsequent enforcement actions?
- Do the regulators have adequate resources for conducting BSA compliance examinations, including the BSA provisions of the USA PATRIOT Act?

We have begun doing this work for the Committee. In general, the major objectives of our review are to determine:

1. How do the regulators' risk-focused examinations of depository institutions assess BSA and AML program compliance?
2. To what extent do the banking regulators identify BSA and AML program violations and take supervisory actions for such violations?
3. How consistent are BSA examination procedures and interpretation of BSA violations across the banking regulators?
4. What resources do the federal banking regulators have for conducting examinations of BSA and PATRIOT Act compliance?

As part of our review, and considering the IGs' findings, we are examining the relevant BSA amendments and banking statutes, regulations, and policies that address the authorities under which the regulators and Treasury take supervisory action for BSA violations and violations of their AML program rules. We are reviewing current examination guidance and procedures that the regulators use for determining compliance with the BSA, and related requirements used during their regular and targeted examinations. We will also try to ascertain the implications of "risk-

focused" examinations for BSA compliance and to determine whether and to what extent the regulators curtail such compliance reviews in their examinations.

We are reviewing the reliability of the data systems used by banking regulators to track bank examinations, including BSA compliance examinations. We plan to obtain information on the bank examinations performed by each banking regulator over the past 4 years and then select a random sample to determine whether and the extent to which a BSA review was conducted or curtailed and the bases for these decisions. We also are obtaining information from the banking regulators on the number of BSA examinations done over the past 4 years and the number and nature of violations they identified. We plan to select and analyze samples of their BSA examinations and supporting workpapers to secure, in part, information on violations identified and the areas of operation covered during the examinations. Additionally, we plan to track supervisory actions taken by the regulators to correct the violations they identified. Our analyses in this area will include assessing the regulators' examination procedures for BSA and AML compliance and the nature of violations and corresponding supervisory actions. We will also review the examinations in our sample to determine the extent to which the examinations reviewed policies and procedures and then tested transactions to see if the policies and procedures were implemented appropriately. We will also determine the extent to which banking regulators vary in the way they conduct their BSA examinations, cite banks for violations, and take enforcement actions.

Key legal issues we will be examining are the ramifications, if any, of the lack of delegation of authority to assess BSA penalties by Treasury to the federal banking regulators, as mandated by statute in 1994. We will examine enforcement of the BSA through the regulators' general safety and soundness authority and enforcement under the terms of the BSA itself to see whether there are differences, including circumstances under which the regulators make referrals to Treasury and law enforcement agencies.

In addition, we will meet with government officials at the federal and state levels and from the banking and credit union industries to gain their perspectives on the risk-focused BSA examination process and post-examination follow-up activities. We have finished our initial meetings with the federal banking regulators; and officials at the Departments of Homeland Security, Justice, and Treasury, including FinCEN. We will have follow-on meetings with them as well as with state banking supervisors,

and representatives from depository institutions of various sizes to gain their views on the consistency of examiner interpretation of potential BSA-related deficiencies and the regulators' BSA examination procedures, and their own internal control activities.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or Members of the Committee may have.

GAO Contacts and Staff Acknowledgements

For questions concerning this testimony, please call Davi M. D'Agostino at (202) 512-8678. Other key contributors to this statement were M'Baye Diagne, Toni Gillich, Barbara Keller, Kay Kuhlman, and Elizabeth Olivarez.

RESPONSE TO A QUESTION OF SENATOR SHELBY FROM JOHN D. HAWKE, JR.

A.1. Mr. Hawke, in addition to the Saudi and Equatorial Guinea accounts, Riggs held numerous other foreign accounts, including what many characterize as what we would call high-risk by FinCEN and OFAC. They include, among others, Burma, Cuba, the Sudan, Iraq, Iran, Syria, and Nigeria. If Riggs' BSA/AML internal controls were so deficient, which is a given, should we be concerned, in other words, should you be concerned that many of these other embassy and special interest accounts could suffer similar inadequacies and violations?

A.1. OCC examiners reviewed Riggs Bank's OFAC controls during the January 2003 BSA examination and did not find any problems with the bank's handling of OFAC country accounts. The examiners reviewed the details of the Iraqi blocked accounts and did not identify any deficiencies or noncompliance with OFAC regulations. Subsequently, OCC examiners obtained and confirmed that appropriate licenses were acquired for Riggs or their banking customers to open accounts or transact business within OFAC sanctioned countries of Burma, Cuba, Iran, Iraq, the Sudan, Syria, and Yugoslavia (Balkans). The bank's OFAC compliance procedures used in the opening account process have also been assessed in subsequent exams and found to be satisfactory.

Most of the above-mentioned OFAC sanctioned countries having either Embassy or Mission accounts within Riggs's Embassy Banking Division were closed in June 2004 as part of the bank's decision to exit high-risk Embassy accounts. There is one exception of an Iranian account that remains open and blocked as required by OFAC. Under the terms of the cease-and-desist orders, the bank is required to review the activity in all high-risk Embassy accounts going back to January 1, 2001, to ensure that Suspicious Activity Reports are filed where appropriate. The OCC will evaluate Riggs Bank's compliance with this and other requirements of the cease-and-desist orders in October of this year.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

June 18, 2004

The Honorable Paul S. Sarbanes
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Sarbanes:

During the Committee's hearing on June 3, 2004, you raised concerns about changes the OCC is making in its organizational structure for compliance supervision. Specifically, you referred to an email from Ann Jaedicke, OCC's Deputy Comptroller for Compliance, that described these changes to include buyouts for compliance employees. You felt that a plan to offer buyouts was inconsistent with my statement that OCC does not intend to reduce the number of its compliance examiners. During the hearing, you requested a copy of a May 2004 memo from OCC's Committee on Bank Supervision that more fully describes the changes we are making. That memo is included with this letter. I hope that the information in this letter and the memo will answer any remaining questions you may have about this issue. Let me be clear, we do not intend to reduce the number of compliance examiners at the OCC.

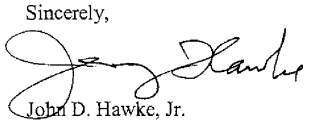
Currently the OCC has 107 compliance examiners who examine banks throughout the U.S. Six managers supervise these employees. The six managerial positions are being eliminated, and the 107 compliance examiners are being reassigned to other managers in the OCC. We believe this realignment of the staff will improve the effectiveness of our compliance program by integrating it into the other aspects of bank supervision.

The OCC is offering buyouts primarily to the managers in the positions that are being eliminated. A few other compliance employees also are eligible for these buyouts. The total number of buyouts available is four. Ten employees, including the six managers, are eligible for the four buyouts.

If none of the eligible employees elect to accept OCC's offer for a buyout, the former managers will be offered positions as compliance examiners and the number of compliance examiners will increase from 107 to 113. If four employees choose to take a buyout, the remaining employees will again be placed in jobs as compliance examiners, and the number of examiners will increase from 107 to 109. In either case, the number of examiners who are available to conduct examinations of banks' compliance supervision will increase, and the overall number of managers in the OCC will decrease.

Consumer protection and compliance with the Bank Secrecy Act are issues that have been and continue to be an important part of OCC's supervision of national banks. We will do nothing to diminish our abilities to supervise these important areas. I hope this has been responsive to your question. If you would like more information or have additional questions, I would be happy to respond.

Sincerely,



John D. Hawke, Jr.
Comptroller of the Currency

Enclosure

OCC News

Posted on May 21, 2004

To: All Employees
From: Committee on Bank Supervision
Subject: Compliance Realignment
Date: May 21, 2004

During the next several months the OCC will change its organizational reporting lines to better align our compliance functions with our other supervisory activities. The goal of the realignment is to enhance our ability to focus examination resources on the banks and banking activities that pose the greatest compliance risks. We believe these steps will improve the effectiveness and integration of this important aspect of OCC supervision and will enhance the coordination of and accountability for compliance supervision. We recognize that the process leading up to this announcement has been prolonged. This has led some staff to be concerned about these changes. However, in light of the many changes taking place in the industry, a careful and deliberate process was necessary to assure that the end result was to make our strong compliance program even stronger.

This realignment will replace our current structure in which compliance field examiners report to assistant deputy comptrollers (ADCs) for compliance. This layer of management will be replaced with five comparably graded compliance expert positions whose work will be focused on banks in the large bank program. In the future, compliance examiners in the field will be assigned to the large bank supervision program or to the mid-size/community bank supervision program. Those working in large banks (as many already are) will report through large bank EICs to the deputy comptrollers for large banks at headquarters. Those assigned to the mid-size/community bank line of business will report through ADCs based in our field offices to the deputy comptrollers in charge of our district offices.

This change does not mean that we intend to reduce the number of compliance examiners. Compliance has been and will continue to be an important component of the OCC's supervision of national banks and their operating subsidiaries, and we value all the compliance specialists working for the OCC.

Although the compliance specialists who move into the large bank line of business will conduct the majority of large bank compliance work, we expect that there may be instances in which the large bank program draws resources from the mid-size/community bank line of business. Compliance work in the mid-sized banks will be funded from the two lines of business, consistent with the way in which the OCC's mid-size bank program currently funds safety and soundness work. Additionally, we intend to create five new lead expert compliance positions in the

mid-size/community bank program. The reporting lines for these positions will be consistent with the other lead expert specialties in the districts.

The compliance department in headquarters will retain responsibility for the development and oversight of OCC's compliance policies and examination procedures. Managed by the deputy comptroller for compliance and staffed by compliance specialists, this department will also be responsible for developing and maintaining early warning systems to identify compliance risks, conducting the training of compliance examiners, providing information to the industry, and aiding in the coordination and communication of compliance issues.

We want to reiterate that these changes will not diminish our commitment to effective and efficient compliance supervision. Compliance is a key component of our 2005 Operating Plan, and we expect our supervisory staff to fully address supervisory issues associated with privacy, predatory lending, the bank secrecy act, the community reinvestment act, and all other consumer compliance regulations. We will complete the implementation of this realignment by September 30, 2004.

Office of Thrift Supervision
Department of the Treasury

James E. Gilleran
Director

1700 G Street, N.W., Washington, DC 20552 • (202) 906-6590

June 9, 2004

The Honorable Jack Reed
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Senator Reed:

Thank you for your request for a statement regarding what supervisory regulations and processes the Office of Thrift Supervision (OTS) has in place to ensure that thrifts operate in a safe and sound manner with regard to outsourcing to foreign service providers. OTS's supervisory efforts in this regard can be categorized as those that are implemented on an interagency basis and those specific to OTS.

Interagency Supervisory Processes

To provide the context in which to understand OTS specific regulations and processes, it is helpful to understand what the federal banking regulatory agencies do on an interagency basis. The Federal Financial Institutions Examination Council[1] (FFIEC) issues interagency guidance to financial institutions regarding the safe and sound operations of financial institutions. Additionally, each of these agencies examines the institutions it regulates to ensure that they are effectively following the guidance issued by the regulators. If, during an examination or at any other time, the primary regulator determines that an institution is not in compliance with regulatory requirements, the regulator may take a variety of steps to enforce compliance. Such actions range from informal agreements to remediate problem areas, to formal public enforcement actions such as cease and desist orders and civil money penalties.

Many U.S. financial institutions use third party service providers for information technology services. Because this is a common practice, the FFIEC has issued guidance related to its expectations regarding vendor management. This guidance spells out what the agencies believe are best practices for vendor management and the agencies' expectations in terms of assessing and mitigating risks associated with outsourcing technology services.[2] In addition, the

[1] The FFIEC is composed of the Office of Thrift Supervision, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, and the National Credit Union Administration.

[2] Chief Executive Officer Memorandum 133, Risk Management of Technology Outsourcing, distributed by OTS on December 13, 2000.

FFIEC is in the process of updating the Information Technology Examination Handbook[3] that deals with outsourcing. The updated version of this section discusses best practices and regulatory expectations regarding the use of foreign service providers.

The FFIEC agencies expect institutions to implement a proper vendor management process that provides policies and procedures that ensure that:

- The Board of Directors and senior management of financial institutions are responsible for and understand the risks associated with outsourcing arrangements and for implementing effective controls to mitigate identified risks.
- Senior management implements an effective due diligence process in selecting a third party provider.
- Senior management deliberately considers and evaluates contract issues to ensure that the rights and responsibilities of each party to the contract are clearly stated and agreed upon.
- Senior management implements an effective system of service provider oversight to monitor the relationship and make modifications as it evolves.

The above is a general overview of expectations. The referenced documents, particularly the Information Technology Examination Handbook, provide extensive details regarding specific expectations, including those dealing with compliance with the USA Patriot Act and the Gramm-Leach-Bliley Act. Within this interagency framework, safety and soundness examiners and information technology examiners regularly assess the adequacy and effectiveness of U.S. financial institutions' internal controls with respect to vendors that provide technology services to them. These examinations are risk focused, and examiners utilize a variety of examination work programs to assess risk and evaluate controls related to both domestic and foreign-based service providers.

OTS Specific Statutes, Regulations, and Guidance

The Office of Thrift Supervision has unique regulations and guidance that apply to foreign-based service providers. These give OTS the ability to:

- Monitor and supervise foreign-based service provider activity that is taking place on behalf of thrifts;

[3] The updated FFIEC Information Technology Handbook contains sections on Information Security, Audit, Technology Service Providers, Electronic Banking, Business Continuity Planning, FedLine and Retail Payment Systems. Additional sections on Outsourcing, Operations, Management, Wholesale Payment Systems, and Development and Acquisition will be published during 2004 and will complete the update process.

- Outline the scope of authorized activities and regulatory expectations of thrifts; and

- Assess the risk associated with the activity and take actions to mitigate the risk if necessary.

Home Owners' Loan Act (HOLA)

HOLA requires thrifts to notify OTS of arrangements with all third party providers. This notice is required even in the absence of a formal contract, and applies to all service providers -- domestic or foreign. The notice is required no later than 30 days after the earlier of the date of the contract, or the date the third party initiates performance of the services. HOLA also makes services performed by a third party subject to regulation and examination by OTS to the same extent as the thrift itself. HOLA thus requires thrifts to notify OTS of the use of a third party provider and gives OTS the authority to examine that provider if necessary.

OTS Regulation -- Electronic Operations Rule

OTS issued a final rule (12 CFR Part 555), effective January 1, 1999, that outlines the authority and regulatory expectations for thrifts to conduct electronic operations. Section 555.310 requires thrifts to notify OTS at least 30 days before establishing a "transactional" website. To date, all notices received have been for services from domestic service providers. If this activity starts moving offshore, OTS would be made aware of it under this regulation and would assess and ensure that risks associated with the move are mitigated.

Guidance -- Thrift Bulletin 82 (TB 82) 'Third Party Arrangements'

In March of 2003, OTS issued guidance to thrifts stating the agency's expectations with regard to all third party arrangements. The purpose of this bulletin was to apply the service provider guidance beyond what typically had been more narrowly interpreted as technology service providers. TB 82 now applies to any service provided by a third party. TB 82 also specifically incorporated new guidance with regard to foreign-based service providers:

- Thrifts with existing[4] arrangements with foreign-based service providers were instructed to immediately notify OTS if they had a composite safety and soundness rating of 4 or 5 or were troubled.

- Thrifts, on an ongoing basis, should notify OTS at least 30 days before entering into any new service provider arrangement with a foreign-based service provider.[5]

[4] As of the date of issuance of TB 82, March 19, 2003.

[5] For domestic service providers, TB 82 provides for a 30 day after-the-fact notice and limits the notice to contracts outside the normal course of business and significant to the operation or financial condition of the institution.

- Thrifts should include a contract provision with each foreign-based service provider recognizing that services it performs on behalf of the thrift are subject to OTS examination. A thrift's use of a foreign provider, and the use of critical data and processes outside U.S. territory, must not compromise OTS's ability to examine a thrift's operations. Accordingly, OTS expects thrifts to establish relationships in a way that does not impede OTS's access to data or information needed to supervise the thrift or to assess the safety and soundness of the thrift's operations.

- TB 82 also advises thrifts to include a provision in contracts with service providers allowing the thrift or OTS to terminate the contract, if the thrift becomes troubled or if OTS formally objects to the arrangement.

Other OTS Initiatives Related to Foreign-Based Service Providers

In addition to the Interagency and OTS-specific activities related to foreign outsourcing, OTS has begun a number of additional initiatives to monitor this activity. For example, OTS recently performed an informal survey of our larger and more complex thrifts to obtain information regarding the type of activities being outsourced, where the provider is located, and whether the provider was affiliated with the thrift.

OTS also maintains an Information Technology Database that is updated during each examination and that shows all significant service providers that have contracted with thrifts in the United States. This database is currently being updated to allow users to flag foreign service providers and make it easier to extract reports specific to them.

Summary

The use of foreign-based service providers is becoming a more common business practice. Proponents of this activity believe that the foreign-based services can be performed more effectively and efficiently. Indeed, cost savings are reported to be in the 40 percent to 60 percent range in some cases. Proponents argue that even with the extra expenses of monitoring activities in an offshore arrangement, financial institutions can gain a better quality of service at a reduced price.

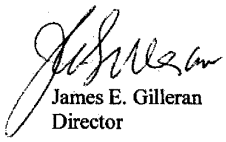
Others argue that the cost of monitoring and managing offshore vendors, if done effectively, eliminates the cost savings for a majority of depository institutions, and that effective management of an offshore third party relationship may not even be feasible in certain political, economic, and legal environments.

OTS is mindful of the changes taking place and is monitoring this activity. While we generally do not interfere with offshore outsourcing arrangements that are implemented with adequate controls, we are prepared to intervene when appropriate controls are lacking. We stress to institutions that it is imperative that internal controls are in place to protect private customer information, regardless of where the electronic processing is performed. In addition, thrifts must be able to assure us that the provisions of the Bank Secrecy Act and the USA Patriot Act, aimed at deterring terrorist activity and money laundering, are implemented effectively at the financial institution and its service providers.

Our examiners evaluate thrifts' compliance with the OTS statutes, regulations, and guidance described above during our Safety and Soundness/Compliance and Information Technology examinations. OTS also has a group of highly skilled specialists in the information technology examination area that conduct intense IT examinations at large complex thrifts and their service providers.

If you or your staff have any additional questions, please do not hesitate to contact me or Kevin Petrasic, Managing Director, External Affairs at (202) 906-6288.

Sincerely,



James E. Gilleran
Director