Testimony of

R. Michael Stewart Menzies, Sr.
President/CEO, Easton Bank and Trust Company

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations

Hearing on

"Suspicious Activity and Currency Transaction Reports: Balancing Law Enforcement Utility and Regulatory Requirements"

May 10, 2007
Washington, D.C.

Chairman Watt, Ranking Member Miller and members of the committee, my name is Mike Menzies. I am President and CEO of Easton Bank and Trust Company in Easton, Maryland. I am pleased to testify today in my capacity as Vice Chairman of the Independent Community Bankers of America (ICBA).

On behalf of ICBA's nearly 5000 member banks, I want to express our appreciation for the opportunity to testify about the burdens community banks face when complying with the Bank Secrecy Act.

Summary of ICBA Position

Community bankers are committed to balanced effective measures that stop terrorists from using the financial system to fund their operations and prevent money launderers from hiding the proceeds of criminal activities. However, **ICBA strongly urges the federal government to recognize the costs and burdens that these requirements place on financial institutions, especially community banks, and to find ways to streamline requirements.**

ICBA believes the government should focus on a risk-based approach in combating money laundering and terrorist financing, with a careful balancing of costs and benefits. To that end, **we support the development of a streamlined and easily applied system to exempt "seasoned customers" from currency transaction reports** and we applaud the House for once again passing H. R. 323 that would implement a seasoned customer exemption.

H. R. 323 is substantially similar to section 202 of Representative Nydia Velazquez's Communities First Act, H. R. 1869, which ICBA strongly supports. That legislation provides critical regulatory and tax relief to community banks and their customers. We urge this committee to carefully consider each of the regulatory provisions of that bill as potential additions to your agenda this year.

In addition, our testimony includes the following recommendations:

- FinCEN needs sufficient resources to manage the data
- Law enforcement should clearly demonstrate the usefulness of the data
- A simple increase in the threshold for CTRs would greatly reduce burden
- The streamlined exemption process in H. R. 323 will help restore the balance between costs and benefits
- BSA requirements should be flexible and easily applied
- Enhanced communication between law enforcement, regulators and banks is extremely important
- Community banks need regulatory relief

Expanding Burden and Reporting

When it initially adopted the Bank Secrecy Act in 1970, the United States Congress determined that "certain records maintained by businesses… have a high degree of usefulness in criminal, tax, and regulatory investigations and proceedings."[1] As a result, community banks were required to maintain "appropriate types of records and the making of appropriate reports."[2]

Over the years, the requirements – and burdens – imposed on community banks under the Bank Secrecy Act have steadily increased. Most recently, in 2001 after the terrorist attacks on New York and the Pentagon, Congress expanded the requirements again in the USA PATRIOT Act, broadening the definition of financial institution to encompass many additional businesses and increasing the requirements for banks and other financial institutions.

As a result, the volume of reports that have been filed under the BSA has been increasing dramatically. According to the Treasury's Financial Crimes Enforcement Network, or FinCEN, the number of suspicious activity reports, or SARs, that banks filed in 1996 was 62,388; by 2000, that number had nearly tripled to 162,720 and in 2005, the last year FinCEN reported a complete year of figures, the number reached over one-half million suspicious activity reports.[3] The number of currency transaction reports (CTRs) has also been increasing – reaching nearly 16 million in 2006.[4]

FinCEN Needs Sufficient Resources to Handle the Data

Before addressing the burden on the nation's community banks, it is important to recognize that sufficient resources are needed to make the information that banks supply truly useful. Unless FinCEN has sufficient resources to be able to make the data worthwhile, it does not make sense to ask banks to file the many reports currently required. Merely collecting the data and tabulating it in a database does not achieve the goal of combating money laundering and terrorist financing. Rather, it is important that FinCEN has the resources and funding to hire sufficient staff to analyze the data and to develop and implement software programs that can monitor the data while fulfilling FinCEN's broader law enforcement mission. FinCEN is not a large organization but since 2001 it has been given increasing responsibility. To handle these responsibilities, especially all the reports banks produce, FinCEN must have the funding it needs.

Insufficient funding is having an impact. For example, last July, FinCEN announced it had stopped work on the BSA Direct Retrieval and Sharing Component project because it had repeatedly missed program milestones and

---

[1] 12 USC 1951. Bank Secrecy Act § 121 (84 Stat. 1116).
[2] Ibid.
[3] *The SAR Activity Review, By the Numbers, Issue 7, November 2006.*
[4] *FinCEN Annual Report for Fiscal Year 2006*, page 11.

performance objectives.[5] The agency's press release stated that, "The level of effort and costs to complete BSA Direct R&S, address all remaining defects of the system, and operate and maintain the system, [were] likely to be much greater than originally projected."[6] At the time it ceased work, $14.4 million had been spent, $5.5 million more than originally projected with an additional $8 million needed before the system could be completed and an additional $2.5 million per year for operations and maintenance.[7] Difficulty in collecting and managing BSA data is ongoing. Recently, FinCEN deferred the effective date of the revised SAR form due to problems with managing the input of data from the new form.[8]

For FinCEN to handle the data that it is statutorily obligated to manage, Congress needs to allocate additional funds. Looking forward, as FinCEN manages more data, it will need more funding and analytical resources to make the continued collection of data worthwhile. With more industries filing reports, the demand for resources and funding to analyze the date properly will only increase.

Use of the Data

Not only FinCEN, but law enforcement agencies need sufficient resources to be able to benefit from the data that FinCEN processes. Perhaps one indicator of how the data that banks produce is used by law enforcement agencies can be found in a regular report issued by FinCEN. It's also worth considering the relationship between banks and law enforcement in assessing this process.

Under the USA PATRIOT Act section 314(a),[9] banks are required to review their records to ascertain whether there is a data match corresponding to a request from a federal law enforcement agency. As of April 24, 2007, according to FinCEN's own fact sheet, this provision allows law enforcement "to reach out to more than 45,000 points of contact at more than 27,000 financial institutions to locate accounts and transactions of persons that may be involved in terrorism or money laundering."[10] Every two weeks, FinCEN transmits a request to banks to search records for data matches, including accounts maintained by the subjects listed in the request. There is no obligation to respond if there is no match. Just after the program initially started, it had to be temporarily suspended because of problems and security concerns over the data transmissions. However, it has since resumed.

It's worth noting that many wrongly assume that these compulsory data searches are automated. For larger institutions, that may be true to some extent.

---

[5] FinCEN press release, July 13, 2006.
[6] Ibid.
[7] Ibid.
[8] *Federal Register,* volume 72, no. 83, May 1, 2007, page 23891.
[9] 31 USC 5311.
[10] FinCEN's 314(a) Fact Sheet, April 24, 2007.

However, we understand that even larger banks have to subject their records to manual processes as well. While the costs for software and automated processing are decreasing, smaller banks do not always have the resources to install the necessary software. As a result, many banks - especially community banks – still must conduct intensive and time consuming manual searches of their records to determine whether there is a match to the FinCEN list. Bear in mind, these searches must be completed immediately because the statute requires the bank to respond within two weeks.

According to FinCEN, from November 2002 until April 24 of this year, banks were asked to search their records for data matches for nearly 5,500 subjects. That means someone in the bank has to review account records in different data systems, including deposit records, consumer loan records, commercial loan records, pension accounts records, trust account records, and other systems in the bank. While software producers would like us to believe that banks have quick and easy customer information programs that allow all these databases to talk with one another, the average bank software does not have the advanced capability to do so. Manual data searches are time-consuming and use resources that the bank might otherwise devote to serving its customers. FinCEN has been working with the industry to focus the requests and to eliminate the need to search records when there is little chance of finding a positive match. Regardless of these efforts, the time needed to respond to these search requests is a substantial burden.

Ultimately, the effectiveness of a program must be judged on its results. After years of broad compliance with BSA bank record searches at a substantial cost to the banking industry, FinCEN reports that the data-match program has led to just under 1,500 grand jury subpoenas, 21 search warrants, 100 arrests, 112 indictments and 9 convictions.[11]

The Burden of Bank Secrecy Act Compliance

As noted above, the nation's community banks are committed to supporting the federal government's efforts to prevent money laundering, terrorist financing and other fraudulent activities. However, ICBA believes that it is critical that resources be focused where the risks are greatest. Over the years, there has been a tendency to require reports that have little value for law enforcement because it *might* be useful. However, these reports merely clog the system and obscure truly suspicious activities. Moreover, all this data places additional demands on the federal government to properly process and analyze the information – and to ensure that it is properly protected in a secure electronic database. Committees in each house of Congress are currently focusing on data security and as part of that process, it is critical that the federal government ensure that the vast amount of sensitive BSA data is properly protected. Every day, there are stories in the media about identity theft and the risks to

[11] FinCEN's 314(a) Fact Sheet, April 24, 2007.

consumers. We cannot overlook the need to secure and protect the large amount of data collected by the government under BSA requirements.

Bankers across the country continue to identify the Bank Secrecy Act as the most burdensome area of compliance. The time it takes for banks to develop systems and procedures, train personnel, audit for compliance, and take the many other steps needed to comply with the many requirements and reports mandated by the BSA are time consuming.

Therefore, ICBA appreciates the efforts by Congress to bring greater focus to this issue and we look forward to continuing to work with Congress, the Treasury and the banking agencies to achieve an effective compliance regime that directs resources to banks, regulators and law enforcement agencies where it can be of the most benefit. For example, one solution ICBA strongly supports is streamlining the process for currency transaction reports (CTRs). H. R. 323 would greatly help streamline the entire reporting process and restore balance to the system of exempting customers from unnecessary CTRs where the current exemption system is not working.

ICBA Supports the "Seasoned Customer Exemption (CTR) Act of 2007"

We applaud this committee and the House for passing H.R. 323. The provisions of the bill are substantially similar to legislation passed by the House last session as part of a comprehensive financial regulatory relief bill. Just as it did last session, the House passed the bill by an overwhelming majority.

As the bill properly notes, "the completion of and filing of currency transaction reports….poses a compliance burden on the industry." Unfortunately, despite these efforts and compliance burdens, the bill also notes that not all the reports are "relevant to the detection, deterrence, or investigation of financial crimes, including money laundering and the financing of terrorism."

ICBA has long advocated developing a simple and easily applied exemption process that can eliminate currency transaction reports that have little value for law enforcement. H.R. 323 that would allow banks to exempt seasoned customers from CTRs without being required to renew the exemption annually. Past efforts to increase the use of the current exemption process have not succeeded, despite years of efforts by interested parties, including industry representatives, regulators and law enforcement.

ICBA supports this committee's efforts and H. R. 323 because they have the potential to eliminate many unnecessary reports that are costly to produce but that offer little or no use for law enforcement. Eliminating unnecessary reporting would result in substantial savings to our banks and increase the time our employees can spend on customers' financial needs. They would also make law enforcement investigation more efficient by eliminating unnecessary data.

The bill offers a definition of which customers would be eligible for this new "seasoned customer" exemption. One of the provisions would require that a customer maintain a deposit account with the bank for at least 12 months. ICBA recommends that the Treasury Department be given some flexibility to shorten this timeframe in appropriate circumstances, as determined by Treasury in consultation with other interested parties, including law enforcement and industry representatives.

Ultimately, though, for this provision to succeed, Treasury will have to develop an exemption process for qualified customers that can be simply and easily applied – in other words, a system that truly works. We look forward to continuing to work closely with this committee, Treasury and banking regulators to find additional solutions to reducing the BSA compliance burden while meeting the needs of law enforcement. We hope today's hearing will improve the chances for this provision to become law since adoption of this important legislation is one step that will help reduce the regulatory burden confronting the nation's community banks.

Increased Threshold for CTRs Would Reduce Burden

Fundamentally, ICBA believes that a simple increase in the dollar threshold for CTRs would be easier to apply. The dollar threshold has not been changed since the Bank Secrecy Act was adopted more than thirty-five years ago. However, we recognize that law enforcement agencies are concerned that such a change might eliminate valuable information for detecting and prosecuting criminal activities, especially as they begin to develop new databases and new technologies that can better use the information diligently supplied by the nation's banks.

ICBA's goal is to find a way to eliminate reports of routine transactions that are costly and burdensome to produce but that provide little use for law enforcement. ICBA has actively participated in many discussions on this issue over a number of years through our representation on Treasury's Bank Secrecy Act Advisory Group and we will continue to pursue a solution through that venue. However, Congressional action will send a strong signal to regulatory agencies and law enforcement that a solution is needed. Community bankers often comment that law enforcement has a tendency to shift costs and burdens to the banking industry. Because it is the industry – and not law enforcement – that bears the costs, there is a tendency to disregard the substantial costs of compliance created by the demands for information. It is vitally important that the costs be assessed against the overall benefits. ICBA believes today's hearings helps bring useful focus to the need for balance.

Why the Current Process Does Not Work

Costs and Burdens Associated with the Current Currency Transaction Reporting (CTR) Process. Many financial institutions report that the cost of using the current exemption process outweighs any associated benefits. As a result, many institutions find it is much simpler and less risky to file a CTR on every cash transaction over $10,000. Our members report that this approach is more practical and cost effective than using the exemption process.

Compliance Responsibility. Using the existing BSA exemption not only consumes a community bank's limited resources in time and money, it also increases the burden on the bank's existing compliance program by requiring the bank to develop policies and procedures for exempting customers, train personnel on the procedures, educate customers on the exemption process, and establish audit programs to monitor compliance with the exemption process.

For example, if a community bank establishes an exemption for a customer under current rules, it must document the decision and re-file an exemption with the government every other year. When refilling, the bank must verify it has conducted an annual review of the account for compliance with the exemption. It then must ensure: (1) that it has up-to-date exemption lists available for all branch personnel; (2) that all branch personnel are properly trained in which customers are exempt; and (3) that all employees know when exemptions can be used because not all transactions for an exempt customer may be exempt.

Resource Allocation. For many institutions, particularly community banks, implementing exemptions under the current rules is not cost effective. Many community banks lack the time or resources to study the exemption requirements and how they would apply to specific customers. Under the current system, it is not only a matter of exempting a customer, but the regulatory burden continues since the bank must continue to monitor exempted accounts and must certify that a customer continues to meet the regulation's exemption criteria. This is especially true for community banks that file a small number of CTRs. For these institutions, simply filing on all cash transactions over $10,000 is a more efficient means of allocating precious compliance resources. Instituting simpler procedures could make the process more cost effective and reduce the risk of compliance violations.

With high turnover of tellers and other branch staff, it is often simpler, less complicated and less confusing simply to train all staff to file the currency report for every cash transaction over $10,000. This policy is plain, simple and easily applied. Unfortunately, it also means many routine transactions are reported.

The advantages of not using the exemption process are that the bank will not mistakenly exempt a transaction that should be reported, and the bank can avoid a portion of the BSA audit and related regulator scrutiny. In other words, the

costs for the current process and the risks associated with using it have caused most bankers – especially community bankers – to conclude the exemption merely creates costs and increases risks.

Automation. Where feasible and within a bank's budget, many larger institutions that file CTRs on every transaction above the $10,000 threshold have elected to automate the reporting process. While cost-prohibitive for many smaller institutions, automated filing systems maximize efficiency by reducing the time that staff must devote to the filing process. Some automated systems automatically generate a CTR for transactions above the $10,000 threshold. Other systems flag transactions for further review by staff. Moreover, since banks must aggregate a customer's transactions in order to properly report currency transactions, automated systems facilitate compliance with the aggregation requirements. However, where banks do rely on automation, it facilitates filing over not filing.

And, it is much more difficult to automate the CTR process if a bank attempts to include exemptions since it requires customization of software systems. Unfortunately, demands on bank technology systems is increasing, not just for BSA compliance, but also provisions under the Fair and Accurate Credit Transactions Act, data security demands, fraud detection and new payment systems technologies such as image processing. As a result, many community banks have concluded it is not cost effective to expend limited resources automating a process fraught with regulatory risk for little benefit.

Suspicious Activity Reporting

Suspicious activity reports, or SARs, are another key element in the entire BSA scheme. ICBA believes that these reports can provide important information. However, it is not always a simple matter to identify activities which may be suspicious. The demands placed on banks to monitor all customer transactions for possible suspicious activities can be time consuming and expensive. Being deputized as law enforcement agents is not a business the banking industry was designed to handle. Banks can and do report activities when they detect something out of the ordinary that cannot be explained. But the requirements are turning into demands that banks closely scrutinize each and every transaction. At one time, there were concerns that banks could be criticized for failing to file a SAR, and there were rumors that regulators had a "zero tolerance" for violations. In part, these rumors were fueled by heavy sanctions imposed on Riggs National Bank, AmSouth and other financial institutions. Examiners in the field also fed the fire with requirements that banks be compared to their peers with respect to the number of SARs being filed and that banks be prepared to fully document and explain and changes in the level of SARs being filed.

Fortunately, the interagency Bank Secrecy Act/Anti-Money Laundering Examination manual issued in 2005 helped address many of these problems,

and the requirements for SAR filing are much better understood by bankers and examiners. However, as with any regulatory requirement, this is an ongoing process and there are still lingering elements of "defensive filing" of SARs. This is diminishing, but many community banks across the country feel it is better to go ahead and file rather than risk examiner criticism. Continuing communication and guidance from regulators to banks – and examiners – will help. This is one of the reasons ICBA so strongly believes that enhanced communication from regulators and law enforcement is critical.

Bank Secrecy Act (BSA) Requirements Should Be Flexible and Easily Applied

To begin to address some of these burdens, ICBA encourages the federal government to continue working with the banking industry to provide additional guidance—such as best practices, questions and answers, or commentary—that is understandable, workable and easily applied by community banks. Overall, the BSA/AML Exam Manual and the subsequent outreach sessions to industry and examiners, where the industry and regulators worked together, are an excellent model. These efforts, in which ICBA played a key part, have helped to greatly reduce some of the BSA compliance burdens faced by community banks. Since cooperation between the government and financial institutions in a true working partnership is vital to stop terrorism and money laundering, ICBA urges the government to expand and enhance communications to alert bankers to fact patterns and practices that may be indicative of money laundering or terrorist financing.

BSA Reporting Should Be Simplified and Focus on Truly Suspect Activities. As the government continues to combat money laundering and terrorist financing, it is important to focus on quality over quantity for all BSA reporting. This is one reason ICBA strongly supports efforts to streamline the process to allow community banks to exempt "seasoned customers" from currency transaction reports (CTRs) so that routine transactions are not reported.

More and more data may not always be beneficial, and ICBA encourages Congress and regulators to recognize this in other areas, too. For example, ICBA is concerned that changes to recordkeeping and reporting for routine wire transfers could impose burdens and costs that far outweigh potential benefits to law enforcement. Law enforcement and the federal government must clearly demonstrate the benefits and usefulness of any new data collection and reporting. And, where unnecessary data is being collected, steps should be taken to eliminate those requirements.

Increased Communication Between Government and Banks

ICBA believes it would be helpful to community banks' efforts against money laundering and terrorist financing if they received better information from law

enforcement about what activities to watch for. Under section 314 of the USA PATRIOT Act, noted above, Congress included a provision designed to encourage law enforcement to enhance communication with financial institutions to improve the banking sector's focus on those transactions that present the greatest risk of money laundering or terrorist financing. Through Treasury's Financial Crimes Enforcement Network's *SAR Activity Review,* law enforcement has been steadily – if slowly - increasing the information it provides banks. ICBA encourages Congress to continue to take steps to ensure that this information is provided by law enforcement agencies. An open dialogue between law enforcement and the industry would help community banks focus efforts where they are the most effective. Fundamentally, though, greater information from law enforcement would help banks identify suspicious transactions – and would encourage banks by helping them know their efforts are worthwhile.

Community Banks Need Regulatory Relief

Regulatory burden, including the burdens and costs associated with unnecessary reporting, is crushing community banks and leading many to merge with other institutions in order to handle the ever-increasing compliance requirements. Regulatory burden relief is important to community banks and our customers because community banks' survival depends on the economic vitality of our communities just as the economic vitality of our communities depends on the local community banks. Community bankers provide tremendous leadership which is critical to local economic development and community revitalization.

Community banks are particularly attuned to the needs of small businesses, our nation's engine for job creation. They are the leading suppliers of credit to small businesses and account for a disproportionate share of total lending to small business. Banks with less than $1 billion in assets hold only 13 percent of bank industry assets. However, they are responsible for 37 percent of bank loans small business loans and 64 percent of bank loans to farms.

ICBA supports a bank regulatory system that fosters the safety and soundness of our nation's banking system. However, statutory and regulatory changes continually increase the cumulative regulatory burden for community banks. In recent years, community banks have been saddled with the privacy rules of the Gramm-Leach-Bliley Act, the customer identification rules and anti-money laundering/anti-terrorist financing provisions of the USA Patriot Act, and the accounting, auditing and corporate governance reforms of the Sarbanes-Oxley Act. When viewed in the aggregate, the regulation creates a substantial and disproportionate burden on community bank. In particular, the provisions of the BSA are especially time consuming and burdensome.

This disproportionate impact of the ever-mounting regulatory burden is significantly affecting community banks.[12] Since 1992, the market share of community banks with less than $1 billion in assets has dropped from approximately 20 percent of overall banking assets to 13 percent. During the same period, the market share of large banks with over $25 billion in assets grew from approximately 50 percent to 70 percent.

It is true that the banking industry as a whole has reported record profits in recent years. However, that good fortune is not shared equally. According to the most recent FDIC Quarterly Banking Profile, banks with over $10 billion in assets do much better in most performance ratios than banks with under $100 million in assets.[13] For example, according to the FDIC, the return on assets at banks with over $10 billion in assets at year-end 2006 was 1.32%. For banks in the $1 billion to $10 billion range, that performance ratio declined to 1.22%. For banks in the $100 million to $1 billion range, the return on assets declined still further to 1.17%. And for banks in the under $100 million asset-size category, their return on assets was only 0.93%. Many community banks report that the burden of compliance with laws and regulations – including BSA compliance – erodes their profitability. These figures help to demonstrate that compliance falls more heavily – and is more costly – for smaller institutions.

With smaller customer and asset bases over which to distribute compliance costs, the proportionate cost of compliance with all laws and regulations – including BSA – is also much higher at community banks. This regulatory burden affects the viability of local community banks – and the amount of funds these banks have to reinvest in their local communities through loans and other activities. For example, an analysis of banking trends conducted by two economists at the Federal Reserve Bank of Dallas concluded that the competitive position and future viability of small banks is at risk. The authors suggest that the regulatory environment has evolved to the point of placing small banks at an disadvantage to the detriment of their primary customers: small business, consumers and the agricultural community.

Larger banks also may have hundreds or thousands of employees to handle the many complications of regulatory demands. However, a community bank with $100 million in assets typically has just 30 fulltime employees while a $200 million bank may have about 60 employees in total. If the bank is faced with a new regulation, it must train one or more current employees to take on added responsibilities. This burden not only places more responsibility on the employee, but also distracts them from their primary duty of serving customers. Unlike larger institutions, the typical community bank cannot merely hire a new employee and pass the costs on to its customers.

---

[12] Gunther and Moore, “Small Banks’ Competitors Loom Large,” *Southwest Economy*, Federal Reserve Bank of Dallas, Jan./Feb. 2004.
[13] FDIC, *Quarterly Banking Profile,* Fourth Quarter 2006.

Conclusion

Specific data is not available that compares the cost of filing CTRs on all transactions above $10,000 to the cost of using the exemptions. In part, because employees at community banks deal with many different issues during the course of the day it is difficult to segregate the costs for individual compliance efforts. However, community banks across the country report that BSA compliance is one of the heavier regulatory burdens to which they have to respond. Adopting H. R. 323 would help alleviate this burden. Anecdotal evidence and comments from financial institutions of all sizes support the notion that avoiding the current exemption process is significantly less burdensome in terms of cost and compliance management. Barring a significant change in the CTR filing process or the exemption regulations, many institutions will continue to file reports on all transactions that exceed the $10,000 threshold as a simple means of complying.

ICBA greatly appreciates this committee's commitment to moving legislation that would reduce the regulatory burden on community banks by clarifying the seasoned customer exemption to the CTR requirement. ICBA looks forward to continuing to work with you in this regard. Thank you.