Testimony of

America's Community Bankers

on

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

before the

Subcommittee on Oversight and Investigations

of the

Financial Services Committee

of the

United States House of Representatives

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Chairman Watt, Ranking Member Miller, and Members of the Subcommittee, I am Carolyn Mroz, President and CEO of Bay-Vanguard Federal Savings Bank in Baltimore, Maryland. Bay-Vanguard Federal Savings Bank is a $134 million depository institution and is a subsidiary of BV Financial, Inc. I am here today representing America's Community Bankers[1] (ACB). I am a member of ACB's Board of Directors, and I serve on ACB's Regulation and Compliance Committee.

We want to thank Chairman Watt for holding this important hearing. Bank Secrecy Act (BSA) compliance is a time-consuming and costly process, and ACB is a strong advocate for regulatory relief in this area. We would also like to thank Chairman Frank and Ranking Member Bachus for their leadership on H.R. 323, the Seasoned Customer CTR Exemption Act of 2007, which was approved by the full House of Representatives earlier this year. This legislation makes important improvements to the current exemption system for Cash Transaction Reports (CTRs) by making it easier to exempt the routine transactions of certain seasoned business customers. We hope that passage of H.R. 323 marks the first step by this Congress towards modernizing the BSA to more appropriately balance the reporting requirements of depository institutions and the information needs of law enforcement agencies.

COMPLIANCE CONCERNS FOR COMMUNITY BANKS

BSA compliance consistently tops the list of the most burdensome regulatory requirements for community bankers. Prior to the terrorist attacks of 9/11, the BSA was primarily a tool for combating drug trafficking and money laundering, a problem most commonly encountered by

[1] America's Community Bankers is the national trade association committed to shaping the future of banking by being the innovative industry leader strengthening the competitive position of community banks. To learn more about ACB, visit www.AmericasCommunityBankers.com

large financial institutions. Today, however, terrorist financing concerns have resulted in a paradigm shift in BSA compliance, and community banks are being held responsible for the same complexity and requirements as multi-national banks, despite differences in their businesses and the fewer resources available to them. ACB supports the goals of these laws; however, inconsistent interpretation of the implementing regulations by examiners and a lack of regulatory guidance have made it increasingly difficult for community banks to comply with anti-money laundering demands and have produced a plethora of unintended consequences.

To illustrate my point, consider an institution like Bay Vanguard, which has $134 million in assets and 31 employees. In addition to serving as President and CEO, I am also our BSA/Compliance Officer. We are a very small bank and our resources do not provide the luxury of a full-time compliance department. For other community banks to comply with these regulations, they must employ a full time senior level BSA officer to manage their BSA compliance responsibilities. The BSA Officer must be a specialist in monitoring and investigating customer transactions, which is a continuous learning process with added costs. Additional bank employees work in concert with our BSA officer to file the Cash Transaction Reports (CTRs) and Suspicious Activity Reports (SARs) with the appropriate regulatory authorities. Because these individuals devote significant time to CTR and SARs, it represents a considerable line item on the bank's operating budget. Because of budget restraints, this takes resources from other areas where the money could be better used, such as hiring additional tellers and loan officers, or funding outreach programs geared towards meeting the convenience and needs of the community. It is important to note that the added payroll and benefit costs, as well as specialized training and continuing education, are a significant burden and expense for

community banks. The training regimen for both new and old employees is on ongoing financial obligation, and third party audits and legal advice for SARs determinations can cost a bank in excess of $25,000 annually. To fully appreciate the financial burden these costs create, you must look at them in the context of a small business. While Congress may be used to approving annual budgets in the billions of dollars, to a community bank, these are real costs that have a great influence on the bank's business decisions and ability to grow.

While there are a number of compliance requirements under the BSA that ACB believes are in need of modernization, today we will limit our testimony to two specific aspects: SARs and CTRs. As the Subcommittee continues its oversight of these monitoring and reporting requirements, we ask that you carefully consider the amount of data banks are required to provide compared to the number of times law enforcement has actually used that data to prosecute terrorism or money laundering. For example, even when law enforcement requests specific information where they may have concerns, FinCEN's 314(a)[2] Fact Sheet dated April 24, 2007 shows that between November 1, 2002 and April 24, 2007, a total of 9 convictions resulted from this unprecedented level of law enforcement investigative authority, as granted through the USA PATRIOT Act. While we are committed to providing the government with the necessary information to combat unlawful and potentially dangerous activities, a greater emphasis should be placed on the quality of data rather than the quantity of data.

[2] Section 314(a) of the USA PATRIOT Act of 2001 (P.L. 107-56), required the Secretary of the Treasury to adopt regulations to encourage regulatory authorities and law enforcement authorities to share with financial institutions information regarding individuals, entities, and organizations engaged in or reasonably suspected, based on credible evidence, of engaging in terrorist acts or money laundering activities. FinCEN issued a proposed rule on March 5, 2002, and the final rule on September 26, 2002 (67 Fed. Reg. 60,579). Section 314(a) requirements are now published in 31 CFR Part 103.100.

SARs

There is a great deal of research that goes into filing a SAR. The narrative section alone is extremely labor-intensive, and banks are required to describe the suspicious transaction or group of transactions in detailed paragraph form. FinCEN instructs institutions to explain the "5 W's" – who, what, when, where, and why – and institutions are prohibited from attaching accompanying data such as spreadsheets, account records and graphs. The FinCEN exam manual suggests that institutions should be prepared for intense scrutiny of the quality of the narrative by the examiners, which creates added pressure to devote considerable time and resources to the effort.

The federal banking agencies are scrutinizing SARs reporting more closely than ever and anxiety over whether an institution should file a SAR is at an all-time high. As a result, many depository institutions believe that filing more SARs is the key to avoiding regulatory criticism. According to the BSA, banks, bank holding companies, and their subsidiaries are required to file a SAR with respect to:

- Criminal violations involving insider abuse in any amount
- Criminal violations aggregating $5,000 or more when a suspect can be identified
- Criminal violations aggregating $35,000 or more regardless of a potential suspect
- Transactions conducted or attempted through the bank (or affiliate) and aggregating $5,000 or more if the bank (or affiliate) knows, suspects or has reason to suspect that the transaction:
    - May involve money laundering or other illegal activity
    - Is designed to evade BSA requirements
    - Has no business or apparent lawful purpose or is not the type of transaction that the customer would normally be expected to engage in and the bank knows of no reasonable explanation for the transaction after examining available facts

Given these onerous and comprehensive guidelines, many institutions file SARs as a defensive tactic to stave off second guessing of an institution's suspicious activity determinations. This mindset is fueled by examiners who criticize institutions for not filing enough SARs based on their asset size. Furthermore, regulators have admitted in public that the agencies do not discourage the "when in doubt, fill it out" strategy. Enforcement actions appear to confirm the idea that it is better to have filed a SAR when it is not necessary than to have not filed one. Additionally, it is more time consuming and paperwork intensive for an institution to document why it elected not to file a SAR than to simply file the report; this in itself is counterintuitive to the mission and intent of the BSA. Institutions believe that the risk of regulatory criticism is higher for not filing, and examiners will disapprove of the bank's documentation or its decision not to file. Filing a SAR should not be done under fear of regulatory reaction. This undermines the intent of the law and effectively turns the BSA on its head, since the value of SAR data will be less valuable and the integrity and usefulness of the SAR system will be compromised by the onslaught of defensive filing.

In this era of increased regulatory scrutiny, community banks deserve more guidance and information. ACB strongly urges the banking regulators, FinCEN, and the Department of Justice to work to help institutions identify activities that are genuinely suspicious and should be reported. Without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

CTRs

FinCEN regulations require financial institutions to file a CTR for all cash transactions over $10,000. Unfortunately, existing CTR laws have departed from the BSA's stated mission of collecting reports and records that "have a high degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence, and international terrorism. As a result, financial institutions file millions of CTRs each year that provide little or no assistance to law enforcement officials.

On the other hand, FinCEN's regulations establish an exemption system that relieves financial institutions from filing CTRs on the cash transactions of certain entities, provided certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance. The exemption process was well intentioned, but community banks have been reluctant to use the exemption system because:

- It is not cost effective for small institutions that do not file many CTRs
- They fear regulatory action in the event that an exemption is used incorrectly
- They lack the time and resources to conduct the research necessary to determine whether a customer is eligible for an exemption and continually monitor the list
- It is easier to automate the process and file a CTR on every transaction that triggers a reporting requirement
- The regulations and the exemption procedures and requirements are overly complex

As a result, FinCEN and law enforcement report that the CTR database is inundated with unhelpful CTRs because financial institutions do not use the exemption procedures that are designed to eliminate CTRs that are of no interest to law enforcement. This ultimately makes it

more difficult to use the database to investigate possible cases of money laundering or terrorist financing.

ACB believes that the BSA should be amended to provide an increase in the dollar value that triggers a CTR filing. The current $10,000 threshold was established in 1970. When adjusted for inflation, $10,000 in 1970 is equivalent to more than $52,925 today[3]. To put it in perspective, the cost of a brand new Corvette in 1970 was approximately $5,000. The cost of a brand new Corvette in 2007 is more than $53,000. We understand that when the regulations were first implemented, there was very little activity over the $10,000 threshold. Today, however, such transactions are routine, particularly for cash-intensive businesses. Raising the threshold does not mean that institutions will be relieved from monitoring account activity for suspicious transactions below the CTR reporting requirement. Increasing the threshold would enable financial institutions to alert law enforcement about activity that is truly suspicious or indicative of money laundering, as opposed to bogging down the data mining process by filing reports on common transactions.

Based upon data that FinCEN provided to the Bank Secrecy Act Advisory Group's ("BSAAG") CTR Subcommittee, increasing the reporting threshold to $20,000 would decrease CTR filings by 57 percent and increasing the threshold to $30,000 would decrease filings by 74 percent. The impact of raising the dollar value is even more astonishing for community banks. An informal survey of ACB members conducted in June 2004 indicates that increasing the dollar amount to $20,000 would reduce community bank CTR filings by approximately 80 percent. With respect

[3] Bureau of Labor Statistics Inflation Calculator
www.data.bls.gov/cgi-bin/cpicalc

to community banks with commercial deposits, businesses of all sizes routinely conduct cash transactions over $10,000.

Emerging software technology is the latest fraud detection instrument used by banks to advance their compliance responsibilities. These systems are designed to identify transactions that are out of character for a typical banking profile or historical account activity, or transactions that are inconsistent with the due diligence the bank has collected on that customer. While a useful tool, automated detection is extremely expensive to purchase and maintain, and is generally not a viable option for main street community banks. According to an informal survey conducted by ACB's Regulation and Compliance Committee, account monitoring software for community banks often costs more than $30,000 to $50,000 (in some cases hundreds of thousands of dollars depending on the product) for the initial purchase and on average $5,000 a month thereafter for maintenance. Software detection is by no means a panacea, and does not replace the need for personnel to study the anomalies identified by the software to determine if the flagged activity warrants a SAR filing. The human aspect is particularly important with respect to SARs, but even in the case of CTRs, most community banks do not process enough CTRs each year to justify spending tens of thousands of dollars on software that automates the cash transaction monitoring and CTR filing process. As a result, these institutions must manually monitor and file CTRs, which is an increasingly time consuming responsibility.

TIME FOR ACTION

For the past several years, law enforcement has been working to develop improved data mining capabilities and new analytical tools to better use CTR data. It may be tempting for Congress to

refrain from proposing legislative remedies in the hopes that law enforcement is able to materially improve data retrieval and analysis. However, the wait and see approach ignores the compliance and economic burdens shouldered by all banks, and particularly community banks. It ignores the requirement that anti-money laundering reports provide "highly useful" information. It ignores the Money Laundering Suppression Act of 1994, which requires the number of CTR filings to be reduced by thirty percent. It also ignores the real-world realities of CTR filing. In the absence of meaningful regulatory relief, depository institutions will continue to file countless defensive SARs and CTRs on every cash transaction of $10,000 or more. While this approach will further bog down the investigation process, it is simpler and often more cost efficient than using the current exemption system.

CONCLUSION

Community bankers fully support the goals of the anti-money laundering laws, and we are prepared to do our part to fight crime and terrorism. ACB members are committed to ensuring our nation's security and the integrity of our financial system. However, we believe the existing statutory and regulatory regime is broken and needs to be repaired, and that the cumulative burden placed on community banks is out of proportion to the results that have been demonstrated to date. Increasingly, financial institutions believe that the federal government has little regard for the amount of time, personnel, and monetary resources that BSA compliance drains from an institution's ability to serve its community. What may seem like insignificant costs to law enforcement have very real business implications for community banks and their communities, and banks should not be expected to report transactions to law enforcement or conduct business in an environment that expects compliance at any cost. The time is now to

review the BSA compliance requirements to ensure that the burden shouldered by the nation's community banks is commensurate with the demonstrated benefit to law enforcement. Broad assurances that law enforcement is able to sift and mine the millions of SARs and CTRs that financial institutions file annually is not enough.

I wish to again express ACB's appreciation for your invitation to testify on this important matter, and I would be pleased to answer any questions you may have.