Testimony of

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On Behalf of the

AMERICAN BANKERS ASSOCIATION

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On

"Improving Financial Oversight: A Private Sector View of Anti-Money Laundering Efforts"

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Madam Chairman and members of the Subcommittee, I am John Byrne, Director of the Center for Regulatory Compliance with the American Bankers Association. The American Bankers Association appreciates this opportunity to discuss how the financial industry is addressing compliance with the USA PATRIOT Act and all of the laws covering anti-money laundering (AML) obligations.

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country. For further information regarding the ABA, please consult the ABA on the Internet at http://www.aba.com.

The ABA and our members continue to work with our government partners in training financial institution employees on detecting and reporting the myriad of financial crimes that involve money laundering and terrorist financing.

Among other things, the Association holds an annual conference with American Bar Association on money laundering enforcement, produces a weekly electronic newsletter on money laundering and terrorist financing issues, offers on-line training on Bank Secrecy Act (BSA) compliance requirements, and has a standing committee of over 40 bankers who have AML responsibilities in their institutions. In addition, we have provided telephone seminars on compliance with Section 326 of the USA PATRIOT Act and AML examination issues. We will also address the nuances of the suspicious activity reporting requirements later this summer. The industry's commitment to deterring money laundering continues unabated and we have trained hundreds of thousands of bankers since the passage of the Money Laundering Control Act in 1986. [1]

When we last appeared before your subcommittee in March 2003, ABA outlined a series of recommendations regarding "needed areas of improvement to USA PATRIOT Act oversight." We are pleased to report that a number of areas of concern have been addressed and our partners in the government continue to work closely with the industry on needed improvements. We ask, however, that the regulatory agencies and law enforcement address several of the remaining 2003 recommendations.

The American Bankers Association has two additional recommendations. First, there needs to be a dramatic change in routine cash reporting under the Bank Secrecy Act (BSA) so that there can be intelligent and efficient use of resources by both the government and the private sector in the continuing challenge of preventing our financial system from being used by criminals. Next, with the increased attention being placed on "risk-based" compliance, the industry needs clear and concise guidance on suspicious activity reporting (SAR) obligations.

As we approach the three-year anniversary of the passage of the USA PATRIOT Act, now is the time to focus on how best to achieve the goals shared by all of us --- a strong and secure financial system.

[1] A 2003 survey by ABA Banking Journal and Banker Systems Inc. found that Bank Secrecy/AML/OFAC was the number one compliance area in terms of cost in the banking industry. It is also interesting to note that in banks under $5 billion in assets, 75.6% of the employees said that compliance was not their only job.

Our statement today covers the status of the 2003 recommendations, as well as a caution regarding what occurs with a lack of consistency in "Anti-Money Laundering (AML) and PATRIOT Act" examination procedures on what constitutes an appropriate SAR program.

In 2003 ABA recommended:

- Creation of an office for USA PATRIOT Act oversight;
- Immediate development of a Staff Commentary for PATRIOT Act and Bank Secrecy Act interpretation;
- Review of the 314 Demands for Record Searches;
- Formal commitment from **all** functional regulators for uniform and consistent PATRIOT Act exam procedures;
- Coordination between the Treasury's Office of Foreign Assets Control (OFAC) and the financial institution regulators to improve advice to the regulated community; and
- Improved guidance and communication on all SAR related issues, particularly in the area of terrorist financing.

In addition to the above, the American Bankers Association strongly recommends:

- Clarify that Financial Institutions are NOT required to file a specific number of SARs in order to have a compliant SAR program, and
- Raising the threshold for filing "Currency Transaction Reports" (CTRs) for corporations and businesses from over $10,000 to over $25,000;

Goals of an Office of USA PATRIOT Act Oversight Can Be Achieved Through Existing Mechanisms

Since we advocated that the Treasury Department create a formal mechanism for responding to questions concerning interpretation of PATRIOT Act obligations, a new Director has been appointed to the Financial Crimes Enforcement Network (FinCEN). William Fox has impressed the industry with his immediate commitment to both enhancing industry-government partnerships and to provide guidance on PATRIOT Act and AML issues. Therefore, we believe that our recommendation that there be "an office within the Treasury to communicate guidance, interpretations and FAQs regarding all PATRIOT Act questions" can be achieved through the new leadership at FinCEN. ABA also believes that the Treasury's Executive Office for Terrorist Financing and Financial Crimes will continue to provide value in offering guidance in addressing the ambiguous requirements of reporting terrorist financing.

FinCEN's Announced Commitment to a Bank Secrecy Act Staff Commentary

Madam Chairwoman, last year we repeated our frustration that the Treasury Department has never fulfilled the 1994 statutory mandate to publish an annual staff commentary on the Bank Secrecy Act regulations (Section 5329). As we stated at the time, "This indifference to congressional direction has contributed to industry confusion, examination conflicts and inconsistent interpretation of Bank Secrecy Act obligations."

We are pleased to report that Director Fox has expressed his commitment to improved guidance through the use of advisories and commentary. We reiterate our promise to work with FinCEN and the appropriate agencies to achieve this overdue goal.

The Improvement of the Section 314 Demand Process

The American Bankers Association was severe in our criticism of the implementation of Section 314(a) of the PATRIOT Act. The 314 process requires financial institutions to search accounts for potential matches to names on government investigative lists. As you may recall, many of our members complained that despite the clear congressional direction to the agencies, there was no apparent connection to terrorism or money laundering in the demands. Instead, the "requests" seemed to be a dumping ground for law enforcement cold cases.

Since that time, the regulators, law enforcement and Treasury made adjustments and the process was revised to "address a number of logistical issues and to develop additional guidance on the information request process."

The announced changes included the following:

- 314(a) requests from FinCEN will be batched and issued every two weeks, unless otherwise indicated in the request.

- After receiving a 314(a) request, financial institutions will have two weeks, rather than one week, to complete their searches and respond with any matches.

- Searches will be limited to specific records and, unless otherwise noted, will be a one-time search.

- If a financial institution identifies a match for a named subject, the institution need only respond to FinCEN that it has a match and provide point-of-contact information for the requesting law enforcement agency to follow-up directly with the institution.

On the whole, these changes have been instrumental in improving the process. While we still have concerns that law enforcement does not always respond promptly to contact from financial institutions on matches, the overall consensus is that 314 is a vastly improved process.

Uniform and Consistent PATRIOT Act/BSA/AML Examination Procedures

ABA has previously emphasized that the banking agencies need to reach agreement on how the financial services industry will be examined for compliance under the PATRIOT Act and the other AML requirements. As we indicated at the time, "too often, institutions of the same approximate size, in the same geographic area and offering the same financial products are treated differently for compliance purposes. This should not continue."

There have been recent examples of coordination of examination procedures by the agencies but the process is not complete and there are some outstanding issues. We will discuss one glaring problem --- assessment of the adequacy of SAR programs, later in this testimony.

While we repeat our 2003 call that Congress ask the regulatory agencies to report on efforts in this area, ABA has seen a commitment to consistency in the past several months. For example, not only has FinCEN Director Fox expressed public support for uniform assessments, but he has also directed the Bank Secrecy Act Advisory group (BSAAG) to form a subcommittee on examination issues. This subcommittee, co-chaired by the ABA and the Federal Reserve Board, will review existing guidance and offer appropriate recommendations. We would be happy to report to this Committee on our findings.

OFAC and the Regulated Community

ABA pointed out last year that the compliance obligations under the laws administered by the Treasury's Office of Foreign Assets Control (OFAC) is a major requirement for the industry. One of the many concerns is what constitutes adequate compliance?

For example, the answer to one of the most common questions "Does OFAC itself require that banks set up a certain type of compliance program?" gives the industry little solace. The answer, according to OFAC, is that OFAC is not a bank regulator and the institution should check with their regulators "regarding the suitability of specific programs to their unique situations."

Madam Chairwoman, ABA and our members still need improved direction from both OFAC and the bank regulators on what is considered an acceptable OFAC compliance program as well as a reasoned analysis on the scope of these requirements. The banking agencies are preparing examination procedures in this area and we hope that the process will shed some light on the industry obligations with the 27 programs administered by OFAC. ABA is planning an OFAC Summit for sometime in July and we will report to the Committee on any outstanding issues.

SAR Guidance

With the increased entities required to file suspicious activity reports (SARs) as well as the heightened scrutiny by regulators on SAR policies and programs, it is essential for the regulatory agencies, law enforcement and FinCEN to assist Suspicious Activity Report (SAR) filers with issues as they arise. This need is particularly obvious in the area of "terrorist financing." This crime is difficult, if not impossible, to discern as it often appears as a normal transaction. We have learned from many government experts that the financing of terrorist activities often can occur in fairly low

dollar amounts and with basic financial products (e.g. retail checking accounts). Guidance in this area is essential if there is to be effective and accurate industry reporting. The bottom line is that terrorist financing can only be deterred with government intelligence.

For money laundering and other financial crimes, government advisories and other publications are a critical source for recognizing trends and typologies. As our Association pointed out in a 2003 comment letter on the "suspicious activity report," the interagency-authored publication, the **SAR Activity Review**, often includes a number of examples of activities that represent reported financial crimes. This information is extremely useful for training purposes. As the private sector co-chair of the **SAR Activity Review**, I can assure you the ABA supports the efforts of FinCEN and the participating agencies in crafting a publication that provides necessary statistical feedback to the SAR filing community. The **SAR Activity Review** has provided a variety of examples of the characteristics of such diverse suspicious activity as identity theft, bank fraud and computer intrusion.

We are pleased that the upcoming edition of the **SAR Activity Review** will provide, for the first time, the summary characterization of all of the suspicious activity categories. This should assist filers in advancing their understanding of the reporting requirements.

The Number of SAR filings should Not Be Determinative of an Adequate SAR Program

As stated above, there is one major problem affecting banks in the AML exam process. Recently, several financial institutions have contacted ABA about examiner criticisms received in reviews of their Suspicious Activity Report (SAR) programs due, in large part, to the number of SARs that the institution has filed. These financial institutions expressed the concern, which we share, that this may reflect new criteria for evaluating the adequacy of SAR programs, namely, that the number of SARs filed meets a minimum threshold, or that institutions are not filing the same number of SARs as "peer" institutions. The concern expressed is that there be new requirements in the form of a "quota" for determining the adequacy of SAR programs consisting, in large measure, of counting the number of SARs filed and, in some instances, comparing the number of SARs filed between "peer" institutions. Obviously, this would be a significant and alarming development in the examination and review process.

It is without question that the continuing importance for filing SARs is to inform governmental authorities of the existence of suspicious activity that may merit further investigation by law enforcement or supervisory agencies. As was stated recently by FinCEN is the "Guidance on Preparing a Complete and Sufficient Suspicious Activity Report Narrative":

The purpose of the Suspicious Activity Report (SAR) is to report known or suspected violations of law or suspicious activity observed by financial institutions subject to the regulations of the Bank Secrecy Act (BSA). In many instances, SARs have been instrumental in enabling law enforcement to initiate or supplement major money laundering or terrorist financing investigations and other criminal cases. Information provided in SAR forms also presents the Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) with a method of identifying emerging trends and patterns associated with financial crimes. The information about those trends and patterns is vital to law enforcement agencies and provides valuable feedback to financial institutions.

Concurrently, one of the primary, if not the most significant, reason for institutions to have adequate SAR programs is to ensure that potentially suspicious activity is appropriately identified and managed within an institution. The adequacy of a SAR program cannot be judged by the number of SAR filings, but rather must be evaluated with regard to the institution's ability to identify potentially suspicious activity, evaluate whether the activity rises to the level of being suspicious requiring the filing of a SAR and, ultimately, lead to a process to determine how the activity is dealt with within an institution.

The notion that the number of SAR filings can determine the adequacy of a SAR program is, by all accounts, faulty. Clearly, an institution that has not filed SARs or has a track record of minimal filings deserves closer scrutiny of its SAR program, as it may be indicative of problems within that program. However, the lack of filings or the limited number of filings should be nothing more than a signal to the supervisory agency that a closer review of the SAR program is warranted. A determination of this type should be the result of a comparison of the number of filings of a particular institution against that institution's pattern of SAR filings rather than a comparison of filings between institutions. As an example of focusing on a particular institution's SAR filings rather than comparing filings between institutions, the Federal Reserve Board instructs its examination staff to:

> *. . . continue the process of assuring that SARs are reviewed prior to the commencement of an examination or inspection. As the Reserve Banks have learned, a pre-examination/inspection review of SARs assists the supervisory staff in assessing compliance with the SAR requirements and provides useful information regarding potential problems that may require special attention during the course of an examination or inspection.*

Variations in the number of SAR filings between like or peer institutions can be attributed to numerous factors and, therefore, is not itself a reliable indicator of the adequacy of a SAR program. The type of customer base that an institution maintains (for example, retail vs. corporate clientele), the markets in which an institution operates or differences in the parameters applied in monitoring customers and their transactions are all factors that may lead to wide variations in the numbers of SAR filings between institutions. Additionally, contrary guidance or direction provided to institutions by the particular functional regulator of an institution can have a significant impact on the way in which an institution views suspicious activity, affecting the number of SAR filings between institutions. (For example, several financial institutions have reported to the ABA that examiners have instructed institutions to file SARs if they believe that they have information that may be of interest to the government, such as identifying an account or transaction related to an investigation that has appeared in the press, without regard to whether suspicious activity actually exists.)

Moreover, regulatory scrutiny of SAR filings (and the recent civil penalty assessed against Riggs Bank for SAR deficiencies) has and will cause many institutions to file SARs as a purely defensive tactic (the "when in doubt – file" syndrome) to stave off unwarranted criticism or "second guessing" of an institution's suspicious activity determinations. Obviously, if that continues, the legitimacy of the information in the SAR database will be called into question.

The SAR process should be addressed as the Federal Deposit Insurance Corporation (FDIC) examination procedures cover the area, by explicitly recognizing that there may be a variety of legitimate reasons for variations in the number of SARs filed by the same institution:

Determine if the institution or any branches had significant changes in the volume or nature of SARs filed, and investigate the reason(s) for these change(s). . . (Note: Increases in SARs may be caused by 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 caused by 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 SARs.)

With the increased focus on SAR programs and the number of SAR filings by institutions, the financial services industry is becoming increasingly concerned about the regulatory review of the SAR process. We believe that there is no correct number of SARs that should be filed in order for a determination that an institution has an adequate SAR program. A comparison between institutions of the number of SARs filed is wrong. It would be helpful if the government would re-state that SAR reporting obligations are based on an institution's analysis of potentially suspicious activity. If an institution has a SAR program that allows for a reasoned analysis of potentially suspicious activity and the institution's program is being followed, there should be no need for discussions regarding numerical threshold of SAR filings and no comparisons between institutions. Madam Chairwoman, the need for SAR guidance must be a major priority and we appreciate the fact that the BSAAG is also looking at these types of issues.

One final point concerning the validity of the suspicious activity reporting process concerns the chilling effect that has resulted from the massive leaks of SAR reports to the media. SARs are confidential documents, prepared after careful analysis, designed to trigger law enforcement investigations. SARs, however, are prepared by financial institutions not law enforcement officials. SARs do not always lead to investigations, let alone convictions. The very real fear that a SAR may appear in print will certainly impact the reporting process.

It is completely unacceptable and potentially criminal for those documents to have been disclosed to major news outlets. We applaud Director Fox for his public condemnation of these actions and urge swift action against the perpetrators.

Cash Reporting --- A Major Change is Warranted

It is clear that there are only a finite amount of resources available in both the government and the private sector to address financial crime. Certainly, the most important report filed by the industry is the Suspicious Activity Report (SAR).

Reporting apparent crime is superior as an investigative tool to routine reports of cash deposits or withdrawals over $10,000. The cash reporting requirements were the result of the Bank Secrecy Act, a 1970 law (PL 91-508) created "to require certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings." The BSA is a reporting and recordkeeping mandate that, in general, requires the filing of currency transaction reports (CTRs) for cash transactions over $10,000. This statute has been costly for the industry to implement, but we acknowledge that it has achieved some success in the money laundering prevention area. Whether or not the benefits have been worth the resource allocation is an issue that has never been adequately addressed.

As far back as 1993, I authored a law review article on the subject of BSA burdens on our industry and their relative lack of utility. I pointed out that the BSA regulations have not always been

consistent with the 1970 goals mentioned above, and that subsequent changes to the Act "have resulted in a patchwork of regulations and laws that have saddled financial institutions with many responsibilities" that have "never been subject to any thorough analysis of whether they have (or will) fulfill the intended purpose of the BSA."[2]

Congress and the agencies also believed there was a need to change how cash transactions were filed and as a result, passed the 1994 Money Laundering Suppression Act. This law received widespread support, in part, because of the Congressional concern that routine CTRs "are expensive for financial institutions to file and for the Treasury to process, and [they] impede law enforcement by cluttering Treasury's CTR database."[3]

The 1994 statutory changes to the CTR reporting system were finally implemented by Treasury's Financial Crimes Enforcement Network (FinCEN) in 1998, and financial institutions may now reduce, to a one-time filing, cash reports of many retailers, governmental agencies and other legitimate entities. Since banks file millions of routine CTRs each year, a mandate to reduce those filings was indeed welcome. Despite industry support for the concept, the number of CTR filings did not drop as dramatically as both the industry and the government had hoped. In fact, in 2002, there were approximately 12 million CTRs, and in 2003 a slight increase. What can be done to bring sanity to a reporting system that includes millions of unnecessary filings?

A February analysis by FinCEN shows that over half of the CTRs filed would be eliminated if the current $10,000 threshold were raised to $20,000 for businesses. The current dollar limit was created close to 35 years ago. [4] While $10,000 is still a large amount of cash for individuals and probably should not be raised, the reports on routine businesses simply clog the system.

Those who would argue that a change in CTR reports will lessen the bank's focus on cash transactions need to be reminded that the industry will still have a reporting infrastructure in place, be required to file SARs on suspicious cash transactions, and would retain the mandate to report individual CTRs over $10,000.

Madam Chairwoman now is the time to adjust a process that is need of repair.

Conclusion

Madam Chairwoman and members of the subcommittee, the ABA has been in the forefront of the industry efforts to develop a strong public-private partnership in the areas of money laundering and

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[2] See, "The Bank Secrecy Act: Do Reporting Requirements Really Assist the Government?" 44 Alabama Law Review 801 (Spring 1993).

[3] Congress enacted the Money Laundering Suppression Act of 1994 (PL 103-325), which, among other things, mandated that the Treasury Department reduce "routine filings" of currency transactions and establish a central location for the filing of "Suspicious Activity Reports" (SARs) to eliminate duplicative filings.

[4] Several bank economists determined that a proper level for the reporting threshold in 1992 would be close to $36,000. See, Alabama Law Review p. 823. Also see, Conference Report accompanying H.R. 3474 (H. Rept. 103-652) p. 186 (August 2, 1994). ABA found that a CTR could cost an institution anywhere from $3 to $15 to file.

now terrorist financing. This partnership has achieved much success but we know that more can be accomplished. We commend the Treasury Department, banking agencies and FinCEN for their recent efforts to ensure a workable and efficient process. The American Bankers Association will continue our support for these efforts.

Thank you and I would be happy to answer any questions.