

Testimony of

Bradley E. Rock

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Committee on Financial Services

Subcommittee on Financial Institutions and Consumer Credit

United States House of Representatives

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Chairman Bacchus and members of the Committee, my name is Bradley Rock. I am Chairman, President, and CEO of Bank of Smithtown, a \$950 million community bank located in Smithtown, New York, founded in 1910. I am also the Vice Chairman of the American Bankers Association (ABA). ABA, on behalf of the more than two million men and women who work in the nation's banks, 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.

I have been honored to testify before this committee on prior occasions to present the views of the ABA on the need to eliminate unnecessary, redundant, or inefficient regulatory burdens that increase costs for banks, reduce the amount of credit available to our communities and fail to make meaningful contributions to the welfare of our citizens. Among the largest of regulatory burdens is the regime of surveillance and reporting on the financial activity of our customers that has been

imposed on banks under the Bank Secrecy Act and subsequent anti-money laundering statutes and regulations. I therefore welcome the opportunity to appear again before you—this time to address the particular issues of regulatory cost versus policy benefit that attend the current state of currency transaction reporting (CTRs)—and to advocate for your consideration an overdue option to reform the system for the mutual advantage of bankers, law enforcement and the American public we all serve.

We support a simplified, meaningful seasoned business customer exemption. We commend you, Mr. Chairman, and the members of this Committee for adopting that straightforward approach as part of H.R. 3505, the Financial Services Regulatory Relief Act, adopted by the House of Representatives on March 8, 2006, by a vote of 415-2. We congratulate you on continuing to pursue this sensible and timely reform in the legislation being considered today, Seasoned Customer CTR Exemption Act of 2006, H.R. 5341.

From the Bank Secrecy Act passed a generation ago to Title III of the USA PATRIOT Act adopted in the wake of the heinous terrorist attacks of September 11, 2001, legislation has united bankers and the government in the battle to combat abuse of our financial system by those who would pervert it to commit criminal offenses, to launder the proceeds of illegal conduct or, more recently, to support the means and ends of terrorism. The ABA and its members share the policy goals of Congress in passing these laws. However, increasingly complex or redundant compliance requirements render these laws far less effective than they might be otherwise.

When establishing the BSA regulatory regime, Congress sought to require reports or records when they have, in the Act's very words, "a high degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence and international terrorism. Unfortunately, in the focus on systems, programs, and procedures, the standard of "high degree of

usefulness” seems to have been neglected. The result has been more reports and paper, with declining usefulness. ABA and its members strongly believe that the current CTR requirements have long departed from this standard of utility and in large measure serve more to distract and impede efforts against crooks and terrorists than to help to expose and stop them.

In my testimony, I would like to make three key points:

- Congress has already recognized that the original currency transaction reporting obligations imposed on banks have become unduly burdensome, generate voluminous data on legitimate routine business transactions adding little to law enforcement’s efforts at meaningful analysis, and therefore need to be refocused to restore the reports to a level of value more closely approximating “a high degree of usefulness.”
- Previously-enacted relief to reduce reporting to a more useful volume has been unsuccessful. While Congress wisely recognized that banks don’t need to collect, and the government does not need to receive and process volumes of records on legitimate business activity by well-known customers, the reform has not been successful in practice because procedures to exercise it are cumbersome and carry significant procedural and supervisory risks.
- Evolution of the BSA reporting regime has further reduced the purpose and value of currency transaction reporting. Requirements for rigorous customer identification programs, suspicious activity reporting, and the availability of focused and detailed information under section 314(a) of the PATRIOT Act leave little value to be added by collecting millions of CTRs on legitimate routine business activity.

Congress Endorses and Law Enforcement Recognizes the Need to Reduce Reporting on Legitimate Business Activity

In 1994, Congress included in the Money Laundering Suppression Act a statutory exemption system for currency transaction reporting. The new two-phase system was intended to address concerns that the number of CTRs being filed for routine business activity adversely affected law enforcement's ability to use the data. As the GAO's testimony in March 1994 stated, "CTRs that report normal business transactions are of no value to law enforcement and regulatory agencies in detecting money laundering activity." Expectations at the time anticipated that a revised exemption process would result in a reduction of CTR filings in the range of 30%. Unfortunately, we should all be disturbed that time has witnessed the number of CTRs overall grow from slightly more than 11 million in 1994, when the two-phase exemption process was passed, to the latest estimate of over 13 million annually, with no signs of abating.

Using FinCEN's conservative estimate of around 25 minutes per report for filing and record-keeping, the banking industry as a whole devoted around 5½ million staff hours of work to handling CTRs in 2005. Our review of ABA members indicates that three-quarters of the filings were for business customers who had been with the bank for over a year. That means that the industry spent around four million staff hours last year filing notices on well-established customers! A similar story can surely be told by the government agencies that receive and process these reports.

In my bank, during the past year, we filed 2,766 CTRs, and we do not have any public companies as customers. In fact, most of these CTRs were filed for ordinary transactions by an ice cream parlor, a clam bar, a restaurant and a high-volume Amoco dealer, all of whom have done business with us for many, many years. My tellers spent more than 460 hours in the branches preparing the CTR forms, and one person in our main office spent more than 1,000 hours checking

the forms for accuracy, checking them against computer printouts, and filing the forms with the appropriate government office. Having watched this process for years, and being thoroughly familiar with the businesses that are the subject of these filings, I can tell you with firm assurance that all of this time and paper did absolutely nothing to advance our collective efforts to thwart money laundering and terrorism.

This trend is only likely to accelerate and demand more and more staff to report on more and more harmless transactions, further burying the real needles of money laundering under an exponentially growing mound of the hay of legitimate business transactions mindlessly recorded at great expense and increasing opportunity cost. Surely neither business nor the government can afford this wasted effort.

We have passed the time of studying what to do—GAO did that in 1994 and concluded then, as we all would now, that unnecessary reporting is taking place. It is about time to take effective action to make the system better. We must find a way to realize the policy objective of focusing on reporting with “a high degree of usefulness”, and to successfully exempt reports on the financial transactions of law-abiding American businesses.

The Current Exemption Process is Irretrievably Mired in Red Tape

ABA worked cooperatively with FinCEN and the federal banking regulators to encourage institutions to make better use of statutory exemptions when they were changed in the late 1990's. Our Association did extensive outreach to our members, and while some institutions adjusted their CTR filing policies and utilized the two-tier exemption process, the general response was lukewarm at best.

Unfortunately, the compliance technicalities for, and examiner second-guessing of, banker use of the exemption and the renewal processes have discouraged many institutions from utilizing the discretionary exemptions. The current Phase II exemptions make distinctions among types of cash intensive businesses or exemptible accounts and require statutorily mandated annual reviews plus resubmission obligations. These specifications generate difficulties in determining whether a customer is eligible for exemption, produce fear of regulatory retribution for misapplying criteria and incur costly additional due diligence. ABA has even received reports from members that examiners have threatened penalties and other formal criticisms for simple late filing of biennial renewal forms, a regulatory climate that shouts, “Warning” more than it does “Welcome.” There should be little wonder then that banks are reluctant to try swimming in these waters.

We have heard it suggested that bankers do not use the exemption process because they have computerized systems that make filing CTRs a snap. I am here to tell you that the snap you hear is the floor boards in my file room straining under the load of my required five years worth of retained CTRs and related BSA compliance records. First, let me note for the record that not all banks can afford computerized CTR filing systems. Second, adopting technological efficiency in the cause of compliance may have value as a cost control effort, but it is no virtue when it only expedites filing useless data about legitimate business activity. Indeed, the suggestion to automate demonstrates a recognition that the vast majority of these reports are repetitive and routine and therefore likely to be of small value in combating money laundering.

A reporting regime that presents us with the choice of suffering the gauntlet of exemption qualification paperwork and concomitant auditor or examiner second-guessing or instead filing numerous useless CTRs, is not sound public policy. That is why tinkering with the current exemption process will not make an appreciable dent in the overwhelming number of CTRs filed each year. As FinCEN conceded in its Report to Congress in October 2002, recommendations for

improving the exemption process regulatorily are at best incremental. Instead, we must start anew with an updated Congressional mandate that clears away the convoluted structure of the present exemption process and substitutes a direct and simplified standard.

Newer Tools Allow Us to Eliminate CTR Filings for Seasoned Customers

The current cash transaction reporting program has been rendered virtually obsolete by several developments: enhanced customer identification programs, more robust suspicious activity reporting, and the use of the more focused and intensive 314(a) inquiry/response process.

In light of these developments, to continue to require CTR filings for business customers whose identity has been verified under a bank's Customer Identification Program (CIP) and tested under a period of experience with the bank and that remain subject to risk-based suspicious activity reporting is an inefficient use of limited resources by bankers and law enforcement. In the field, it diverts scarce examiner resources, focusing on compliance with *technical* reporting standards rather than carefully evaluating bank programs for detecting transactions that possess a likelihood of involving money laundering and terrorist financing.

Exempt Seasoned Customers from CTRs

Accordingly, **we support H.R. 5341, embodying the recognition that the best way to improve the utility of cash transaction reporting is to eliminate the valueless reports being filed on legitimate transactions by law-abiding American businessmen and businesswomen.** This improvement can be achieved by establishing a seasoned customer exemption for business entities, including sole proprietorships, as endorsed by FinCEN last year in testimony before Congress and now embodied in H.R. 5341. (ABA proposed a similar concept in its response of May

4, 2005 to the banking agencies' request for comment for burden reduction suggestions under the Economic Growth and Regulatory Paperwork Reduction Act.¹⁾

The exemption, as proposed in the bill and supported by ABA, is comprised of three elements: Existence as an authorized business, maintenance of a deposit account at a depository institution for 12 months, and use of the account to engage in multiple reportable currency transactions. The simplicity of this standard avoids the unnecessary compliance barbs that have previously snagged past efforts to make effective use of prior exemption systems. This straightforward definition is essential for the exemption to work and to reduce filing reports on routine business activity.

It is important to remember that cash transaction data will not be lost, but rather will continue to reside in the bank account records. It will, therefore, be available to law enforcement whenever sought in connection with a targeted inquiry from government enforcement entities. In particular, by using the USA PATRIOT Act 314(a) inquiry process, law enforcement will be able to locate transaction data and other relevant information on a broad range of accounts of suspects. That more targeted approach is working and producing tangible results today.

As FinCEN reported on April 25, the 314(a) process has been used by fifteen federal agencies from November 2002 to April 2006 covering over 500 significant money laundering or terrorist financing cases identifying more than 4,000 subjects of interest. The 314(a) process has yielded the identification of 1,932 new accounts, leading to 1196 Grand Jury Subpoenas, producing 90 indictments, 79 arrests and 10 convictions. Although the process has been in place less than four years and many money laundering or terrorist financing cases take several years to develop before

¹ <http://www.aba.com/NR/rdonlyres/365382A4-2EC6-4B41-93A6-28BFAD2779FB/39308/EGRPRAMay2005.pdf>

they are actually prosecuted, the indictments, arrests and convictions are impressive. To put it mildly, there are no comparable measures of success for cases initiated through CTRs.

It has been suggested that the 314(a) process is flawed because it “can only be used on the most significant terrorism and money laundering investigations.” However, ABA believes that requirement is one of its great strengths because it better matches the benefit of the information collected with the burden imposed on the banks. At least now when banks are called on every two weeks under 314(a) to search for and report all accounts maintained by a subject of interest, they are doing so for an investigation that is considered a significant terrorism or money laundering matter—not a fishing expedition.

As H.R. 5341 makes clear, all seasoned business customers would continue to be subject to suspicious activity monitoring and reporting. SARs provide precise account and related transaction information as well as extensive narrative detail not available in CTRs. This reporting enables law enforcement to focus resources on conduct or activities where there is a greater likelihood of genuine risk and where investigative resources can be used more productively. In addition, the SAR procedures permit law enforcement to obtain the bank’s entire supporting investigative file upon request, without needing a subpoena.

As FinCEN reported in 2002, SARs have replaced CTRs as the primary tool for identifying suspicious activity. CTRs are now used to locate financial activity of already identified subjects of interest—the same purpose for which 314(a) inquiries are made. Although there have been examples cited by law enforcement of the continued use of CTRs, they do not specifically rebut the wisdom of a seasoned customer exemption. Talk about “connecting the dots” amounts to nothing more than anecdotal illustrations of how spotty the utility of CTRs on American businesses has

become. They do not demonstrate that CTRs on seasoned customers meet the statutory requirement of “a high degree of usefulness.”

After all, CTRs on non-seasoned entities would still be filed, reporting the movement of cash that does not go through an established business account relationship. In addition, law enforcement will have all the identifying information in the seasoned customer designation wherever and whenever that business has seasoned status. In other words, law enforcement will continue to have access to information on where subjects of interest are conducting their financial affairs.

As former FinCEN Director William Fox stated in a September 2005 testimony on the seasoned customer proposal before this Subcommittee, “We believe this language addresses many of the issues with our current exemption regime that were causing it not to have its intended effect. Due to its complexity and the burden involved in exempting customers, financial institutions were not taking advantage of the exemption regime. This proposal seeks to streamline the exemption process by focusing on a one-time notice to [FinCEN] of an exemption and focusing on the customer’s relationship with the bank as the grounds for such exemption. We believe that these changes will make the exemptions more effective while still ensuring that currency transaction reporting information critical to identifying criminal financial activity is made available to law enforcement.” ABA joins in those sentiments and strongly supports the Seasoned Customer CTR Exemption Act, H.R. 5341 that seeks to follow through on former Director Fox’s endorsement.

Conclusion

Eliminating CTR filings for seasoned customers would have the following benefits:

- The vast majority of the over 13 million CTRs filed annually would stop, saving the time, money, and labor expended by businesses to fill out forms, and consumed by law enforcement to process them.
- There would be an improvement in the quality of SARs, eliminating those that are filed today in connection with innocent, idiosyncratic deposit activity. Banks would be able to focus their energies on detecting genuinely suspicious currency transactions, regardless of artificial thresholds.
- We would make an enormous stride forward in focusing our anti-money laundering efforts – by both law enforcement and the banking industry – on the real crooks and terrorists with far greater likelihood of detecting and stopping their activities.

I thank the Chairman and his colleagues for their commitment to improving the BSA system and assure you that ABA and its members share that commitment. We are all striving to make the system work best, to protect the security of our banking system from abuse by money launderers and terrorists, and to safeguard the confidence that our customers have that the integrity of their legitimate business conduct is respected.