STATEMENT OF DIRECTOR ROBERT W. WERNER
FINANCIAL CRIMES ENFORCEMENT NETWORK
UNITED STATES DEPARTMENT OF THE TREASURY

BEFORE THE
HOUSE FINANCIAL SERVICES SUBSOMMITTEE ON FINANCIAL INSTITUTIONS
AND
CONSUMER CREDIT

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Chairman Bachus, Ranking Member Sanders and distinguished members of the Subcommittee, I appreciate the opportunity to appear before you today to discuss H.R. 5341, the "Seasoned Customer CTR Exemption Act of 2006." Balancing the regulatory burdens imposed upon the financial services industry under the Bank Secrecy Act (BSA), while at the same time, ensuring an unimpeded flow of useful information to law enforcement officials is an ongoing challenge that requires the attention of lawmakers and regulators alike. As the recently appointed Director of the Financial Crimes Enforcement Network (FinCEN), which is responsible for administering the BSA, I take this issue seriously and look forward to working with the members of this Subcommittee in our ongoing fight against illicit financial activity.

I am happy to be here today with Michael Morehart, who is Chief of the Terrorist Financing Operations Section in the Counterterrorism Division of the Federal Bureau of Investigations (FBI), and Kevin Delli-Colli, Deputy Assistant Director for the Financial and Trade Investigations Division at the Immigration and Customs Enforcement (ICE) Department of Homeland Security. Both of these agencies work tirelessly to keep our country safe from terrorist activity, and I am gratified that, in part, they accomplish their missions by utilizing financial information provided to FinCEN under the BSA. Our partnership with these law enforcement agencies allows for the seamless flow and effective utilization of this critical information in our united fight against terrorist financing and money laundering.

As the administrator of the BSA, it is important for FinCEN to work hard to assess and reassess the proper balance between the filing burdens imposed upon financial institutions and the needs of the law enforcement, intelligence and

regulatory communities for the data reported under the BSA. Moreover, as you know, the BSA's anti-money laundering program requirements help financial institutions protect themselves, and thus the U.S. financial system, from abuse by criminals and terrorists. Effective anti-money laundering and counter-terrorist financing programs assist financial institutions both to identify and mitigate the risks inherent in their operations. The BSA's record keeping and reporting requirements provide transparency in the financial system and help create a financial trail that law enforcement and other agencies can use to track criminals, their activities, and their assets.

Twelve types of reports are required under the Bank Secrecy Act. The reports filed most often are:

- **Currency Transaction Reports (CTRs)**, which are filed in connection with deposits, withdrawals, and exchanges of currency exceeding $10,000.

- **Suspicious Activity Reports (SARs)**, which describe suspicious financial transactions of a particular dollar threshold and relevant to a possible violation of law or regulation. These reports are especially valuable to law enforcement and intelligence agencies because they reflect activity considered problematic or unusual by financial institutions, casinos, money services businesses, and the securities industry. SARs contain sensitive information and, consequently, may be disclosed and disseminated only under strict guidelines.

The number of Bank Secrecy Act reports filed in Fiscal Year 2005 was more than 5 percent higher than the number filed the previous year, rising from nearly 15 million in Fiscal Year 2004 to approximately 15.8 million in Fiscal Year 2005. Increases in the number of SARs and CTRs accounted for most of the rise during this period.

- The number of SARs increased by about 32 percent, from 663,655 to 878,021; and

- The total number of CTRs grew by nearly 6 percent, from 13.7 million to 14.2 million.

Relevant to this hearing is the fact that reporting by financial institutions of CTRs has been the foundation of the Bank Secrecy Act since its inception. In fact, prior to 1996 when regulations issued by FinCEN and the Federal Banking Agencies required banks to file SARs, CTRs were the primary BSA tool used by law enforcement to identify activity indicative of money laundering. Although SARs have been required to be filed by a growing number of financial institution

industries since 1996, these reports have augmented our ability to stem the flow of illicit financial transactions by providing different, but often complementary, types of data to CTR filings.

It is important to note that SARs and CTRs should not be viewed as duplicative filings by financial institutions. Each provides their own set of value and intelligence that may initiate or assist in an investigation. However, the perception that every BSA filing should eventually lead to a prosecution is simply unrealistic. In addition to their investigative value, SARs and CTRs deter money-laundering activities. We have seen examples of this when criminals structure their deposits in our financial system to avoid filing requirements. Structured transactions designed to hide the movement of illicit funds force criminals to exert more time and energy while providing law enforcement additional information when tracing a pattern of activity. Finally, this data contributes to threat assessments, vulnerability studies and other more strategic analytic products that contribute significantly to our fight against illicit finance.

Prior to the implementation of SAR requirements, analysts and law enforcement personnel using CTRs as a tool to find indicia of suspicious activity were required to review individual CTRs. Therefore, the number of useful CTRs being filed for routine business activity raised concern about law enforcement's ability to effectively use the database. It was this concern, along with the time and cost associated with each filing, which led to enactment of the Money Laundering Suppression Act of 1994, which amended the BSA by establishing a statutory exemption system for currency transaction reporting.

The statute established two classes or "Phases" of exemptions. Under the Phase I exemption, Treasury has by regulation allowed financial institutions to exempt from CTR reporting requirements, transactions between depository institutions and the following specified categories of customers: (1) a bank; (2) a government agency (of the US, any state, or any political subdivision) or government instrumentality; or (3) a publicly traded business or certain subsidiaries of publicly traded businesses. A business that is not an "exempt person" under Phase I, because it does not meet the definition of a "listed business," still may be an "exempt person" as defined in Phase II of the exemption under two circumstances: (1) as a "non-listed business" or (2) as a "payroll customer."

In order to qualify as a Phase II customer, the entity must: (1) have maintained a transaction account at the exempting bank for at least 12 months; (2) frequently engaged in transactions in currency with the bank in excess of $10,000 (FinCEN interprets frequently as eight times in one year); and (3) be incorporated

or organized under the laws of the United States or a State, or be registered as and be eligible to do business within the United States or a State.

It should be noted that, under the present Phase II exemption, certain businesses are ineligible to be treated as an exempt non-listed business. These include businesses that: (1) serve as financial institutions or agents for financial institutions of any type; (2) purchase or sell to customers motor vehicles of any kind, vessels, aircraft, farm equipment or mobile homes; (3) practice law, accountancy, or medicine; (4) auction goods; (5) charter or operate ships, buses, or aircraft; (6) are pawn brokerages; (7) engage in gaming of any kind (other than licensed betting at race tracks); (8) are investment advisory services or investment banking services; (9) engage in real estate brokerage; (10) engage in title insurance and real estate closings; (11) engage in trade union activities; and (11) engage in any other activity that may, from time to time, be specified by FinCEN

In determining whether to exempt a customer under either Phase, a bank must document the basis for its decision and maintain such documents for five years. After a bank has decided to exempt a customer, the bank must file a Designation of Exempt Person form. For Phase I customers, the form has to be filed only once (though the bank must annually review the customer's status). For Phase II customers, the form must be re-filed every two years as part of a biennial renewal process. (As with Phase I customers, the bank must also annually review the status of Phase II customers.)

Despite the efforts of FinCEN and industry groups to encourage use of the revised CTR exemption system, financial institutions have remained hesitant to do so. Over time, many financial institutions have told us that they do not utilize this exemption process because of its complexity or the fear of misapplying the rules. In an October 2002, report prepared by FinCEN for Congress on the use of CTRs, some frequently cited reasons for not using the exemption system were:

- The fear of regulatory action if an exemption turns out to be wrong;
- Difficulty in determining whether a customer is eligible for exemption;
- The additional costs associated with due diligence;
- Lack of staff time to review CTRs for possible exemptions; and
- The transactions requiring CTR filings are too infrequent.

In an attempt to address these concerns, FinCEN took significant steps toward ensuring more effective and uniform application of the BSA. We worked with Federal and state banking agencies to negotiate and implement information sharing agreements that give us more comprehensive data and feedback on BSA compliance. We also worked with regulatory agencies to promote more uniform examination procedures for compliance with the BSA, faster and more consistent

compliance activities, and joint action in cases of egregious violations of the law. Nonetheless, it is clear that the current exemption system continues to be under-utilized.

H.R. 5341, like Section 701 of H.R. 3505, which passed the House of Representatives in March, is an attempt to address this concern by reducing CTR reporting requirements for seasoned customers – cash deposits by the local Wal-Mart store would be a typical example. In the fall of 2005, my predecessor offered technical assistance to this Committee on the CTR exemption language contained in H.R. 3505. Although we support the intent of this provision, as well as the effort and expertise behind the assistance we provided, as we all recognize, it is imperative that we avoid undermining law enforcement's efforts to combat terrorist financing. As such, we must be very attentive to reasonable concerns raised by law enforcement regarding the potential loss of the investigative value of CTR data presently collected.

In that regard, it is my understanding that law enforcement has significant concerns with the proposed language of this provision that would permit the exemption of certain businesses that are presently ineligible for CTR filing exemption under the current system *(i.e .car dealerships, attorneys, physicians, accountants)*. The ability of law enforcement to utilize BSA data has been improving at a rapid pace in light of advances in technology and analytic practices. This has led to a concern on their part that we will end up losing data that, once excluded, we will be unable to assess the value of through subsequent data mining. Given the concern expressed by our law enforcement partners, we believe it would be prudent to permit further study of the issue before making any changes to the current exemption system.

Such a study provides both the financial services industry and law enforcement an opportunity to define clearly, through an empirical study, those areas that represent either a compliance burden or the potential loss of benefit from useful data. Through such a cost-benefit analysis, we may be able to highlight opportunities for the regulators, law enforcement and the regulated community to achieve a balanced and workable alternative to the current regulatory regime.

In conclusion, Mr. Chairman, we stand ready to assist you in reducing the number of CTRs that provide little or no value for law enforcement purposes. Like H.R. 3505, we believe H.R. 5341 is a step in the right direction, but share a responsibility with you and law enforcement in considering any potential loss of BSA data law enforcement considers important to their investigations. Thank you for the opportunity to appear before you today. I look forward to any questions you have regarding my testimony.