

Testimony of Diana L. Taylor  
New York State Superintendent of Banks  
May 26, 2005

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DIANA L. TAYLOR  
NEW YORK STATE SUPERINTENDENT OF BANKS**

Before the  
FINANCIAL SERVICES SUBCOMMITTEE ON OVERSIGHT AND  
INVESTIGATIONS

UNITED STATES HOUSE OF REPRESENTATIVES

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## INTRODUCTION

Good morning Chairwoman Kelly, Congressman Gutierrez and members of the Subcommittee. I am Diana Taylor, Superintendent of Banks for the State of New York.

The New York State Banking Department is the regulator for more than 3,400 financial institutions and financial service firms in New York State. This number includes state-chartered banking institutions, the vast majority of U.S. offices of international banking institutions, all of New York State's money transmitters, check cashers, mortgage brokers, mortgage bankers and budget planners. The aggregate assets of the companies and institutions supervised by the Banking Department are nearly \$2 trillion.

Thank you for holding this hearing on an issue that is of great interest to those of us who oversee the financial services industry at the state level, and who are very concerned about the sometimes conflicting priorities of regulation, law enforcement, and the ability of necessary businesses to operate. This has become a very serious concern as issues of financial crimes, especially money laundering, figure so prominently today.

On 9/11 the New York State Banking Department, from its vantage point two blocks south of the World Trade Center, learned only too well how destructive terrorism can be. But in the days that followed, as we helped the financial system to recover, we saw how crucial that system is to maintaining our way of life in America. The entire country held its breath as first the banks, the bond, and then the equity markets got back on their feet. In the aftermath, financial institutions, regulators and law enforcement gathered together in a series of meetings to brainstorm on how to detect and prevent our financial system from being used to further terrorist aims. Today, rather than working together to defeat terrorism, these three sectors are often working at odds with each other.

I would now like to address the three points you mentioned in your letter, Chairwoman Kelly: the recent Memoranda of Understanding between my Department and FinCEN and the IRS; challenges we are currently facing with regard to BSA/AML compliance in the Money Services Business (MSB) area; and our interaction with the IRS when monitoring MSBs.

## 1. IRS and FinCEN MOUs

First, FinCEN and the federal banking supervisors released crucial guidance on BSA/AML compliance for banks doing business with MSBs such as check cashers and money transmitters. This very welcome development promises a strong step in the direction of clarifying for the banks their BSA/AML requirements with respect to MSB customers. This guidance assists banks in determining the measures they should undertake. One very important issue that was made clear is that banks are not expected to become or act as MSB regulators. At the same time, separate guidance was issued by FinCEN to MSBs clarifying their BSA/AML requirements.

Second, significant progress has been made toward a plan to achieve a coordinated approach among regulators. Over the winter, the Conference of State Bank Supervisors (CSBS) worked diligently with all of the states, our federal bank regulatory counterparts, FinCEN and the IRS to produce two model Memoranda of Understanding (MOUs) setting forth procedures for the exchange of certain BSA information between the states and FinCEN and the IRS, concerning bank and MSB examination information, respectively.

This is great progress. I was proud to be the first to sign these MOUs on behalf of my state of New York and am thrilled to be able to tell you that on June 1<sup>st</sup> more than 30 states plan to take part in an MOU signing ceremony at the CSBS Annual Meeting.

Another aspect of our agreement is that the states will receive analytical tools from FinCEN that will maximize resources and highlight areas and businesses with higher risk for money laundering. The agreement with the IRS will allow for examination-sharing to reduce duplicative efforts and establish an ongoing working relationship.

This is an unprecedented co-operative agreement. This effort recognized that the state regulators are an important part of the solution. We have all recognized that no one of us can be effective in this area without the others. Each one of us has resources needed by the others to do their jobs effectively.

Both FinCEN and the IRS were exceptionally cooperative in outreach efforts to answer all state questions about the agreements, and as a regulator who is keenly concerned about the MSBs enjoying a viable and visible future, I am deeply grateful for this. Not only will these agreements provide additional information to the regulators, the more information FinCEN receives and is able to analyze, the better the guidance from state and federal regulators will be.

I will be happy to keep you and your committee informed on how this co-operation continues.

## 2. Challenges we are facing with regard to BSA/AML Compliance in MSB area

You are aware of the fact that many banks have decided not to do business with MSBs as a result of BSA compliance issues. The guidance and MOUs I just referred to will hopefully ameliorate this issue. We will all keep you informed.

There are other challenges. One that is particularly worrisome is the issue of who, if anyone, should regulate the agents that MSBs employ to do their business, and if so, what should that regulation entail? In New York State, there are approximately 73 money transmitters, but there are 29,000 agents. Clearly, this would be an enormous task.

Then there is the issue of SARs. In the current environment, financial institutions are worried that they will be punished severely for seemingly minor infractions, even when they are operating responsibly and have state of the art compliance systems in place. There is no system in the world which is going to catch every single instance of money laundering or terrorist financing.

The Financial Services Roundtable agrees that there should be some room for error. In their May 10th petition, the FSR recommends that FinCEN and law enforcement agencies provide additional guidance on SARs that includes 'safe harbor' language. I hope that this recommendation will be given serious consideration, as I believe that automatically penalizing banks for isolated instances of late filings or missed filings in the context of an otherwise solid compliance history is an unhelpful practice, as it gets us no closer to those who are actually committing the crimes.

We have a long way to go in coordinating and communicating with law enforcement. The issue of "defensive SARs" is a symptom of a much larger problem. There are some who perceive that prosecutors are going after financial organizations for failure to file SARs – sometimes a single SAR, without giving due consideration to prior compliance and SAR filings. Because of this, some regulators are telling institutions that if they are at all suspicious of a transaction, file a SAR, which has resulted in FinCEN being inundated and begging people not to file "defensive" SARs. We need to make sure that everyone understands the standards to which they are being held, and that those standards make sense.

While we have taken great steps forward in terms of cross-agency communication, particularly in the area of the MSBs, we have a long way to go before we can agree on a sensible protocol that keeps our financial entities

secure, and succeeds in isolating and prosecuting the real evil doers. The protocol should envision regulators playing their traditional role in helping their regulated entities stay on the straight and narrow, knowing what is expected of them; law enforcement sharing information with regulators in tracking down the bad actors and prosecutors going after the people who have intentionally done something wrong – not a bank that neglected to file a SAR.

I believe that the basic problem lies in the way we play our respective roles. For instance, law enforcement may expect SAR filings to be a simple matter and, as a result, they have high expectations; yet they've issued little guidance. Some financial institutions may still look at SAR requirements as a burden that they should not be required to shoulder. Finally, prosecutors may look to indict without fully appreciating or understanding the complexity and operational volume of the financial industry, of which a SAR is but one piece. These different expectations and roles, shaped as they are by a partial understanding of each other's mission is at the root of our problem. I hope that the recent progress in carving out the MOUs shows that we can work to better understand and be responsive to each sector's needs.

At the same time, we are all very concerned with choking off the supply of money to terrorists and other criminal elements. This is a critical task. I agree with Bill Fox, when he said about world changes that after 9/11 the Bank Secrecy Act moved to the front and center of the banks', regulators' and law enforcement world and, as he put it: "...the changes in orientation that have occurred relating to the Bank Secrecy Act are...here to stay."

We need to work together to make sure the laws are having the intended consequences, which are to stop and punish criminal or terrorist activities, but at the same time to allow our financial system to operate efficiently and effectively.

### 3. Interaction with IRS when monitoring MSBs

We are looking forward to building our relationship with the IRS with regard to MSB supervision. As we are just now beginning this cooperative arrangement, I cannot give a progress report at this point, except to say 'so far so good'. However, I am looking forward to giving you a progress report of our accomplishments and mutual achievements in the not too distant future.

The real lesson of this discussion is that to have a real and lasting effect on illegal activity, it is essential that the agencies involved in the regulatory, investigative and enforcement frameworks for banks proactively cooperate with each other.

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Just as we forged an MOU between the states, the federal banking agencies, FinCEN and the IRS, I think we need to come to an understanding, perhaps an MOU, with the DOJ so that its actions and those of the US attorneys are not at cross-purposes to those of the regulators. We must once again brainstorm together to find a way to detect and prevent our financial system from being used to further terrorist aims. To achieve this crucial goal, we must all work together.