Testimony of

John J. Byrne

On Behalf of the

American Bankers Association

Before the

House Financial Services Oversight and Investigations Subcommittee

United States House of Representatives

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Subcommittee Chairwoman Kelly and Members of the subcommittee, I am John Byrne, Director of the Center for Regulatory Compliance of the American Bankers Association (ABA). ABA appreciates this opportunity to discuss how the financial industry is addressing the many compliance issues with suspicious activity reporting and the challenges with providing bank services to money services businesses (MSBs).

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.

ABA and our members continue to work with our government partners in training financial institution employees to effectively detect and report the myriad of financial crimes that involve money laundering and terrorist financing. For example, we plan to address the expected June 30 interagency Bank Secrecy Act (BSA)/anti-money laundering (AML) examination procedures in a number of education programs with the government later this year. All in all, the Association has trained hundreds of thousands of bankers since the passage of the Money Laundering Control Act in 1986.[1] The industry's commitment to deterring money laundering continues unabated.

Among other things, ABA holds an annual conference with the American Bar Association on money laundering enforcement, produces a weekly electronic newsletter on money laundering and terrorist financing issues, offers online training on BSA compliance, and has a standing committee of more than 80 bankers who have AML responsibilities within their institutions. In addition, we provide telephone seminars on important and often confusing issues such as MSB relationships and compliance with Section 326 of the USA PATRIOT Act.

[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 to the banking industry. It is also interesting to note that in banks under $5 billion in assets, 75.6 percent of the employees said that compliance was not their only job.

As we told this subcommittee on May 4, "there has been clear movement and commitment for further action from the highest levels of the federal banking agencies" for a uniform approach to BSA compliance. However, ABA would again remind the subcommittee that the industry remains concerned about the quality of communication that exists between these same agencies and the field examiners. In fact, we will highlight one particular issue that occurred after the May 4 hearing that emphasizes our concerns. ABA remains optimistic that the commitment mentioned above is real and will resolve the issues quickly.

Madam Chairwomen, your May 20 letter of invitation asked us to address three issues:

- An update on what is being done to "standardize" BSA compliance challenges;
- Why the industry is engaged in the "defensive" filings of suspicious activity reports (SARs); and,
- What BSA compliance concerns are associated with MSBs.

To update Members on the issues presented by the letter of invitation, we offer the following observations and recommendations:

1. The pending interagency examination procedures will provide an opportunity for both the industry and the federal banking agencies to work together and prevent confusion and second-guessing. We urge Congress to seek an update on the practical effect of these procedures in early 2006.

2. As we told this subcommittee earlier this month, "it is counterproductive to label an entity 'high risk' without also issuing guidance on how to mitigate that risk." Finally, the agencies agreed and produced the interagency guidance on working with MSBs. It is early for a complete assessment, but the direction of the guidance is a strong first step for clarity.

3. Defensive SAR filings are the result of the dearth of useful guidance and a lack of a balanced approach to examiner oversight. The federal banking agencies must insist that their field examiners not "second-guess" SAR decisions made by the financial sector or the volume of SARs will continue to skyrocket.

Consistent Examination Procedures Should Address the Current State of Confusion

ABA has previously emphasized to Congress that the banking agencies need to reach agreement on how the financial services industry will be examined for compliance under the USA PATRIOT Act and the other AML requirements. We are pleased to note that the final interagency procedures are now planned for release June 30. These procedures, if implemented appropriately, should address a glaring problem – the assessment of the adequacy of SAR programs.

ABA is pleased that the agencies are exhibiting a commitment to greater consistency in 2005. For example, not only has FinCEN Director William 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. As an aside, I would note that the congressionally created Bank Secrecy Act Advisory Group should be a model for government-private sector cooperation.

This subcommittee, co-chaired by ABA and the Federal Reserve Board, has met several times – as recently as April 29 – to discuss the pending interagency examination procedures.

Uniform exam procedures will assist with the industry concerns about examination inconsistency and the continued threat of "zero tolerance" by these same errant examiners. However, we strongly urge Congress to ensure that all banking agencies engage in industry outreach when the AML exam procedures are made public. The agencies appear committed to such outreach and we believe a nationwide series of "town hall" meeting events will ensure that both sides will know what to expect in this complicated compliance area.

MSBs and Banks: An Example of Regulatory Confusion

A major challenge facing the banking industry has been how to fulfill our obligations regarding appropriate relationships with MSBs. The banking industry certainly understands and appreciates the need to analyze the levels of risk involved with maintaining MSB relationships. We know the importance of providing banking services to all segments of society. For some, the remittance services that MSBs frequently provide are an essential financial product. Remittance flows are an important and stable source of funds for many countries and constitute a substantial part of financial inflows for countries that have a large migrant labor force working abroad.

The problem, however, is how much analysis is sufficient. At times, banks appropriately exit relationships due to the risk inherent with a particular MSB. At other times, banks want to continue certain valued relationships.

Officially recorded remittances received by developing countries are estimated to have exceeded $93 billion in 2003. They are now second only to foreign direct investment (around $133 billion) as a source of external finance for developing countries. In 36 out of 153 developing countries, remittances were larger than all capital flows, public and private combined.

Remittance flows go through both formal and informal remittance systems. Because of the importance of such flows to recipient countries, governments have made significant efforts in recent years to remove impediments and increase such flows. At the same time, however, there has been heightened concern about the potential for remittance systems, particularly those operating outside of the formal banking system, to be used as vehicles for money laundering and the financing of terrorism. It is believed that the risk of misuse of remittance systems would be reduced if transfers were channeled through remittance systems that are subject to regulations by governments.

To address the risks, a two-pronged approach is evolving: One prong involves efforts by governments to encourage the use of formal systems (such as banks) by lowering the cost and increasing the access of users and recipients to the formal financial sector. Such efforts should concentrate on the reduction of artificial barriers such as unnecessary regulatory standards that impose costs ultimately borne by consumers.

The second prong includes initiatives by governments to implement anti-money laundering standards for entities such as MSBs. This has clearly been occurring in the United States and, as we have heard from other witnesses, the MSB regulatory infrastructure is robust and effective.

A challenge that underlies this situation is that there exists in most countries a large pool of "unbanked" individuals. Such individuals are often accustomed to using both formal (and regulated) financial institutions and very informal (and unregulated) financial services providers. Economic and social incentives that move this group towards "underground" financial services providers ultimately harm the interests of the unbanked, of law-abiding financial services providers, and of the general public. Moreover, the underground financial services providers may service both law-abiding unbanked persons, as well as criminals. Thus, governmental actions that discourage the unbanked from entering depository institutions may have the effect of also making anti-money laundering goals far more difficult to attain. These facts have helped make it clear that the MSB-bank environment needs radical change.

The necessary services that MSBs provide are being severely hampered by regulatory excess. The federal banking agencies issued an interagency policy statement on March 30 and sorely needed interagency guidance on April 26, but this guidance now must be clearly communicated to examiners.

On March 8, I had the opportunity to co-chair a meeting of BSAAG on the MSB problem. For eight hours, we heard dramatic examples from 44 witnesses of lost business, economic failures and rampant regulatory confusion. The theme of confusion was echoed by all of the banks. FinCEN and the federal banking agencies are to be commended for working toward guidance to address this policy morass. On May 4, we urged the agencies to act swiftly and inform examiners to adjust their reviews of MSBs that are associated with banks. I would like to report that at least one large southwestern bank reported to ABA that its current BSA exam showed the oversight agency to be well-versed in the MSB guidance. This is indeed a positive sign.

Lack of SAR Guidance Results in Unnecessary Filings

With the increased number of entities required to file 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 filers with issues as they arise.

Government advisories and other publications are a critical source for recognizing trends and typologies for money laundering and other financial crimes. As the industry emphasized in the April 2005 issue of the interagency-authored publication, **SAR Activity Review**, there are a number of examples of activities that are characteristic of financial crimes and that can be used as teaching tools. This information is extremely useful for training purposes. As the private sector co-chair of the **SAR Activity Review**, I can assure you 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 suspicious activities that offer tell-tale signs of such diverse activities as identity theft, bank fraud, and computer intrusion.

We are pleased that the 2004 edition of the **SAR Activity Review** provided, for the first time, summary characterizations of all of the major suspicious activity categories. This should assist filers in advancing their understanding of the reporting requirements.

As stated above, there are several problems affecting banks in the AML exam process related to SARs. ABA has previously mentioned the many examples of examiner criticisms received by our members during reviews of their SAR programs. Whether it has been criticism of the number of SARs that the institution has filed or "second-guessing" by examiners as to why a SAR was not filed, we remind Congress that this situation demands immediate attention.

Moreover, regulatory scrutiny of SAR filings (and the recent civil penalties assessed against banks for SAR deficiencies) has caused 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. In fact, the *American Banker* has reported that, in March 2005, the banking industry filed 43,000 SARs: a 40 percent increase from a year earlier.

As FinCEN Director William Fox stated so eloquently in the April **SAR Activity Review**:

> *While the volume of filings alone may not reveal a problem, it fuels our concern that financial institutions are becoming increasingly convinced that the key to avoiding regulatory and criminal scrutiny under the Bank Secrecy Act is to file more reports, regardless of whether the conduct or transaction identified is suspicious. These "defensive filings" populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns.*

We would like to commend Director Fox for addressing our previous recommendation, which we outlined in testimony in May 2004, by creating a BSAAG subcommittee on SAR issues. I would note that the first meeting has already occurred and the issue of defensive filings is a top priority.

Our members continue to express their concerns on the rampant second-guessing that still continues. For example, just last week a bank told us that it had extensive documentation on why it did not file a SAR, only to be told by the examiner that it must file. This example, which is not isolated, is a major reason why banks feel they have no other option but to err on the side of filing. Our hope continues to be that the examination procedures and additional interpretations on SAR issues will result in returning SARs to their original place – forms filed only after careful analysis and investigations with no second-guessing by regulators.

Revamping the Outdated CTR System

Another way of ensuring that government and industry resources are used effectively in the area of financial crime detection is to remove unnecessary data collections.

As ABA has previously testified, the 35-year-old rules related to cash transaction reporting (CTR) have become redundant and lost their usefulness. ABA believes that the time has come to dramatically address this reporting excess by eliminating CTR filings for transactions conducted by seasoned customers through their bank accounts.

ABA notes that the purpose of Subchapter II of Chapter 53 of Title 31 establishing the BSA regulatory regime is to require certain reports or records when they have "a high degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence and international terrorism. ABA and its members strongly believe that the current CTR reporting standards have long departed from this goal of achieving a high degree of usefulness.

ABA members believe that CTR filing has been rendered virtually obsolete by several developments:

- formalized customer identification programs;
- more robust suspicious activity reporting; and,
- government use of the 314(a) inquiry/response process.

We believe that CTRs are no longer analyzed to identify unknown criminal agents. Rather they are used, at most, to try to match already known suspects to locate potential account activity. As noted above, section 314(a) is much more efficient for identifying account activity of known suspects because it has the value of capturing accounts involving more than just cash transactions.

We believe that combining improved monitoring conducted by institutions as part of their SAR processes with better mining of SAR data by law enforcement as well as judicious use of the 314(a) process yields a more effective approach to law enforcement investigation of patterns of fraud, money laundering and terrorism funding. Consequently, we believe the time has come to recognize the redundancy of CTR filings for seasoned customers with transaction accounts and to eliminate this inefficient use of resources by bankers and law enforcement.

Changing the thinking about mandating the collection of routine cash data would have the following benefits:

- The vast majority of the over 13 million CTRs filed annually would stop, saving many hours a year in filling out forms;
- Wasteful SARs would cease. These SARs amount to almost 50 percent of all BSA-required SARs. Rather than filing specious structuring reports, banks could focus their energies on detecting suspicious handling of currency regardless of artificial thresholds;
- Bank systems and resources could be redirected from CTR monitoring to support further improvement in suspicious activity reporting;
- Regulatory criticism of technical mistakes with CTR filings would cease;
- Issues surrounding the CTR exemption process would be eliminated; and,
- Law enforcement could redirect resources to better evaluating SARs.

While BSAAG has been reviewing the cash transaction system with an eye toward simply modifying elements such as the exemption process, ABA believes that a more comprehensive approach overall is needed.

Conclusion

ABA has been in the forefront of the industry efforts to develop a strong public-private partnership in the areas of money laundering and 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. ABA will continue our support for these efforts.

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