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FEDERAL DEPOSIT INSURANCE CORPORATION

TESTIMONY OF

FEDERAL DEPOSIT INSURANCE CORPORATION

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ON

BANK SECRECY ACT ENFORCEMENT,
MONEY LAUNDERING AND CRIMINAL ACTIVITY
IN INSURED FINANCIAL INSTITUTIONS

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND INSURANCE
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
UNITED STATES HOUSE OF REPRESENTATIVES

10:30 a.m.
June 9, 1987
Room 2128, Rayburn House Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to testify today on behalf of the Federal Deposit Insurance Corporation.

The FDIC insures approximately 14,300 of the nation's commercial banks and some 500 savings banks. I represent the FDIC's Division of Bank Supervision which is responsible for the supervision and examination of approximately 8,300 state chartered banks that are not members of the Federal Reserve System. While some of these institutions have assets over \$1 billion, most are smaller banks serving the financial needs of their local communities. The FDIC examines these banks for safety and soundness, as well as for compliance with Federal laws and regulations, including the Bank Secrecy Act ("BSA") and the Treasury's currency reporting regulations.

My testimony today will describe the actions taken by the FDIC as a result of the enactment of the Money Laundering Control Act of 1986 and address other issues concerning the Bank Secrecy Act and bank fraud and insider abuse. I will begin by outlining the steps we have taken to require banks to monitor their own compliance with the BSA.

REQUIRED PROCEDURES FOR MONITORING BANK SECRECY ACT COMPLIANCE

On January 27, 1987, the FDIC Board of Directors adopted a rule requiring all insured state nonmember banks to establish and maintain procedures to assure and monitor compliance with the Bank Secrecy Act. Other federal regulators

adopted substantially the same regulation. The rule, which became effective on April 27, 1987, requires banks to install and maintain a compliance program that, at a minimum, provides for:

- (1) A system of internal controls to assure ongoing compliance;
- (2) Independent testing of compliance by bank personnel or by an outside party;
- (3) A designated individual or individuals responsible for coordinating and monitoring day-to-day compliance; and
- (4) Training for appropriate personnel.

The regulation requires a written compliance program that is approved by the bank's board of directors, with the approval noted in the board meeting minutes.

On May 16, 1987, the FDIC issued guidelines elaborating on the four minimum requirements of the FDIC's new regulation. A copy of the guidelines is attached as an Appendix. The guidelines stress that the new rules require banks to adopt internal procedures to insure compliance with the Treasury's regulations, but that the FDIC regulation does not supplant any of the Treasury rules. The guidelines notify banks that, in order to meet the minimum standards of the regulation, they must provide written instructions and copies of the Treasury's reporting forms to all employees involved in transactions with customers. The guidelines also emphasize that merely installing procedures that meet the minimum requirements will not be sufficient to satisfy our regulation if banks handle a large volume of currency, operate from numerous locations, or operate offices in border areas or in areas where money laundering or drug trafficking is prevalent. These

banks must install extensive controls, plans and procedures that go beyond the minimum requirements set forth in our rule. The guidelines notify banks that they will be cited for having an ineffective compliance program if numerous or serious violations of the Treasury's rules are discovered, even if their formal policies and procedures seemingly satisfy the regulatory standard. In other words, we are looking for substance over form.

In addition to promulgating the new BSA regulation and guidelines, the FDIC has taken steps to insure greater compliance with Treasury's regulations. On May 13, 1987, the FDIC notified all FDIC-supervised banks of changes in the Treasury's currency reporting regulations and advised them of their obligation to comply with those rules on or before the effective dates.

All State nonmember banks also have been supplied with the interagency examination procedures used by examiners. We have encouraged their use by bank auditors in order to check their own banks for compliance with the new independent testing requirement.

The new regulatory requirements place the responsibility for conducting BSA compliance audits squarely on the financial institutions. The FDIC's regulatory guidelines direct banks to conduct a compliance audit at least annually and strongly suggest that this responsibility be assigned to the internal audit department or to the bank's outside CPA firm.

In addition to directing bank regulators to require banks to adopt BSA compliance programs, the Money Laundering Control Act authorizes the agencies to use powerful new enforcement tools. Specifically, a cease and desist order

may be issued if the FDIC finds that an insured nonmember bank has failed to establish and maintain procedures to assure compliance with BSA regulations or to correct problems with its compliance procedures that have been cited by examiners. Civil money penalties of up to \$1,000 a day for any single violation also can be assessed for failure to assure BSA compliance. These new civil enforcement powers enable regulators to take swift action against a bank while any possible criminal violations are pursued by the Internal Revenue Service on a separate track. Prior to the enactment of these amendments, civil action often was delayed, sometimes for lengthy periods, pending the outcome of a criminal investigation.

RIGHT TO FINANCIAL PRIVACY ACT

The letter of invitation requested comments on the Right to Financial Privacy Act ("RFPA"). The Money Laundering Control Act amended the RFPA to protect banks from civil suit for wrongful disclosure of RFPA-protected information if the bank's disclosure to law enforcement agencies is limited to:

- (1) the name of any individual involved in suspected illegal activities;
- (2) other identifying information about any individual or account involved in suspected illegal activities; and
- (3) the nature of the suspected illegal activities.

Legislative history suggests that these amendments were designed to encourage banks to be good citizens and report suspected illegal activity. We believe the amended Act is adequate in this regard although there is currently some debate about what constitutes "suspected illegal activity." According to bank officials, it would be extremely helpful if guidance were available to aid

them in distinguishing "suspected illegal activity" from merely suspicious behavior. The FDIC, in conjunction with the Bank Fraud Enforcement Working Group, is currently revising the criminal referral form that is used by banks to report apparent crimes. After it is revised, the new form will direct banks to report suspected violations of the new money laundering statutes and to report transactions that are structured to evade currency reporting requirements -- the latter constituting a new offense under the law. When we inform them of these revisions to the criminal referral form, we also intend to offer guidance to FDIC-supervised banks on what constitutes a suspected violation of these new statutes.

When viewed in concert with the new money laundering statutes and the criminal reporting requirements, last year's amendments to the RFPA more clearly define the responsibilities of financial institutions to report suspected crimes in a prompt and concise fashion. Nonetheless, we believe additional amendments would be desirable to aid law enforcement and to protect public confidence in the banking system. Adding an insider exemption, such as the one proposed by this Committee in the last session, would improve the quality of examiner-generated referrals naming insiders and might permit prosecutors to undertake more cases involving bank employees without having to convene a Grand Jury. Such an exemption would thereby improve the efficiency of the system and the probability of prosecution.

We do not believe, however, that the insider exemption would stimulate significantly the flow of information from banks to federal law enforcement agencies about the suspected fraud and abuse of top-level managers. Moreover,

recent analysis of major criminal referrals involving FDIC-supervised banks reveals a growing proportion of fraud committed by outsiders, or by outsiders in conjunction with insiders. In our view, the insider exemption is not broad enough to effectively improve the criminal referrals of major cases and might complicate matters where both insiders and outsiders are suspected.

As an alternative, we recommend the RFPA amendment proposed by the Bank Fraud Enforcement Working Group. That amendment would permit the transfer, without notice to the customer, of financial information lawfully in the possession of one government authority -- such as a bank supervisory agency -- to another government authority -- such as the Justice Department -- for a law enforcement purpose within the jurisdiction of the receiving agency.

CHANGE IN BANK CONTROL ACT AMENDMENTS

The Money Laundering Control Act of 1986 made four major changes to the Change in Bank Control Act. Two of the changes clarified the FDIC's authority to investigate Change in Control Notices and to seek temporary or permanent injunctions to enforce compliance. The requirement to publish Notices of Changes in Control likewise validated an existing FDIC requirement directing the proposed acquirors to publish notice of their intentions in a local newspaper. Another amendment provided a 60-day review period for change in control notifications, an additional 30-day period in the discretion of the agency, and up to two additional 45-day periods for certain specified reasons. Prior to these amendments to the Change in Bank Control Act, the time for review was 60 days, an additional 30 days (agency discretion was not specifically mentioned) and unlimited additional time for certain specified reasons.

In the great majority of cases, the prescribed time periods are adequate to provide the necessary review before a proposed change in control may take place. But there have been occasions where, for reasons beyond the control of the FDIC, a final evaluation of an acquiror could not be made within the prescribed time. For example, if during an investigation of an acquiring party it is learned that the party is the subject of a Grand Jury investigation, the FDIC may not be able to determine the outcome prior to the expiration of the change-in-control time limits. We then are placed in the position of being unable to deny a change in control due to the absence of an appropriate basis for denial. However, the subject eventually may be charged with crimes, conviction of which would have provided a basis for denial. We are disadvantaged not only by our inability to obtain the result of the Grand Jury investigation, but also by the fact that our own investigation of the subject may be delayed or limited as a result of the ongoing Grand Jury investigation.

We are working through the Bank Fraud Enforcement Working Group to resolve this problem either through better cooperation or by proposing an amendment to Rule 6-E of the Grand Jury Secrecy Rules.

The Money Laundering Control Act also directed the regulatory agencies to make an independent determination of the accuracy and completeness of any information furnished by an acquiror in connection with a Notice of Acquisition of Control. Prior to this amendment to the Change in Bank Control Act, the type and scope of each investigation was left to the agency's discretion. We have issued new guidelines to our Regional Directors implementing this provision. These new guidelines formalize the investigation

requirements and, in some areas, expand the scope of investigation into the financial position and background of prospective acquirors of insured state nonmember banks.

Regional Directors are expected to make an independent determination of the completeness of any information required in connection with a Change in Control Notice and to prepare a report of their findings. The sources of background information have been expanded to include credit reporting agencies, news services, court records and independent appraisers. In addition, regional offices are authorized to require audited financial statements, to directly verify personal assets and liabilities and to conduct special investigations to determine the accuracy of the information submitted by a prospective acquiror.

At this time we would not recommend any additional substantive amendments to the Change in Bank Control Act. However, we would support some clarifying language and minor amendments to permit agency discretion in determining the accuracy of information submitted by a proposed acquiror and to provide an unlimited time period for reviewing a Notice under specified circumstances.

BANK FRAUD AND BANK FAILURES

The letter of invitation requested our views on the relationship between fraud and bank failures. Clearly, fraud and insider abuse are important factors in bank failures. Immediately prior to the closing of an insured bank, FDIC examiners attempt to assess the extent to which insider abuse and/or apparent criminal activity may have contributed to the failure of the institution.

Based on these assessments, we have concluded that serious insider abuse, fraud and/or apparent criminal activity contributed significantly to about one-third of the bank failures in recent years. This ratio has remained relatively constant over the past two years and so far in 1987. Except in a few obvious cases, it is difficult to isolate apparent criminal conduct from the broader conduct of insider abuse prior to a bank failure and virtually impossible to state unequivocally that such criminal conduct led to the bank's demise. Nevertheless, we estimate that outright criminal activity was a major contributing factor in 12 to 15 percent of bank failures.

Rather than concentrating on whether bank fraud and insider abuse is the cause of a bank failure, in our view it is much more useful to focus on bank fraud as a major national problem in both open and closed institutions. To illustrate, the FBI is currently investigating criminal conduct in almost 300 bank failure cases. However, over 7,000 cases of bank fraud and embezzlement are pending at the FBI, 3,000 of which involve losses over \$100,000. As these figures indicate, bank fraud is not disproportionately associated with failed banks.

EFFORTS TO ADDRESS BANK FRAUD AND INSIDER ABUSE

Over the past two and one-half years, the FDIC -- of its own accord and in conjunction with the Bank Fraud Enforcement Working Group -- has taken several major steps to attack fraud and insider abuse in the nation's banking system. For example:

The criminal reporting system has been completely revised to require banks, by regulation, to report apparent crimes to U.S. attorneys, federal investigators and to the FDIC on a standard referral form.

Communication and cooperation with law enforcement agencies has been improved significantly through a network of personal contacts.

In March 1987, FDIC published a list of time tested "Red Flags" and other warning signs of fraud and abuse to be used as an aid to examiners and auditors.

The FDIC also has designated some 60 senior examiners as bank fraud specialists who will be given specialized training in bank fraud and insider abuse.

Training opportunities for examiners, investigators and liquidators have been greatly increased by the addition of an interagency school on white collar crime, joint FBI/examiner training sessions and expanded coverage in the FDIC schools.

The FDIC has designated special review examiners and regional counsel in regional offices to prepare criminal referrals, coordinate investigative assistance and testimony, and advise banks and other examiners on criminal laws and criminal referral requirements.

Liquidators and other employees of the Division of Liquidation now are given special training and refresher courses on bank fraud and insider abuse and investigation techniques.

Computer systems at both the FDIC and in the Justice Department have been installed to collect information about criminal referrals for tracking and analytical purposes and to identify subjects of criminal referrals by name recognition.

In addition to these steps, we are emphasizing the importance of codes of conduct and enhanced audit capabilities to deter and prevent fraud and abuse. We currently are considering a proposal to require FDIC-supervised banks to have an annual outside audit of their financial statements.

We believe these initiatives, together with the overhaul of the federal criminal code (specifically the new bank fraud statute, the amended bank bribery statute and the money laundering statutes), provide the necessary tools to deal with the problem. The resources to effectively use the tools, however, are in short supply. An acute shortage of prosecutors exists in certain sections of the country -- most notably Texas, Oklahoma and Southern California. As a result, we are concerned that many of the FBI's 3,000 cases that involve losses over \$100,000 will not be prosecuted before the expiration of the applicable statutes of limitations.

INTERAGENCY COOPERATION

The Bank Fraud Enforcement Working Group has been mentioned several times already. This group was established by the Attorney General in late 1984 to

address the growing problem of bank fraud and insider abuse in the nation's financial institutions. The group's success in achieving its original goals has exceeded our expectations. The Bank Fraud Enforcement Working Group is largely responsible for the programs dealing with bank fraud and abuse that I mentioned earlier.

We have embarked on a similar approach to address money laundering and our Bank Secrecy Act responsibilities. At the direction of the Treasury Department, the Bank Secrecy Act Working Group was formed in May, 1986, to review and evaluate all aspects of the Bank Secrecy Act, to coordinate and promote more efficient BSA enforcement and to insure better cooperation and communication between Treasury and the various agencies assigned the responsibility to enforce the BSA regulations. Subgroups have been organized and are currently discussing the following issues:

- (1) a plain English revision of the Treasury's currency reporting regulations;
- (2) uniform reporting of violations and civil money penalty referrals;
- (3) targeting of examinations;
- (4) ways to transfer administrative rulings and other guidance to financial institutions; and

(5) guidelines for granting customer exemptions.

In short, the agencies are working closely together to improve regulatory efficiency and to inform the banking and thrift industries of their legal and moral obligations under the Bank Secrecy Act.

CONCLUSION

In testimony before this Subcommittee last year, we stated that the FDIC had begun to review Bank Secrecy Act compliance during safety and soundness examinations rather than only during compliance examinations and that we had begun conducting targeted examinations based on information provided to us by the Customs Service, IRS or Treasury. Our current examination strategy is to review for BSA compliance at safety and soundness examinations, at compliance examinations -- if a safety and soundness examination has not been conducted during, or is not scheduled for, the calendar year -- and at targeted examinations as directed by the Washington Office. Follow-up visitations are contemplated in cases where civil enforcement action is likely or has been initiated.

I would like to stress, however, the difficulty in detecting money laundering during the bank examination process. Even under the best of conditions -- when examination resources are not as strained as they are today -- FDIC examiners' presence in insured banks is limited to a few weeks out of each two- to three-year period. The examiner reviews only a sample of transactions, over a period of about two weeks, and visits only a few selected offices of the bank. Clearly, a review based on a small sample of

transactions cannot predict absolutely that failures to file currency transaction reports did not occur on the days not sampled. Moreover, corrupt employees can circumvent the bank's controls and conceal violations from examiners. Therefore, the examination process cannot assure day-to-day compliance.

The examination process also is not designed, and cannot be counted on, to detect suspicious activity emanating from outside the bank. What it can do effectively is to insure that banks install and operate internal controls and procedures to comply with BSA rules. The new compliance requirements promulgated under the Money Laundering Control Act that mandate internal controls, independent testing and training apply directly to day-to-day bank operations. As a result, the ability of the bank regulators to assure compliance with BSA regulations has been strengthened significantly.

This concludes my prepared statement. I will be pleased to answer any questions the Committee may have. Thank you.

BANK SECRECY ACT COMPLIANCE

BL-16-87
May 18, 1987TO: CHIEF EXECUTIVE OFFICERS OF
INSURED STATE NONMEMBER BANKSSUBJECT: Guidelines for Monitoring Bank Secrecy Act Compliance

MINIMUM REQUIREMENTS: On January 27, 1987, the FDIC adopted a rule requiring all insured state nonmember banks, including insured state branches of foreign banks, to establish and maintain procedures to assure and monitor compliance with the Bank Secrecy Act (BSA). By April 27, 1987, banks must have a compliance program that, at a minimum, provides for:

- (1) A system of internal controls to assure ongoing compliance;
- (2) Independent testing of compliance by bank personnel or by an outside party;
- (3) A designated individual or individuals responsible for coordinating and monitoring day-to-day compliance, and
- (4) Training for appropriate personnel.

The compliance program shall be reduced to writing, approved by the bank's board of directors and noted in the minutes. The program and procedures will be reviewed during the course of regulatory examinations.

ADDITIONAL GUIDANCE: Section 326.8 of the FDIC's Rules and Regulations governs procedures within the bank to insure compliance with Treasury Department rules. The FDIC requirements are separate and apart from the substantive reporting and recordkeeping requirements of the BSA and 31 CFR 103. To satisfy the FDIC's requirements, banks must provide written instructions and copies of the required forms to all employees involved in transactions with customers.

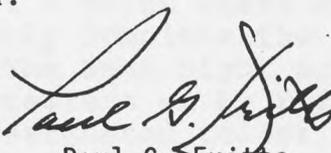
In addition, banks must have installed an effective compliance program that not only meets the minimum requirements of the FDIC's rule (Section 326.8), but addresses the specific circumstances of each banking office. For example, banks or offices handling a large volume of currency, banks operating from numerous locations, and banks with offices in border areas or in areas where money laundering or drug trafficking is prevalent, must have installed extensive controls, plans and procedures going beyond the minimum requirements of Section 326.8.

The true test of the compliance program's effectiveness is its ability to prevent violations. Thus, if examiners find numerous or serious violations of the Treasury's regulations, the compliance program will likely be judged inadequate and violations of Section 326.8 will be cited.

Guidelines elaborating on the four points of the regulation are included in this pamphlet.

EXAMINATION PROCEDURES: Also included herein are the procedures used by FDIC examiners to determine compliance with the Bank Secrecy Act and Treasury's regulations.

The independent testing requirement demands the use of examination or audit procedures by auditors, outside parties or employees who are independent of the currency reporting function. The FDIC's procedures may be used as a model for developing such procedures within the banking organization.



Paul G. Fritts
Director

Attachments

Distribution: Insured State Nonmember Banks (Commercial and Mutual)

GUIDELINES FOR MONITORING BANK SECRECY ACT COMPLIANCE

Section 326.8(b) of the FDIC's Rules and Regulations requires banks to develop and administer a program to assure compliance with the Bank Secrecy Act (BSA) and 31 CFR 103. The compliance program must be in writing, approved by the bank's board of directors and noted in the minutes.

Section 326.8(c) sets out four minimum requirements of the compliance program. To meet the minimum requirements, a bank's compliance program should include:

1. A system of internal controls. At a minimum, the system must be designed to:
 - Identify reportable transactions at a point where all of the information necessary to properly complete the required reporting forms can be obtained. The bank might accomplish this by sufficiently training all tellers or by referring large currency transactions to a designated teller. If all pertinent information cannot be obtained from the customer, the bank should consider declining the transaction.
 - Ensure that all required reports are completed accurately and properly filed. Banks should consider centralizing the review and report-filing functions within the banking organization.
 - Ensure that customer exemptions are properly granted and recorded. The compliance officer or other designated officer should review and initial all exemptions prior to granting them.
 - Provide for adequate supervision of employees who accept currency transactions, complete reports, grant exemptions or engage in any other activity covered by 31 CFR 103.
 - Establish dual controls and provide for separation of duties. Employees who complete the reporting forms should not be responsible for filing them or for granting customer exemptions.
2. Independent testing for compliance with the BSA and 31 CFR 103. The independent testing should be conducted at least annually, preferably by the internal audit department, outside auditors or consultants. Banks that do not employ outside auditors or consultants or that do not operate internal audit departments can comply with this requirement by utilizing for testing employees who are not involved in the currency reporting function.

The compliance testing should include, at a minimum:

- A test of the bank's internal procedures for monitoring compliance with the BSA, including interviews of employees who handle cash transactions and their supervisors.
 - A sampling of large currency transactions followed by a review of CTR filings.
 - A test of the validity and reasonableness of the customer exemptions granted by the bank.
 - A test of the bank's recordkeeping system for compliance with the BSA.
 - Documentation of the scope of the testing procedures performed and the findings of the testing. Any apparent violations, exceptions or other problems noted during the testing procedures should be promptly reported to the board of directors or appropriate committee thereof.
3. The designation of an individual or individuals to be responsible for coordinating and monitoring compliance with the Bank Secrecy Act. To meet the minimum requirement, each bank must designate a senior bank official to be responsible for overall BSA compliance. This might be the Compliance Officer, Chief Auditor or another officer of similar status. In addition, other individuals in each office, department or regional headquarters should be given the responsibility for day-to-day compliance.
4. Training for appropriate personnel. At a minimum, the bank's training program must provide training of tellers and other personnel who handle currency transactions. In addition, an overview of the BSA requirements should be given to new employees and efforts should be made to keep executives informed of changes and new developments in BSA regulation.

Depending on the bank's needs, training materials can be purchased from banking associations, trade groups or outside vendors or they can be developed by the bank. Copies of the training materials must be available in the bank for review by examiners.

EXAMINATION OBJECTIVES

1. To determine whether the institution reports large currency transactions to the IRS and international currency transactions to the Customs Service in accordance with 31 C.F.R. Part 103.
2. To determine whether the institution obtains taxpayer identification numbers from its customers and maintains certain records which might aid federal investigators in tracing and reconstructing loan and deposit transactions.
3. To determine that the institution has installed adequate policies and procedures, audit coverage and employee training programs to ensure that the requirements of 31 C.F.R. part 103 are well known to affected employees and that compliance is adequately monitored from within the organization in compliance with Section 326.8 of FDIC Rules and Regulations.

Financial Recordkeeping and Reporting Regulations, 31 CFR Part 103 Examination Procedures to be used by Examiners of Banks, Thrift Institutions and Credit Unions

General

As a means to detect the incidence of money laundering, for any of a multitude of illicit activities, the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Reporting Act, the Bank Secrecy Act, was enacted October 26, 1970. Among other things, the Act allows the Department of the Treasury (Treasury) to delegate certain compliance responsibilities to other governmental agencies. In an effort to ensure compliance with the Act by bank and nonbank financial institutions, Treasury delegated supervisory authority to the financial institution regulators.

Different methods are available for selecting financial institutions for examination. These include:

- Scheduled examinations - an identified core group of institutions which will be examined on a regular basis.
- Targeting - identifying financial institutions for special investigations based upon analyses of financial or other data, and/or
- Sampling - selecting institutions for examination by randomly sampling a specific population.

Each regulatory agency has its own policy which addresses the examination schedule. The use of the above methods is determined independently by each agency.

Procedural

The following procedures for testing compliance with Financial Recordkeeping and Reporting Regulations (Bank Secrecy Act), 31 CFR 103, are set forth in two separate sections which are progressively extensive in scope. The limited review includes "stops" which provide the examiner with the opportunity to determine whether the examination can be concluded or whether the examiner should continue. Banks targeted for special compliance examinations should receive the expanded review procedures in every case.

The limited review requires the examiner to establish that the examined institution has appropriate operating and auditing standards. In addition, it requires the examiner to conduct a detailed review of the institution's internal audit function and entails the examination of procedures and selected workpapers, reports and responses. The review of auditing methodology and implementation enables the examiner to determine the scope of the examination.

The expanded review sets forth guidelines for the examiner in conducting a review of a sample of actual transactions and related documentation.

Limited Review

The purpose of this section is to determine that the financial institution under examination has established operating standards and audit procedures that ensure compliance with the requirements of the Financial Recordkeeping and Reporting of Currency and Foreign Transactions Reporting Act, 31 CFR 103.

It is recognized that the reporting requirements will not be applicable to certain credit unions which do not conduct cash transactions.

PROCEDURES

1. The examiner should ascertain that the institution has established in writing formal operating procedures to ensure compliance with the regulations. Review the institution's policies and procedures, internal controls and training regarding the Act.
 - a. Reporting -- Operating procedures should set forth the requirements of the regulations and establish compliance guidelines with respect to large cash transactions and exemptions granted to customers.
 - b. Recordkeeping -- The institution's record retention schedule should, at a minimum, include the record retention requirements of the regulations. Furthermore, requirements for the maintenance of lists of customers from whom taxpayer identification numbers have not been obtained should be included.

2. Obtain a copy of the institution's list of exempt customers and review the institution's correspondence with the Internal Revenue Service (IRS) or Department of the Treasury (Treasury) regarding exemptions. Through a review of these documents, determine:
 - a. that the exemption list conforms to the requirements of the regulations (name, address, business, nine digit Federal taxpayer identification number, reason for exemption, etc.) (103.22(f)), and that the exemptions appear reasonable.
 - b. that the institution has, in granting exemptions, adhered to its established policy and has documentation to support the limits established.
 - c. if a denial for a special request for exemption from the reporting requirements has been sent to the institution. If so, ascertain that currency transaction reports are being filed on that customer when a reportable transaction occurs. If the number of denials is large, select a sample to review.
3. The examiner should review the file of reports submitted (Forms 4789 and 4790) and ascertain that they are properly completed and filed as required. Review correspondence from IRS/Treasury to be cognizant of incorrect or incomplete CTRs returned to the institution for corrective action. Follow-up on the disposition of these forms. (See CTR review guidelines at the end of this section.)

4. The examiner should ascertain that the institution has established a program of employee education with regard to the requirements of the regulations.

a. Tellers, through an ongoing training program, should be apprised of the reporting requirements for large cash transactions.

b. Operations personnel should be made aware of the current requirements of the regulations and management should periodically reinforce the importance of compliance.

c. Knowledge of the recordkeeping and reporting requirements of the regulations and operating procedures should be ascertained by interviewing the following: the institution's management, auditors, internal control personnel, tellers, platform personnel, branch managers and personnel in cash vault operations.

Determine if currency transactions are conducted in other areas of the institution such as the trust department, bank dealer department, loan department and international department. If so, ascertain that personnel which handle currency in these departments are knowledgeable of the regulations and operating procedures. Determination of how these individuals became knowledgeable of the regulations should be documented (i.e., initials on a circular, attendance at training sessions, attending seminars, etc.).

Procedure 5 is to be omitted if the institution does not have an internal audit function. In such cases, the examiner should ascertain that a program of management review or self audit has been established which encompasses the requirements of the regulations.

5. The examiner should test the institution's audit procedures and determine that internal audit function provides coverage of the following sections of the regulations.

- a. Reporting -- Coverage of the domestic and international reporting requirements should be found in the procedures and should include a review of actual tellers work and Forms 4789 and 4790.
- b. Recordkeeping -- Coverage of the institution's recordkeeping activities should encompass a test of adherence to the in-house record retention schedule. It is understood that this schedule should meet the requirements of the regulations.
- c. Exemptions -- Coverage should include audit steps necessary to ascertain that the institution is maintaining a list of exempt customers which includes their affiliations as required by the regulations. The examiner should expect the audit procedure to provide a test of the reasonableness of the exemptions granted.
- d. Foreign Accounts -- Coverage in this area should require the auditor to ascertain that the institution has filed Form 90-22.1, if applicable, declaring interest in a foreign financial account.

6. The examiner should review the results of the prior examination report and follow-up on any deficiencies.

7. The examiner should review the totals of cash shipped to and/or received from the Federal Reserve Bank (reported on Form MD-115) or correspondent banks during the last six months. If, in the examiner's judgement, amounts shipped to the Federal Reserve Bank appear high in relation to amounts reported on Form 4789 for the same six month period, the examiner should discuss the findings with management and secure an explanation. Substantiate the explanation and document it in the workpapers.

During this process the examiner may become aware of unusual currency flows from correspondent banks. If this occurs, the examiner should convey such findings to his supervisor. Ultimate dissemination of this information should be made to other examiners or financial institution regulatory agencies.

STOP

At this point, the examiner has to exercise judgment in deciding whether further examination and testing is needed.

- If the examiner is satisfied with the results from the steps above, the findings should be summarized in workpapers, which should include reasons for not extending the examination to include the expanded procedures.

- If, however, it is determined that further work is warranted, the examiner should implement the expanded procedures.

Expanded Procedures

The purpose of the expanded procedures is to conduct on-site examination of teller and other bank operations relative to Financial Recordkeeping and Reporting Regulations. This section sets out procedures and guidelines the examiner should use when conducting test checks for compliance with the regulations. Criteria for selection of branches for detailed review are listed along with general guidelines applicable to either multiple or single office financial institutions.

This phase of the examination should include a minimum of five to ten days of transactions and one to three branch offices. Branch examinations should encompass a review of the work of selected tellers within the days selected. If a significant number of transactions are not reported, the test period may be extended.

The selection of tellers should be governed by the institution's internal procedures. For example, if it is the institution's practice to direct all large currency transactions to specific tellers, the examiner may concentrate on the work of those tellers. In absence of such procedures, or if the procedures are not being followed, the work of all tellers should be reviewed.

- I. Complete Exhibits A and B: A Review of Currency Distribution/Cash Control Center and Branch Operations

- A. Submit Exhibit A, the Currency Distribution and Cash Control Center Letter and its attached Currency Shipment/Distribution Report to the Officer-in-Charge of the Center.

- B. If branches ship directly to a Federal Reserve Bank or a correspondent institution, then a copy of Exhibit A must be submitted to every branch that does ship currency directly to a Federal Reserve or correspondent institution.

- C. Check the records maintained at the Currency distribution/cash control center or the branch to ensure that information in those records is compatible with information provided by the Officer-in-Charge in Exhibit A and the guidelines outlined below. (See Section II)

- D. A Branch Office Letter (Exhibit B) should be personally addressed and sent to every branch.

II. Guidelines for Selection of Branches for On-Site Review

- A. In reviewing the information provided in Exhibits A and B, examiners should use the following criteria to select branches for on-site review:
 - 1. Branch requests for large denomination currency represent the most significant portions of their total branch currency requirements;

2. Branch requests for large denomination currency are significantly greater than average branch requirements;
3. Branch does not ship large denomination currency;
4. Branch reports no exempt list;
5. Branch manager would not sign the statement (Exhibit B); and
6. Branch is characterized by unusual cash transactions with the Cash Control Center, Federal Reserve Bank, or correspondent institution.

- B. In the absence of significant leads, consider selection of branches for on-site review by sampling on a random basis.

III. General Guidelines for On-Site Review

- A. When at the office location, the examiner is to review the work of selected tellers for a specific time period. (See above criteria for selection of tellers. Recommended time period: minimum five days, preferably ten days.) The examiner should take into account the time period allowed for filing Forms 4789 or 4790 and the processing time in selecting the time frame in which the examination will be conducted. The grace period for filing is 15 days, and processing time is 45 days. If the examiner is reviewing transactions for two weeks, or 14 days, the test period should be 60 days or longer prior to the examination date.

- B. Obtain for selected tellers, completed cash proof sheets for as many consecutive dates as are practical. From a day-to-day comparison of total \$50 and \$100 bills, determine specific tellers who experienced a significant (\$10,000) fall-off in these denominations that is not supported by the tellers transactions. Incidents of this type should be reported to the examiner-in-charge as possible evidence of currency washing.

IV. Review Procedures for Selected Tellers and Selected Dates

- A. Obtain and review tellers' documentation for the selected dates.
- B. Note any cash-in or cash-out transactions of more than \$10,000.
- C. In instances where such transactions were discovered, determine the type of transaction and if it was reported. Transactions with non-exempt customers which were not reported should be researched to ascertain if they are truly subject to the regulation.
- D. Review consecutive transactions which total in excess of \$10,000 to ascertain if they were made by or for one depositor.
- E. The following transactions should be checked. While performing the following steps, the examiner should be aware of repetitive unreported currency transactions by customers, a customer, or in an account or group of accounts controlled by one entity. Based on the activity, the customer or account(s) may be targeted for additional

investigation of currency transactions occurring in different time periods.

1. Cashed checks -- Items should be traced to ascertain if they are a cash-out of more than \$10,000 or part of a split transaction. Split transactions which do not involve a cash-out of more than \$10,000 should be eliminated.
2. Cash deposits -- Any transaction involving the receipt of more than \$10,000 cash.
3. Savings withdrawal -- Cash withdrawals of more than \$10,000.
4. Personal money orders or official checks sold -- Any sale for more than \$10,000 cash must be reported, even to exempt customers. Be aware of consecutive items sold. A check of paid items could reveal that they were sold to the same customer.
5. Savings bonds sold or cashed -- Transactions involving more than \$10,000 cash.

6. Official checks cashed -- Cash-outs of more than \$10,000.
 7. Loans -- Note teller receipt or pay-out of more than \$10,000 cash.
 8. Securities sold or purchased -- If the institution acts as agent for an individual and the transactions involve more than \$10,000.
 9. Fiduciary powers -- if the institution's trust department is conducting currency transactions for customers which exceed \$10,000.
 10. Wire department.-- wire transfer and telex logs to determine cash transactions exceeding \$10,000.
 11. Other areas -- investigate other areas of the institution where currency transactions exceeding \$10,000 may be occurring.
- F. The examiner should obtain and review the list of exempt customers. Lists which appear inordinately long or which contain names of customers the size or nature of whose business would not ordinarily merit exempt status should be discussed with management of the institution under examination. If after discussion with management the examiner feels that criticism may still be warranted, the matter should be referred to the examiner's supervisor or district office.
- V. List Exceptions for Possible Inclusion in the Report of Examination/Supervisory Letter.

A. Determine the severity of noncompliance with the Act and management's attitude toward compliance. Violations and poor internal controls may warrant a civil or criminal referral to the Department of the Treasury. Report comments should not include references regarding the willfulness of a violation or act on the part of the institution or its employees.

GUIDELINES FOR REVIEWING RETAINED COPIES OF
CURRENCY TRANSACTION REPORTS FILED BY
FINANCIAL INSTITUTIONS

Background

Examiners performing examinations of financial institutions for compliance with the provisions of 31 CFR Part 103 are required to inspect retained copies of CTRs for accuracy and completeness. Personnel of financial institutions should also be instructed by examiners in the proper method of completing and filing the form. The IRS, in processing the forms, edits all CTRs filed for accuracy and completeness. When critical information is incomplete, illegible or is not provided, IRS corresponds with the financial institution to obtain the information.

Purpose

The purpose of these guidelines is to establish uniform examination procedures for the various financial institution supervisory agencies. The guidelines provide specific items of concern in reviewing CTRs, instructing financial institution personnel, and requiring amended or corrected reports to be filed.

General Procedures

- Use the instructions on the reverse side of the CTR to provide guidance in proper completion of the form.

- Encourage financial institutions to type or legibly print forms.

- Ensure that CTR correspondence from IRS has been correctly answered. Review all CTR correspondence, whether or not associated with any particular CTR filings.

The IRS may correspond with the financial institution when one or more of the critical information elements as specified in these guidelines are incomplete, illegible, or not provided. The correspondence is sent to the officer in charge of the financial institution at the address location indicated in Part V of the CTR. Ensure that responses are made timely (within 10 days).

- Request copies of any correspondence with IRS relating to incorrect or incomplete CTRs.
- Require an amended or corrected form to be filed as follows:
 - If the form was not corrected as a result of correspondence from the IRS.
 - If (in the absence of IRS correspondence) the form does not adequately provide critical information as indicated in the review guidelines.
- Amended Form Instruction

- On a copy of the CTR originally filed, circle in red the incorrect, illegible or missing information.

- On a clean CTR, enter "AMENDED" or "CORRECTED" at the top margin above the Currency Transaction Report legend.

- Enter only the correct or amended information on the clean form in the appropriate line item or box.

- Sign and date the amended or corrected form.

- Staple the amended or corrected form on top of the copy of the originally filed form.

- Mail to the IRS Data Center, P. O. Box 32621, Detroit, MI 48232 ATTN:
CTR Processing.

CRITICAL INFORMATION ELEMENTS ON THE CURRENCY TRANSACTION REPORT

The IRS Data Center may correspond with a financial institution to obtain correct information when the following data elements are illegible, incorrect or not provided on the CTR.

Part I.

- If none of the items in Part I are completed and there is no indication that the transaction was a night deposit, mail deposit/shipment or a multiple transaction.
- If name, address, city, state or zip code is incomplete, illegible or not provided.
- If a nine-digit social security number is not provided, is incomplete or illegible and the individual is conducting the transaction for himself or herself. (A SSN is not required if the individual is conducting the transaction for another person).
- If the method of verifying identification is illegible, incomplete or not provided. Statements such as "known customer" or "known to us" are not sufficient. Financial institution should obtain the required data on known customers from account records, signature cards, etc.
- If the Part I person is other than an individual. (Exception: Names of armored car service companies are acceptable).

Part II.

- If name, and address is incomplete, illegible or not provided, except when the individual in Part I is conducting the transaction for himself or herself.
- If a nine-digit TIN (employer's identification number or social security number) is not provided, or is illegible. The box for TIN should contain the word "NONE" if the customer is a foreign person who has no TIN.

Part III.

- If the nature of the transaction in Part IV effects a customer's account (e.g. deposit, withdrawal) and account number is illegible or not provided.

Part IV.

- If an appropriate box in item 1 is not checked.
- If item 2, 3, or 4 is not completed or is illegible.
- If the nature of the transaction is a check purchased or check cashed and the information in item 6 is incomplete, illegible or not provided.

- If the TIN (EIN or SSN) is not nine digits or is otherwise incorrect or not provided.
- Central compliance office addresses are not acceptable.

Note: An amended form requiring the change of only this element should not be submitted. However, if an amended form is required for one of the other critical elements, this element should also be corrected.

CURRENCY DISTRIBUTION AND CASH CONTROL CENTER LETTER

_____ Date: _____
 _____ Officer-in-Charge Branch#: _____
 Currency Distribution/Cash Control Center
 _____ Location

Dear Sir/Madam:

In order to facilitate our review for compliance with Financial Recordkeeping and Reporting Regulations, please submit the following information. Supporting source records should be made available for review upon request.

 Examiner

Please provide, according to the attached format, the following information for the period _____ to _____, inclusive.

- 1) For branches which ship and receive currency through a central currency distribution center within the institution please provide:
 - a) A list of all currency shipments between the distribution center and the Federal Reserve Bank or correspondent institution;
 - b) A list, by branch, of all currency shipments between the distribution center and branches;
 - c) A list of currency shipments between branches;
 - d) A list of branches which have shown a significant increase in the use of large bills during the past twelve months, either as a portion of their total shipment of currency or in comparison to other branches.
- 2) For branches which transact (ship and/or receive currency) with the Federal Reserve Bank or correspondent institution:
 - a) A list of all currency transactions between the branch and the Federal Reserve Bank or correspondent institution;
 - b) A list of all currency transactions with other branches.
- 3) Copies of all correspondence with the Department of the Treasury or the Internal Revenue Service regarding exemption lists, requests for special exemptions and incorrectly filed CTRs.

Signed _____
 (Title and Position)

CURRENCY SHIPMENT/DISTRIBUTION REPORT

from _____ to _____

Officer-in-Charge _____

Institution Name _____

Location _____

CURRENCY RECEIVED

CURRENCY SHIPPED

Date	Received from	Total amount of shipment	Total amount of large (\$50's & \$100's bills)	Date	Shipped to	Total amount of shipment	Total amount of large (\$50's & \$100's bills)

(Signed) _____
(Title and Position)

Date

BRANCH OFFICE LETTER

Date: _____

_____, Officer-in-Charge

_____, (Office)

_____, (Location)

Dear Sir/Madam:

To facilitate our examination of compliance with Financial Recordkeeping and Reporting Regulations under Public Law 91-508, please furnish the examiner-in-charge with the information listed below.

Examiner

- 1) A copy of your list of customers who normally have currency transactions over \$10,000 (exempt customers).
- 2) Describe how currency transactions over \$10,000 for customers are recorded and reported by individual tellers at your office.
- 3) Describe the records used at your office to document, by denomination, currency transfers between tellers, including transfer from and to vault cash.
- 4) Name of person in your office who is responsible for filing Currency Transaction Reports (Form 4789).
- 5) Indicate where copies of all Currency Transaction Reports (Form 4789) prepared by your office are maintained.
- 6) A list of transactions for which Currency Transaction Reports (Form 4789) are due to be filed but have not yet been submitted by your office.
- 7) If periodic reviews are conducted by office management of exempt customers to ensure that their status has not changed under Recordkeeping and Reporting Regulations, please make supporting documentation available, including:

- a) dates of last two reviews;
- b) description of work reviewed;
- c) names of individuals who conducted the review and their findings.

Currency Transaction Reports (Form 4789) have been completed for all required transactions. Lists of customers who normally have currency transactions over \$10,000 (exempt customers) are currently maintained.

(Signed) _____
Office Manager