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STATEMENT ON

GAO REPORT ON ENFORCEMENT OF THE BANK SECRECY ACT

PRESENTED TO

SUBCOMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATION
COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

BY

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10:00 a.m.
Thursday, July 23, 1981

Room 2128 Rayburn House Office Building

Mr. Chairman, I am pleased to be here today to testify in response to the findings of the General Accounting Office on the Bank Secrecy Act reporting requirements.

The bank regulatory agencies were given an opportunity to provide written comments on an earlier version of the GAO's report, and I will reiterate some of those comments at this time.

Deficiencies in the Regulations Prior to July 1980

The GAO has concluded that the examination procedures and techniques employed in the past by bank regulatory agencies were generally inadequate to detect nonreporting of currency transactions, that procedures were insufficiently comprehensive to ensure substantial compliance by the industry.

We would point out as we have in earlier testimony before this subcommittee and in our written comments to GAO that until June of 1980--when the Treasury adopted amendments to the currency reporting regulations which closed the loopholes and significantly tightened the rules--the reporting requirements were very difficult to enforce. Under the previous regulations financial institutions could legally evade the spirit of the Bank Secrecy Act if they chose to do so, and our examiners could do little about it.

For example, (1) the exempt customer provisions were so loosely worded that almost any customer of the bank (who made large currency deposits or withdrawals with some regularity) could be granted an exemption, (2) banks were not required to retain copies of Currency Transaction Reports, and

(3) the rules did not require banks to maintain a list of their exempt customers, merely the ability to generate a list if requested by the Secretary of the Treasury. Our examiners did not have the legal authority to require that such a list be maintained.

The amendments adopted in June of last year closed these loopholes and, we believe, sufficiently tightened the rules to enable examiners to identify undisputed violations of the reporting regulations. The amended rules will resolve many of the practical problems encountered by our examiners which have contributed to what may have been perceived as ineffective enforcement.

New Compliance Examination Procedures

In April of this year, FDIC implemented new examination procedures for determining compliance with the Bank Secrecy Act regulations. The procedures are now in place nationwide and were uniformly adopted by the FDIC, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System.

The new procedures consist of a two-stage examination approach designed to identify banks which require a more intensive review and to avoid imposing burdens of full-scope examinations where they are not warranted.

The first stage, or module as it is called, requires the examiner to establish that the institution has appropriate operating and auditing standards. In addition, the module requires the examiner to conduct a detailed review of the institution's internal audit function and to check procedures and selected workpapers, reports and responses. This review of auditing methodology and implementation should help the examiner to decide whether to conclude the review at this point or examine further.

The second module involves an intensive examination of teller operations for compliance with the financial recordkeeping and reporting regulations. It sets out procedures and guidelines the examiner should use in checking actual transactions and related documentation. Criteria for selection of branches for such detailed review are provided along with general guidelines that apply to examination of multiple and single-office financial institutions. Under this second module the examiner reviews a minimum of five, and preferably ten or more, days of transactions at one to three branch offices.

The procedures have been fully integrated into FDIC's regular compliance examination program which also covers compliance with federal consumer laws and the Bank Protection Act. The compliance examination program is administered by a single review examiner in each of our regional offices who is responsible for instituting follow-up actions with banks which have been cited for violations by the compliance examiner. This follow-up action can take

various forms, from a mere phone call or letter asking for bank management's affirmative intentions to correct deficiencies cited in our report to initiation of formal administrative actions to correct the situation.

Training and Orientation

Compliance review examiners from each region, those responsible for administering the compliance program, were given an orientation to the new examination procedures prior to their implementation. Examiners attending FDIC's compliance school are also trained in the new methods and procedures--approximately 200 examiners and assistants are enrolled each year. Comprehensive guidelines supporting the new procedures were developed with the input of examiners who participated in the special investigations under project "Greenback", a multi-agency effort to identify and investigate Florida banks handling large amounts of surplus currency. The guidelines have been issued to all examiners and assistant examiners.

Examination Resources

Since the new procedures have only recently been introduced, we have not collected enough data to comprehensively assess their performance vis-a-vis previous procedures. It is our opinion, however, and this is borne out by conversations with Review Examiners in the regions who are closer to the day-to-day situation, that the new concept is working very well.

Senior level bank managers are becoming more aware of their responsibilities under the bank secrecy rules, and we expect compliance to improve if for no other reason than bank managers know our examiners are now taking a closer look.

At this time, the FDIC has no plans to discontinue on-site examination for compliance with bank secrecy rules. Our compliance program is distinct and separate from our safety and soundness examination program and will continue to involve periodic on-site examinations.

GAO's Recommendation for 10% Random Selection

The GAO has recommended that the agencies make comprehensive examinations (i.e. perform both the first and second modules) in a random selection of 10% of banks in an examination cycle.

We oppose this suggestion because it would lead to an inefficient allocation of limited examination resources. For example, we know that the vast majority of small rural banks do not handle many large currency transactions. Some of these banks, however, would inevitably be selected for comprehensive review on a random basis. It seems futile to expend examiner time reviewing several days' records of transactions in banks where there are no indications that large currency transactions have been processed. We believe that with our new

examination procedures coupled with our examiners' experience and talents, we will detect any unusual cash flows or patterns in these small banks and are confident that a representative number of comprehensive examinations will be initiated in all areas of the country as a result of the selective criteria built into the two-module examination procedures.

We believe that 10% represents a reasonable target for comprehensive examination of banks in the first examination cycle. Until experience proves otherwise, we intend to concentrate our selective examination efforts in geographical areas where problems are apparent, (e.g., South Florida, the border areas of Texas, Southern California, etc.). Banks selected for comprehensive treatment in targeted geographical areas of course would be in addition to those banks selected through regular two-module procedures.

We believe that selecting banks for comprehensive review from criteria derived from actual experience, rather than random selection, will provide for better regulation in the long run and provide the examining agencies with the flexibility needed to efficiently allocate their limited resources.

Cooperation with Treasury and Law Enforcement Agencies

The FDIC has been fully cooperating with the Treasury Department in its enforcement of the Bank Secrecy Act. Project "Greenback" is one example of our cooperation. At the request and direction of the Treasury, the FDIC

completed three special investigations of state nonmember banks exhibiting unusual currency flows. Another state nonmember bank was later identified from the cash shipment records of one of the selected national banks, and an FDIC review ensued.

Serious problems with large currency transactions were uncovered at one of the four state nonmember banks, and the situation is currently under investigation by a federal grand jury. Our investigation report of at least one of the other banks has been referred by Treasury to IRS for possible criminal investigation.

We have also cooperated directly with the Internal Revenue Service. That agency's Criminal Division has been authorized by Treasury to initiate criminal investigations relating to large currency transactions violations in 13 state nonmember banks; 7 in Florida, 5 in Texas and 1 in Oklahoma. In these situations, we do not conduct regular compliance examinations until IRS has completed its investigation but provide examiners to assist the investigators when requested. Currently we are providing such assistance in two cases in Florida and one case in Texas. We will continue to provide such assistance wherever and whenever we can to the extent that such demands do not seriously impede other priority commitments.

We have recently established communications with IRS officials in the New York and Chicago areas and are exploring ways to improve cooperation and exchange of

information at local levels. We believe that initiatives of this type will be expanded to other areas of the country and will further strengthen enforcement of the bank secrecy rules.

Recent Developments

In a cooperative effort to make further improvements in the currency transactions reporting system, FDIC and the other agencies agreed with Treasury to facilitate return of incomplete or inaccurate Forms 4789 filed by banks with the IRS Reports Analysis Unit in Ogden, Utah. We have also agreed to notify the banks under our supervision that IRS will no longer accept currency reports on outdated forms and are in process of distributing a bank letter to this effect which includes a copy of the revised Form 4789. The form is suitable for photocopying by those banks which do not have a ready supply of up-to-date forms.

Summary

In summary, many of the deficiencies included in GAO's report have been eliminated or corrected. The FDIC is committed to improving the compliance monitoring and enforcement of these rules and has taken the necessary steps to fulfill this commitment. In so doing, many of the GAO's recommendations have already been adopted.

While our experience with the new examination program is too limited at this time to accurately project its increased cost or assess its merits, we are certain that examination hours and FDIC's costs dedicated to bank secrecy compliance will increase in the current as well as future examination cycles. Because of the tightened reporting requirements (more reports are now required and more customers are covered by the regulations) compliance costs to the banking industry will also be increased; perhaps significantly.

We trust that over the next two or three years our efforts will at least assist in providing a better framework to accurately assess the benefits and usefulness of these reports in containing criminal activity in relation to the overall costs of the regulatory program. It is in this spirit that we support GAO's recommendation that Congress amend the Bank Secrecy Act by inserting a provision to require reauthorization of the reporting requirements in 1984.