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STATEMENT ON

EFFECTIVENESS OF THE BANK SECRECY ACT,
ITS RELATIONSHIP WITH FINANCIAL INVESTIGATIONS AND PROSECUTIONS.

PRESENTED TO the House

SELECT COMMITTEE ON NARCOTICS ABUSE AND CONTROL
~~U.S.~~ HOUSE OF REPRESENTATIVES

BY

JESSE G. SNYDER
CHIEF, INTELLIGENCE SECTION
DIVISION OF BANK SUPERVISION
FEDERAL DEPOSIT INSURANCE CORPORATION

1:00 P.M
FRIDAY, OCTOBER 9, 1981

FORT LAUDERDALE CITY HALL
FORT LAUDERDALE, FLORIDA

Mr. Chairman, I am pleased to be here today on behalf of the Federal Deposit Insurance Corporation (FDIC) to discuss the progress which has been made in improving the effectiveness of the currency transaction reporting mechanism prescribed by the Bank Secrecy Act and to explain the FDIC's role in assisting federal law enforcement agencies in their efforts to investigate and prosecute drug traffickers.

The FDIC insures approximately 14,800 of our nation's commercial and mutual savings banks and is responsible for examination and supervision of approximately 9,300 of these institutions which are state-chartered and not members of the Federal Reserve System. The FDIC has been delegated the responsibility to assure compliance with Bank Secrecy Act rules by the banks it supervises.

Loopholes Tightened by June 1980 Amendments

Until June 1980 when the Treasury Department adopted amendments to the currency reporting regulations which closed 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 (CTR's), and (3) the rules did not require banks to maintain lists of their exempt customers, merely the ability to generate lists if requested by the Secretary of the Treasury. Our examiners did not have the legal authority to require that such lists 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 have resolved many of the practical problems previously encountered by our examiners.

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, consisting of a two-stage examination approach, are designed to identify banks which require a more intensive review and to avoid imposing burdens of full-scope examination 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 helps the examiner 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 currency reporting requirements. 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. Administration of the compliance examination program is centralized in each of our regional offices, where responsibility is lodged for instituting follow-up actions with banks which have been cited for violations by compliance examiners. 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 reports to initiation of formal administrative actions to correct the situation.

Examination and Enforcement Experience Under the New Procedures

Our examination results to date under the new procedures bear out earlier assumptions that the incidence of noncompliance with the currency reporting regulations is more prevalent in certain sections of the country. For example, of the 138 Module II or full scope examinations conducted since April of this year, 121 were conducted in our Atlanta, Chicago, Dallas and San Francisco Regions. Also, we expect examinations to reflect greater than average noncompliance in our New York Region (which includes Puerto Rico) as the new examination program progresses. As of September 30, approximately 1,100 insured state nonmember banks had been examined for Compliance with 31 C.F.R. 103 under the new procedures. The Module II or full-scope examination was employed in about 13% of these banks. Based on these examination results our Regional Offices initiated one cease and desist order and 57 Memoranda of Understanding. A cease and desist order must be approved by the FDIC's Board of Directors and is a more formal enforcement action. Memoranda of Understanding are written agreements entered into by the FDIC's Regional Director and the boards of directors of offending banks. Failure to abide by these understandings on the parts of banks may lead to the issuance of cease and desist orders.

Our most intense enforcement efforts have been concentrated in the areas where problems are evident. For example, in the Atlanta Region, which encompasses the states of Florida, Georgia and Alabama, 36% of all Bank Secrecy examinations were carried to the Module II level. One Cease and Desist Order relating to Bank Secrecy Act problems is now in effect and 43 Memoranda of Understanding have been initiated. In addition to our formal efforts to assure compliance, the Atlanta Regional Office staff has instituted a program to follow up personally with bank managers on all violations of failure to file CTR's which are cited during examinations. Our Atlanta staff has also conducted seminars for bankers which include detailed coverage of the currency reporting requirements and demonstrations of how to properly complete CTR's.

Through direct mail notices and reminders, personal contacts, and our regulatory seminars, coupled with publicity surrounding criminal law enforcement activities, bankers have become much more aware of their responsibilities under the bank secrecy rules. Bankers have also been put on notice that willful disregard for the regulations will be forcefully dealt with and might result in civil money penalties or criminal sanctions. As a result of these efforts, we expect compliance to continue to improve significantly.

FDIC Assistance to the Treasury and Law Enforcement Agencies

The FDIC has been fully cooperating with the Treasury Department in its enforcement of the Bank Secrecy Act. Violations of 31 C.F.R. 103 found in the banks we supervise are reported to the Treasury on a quarterly basis. We provide detailed information concerning specific situations to Treasury upon request. Project "Greenback" is another example of our cooperation. At the request and direction of the Treasury, the FDIC recently 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 banks, and the situation is currently under investigation by a federal grand jury. Our investigation report on 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 18 state nonmember banks; nine in Florida, five in Texas, three in New Jersey and one each in Oklahoma and Connecticut. One investigation in Florida and one in Texas have since been completed. In these situations, we do not conduct a regular compliance examination until the IRS has completed its investigation but provide examiners to assist the investigators when requested. Currently we are providing such assistance in Florida and 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. In fact, the Director of our Division of Bank Supervision has just issued guidelines to our Regional Offices covering our providing examiner assistance to law enforcement authorities. Our policy of maximum cooperation is clearly stated in the directive, and the new guidelines should make it easier for Regional Directors to authorize examiners to assist law enforcement officials.

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 regarding violations at local levels. The legal hurdles have almost all been cleared, and we expect to be able to directly exchange information by year end. 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 Act rules.

In a cooperative effort to make further improvements in the currency transactions reporting system, FDIC and the other bank regulatory agencies also agreed with Treasury to facilitate return and correction of incomplete or inaccurate Forms 4789 which banks had filed with the IRS Reports Analysis Unit in Ogden, Utah. In addition to direct contact with the specific banks involved we have notified all banks under our supervision that IRS will no longer accept outdated or inaccurate reports and provided a copy of the revised Form 4789 suitable for reproduction by those banks which may not have a ready supply of up-to-date forms.

Legal Barriers to Information Interchange

The Right to Financial Privacy Act (RFPA) which was passed by Congress in 1978 to protect bank customer records from unwarranted scrutiny by government authorities makes it difficult for bank regulatory agencies to transfer some information gathered during bank examinations to law enforcement agencies. In fact, unless the information clearly points to a violation of law, it may not be legally passed on at all.

An example is probably the best way to explain how the RFPA serves as a barrier to the flow of information between federal agencies. Assume that during an examination an FDIC examiner discovers inordinate amounts of cash are being channeled through an insured bank by those he may suspect to be drug traffickers. The cash transactions, however, flow through the accounts of "ABC Grocers", a proprietorship. The grocery store accounts can be exempted from the reporting requirements and if they are, the transactions are not required to be reported to the IRS on Form 4789. According to most interpretations of the RFPA, information about this situation <u>cannot</u> be transferred to the IRS because a violation of law is not evident. In other, less extreme cases where some violation of federal law is apparent but where Title 31 violations are not evident, the FDIC can, under the RFPA, notify the IRS or Treasury but must also notify the customer within 14 days that information from his account was transferred to another federal agency for a legitimate law enforcement purpose.

Another impediment which may not be readily apparent is that the RFPA prescribes penalties for individual employees of a federal agency who improperly transfer customer information. Even where an employee is instructed by a supervisor to disclose information and the disclosure is later considered to violate the RFPA, the employee could conceivably be penalized. Thus, some examiners may be reluctant to initiate a referral of information to or discuss it with another federal agency because they do not feel comfortable with the intricacies of the statute.

These barriers are not insurmountable and we have worked hard to ensure that information which may be important to law enforcement officials gets to them in a timely manner and without violating the privacy laws. Information flowing in the other direction, i.e., from law enforcement agencies to the bank regulators, appears to be even more inhibited by federal restrictons. For instance, if Treasury could identify suspected banks or provide other minimal intelligence to our Regional Directors, we could intensify examination efforts in those areas and communicate our findings to local IRS officials. Apparently, because of the secrecy restrictions of the Federal Grand Jury process, and perhaps due to limitations imposed by the Privacy Act of 1974, such information is seldom communicated to us.

Conclusion

In summary, significant progress is being made in several important areas which will ultimately insure a higher level of compliance with the currency reporting requirements by the banking industry. First, the June 1980 amendments closed loopholes which may have allowed some banks to ignore the spirit of the Bank Secrecy Act. Second, the new examination procedures implemented by the bank regulatory agencies are very comprehensive and should foster greater compliancce. Third, much progress has been made in improving cooperation among law enforcement agencies and bank regulators; particulary in exchanging information at local levels. Fourth, our enforcement efforts are yielding results.

The FDIC has been relatively successful in bringing about compliance through its use of Memoranda of Understanding between FDIC and banks' board of directors and is prepared to initiate formal administrative action where necessary. Strategic use of Treasury's civil money penalty powers, an option that has not yet been sufficiently employed, could be effective in bringing about compliance in specific, egregious situations. Such penalties, coupled with possible criminal sanctions, may have additional deterrence value.

As further progess is made in this cooperative effort to effectively curb illegal activities, we are becoming more confident that more of the related cash transactions will be reported and that better audit trails will exist to track the movements of large amounts of cash through the banking system. Our efforts to improve compliance coupled with increased efforts by law enforcement authorities should lead to a greater number of successful prosecutions of criminal drug traffickers. Thank you.