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FEDERAL DEPOSIT INSURANCE
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STATEMENT ON

FDIC OPERATIONS CONCERNING THE CURRENCY AND FOREIGN TRANSACTIONS REPORTING ACT

PRESENTED TO

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

BY

IRVINE H. SPRAGUE, CHAIRMAN
FEDERAL DEPOSIT INSURANCE CORPORATION

9:30 a.m.
Wednesday, December 3, 1980

Room 2128 Rayburn House Office Building

Mr. Chairman, I am pleased to be here today in response to your request for testimony from the Federal Deposit Insurance Corporation on its operations relating to the Bank Secrecy Act and the Currency and Foreign Transactions Reporting Act.

I will include a progress report on our efforts to improve our compliance activities in line with recommendations of the General Accounting Office.

The function of the FDIC is to insure deposits and promote the safety and soundness of the banking system. We are concerned with any threat to safety and soundness, including threats that can be posed by drug-related money. The Bank Secrecy Act of 1970 is intended to generate records of the movements of large amounts of cash so that the appropriate law enforcement agencies will have another tool in their effort to combat drug trafficking, tax evasion and other offenses.

The responsibilities imposed on the FDIC under the Bank Secrecy Act are related to our supervision of State nonmember banks. As part of our compliance examination activities, we regularly examine such banks to ensure that they are complying with requirements of the Act and with the Treasury Department regulations. We have revised our compliance standards to conform to the amendments to the Treasury regulations that became effective July 7.

We have also been working with the other members of the Federal Financial Institutions Examination Council (FFIEC) to

develop uniform, cost-efficient compliance examination procedures to improve our joint enforcement of the law and regulations. The Council's Task Force on supervision has developed proposed new procedures. The FDIC has begun testing them in four regions. I will discuss this project in detail later in my remarks. At this point, a review of existing law and FDIC enforcement activities may be helpful.

Existing Law

The Bank Secrecy Act (Pub. L. 91-508), which includes the Currency and Foreign Transactions Reporting Act, requires that certain transactions in United States currency be reported to the Department of the Treasury. Pub. L. 91-508 amends the Federal Deposit Insurance Act to require insured banks to maintain records found by the Secretary of the Treasury to have a high degree of usefulness in criminal, tax or regulatory investigations or proceedings. Treasury Department regulations implementing this law require financial institutions to report to Treasury currency transactions of more than \$10,000 except for those with other financial institutions or with established customers where the bank may reasonably conclude that the transactions are commensurate with the customary conduct of the customer's business. The regulations also require reports of transportation of currency or monetary instruments exceeding \$5,000 into or out of the United States.

Records required by the regulations to be retained by banks include records of extensions of credit in excess of \$5,000 (unless secured by an interest in real property), and records of requests received by or given to a financial institution resulting in transfers of funds, currency, or other monetary instruments of more than \$10,000 to a person outside the United States. Banks must also maintain taxpayer identification numbers of depositors, original or microfilm copies of documents granting signature authority, deposit statements, checks, drafts and money orders (with certain prescribed exceptions), records of receipts of currency in excess of \$10,000 unless received through a domestic financial institution, and records which would be needed to reconstruct a demand deposit account and to trace a check in excess of \$100 deposited in such account through its domestic processing system. The regulations prescribe the maintenance by banks of additional similar records of banking transactions.

The Bank Secrecy Act provides for civil and criminal penalties, authorizes the Secretary to apply for injunctions or search warrants, and provides for delegation of responsibility to assure compliance with the requirements of the law to the appropriate supervisory agencies.

FDIC Activities

Our major vehicle for carrying out the responsibilities delegated to the FDIC is our regular compliance examination procedure. Our review monitors bank compliance with the Bank Secrecy Act, bank handling of currency, and bank internal controls designed to prevent employee misconduct or bank abuse.

In the course of a compliance examination, the examiner interviews appropriate bank officers and employees and reviews bank policies and procedures, records, audit reports, and other documentation. The examiner uses a checklist and guidelines developed by the Treasury Department in consultation with the financial regulators after passage of the Bank Secrecy Act. We are cooperating with the Treasury Department in its efforts to devise more effective means of reviewing bank compliance with this Act.

All violations discovered by the FDIC are reported to the Treasury Department, either quarterly or sooner if an individual case seems to warrant. We also provide the Treasury Department a quarterly list of all banks that our examinations reveal have failed to report transactions covered by the Act, or have failed to maintain a list of exempted customers.

FDIC headquarters review of 2,800 compliance examinations for the first three quarters of 1980 revealed that 3.2 percent of these banks had failed on at least one occasion to file a

Currency Transaction Report on a transaction in excess of \$10,000. Our review also showed that some 3.3 percent of the banks we examined had failed to maintain a list of customers whose transactions had been exempted from the reporting requirement.

In our experience, violations usually have proved to be inadvertent and have resulted from misunderstanding, improper training, human error, or operational shortcomings on the part of banks. In most situations involving violations that we report to Treasury, we are able to make corrections through the examination process by bringing such matters to the attention of bank management.

There were no occasions when we found the need to recommend civil penalties for violation of the Bank Secrecy Act. If we uncover any indication of possible criminal activity in a compliance examination of a bank, it is our policy to report our findings to the appropriate law enforcement authorities.

There have been a few cases in which violations have warranted inclusion in FDIC cease-and-desist orders. We also have referred to Treasury at least two specific situations, prior to 1979, which appeared to indicate willful attempts to circumvent requirements.

The Treasury, in its follow up on apparent violations, usually deals directly with the bank. In some instances, Treasury may consult with the FDIC.

New Compliance Examination Procedures

The Treasury Department in its July 7 amendment made several changes to the financial recordkeeping and reporting regulation. The amended regulation (1) requires a financial institution to file a report within 15 days after a transaction occurs; (2) requires the institution to retain a copy of the report for five years; (3) requires the institution to record more specific information concerning a customer's identity; (4) further limits a bank's authority to exempt transactions from the reporting requirement; and (5) requires a bank to make and retain a record of the authorization of such an exemption. The FDIC by bank letter of June 17 notified banks under its supervisory jurisdiction of the changes.

The FDIC has been participating in the effort of the FFIEC Task Force on Supervision to create uniform, cost-efficient procedures for checking bank compliance with the amended regulations. This is in line with the General Accounting Office recommendations in its October 1 testimony before your Subcommittee.

The Task Force considered alternative approaches in this area and agreed on a set of proposed procedures for testing by member agencies. The FDIC tests are now under way in 20 banks -- five in each of four Regions: San Francisco, Madison, Minneapolis and Atlanta. After the testing period ends December 17, 1980, the Task Force will evaluate the results and make its recommendations to the Council.

The test procedures consist of a two-tier 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 tier, 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 on-site examination of teller operations for compliance with the financial recordkeeping and reporting regulations. Module II 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 Module II the examiner reviews a minimum of five, and preferably ten or more, days of transactions at one to three branch offices. The review encompasses the work of all tellers.

We are submitting a copy of the instructions for the Module I and II procedures.

The two-tier approach came about as a result of FDIC's cooperation with the Treasury Department, the General Accounting Office and other involved parties in an effort to devise more effective means of reviewing bank compliance with the law and regulations. Last Spring, at the Treasury Department's request, we had tested the use of more extensive examination procedures in our Atlanta, Dallas, New York and San Francisco Regions. Those procedures involved a more extensive check of bank records of currency transactions and required more auditing on the part of the examiner. The procedures were a modified version of those developed by the Federal Reserve Bank of New York.

The test results showed that the more extensive procedures required almost ten times as many hours by FDIC examiners on financial recordkeeping and reporting regulations than previously. The bulk of this tenfold increase in examination hours was spent reviewing actual large transactions to determine if they were being reported properly.

This in-depth review of transactions, however, did not uncover significant numbers of violations. In all test cases, only isolated failures to file currency reports were noted. In no bank in which the full-scope procedures were tested were serious weaknesses in internal procedures or willful noncompliance on the part of bank employees discovered by our examiners.

Officials of the FDIC, the Office of the Comptroller of the Currency and the Federal Reserve System involved with that test project concluded that this extensive and time-consuming review of transactions could be reserved for selected banks. Wholesale implementation of the tested procedures would have been unduly burdensome to banks and would have represented an inefficient allocation of examiner resources.

The FDIC and other members of the Task Force then developed another examination plan for general use. This proposal included three related modules that were progressively extensive in scope. In October, the proposal was reviewed by officials of the General Accounting Office, the Treasury Department, the Comptroller of the Currency, the Federal Reserve, the Senate Committee on Banking, Housing and Urban Affairs, and by your Committee. The consensus, reflected in the GAO testimony, was that the first module of that plan was cursory and would not indicate whether further review should be undertaken. In response, the FFIEC Task Force redesigned the procedures, reducing them to two modules and expanding the scope of the first module. These are the procedures now undergoing testing.

Other Cooperative Efforts

Besides the examination procedures, we have also cooperated with other Treasury Department efforts to deal with the drug-money problem. We have participated with Treasury and our

partner Federal bank regulators regulators in a study of the flow of currency among Florida banks. The study involved a review of records of banks which appear to show a significant difference between amounts reported on currency transaction reports and amounts deposited in the Federal Reserve Bank.

In late 1979, FDIC representatives from four Florida field offices and the Atlanta Regional Office attended a training session on the monitoring of currency flows. The session was conducted in Miami by the Treasury Department and the Federal Reserve.

The FDIC also is participating currently in the Treasury Department's study of the use of large denomination currency.

On the State level, the FDIC provides assistance to State bank regulatory agencies in dealing with bank problems stemming from drug-related money. We follow a practice of cooperation and assistance with State bank regulatory agencies on all examination matters. It is FDIC policy to maintain open communications lines and cultivate good working relationships with those agencies. It is our long-standing policy to report any indication of illicit activities to State authorities.

Other FDIC Efforts

The FDIC has taken other initiatives to encourage compliance with the Act.

Our June 17 bank letter informing banks of changes in financial recordkeeping and reporting requirements also warned against laxity in internal bank procedure which may facilitate illegal activities. The letter put banks on notice that the FDIC would diligently enforce compliance with the new Treasury Department regulations.

On another front, we have broadened and improved our program of background checks on prospective owners of banks. It has been our longstanding practice to check on backgrounds of the organizers of new banks. This is a part of the application process for insurance. However, until enactment of the Change in Bank Control Act of 1978, there was no requirement that the FDIC be notified of proposed acquisitions of existing banks. We often had no opportunity to check in advance on the backgrounds of acquiring individuals. Since enactment, however, we have been able to establish a strengthened and more comprehensive program of background checks both for buyers of existing banks and for organizers of new banks.

We now routinely check the backgrounds of U.S. citizens through the Records Management and Identification Divisions of the FBI. This technique has been reliable in determining whether an individual has properly disclosed past criminal behavior or associations.

The verification of backgrounds of noncitizens has presented a more difficult problem. Generally, an inquiry to the FBI about a noncitizen would yield information only if the individual had been previously charged, convicted, investigated or criminally associated in the United States. Information about a noncitizen's background in his home country or any other country often must be gathered from other sources. Where appropriate, the FDIC consults with the following agencies regarding a noncitizen who proposes to organize or acquire control of banks we supervise:

- FBI
- Drug Enforcement Administration
- U.S. Embassy in the individual's home country
- U.S. International Development Cooperation Agency
(Department of State)
- Interpol (Department of Justice)
- U.S. Customs Service

More recently, we have explored the possibility of making some background checks through the Central Intelligence Agency.

Summary

The law seeks to strike a fine balance between the rights of bank customers whose funds are obtained through legitimate means

and the need to apprehend perpetrators of criminal activity, including drug trafficking. We strive to carry out the law in the same spirit -- to use the tools available to us to detect any problem and to deal with it effectively without encroaching on the rights of innocent persons or unnecessarily intruding into the banking business.

The FDIC will continue to carry out its responsibilities. We are carefully examining insured State nonmember banks for compliance with the Bank Secrecy Act and regulations, and we are cooperating fully with the Treasury Department in its enforcement of the Act. Our policy is to maintain this constructive and cooperative working relationship.