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[Drug related money and the banking system]

STATEMENT

BEFORE THE

Senate

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

UNITED STATES SENATE

BY

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5302 DIRKSEN SENATE OFFICE BUILDING

10:00 A.M.

FRIDAY, JUNE 6, 1980

Mr. Chairman, I am here today in response to your request for testimony from the Federal Deposit Insurance Corporation on drug related money and the banking system.

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 responsibilities imposed on the FDIC under the Bank Secrecy Act of 1970 involve 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 the Treasury Department regulations. We will be revising our compliance standards as necessary to conform to the amendments to the regulations published this week by the Treasury Department to become effective in 30 days. Violations of the Act or regulations are reported to the Treasury Department. Any evidence of criminal activity is reported to the Justice Department.

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.

Proposed Amendments

S. 2236 would amend the Currency and Foreign Transactions Reporting Act (Title II of the Bank Secrecy Act) in the following respects:

1. Present law imposes a reporting requirement on any principal, agent or bailee who knowingly transports or causes to be transported monetary instruments into or out of the country. This bill would extend the reporting requirement to the act of knowingly attempting to transport or to have transported such monetary instruments into or out of the country. This is intended to close a loophole in current law by permitting the imposition of fines on persons participating in the uncompleted act of transporting currency without meeting the reporting requirement.

2. The Act currently provides that any instrument of more than \$5,000 brought into or taken out of the country without being reported is subject to seizure and forfeiture. The amendment would incorporate into the Act the practice followed by the Treasury Department of imposing seizure and forfeiture only if the regulations have been knowingly violated.

3. At present the Secretary of the Treasury may apply for a search warrant when he has reason to believe that monetary instruments are in the process of being transported and there has not been compliance with the reporting requirements of the Act. Under provisions of other law, the Secretary is authorized to issue regulations for the search of baggage and persons coming into the country, and customs agents are authorized to search vehicles, persons, trunks and envelopes without a warrant when the agent suspects there is merchandise which has been introduced into the U.S. in a manner contrary to law. S. 2236 would grant specific statutory authority for a customs officer to search without a warrant a vehicle, envelope or container, or person entering or leaving the country, if the officer has reasonable cause to believe monetary instruments are being transported in violation of the reporting requirements of the Act.

4. Present law authorizes the Secretary of the Treasury to impose forfeiture and money penalties on persons violating the Act's reporting requirements for imports and/or exports of monetary instruments. Under the proposed amendment the Secretary could authorize payment of rewards for original information leading to recovery of a criminal fine, civil penalty or forfeiture which exceeds \$50,000. The reward may not exceed 25 percent of the recovered amount or a maximum of \$250,000.

As one of the agencies to which the Secretary of the Treasury has delegated responsibility for enforcing the Currency and Foreign Transactions Reporting Act, the FDIC supports this bill and believes it would aid Treasury in making enforcement more effective.

FDIC Activities

Our major means of carrying out our delegated responsibilities under the Bank Secrecy Act is our regular compliance examination procedure. During the course of a compliance examination, an examiner will check for 16 separate points of compliance with the Act and regulations. FDIC headquarters review of 4,800 compliance examinations for 1979 revealed a variety of technical failures to comply with specific points. For example, 1.9 percent of banks had failed on at least one occasion to file a Currency Transaction Report on a \$10,000 currency transaction. Some 4.6 percent of banks had failed to maintain a list of customers whose transactions had been exempted from the reporting requirement.

We provide the Treasury Department on a quarterly basis a list of all banks under our supervision which failed to report transactions -- other than exempted transactions -- covered by the Act, and those which failed to maintain a list of exempted customers.

There have been no occasions when the FDIC found the need to recommend civil penalties for violation of the Bank Secrecy

Act. In all cases we have been able to resolve problems administratively, usually by having the banks correct unintentional errors.

Specific Questions

I turn now to specific questions raised by your committee. The first question asks about the threat drug-related money poses to the integrity of banks in Florida. The present state of the law does not reach the question of whether deposits are drug related or otherwise specifically identified. We are concerned about any threat that drug related money may pose to the safety and soundness of our banking system. The nature and extent of any such threat are difficult to ascertain. We strive to carry out our delegated responsibility under the Act and the Treasury regulations with a minimum of intrusion into the privacy of the depositor and with minimum disruption to banking functions.

Your second question addresses the efforts of the FDIC to deal with drug money problems in the Florida banks over which it has supervisory responsibility. I have already discussed our compliance examination procedures. If we uncover any evidence of possible criminal activity, it is our policy to report our findings to the appropriate law enforcement authorities.

Your third question concerns the procedures followed by the FDIC to monitor bank compliance with the Bank Secrecy Act, bank handling of currency, and bank internal controls designed

to prevent employee misconduct or bank abuse. All of these matters are incorporated into our bank examination procedures.

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 have cooperated with the Treasury Department in its efforts to devise more effective means of reviewing bank compliance with this Act. At the Department's request, we are currently testing the use of more extensive examination procedures in our Atlanta, Dallas, New York and San Francisco Regions. The revised procedures involve a more extensive check of bank records of currency transactions and require more auditing on the part of the examiner.

We are also cooperating with the Treasury and our partner bank regulators in a study of the flow of currency among Florida banks. The study involves 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 Federal Reserve.

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

Question four asks about the assistance provided by the FDIC 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 in the same manner as with the appropriate Federal authorities.

Question five asks us to address any problems encountered by the FDIC in examining banks that may handle drug related money or be controlled directly or indirectly by known or suspected drug traffickers and their associates. Question six inquires into the responsibility of banks and bankers not to handle drug related money.

These two questions bear on a difficult area, especially since no Federal law requires that the source of a depositor's funds be identified. The Treasury Department, the financial regulators and other government agencies work together using existing statutory authority to address these questions. 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. It is a delicate process, requiring close cooperation among the governmental agencies, and we are working at it diligently.

Conclusion

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