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**Statement by**

**The Honorable John P. LaWare**

**Governor**

**Board of Governors of the Federal Reserve System**

**before the**

**Committee on Banking, Finance and Urban Affairs**

**United States House of Representatives**

**May 26, 1993**

Mr. Chairman, I am pleased to appear before the Committee on Banking, Finance and Urban Affairs to discuss the Federal Reserve's role in the government's anti-money laundering efforts. The Federal Reserve places a very high priority on supporting efforts to attack the laundering of proceeds from illegal activities through our nation's financial institutions and, over the past several years, has engaged extensively in anti-money laundering endeavors.

We believe that the Fed has an important role to perform in the federal government's efforts to detect and deter money laundering activities within banking organizations, as well as to provide assistance to law enforcement agencies in their efforts to suppress these criminal activities and seize proceeds gained from them. As I will describe in more detail, the Federal Reserve has participated in, and provided assistance to, the federal government's efforts in attempting to eliminate money laundering activities.

Currently, the Board, through the varied functions that it performs on a routine basis, such as examinations of state member banks and the U.S. branches and agencies of foreign banks, as well as through special projects and various other programs, monitors financial institutions in an attempt to stop money laundering activities. We have also devoted significant resources to providing technical assistance and training both to domestic and foreign law enforcement and banking supervisory agencies.

An example of the Federal Reserve's commitment in this area was the creation, in January 1990, of the Federal Reserve System Working Group on Money Laundering Activities. Chairman Greenspan created this senior level Working Group to review the Board's initiatives on money laundering and identify new ways to contribute to the federal government's anti-money laundering efforts. The Working Group placed special emphasis on providing assistance to domestic and international law enforcement organizations. It also developed internal programs and procedures for Board and Reserve Bank staffs to implement in their normal supervision and regulation of financial institutions and provision of services to banking organizations. The Working Group formed three task forces, in the areas of cash, funds transfer and supervision. The three task forces focused on identifying areas within the Fed in which better procedures would detect and deter money laundering activities. Many of the activities that I will address today are the result of the efforts of the Working Group and its task forces.

**Federal Reserve Programs for Controlling Money Laundering**

During the course of each Federal Reserve examination of a state member bank or U.S. branch or agency of a foreign bank, a Bank Secrecy Act compliance examination is conducted. Such examinations are scheduled to occur every year. When deemed necessary, Fed examiners may conduct special targeted examinations of financial institutions if there is reason to

believe that violations of the Bank Secrecy Act may be occurring or other suspicious activities are identified.

In order to conduct effective examinations for compliance with the Bank Secrecy Act, all Federal Reserve examiners receive training in understanding the basics of money laundering. Examiners are also trained in the provisions of the Bank Secrecy Act and Treasury's rules and regulations implementing it and in identifying suspicious activity that may be associated with money laundering. This training is provided during initial courses that our examiners attend upon entering the Federal Reserve System. Additional training regarding Bank Secrecy Act compliance and related matters is also provided to experienced examiners during the course of supplemental training programs in which they are required to participate over their careers, as well as training programs sponsored by the Federal Financial Institutions Examination Council and various law enforcement agencies.

I must emphasize, however, that even with the extensive training provided to our examiners, it is difficult for even the most experienced bank examiners to detect sophisticated money laundering schemes during the course of an examination. Well trained examiners are able to determine if financial institutions are in compliance with the various specific provisions of the Bank Secrecy Act. Bank examiners are also able to determine if financial institutions have in place systems to identify and report to the appropriate law enforcement and supervisory

agencies any suspicious activity occurring at or through those institutions. By identifying institutions not in compliance with the various requirements of the Bank Secrecy Act or who do not have systems in place to report suspicious activity, the Fed provides critical data to government enforcement agencies.

In order to enhance the ability of bank examiners conducting Bank Secrecy Act compliance examinations, the Board, in late 1991, created a special committee of bank examiners with the most experience in Bank Secrecy Act compliance-related matters. As a result, procedures for Bank Secrecy Act compliance examinations that are better suited to today's changing environment were developed. These procedures have been successful during field tests throughout the Federal Reserve System over the past year. Our staff is also developing better procedures to review the operations of U.S. banks in foreign jurisdictions which do not have laws and regulations comparable to the Bank Secrecy Act. We have identified several specific areas of foreign operations that should be reviewed to determine if the U.S. bank is susceptible to money laundering activities.

To strengthen banks' anti-money laundering efforts, we have been encouraging financial institutions to adopt more comprehensive "know your customer" policies to protect them from illegal penetration of their facilities by money launderers. The Board believes that the best protection is for banks to possess sufficient knowledge to clearly identify each customer and to

have a full understanding of the type of business engaged in by the customer.

It is certainly not sufficient to simply identify those institutions that are not in compliance with anti-money laundering statutes, without taking action to ensure future compliance. To this end, the Board initiates appropriate enforcement actions against the domestic and foreign banking organizations which it supervises to address instances of noncompliance. While the Office of Financial Enforcement of the Department of the Treasury initiates civil money penalties against banking organizations for specific violations of the Bank Secrecy Act, the Board addresses such matters as the lack of internal controls and procedures. For this purpose, the Board may use its cease and desist and civil money penalty assessment authority. Recent actions to address noncompliance in this area include the assessment of fines of \$200,000 each against two foreign banking organizations that were found to have inadequate internal controls and systems to assure compliance with the Bank Secrecy Act.

#### Tracking of Currency by the Federal Reserve

One of the initiatives proposed by the Cash Task Force of the Board's Working Group on Money Laundering Activities was the development of a system whereby currency flows to and from Reserve Banks would be monitored on a regular basis and abnormalities in the normal flows, either surpluses or

deficiencies, would be identified and further investigated. During the development of this project, the Federal Reserve Bank of Dallas initiated a cash flow study to establish the normal range of cash activities for each of the financial institutions that used that Reserve Bank's cash services. Once these norms had been established, the Bank was able to identify and investigate deviations in the normal pattern of cash transactions by their customers.

The results of the study by the Dallas Reserve Bank were discussed with various law enforcement agencies. It was determined that the most efficient means of gathering, analyzing and disseminating currency flow data from around the United States was to have each of the Reserve Banks report all of their cash flow data to a single federal government agency more suited to the task of providing financial investigative assistance to the law enforcement community. This resulted in the establishment of an agreement between the Federal Reserve and the Financial Crimes Enforcement Network of the Department of the Treasury (FinCEN) for each Reserve Bank to provide FinCEN, on a monthly basis, specific information on cash shipments, by denomination, to and from the Reserve Banks by their financial institutions. Once FinCEN obtains this information, it initiates an analysis of the information and identifies abnormalities by geographic locale or financial institution. This information is then passed on to law enforcement officials, as well as to the responsible supervisory agency for further investigation.

In addition to the provision of currency flow data to FinCEN, each of the Reserve Banks has adopted a "know your customer" policy similar to that which the Federal Reserve encourages private sector financial institutions to adopt. These policies are designed to ensure that each Reserve Bank has an understanding of the normal business practices of its cash customers and, therefore, can identify and review inconsistencies, should they arise.

**Money Laundering and Fedwire**

Several initiatives are now underway to provide assistance in tracking funds through the Fedwire system. One initiative is known as the "scanning program." Using information relating to suspected money launderers supplied by agencies such as the FBI and the U.S. Customs Service, the program enhances law enforcement's ability to track funds transfers through the Fedwire.

Fed staff is now meeting with law enforcement agency representatives in Washington, D.C. and throughout the United States to acquaint them with the potential uses of the scanning program. The program has been used successfully by various law enforcement agencies to date; and, in recent weeks, several Reserve Banks have reported an increased number of inquiries from law enforcement agencies about how to use the program.

In an effort to further augment the ability of the wire payment systems to track funds transfers, in late 1992 the Fed



recommended that the Federal Financial Institutions Examination Council adopt a policy statement encouraging financial institutions to include complete identifying information about the originator and beneficiary of a wire transfer in the payment message. We took this step because enforcement agencies indicated that this information would be useful in conducting investigations. The Council's five regulatory agencies have now adopted such a policy statement and distributed it to banking organizations in December 1992.

As you are aware, the Federal Reserve and the Department of the Treasury are also engaged in developing recordkeeping requirements for funds transfer as a result of provisions of the Annunzio-Wylie Anti-Money Laundering Act. Even prior to this legislation, the Federal Reserve was actively assisting in the development of funds transfer recordkeeping requirements.

The design of funds transfer recordkeeping requirements is a very complex and technical undertaking. While the Board agrees that it may be beneficial to use information from funds transfers for investigations of money laundering activity, or to trace the proceeds of such activity, we also have a continuing interest in ensuring the efficiency and integrity of the payments system. It is important that the impact of any funds transfer recordkeeping requirements be carefully weighed to ensure that they do not result in a degradation in the efficiency and attractiveness of the large-dollar payments system. More

importantly, recordkeeping requirements that are too onerous could have serious adverse consequences for the competitive position of U.S. financial institutions. We believe that recordkeeping requirements are being developed that will meet the needs of the government's anti-money laundering efforts and, at the same time, protect the efficiency and the integrity of the payments system.

#### Coordination with Federal Law Enforcement Agencies

The Fed routinely coordinates with federal law enforcement agencies with regard to anti-money laundering activities. The scope of this coordination varies from the development and implementation of a criminal referral form that specifically addresses money laundering offenses to specific, case-by-case assistance to law enforcement agencies resulting from examinations of financial institutions that appear to be engaged in violations of the Bank Secrecy Act or related offenses.

The Board also continues to maintain a close working relationship with Treasury's Office of Financial Enforcement with regard to the enforcement of the Bank Secrecy Act. As you are aware, the Office of Financial Enforcement promulgates all regulations with regard to the Bank Secrecy Act that affect financial institutions; and it is the joint responsibility of the Federal Reserve, the other federal financial institutions supervisory agencies, and the Office of Financial Enforcement to

ensure that financial institutions comply with these rules and regulations. To this end, the Fed routinely provides the Office of Financial Enforcement, on a quarterly basis, with information related to noncompliance with the Bank Secrecy Act by the domestic and foreign financial institutions that are examined by us during the quarter.

Over the past year, Board staff also began a dialogue with the Money Laundering Section of the Department of Justice's Criminal Division to coordinate better the review of pertinent intelligence information. We now work closer with Justice staff to identify potential money laundering at or through domestic banking organizations or foreign financial institutions doing business in the United States.

On the international front, the Federal Reserve is an active participant in the Financial Action Task Force, which was established by the G-7 group of countries. Board staff has a significant role in the U.S. delegation to the Financial Action Task Force, and has provided resources to the Financial Action Task Force's efforts to provide educational assistance to countries that are attempting to understand the money laundering problem and develop programs to combat such activity. The staff has travelled to such places as Hungary, Poland, Austria, Singapore, the United Arab Emirates and Saudi Arabia to provide training and technical assistance under the auspices of the Task Force.

**Resources the Federal Reserve Has Committed to Anti-Money Laundering Initiatives**

As I have described, extensive resources have been dedicated to the Federal Reserve's anti-money laundering efforts. At a minimum, each banking organization supervised by the Fed receives a regular examination for Bank Secrecy Act compliance, which is an effort that requires significant human resources and expense. In addition to the use of our examination force to conduct Bank Secrecy Act examinations and special targeted reviews, the Board, in late 1989, augmented the resources dedicated to this area when it created a new senior level staff position within the Division of Banking Supervision and Regulation to coordinate and enhance money laundering-related matters. Since December 1989, the Special Counsel appointed to this position has assumed responsibility for coordination of matters related to money laundering and Bank Secrecy Act compliance, including investigation, enforcement and training. Over the past three years, the Special Counsel, who is a recognized expert with respect to the Bank Secrecy Act and money laundering offenses, has travelled widely abroad and throughout the United States representing the Board on Bank Secrecy Act-related training programs and other international matters pertaining to the federal government's anti-money laundering efforts. He has provided assistance to the Departments of State and Treasury, and each of the many other federal administrative and law enforcement agencies responsible for Bank Secrecy Act-related matters. Last month, the Board added to the staff of the

Special Counsel's office by hiring a Senior Special Examiner with extensive Bank Secrecy Act experience to assist the Special Counsel's anti-money laundering efforts.

**Estimates on Money Laundering and the Effectiveness of  
Currency Transaction Reports**

You have requested that we estimate the amount of funds laundered in the United States annually. While the Fed does not develop or maintain such statistics, it does rely on information provided by other government agencies in this area. The Financial Action Task Force estimated that, in 1990, the United States share of drug proceeds was \$100 billion. More recently, the FBI has estimated that the amount of money laundered through the United States on a yearly basis from narcotics trafficking, as well as other major crimes, is \$300 billion.

You also requested our views on the effectiveness of the Currency Transaction Reports required to be filed by financial institutions for most cash transactions in excess of \$10,000. As I stated previously, the Federal Reserve is required to monitor compliance by financial institutions with regulations promulgated by the Department of the Treasury. While the Fed continues to examine for compliance with the currency reporting requirements, it does not use the data contained in the Currency Transaction Reports for investigative purposes and, therefore, has no means by which to assess their effectiveness to the law enforcement community.

**Evaluation of the Effectiveness of the Federal Reserve's  
Anti-Money Laundering Efforts**

Our anti-money laundering efforts have been extensive over the past several years. We conduct regular Bank Secrecy Act examinations of all the domestic and foreign banking organizations that we supervise, and the Board is the only banking agency that has created and staffed senior staff positions dedicated to developing, coordinating and overseeing an anti-money laundering program. While it is difficult to quantify results in this area, it is important to note that the federal law enforcement community looks toward, and relies on, the Federal Reserve for assistance and guidance with respect to money laundering matters. Further, the international banking supervisory community relies on our extensive expertise to develop and coordinate international anti-money laundering programs.

We expect that the Fed's Bank Secrecy Act examination program and the notable formal enforcement actions addressing Bank Secrecy Act-related deficiencies that have been taken by this agency have had some deterrent effects. Our staff has been advised that many U.S. branches and agencies of foreign banks have retained legal counsel and accounting firm consultants to develop enhanced internal Bank Secrecy Act compliance procedures for their institutions after the Board's announcements regarding its recent enforcement actions. Similarly, there has been increased attention given to Bank Secrecy Act compliance matters by the legal profession and by bankers during the course of

recent symposiums and training sessions. This increased attention is another indication that banking organizations and their outside professionals are responding to the anti-money laundering efforts of the federal departments and agencies responsible for this area.

**Conclusion**

As I have described, over the last several years the Federal Reserve has taken significant steps in all of its relevant areas of responsibility to develop programs, procedures and systems to assist in the government's anti-money laundering efforts. These efforts have made the Fed a leader in the bank regulatory community's anti-money laundering mission. The Chairman, members of the Board and the staff have worked to develop and implement programs and procedures in the bank supervision, currency and payments system areas that enhance the government's ability to detect and deter money laundering activities in financial institutions. The continued tuning and improvement of this effort is an established Board policy.