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Statement by

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Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Financial Institutions Supervision,

Regulation and Insurance

of the

Committee on Banking, Finance and Urban Affairs

United States House of Representatives

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I appreciate the opportunity to appear before the Subcommittee on behalf of the Federal Reserve. The Subcommittee asked the Board to discuss the efforts being taken to enlist the cooperation of foreign authorities in eliminating the use of the international banking system by criminal elements.

Before I begin to discuss this topic, however, the Chairman of the Subcommittee requested that I familiarize the Subcommittee members with the duties and responsibilities of the Federal Reserve in enforcing the Bank Secrecy Act of 1970 and the Money Laundering Control Act of 1986. I will also take this opportunity to inform the Subcommittee about the enhancements to the Federal Reserve's procedures on examining for compliance with provisions of the Acts and efforts taken to date to educate the banking system on our procedures and the Acts in general.

Responsibilities of the Federal Reserve under the Bank Secrecy Act

The Federal Reserve, in conjunction with the other banking supervisory agencies, has the responsibility for monitoring financial institutions to determine their compliance

with the recordkeeping and reporting requirements of the Bank Secrecy Act. This authority is delegated to the Federal Reserve by the Department of the Treasury.

Among other requirements, the Bank Secrecy Act orders financial institutions to report currency transactions of certain customers which exceed \$10,000. During 1986 the Federal Reserve conducted 844 examinations of State member banks and Edge Act corporation offices for compliance. These compliance reviews found violations of the Bank Secrecy Act at 153 banks or offices. These violations included incomplete or inaccurate currency transaction reports, failure to file reports, and failure to maintain exemption lists with the required information.

The vast majority of these violations were found to be technical in nature. The violations resulted primarily from procedural problems or misinterpretations of the reporting requirements.

When it appears that an institution has willfully avoided the Bank Secrecy Act's reporting requirements, however,

then the matter is referred immediately to the Department of the Treasury. The staff members of the Department of Treasury review each report to determine if a criminal investigation is warranted or whether civil money penalties should be assessed. Of course, every violation discovered by bank regulatory agencies is reported to the Department of the Treasury on a quarterly basis.

Compliance with Anti-Drug Abuse Act of 1986

Section 1359 of the Anti-Drug Abuse Act of 1986 required the Federal banking agencies to develop regulations requiring insured banks to establish and maintain the necessary procedures that would ensure compliance with the Bank Secrecy Act. On January 21, 1987, the Board amended Regulation H to require State member banks to establish a program that would assure compliance with the recordkeeping and reporting requirements of the Bank Secrecy Act. The regulation requires that a written compliance program be established which is approved by the bank's board of directors. The compliance

program must, at a minimum, include four elements: (i) a system of internal controls; (ii) independent testing for compliance; (iii) designation of individual(s) to be responsible for compliance; and (iv) appropriate training of employees. The regulations were published in the Federal Register on January 27, 1987 and required banks to have a program implemented by April 27, 1987.

In addition to formulating the required regulations the Federal Reserve also has the responsibility for ensuring compliance through the examination of its regulated banks. During an on-site examination, a State member bank's written procedures are carefully scrutinized to ensure that all of the Bank Secrecy Act's recordkeeping and reporting requirements are addressed. Cease and Desist proceedings are required if a bank does not have a written compliance program or has not corrected previously cited problems. Written documentation is reviewed to ensure that, among other considerations, the bank has adopted the appropriate measures for establishing and maintaining the list of

customers who have been exempted from the reporting requirements of the Bank Secrecy Act. Also, the documentation must provide for review procedures to make certain that each Currency Transaction Report is filled out completely and accurately prior to the time it is forwarded to the Internal Revenue Service.

Board staff is presently in the process of strengthening the procedures followed by the Federal Reserve in enforcing the Bank Secrecy Act. Procedures designed to help detect violation of the law, developed by the Bank Secrecy Act Interagency Working Group chaired by the Treasury Department, are being incorporated into our examination instructions. In addition, staff is revising the Currency and Foreign Transactions Reporting Manual, which includes the examination procedures, to reflect the recent amendments to the Bank Secrecy Act and include exemption and reporting data recently developed by the Internal Revenue Service.

Board staff has provided assistance to State member banks in meeting the new requirements of Regulation H by issuing

guidelines for establishing policies and procedures for maintaining compliance with the Bank Secrecy Act. We also provide sample documentation which will serve as a reference for banks which rarely conduct large cash transactions with their customers and do not have complex or sophisticated internal operations.

Also, Board staff members were active participants in the recent seminars conducted by the American Bankers Association and a teleconference by the Bank Administration Institute. These programs provided a forum for over 7,000 bankers to discuss the fight against drug trafficking and money laundering. They also provided the opportunity to update the industry on the 1986 amendments to the Bank Secrecy Act.

The Anti-Drug Abuse Act of 1986 also amended the Change in Bank Control Act. The Change in Bank Control Act requires persons seeking to acquire control of a bank or bank holding company to provide the appropriate Federal banking agency with notice of the proposed acquisition at least 60 days prior to the transaction. During the 60-day period the Federal Reserve has

the responsibility to conduct investigations of competence, experience and financial ability of each notificant and make an independent determination of the accuracy and completeness of the information provided. The Board must also perform a competitive analysis of the proposal. The amendments to the Change in Bank Control Act require the Federal banking agencies to publish the name of each party seeking to acquire control of a bank or a bank holding company and the name of the target institutions and to solicit public comment on the proposed acquisition, in particular from persons in the geographic area in which the bank to be acquired is located.

In addition, the amendments permit the Federal banking agencies to extend the period of agency review of proposed acquisitions. The agencies may extend the 60-day review period for 30 days at the agency's discretion. Two additional 45-day extension periods are permitted if the agency determines that additional time is necessary to investigate a notificant's compliance with the Bank Secrecy Act. The extension period is

also available if the agency is unable to complete its review of the notice because the notificant has not provided all relevant information, has provided information that is substantially inaccurate, or has delayed in providing appropriate information.

The Board recently proposed amending its regulations regarding the Change in Bank Control Act to implement the amendments to the Act made by the Anti-Drug Abuse Act of 1986. The comment period for the proposal expired March 6, 1987 and the Board is following the procedures in the proposal pending final issuance of the regulation.

International Cooperative Efforts

In addition to concentrating on enhancing its domestic oversight of the Bank Secrecy Act, the Federal Reserve has also been working to obtain the cooperation of the international regulatory community in implementing policies aimed at eliminating criminal elements in the international banking system. The Federal Reserve is also collecting information on

how U.S. banks police their own activities to ensure that procedures are in place to ascertain if criminal elements are using the international payments system.

Bank supervisory authorities agree it is important to cooperate in attempting to eliminate, to the extent possible, the use of the international banking system by criminal elements. However, they often point out that while their role as information providers can be enhanced, a more effective force for deterrence may be the law enforcement agencies. Nevertheless, bank supervisors recognize that it is increasingly important to protect the banking system against criminal exploitation.

It is also interesting to note that countries in addition to the U.S. are becoming more active in this area. Switzerland, for example, often described as a preferred haven for money laundering, has recently published proposals for making money laundering a crime. The proposal was introduced by the Federal Justice and Police Department, which is illustrative of

the critical role of law enforcement authorities in developing approaches to hinder criminal use of the banking system.

The Federal Reserve is continuing its efforts to heighten the sensitivity of foreign bank supervisory authorities to the problems of money laundering and, more generally, to educate those authorities about United States laws. The need for strengthened international cooperation in this area has been raised by the Federal Reserve in a number of meetings with the Basle Committee on Bank Regulation and Supervisory Practices.¹ As a result of these discussions, the Committee has asked the Federal Reserve and the Office of the Comptroller of the Currency to develop jointly a Code of Conduct. This code, and ensuing discussions of it, may eventually evolve into a viable document

¹The Basle Committee was established at the end of 1974 by the central bank governors of the Group of Ten industrialized countries with the objective of strengthening collaboration among national authorities in their prudential supervision of international banking. The Committee, whose members are officials of the central banks and supervisory agencies, meets four times a year at the Bank for International Settlements in Basle, Switzerland. It is sometimes referred to as the Basle Supervisors' Committee or Cooke Committee, after its current chairman, Mr. W. P. Cooke.

to promote international agreement on the role that banks should play in helping to eliminate criminal elements from the international banking system. Several countries have indicated a desire to work with the U.S. authorities in preparing this paper. A first draft of the code will be completed shortly. The Federal Reserve will then begin a series of bilateral discussions aimed at securing general agreement with the code and soliciting opinions on the degree to which individual countries can ensure compliance by their banks.

The Federal Reserve is also working with Department of Treasury officials to initiate an educational program on U.S. laws. This program would focus on the commitment of our government to eliminate the use of the banking system by criminal elements. Our support for this effort is wholehearted because we believe that an important step in the process of securing international cooperation is educating the principal parties, both in bank supervision and in the area of law enforcement, to

the commitments made by the United States concerning money laundering.

The Federal Reserve has also initiated efforts to determine the extent to which overseas branches of U.S. banks have in place proper procedures to implement safeguards against money laundering. Examiners are being instructed to question management at each branch being examined as to what internal control measures the bank has taken to prevent money laundering activities. In addition to providing information for the report required by Section 1363 of the 1986 Act, this effort will serve as a basis for discussions with individual banks regarding compliance with the spirit of the money laundering control act.

The efforts just described are obviously initial steps being taken to set the groundwork for further work in this area. Progress is being made and the Federal Reserve believes that efforts undertaken to date have been generally well received. The members of the Basle Committee appear to be more receptive to dealing with the issue of money laundering now than in the past.

The efforts of the U.S., and now Switzerland, may serve as role models to other countries in focusing their attention on these issues. The Federal Reserve will continue to focus its attention in this area and to assist the Department of the Treasury in carrying out the requirements of Subtitle H of the Anti-Drug Abuse Act of 1986 and the Bank Secrecy Act.

Iran-Contra Investigation

The letter inviting the Board to testify requested information regarding any role the Federal Reserve is undertaking in the Iran-Contra investigation. The Federal Reserve has not been asked to play any specific role in this investigation although our staff did respond orally to a request for technical information about the operation of the international payment systems.

This concludes my opening remarks but I will, of course, be willing to respond to any questions.