

Testimony of
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For the
STATE OF NEW YORK

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Good morning and thank you Mr. Chairman for holding this hearing on this very important and very problematic issue.

I am Diana Taylor, Superintendent of Banks for the State of New York. My Department is the regulator for over 3,400 financial institutions in New York State, including state-chartered banking institutions, the vast majority of the United States offices of international banking institutions, all of New York State's money transmitters, check cashers, mortgage brokers, mortgage bankers, and budget planners. The aggregate assets of the companies and institutions supervised by the Banking Department are nearly \$2 trillion.

I am honored to testify before you today on the issues that we confront as a state regulator with regard to enforcing the Bank Secrecy Act (BSA) and anti-money laundering (AML) programs in the non-bank sector, the MSBs.

The New York State Banking Department is responsible for licensing, supervising, examining and regulating the check cashing and money transmitting businesses. We currently license 213 check cashers with 964 locations, employing 4,000 people. In 2003, in New York State alone, licensed check cashers cashed more than 36.4 million checks with an aggregate face value of some \$16.5 billion. Put another way, on average, New Yorkers cash nearly 100,000 checks worth more than \$45 million every day using these non-bank entities.

There are 72 licensed money transmitters operating in New York through approximately 28,000 agents in New York State, employing more than 63,000 people. In 2003, these licensed money transmitters processed more than 95 million travelers checks, money orders, official checks issued on behalf of banks and remittances with an aggregate face value of over \$85.9 billion in New York alone. Total nationwide figures for New York State money transmitters exceeded one billion transactions with an aggregate face value of over \$1 trillion.

These MSBs are a portal into our nation's banks and, through them, into our financial system.

There are two major problems. The first is that supervision and regulation of this industry is very uneven. For a number of reasons, where MSBs are concerned, Federal laws that have been

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passed to prevent banks from unwittingly serving as a conduit for money laundering are not being enforced to the same level from state to state.

The second problem is that there has been a complete lack of co-ordination between the Federal designee for examination and enforcement authority, the IRS, and the State regulators. We do not share information as we should. I would go further and ask if the IRS is the appropriate Federal agency to spearhead these efforts.

We need to meet in the middle.

What is clear and undeniable is that the state regulators of MSBs can be a powerful tool for enforcing these Federal laws, but there is much that needs to be done before we reach that goal.

I suggest that there are three actions that need to be taken to put us on the right track.

First: We need formalized, set-in-stone procedures for two-way communication and coordinated exams between the state banking supervisors, which are the licensers, regulators, supervisors and examiners of MSBs, and the Federal government. I understand that the IRS is developing an MOU that would have them sharing information on these issues with state tax collection entities. For AML and BSA purposes this makes little sense, because it does not go far enough.

The regulators of MSBs are left out! These are the entities which are on the ground, dealing on a day-to-day basis with these 50,000 (and growing) institutions. I urge FinCEN and the IRS to work with existing channels such as the State Financial Regulators Roundtable (SFRR) to draft an MOU that the state MSB regulators can embrace to make sure that the BSA is effectively enforced with respect these entities nationwide.

Second: The states need federal funds to train state examiners to do AML and BSA exams with respect to MSBs.

Third and just as important: Congress should make it clear that state banking regulators have the authority to enforce the BSA/AML laws for MSBs in their states. Absent that unambiguous

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message, you have a hodgepodge of activity on the states' parts that runs the gamut from aggressive to anxious anticipation.

For example, 39 states currently require money transmitters to be licensed. Imagine if every state understood that they are also federally empowered to enforce the BSA and the USA Patriot Act! The state regulators will be a powerful tool and partner for enforcement when they are explicitly authorized to do so.

While banks are bound by the law to report suspicious activities and we, along with our federal counterparts, consider it to be our mission to ensure that banks know exactly what is expected of them in this regard, it remains a fact that bad money can pass, via a money transmitter, through a bank and to an unsavory entity without the bank even having a chance to know the customer.

And these businesses move a lot of money through our banks.

As tough as we are on banks in terms of ensuring that they know what is required of them under our laws, we are not doing enough to guard the non-bank portals into our banking system. That puts the banks, and all of us, at risk.

Despite the fact that current federal law does not empower states to enforce the BSA/AML standards on MSBs, a recent CSBS survey shows that 19 states are already conducting BSA/AML exams of money service businesses and more are actively exploring how they can proceed. The survey also demonstrates clearly that there is a crying need for better communication among the states and the IRS.

Based on our own experience, even though we license, examine and supervise MSBs, other than at the criminal investigation level, interaction and coordination with the IRS on examinations or enforcement is de minimus.

In New York in particular, we depend on the protections that the BSA and AML statutes provide, as we have been designated a high intensity financial crime area (HIFCA) and a high intensity drug crime area (HIDCA), we are constantly at a heightened level of risk for crimes involving money laundering, drug trafficking and terrorism.

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Obviously, we have good reason to care about effective BSA enforcement.

There is a solid wall of law enforcement entities and groups that work to detect these HIFCA and HIDCA activities and enforce the BSA laws. What is needed to police the MSBs, which, as largely unregulated entities nationwide, could be perceived as a conduit for criminal activity, is a strong state regulatory base to function alongside the criminal investigators, as a partner.

What we, the regulators of MSBs can contribute is parallel to what we, with our federal banking regulator partners, provide on the bank side of the BSA.

It is the regulators that can require these entities to have effective BSA compliance programs in place; examine and detect non-compliance with BSA laws; issue enforcement actions to correct and penalize violations; and oversee compliance with corrective actions.

But in order to do that, we must have clear channels of communication.

Two years ago, SFRR, which is the umbrella organization for all state financial regulators, invited the Treasury Department and the IRS to a meeting to begin discussions on instituting a formal agreement to cooperate, coordinate and share information in an effort to enforce AML and BSA laws with regard to money transmitters and check cashers.

To date, overtures from SFRR have not been successful in achieving such cooperation, much less a productive meeting.

How much more effective could we all be if we worked together? In New York, for example, the BSA/AML concerns with regard to all the entities we supervise or regulate are met through the application, examination and supervisory processes.

During the application process, applicants must provide an Anti-Money Laundering Compliance Manual, and an affidavit indicating compliance with the USA PATRIOT Act, inclusive of the four requirements for an effective anti-money laundering compliance program:

- First, policies, procedures and internal controls designed to ensure compliance with the BSA.
- Second, designating a compliance officer responsible for day-to-day compliance with the BSA and the compliance program.
- Third, education and/or training of appropriate personnel; and
- Fourth, independent review to monitor and maintain an adequate program.

At a minimum, the first three points must be checked off prior to the issuance of the license. This allows the Department to assess the BSA/AML knowledge base of the applicant and ensure – from the very beginning – that the compliance program is adequate.

The examination process applied approximately 9-12 months after licensing allows the Department to test the implementation of the compliance program presented during the application process.

After the initial examination a licensee is subjected to either an annual (money transmitter) or bi-annual (check casher) examination cycle. Needless to say, to examine every licensee outlet would not be possible. The examination process is conducted on the consolidated licensee level.

For consistency, the core BSA/AML examination program that we use is the same as that used by the Federal agencies. Although a standardized examination program is available, it is a flexible format that may be tailored to the risk profile of a given licensee. In addition, all sources of information available are used to determine a licensee risk profile, e.g. CTRs and SARs filed with FinCEN. In the field, transaction testing is performed using a variety of sampling techniques, i.e. identified high-risk transactions. In addition, a visitation program is executed on selected agent locations.

A mix of examination resources is used. The Department's Criminal Investigation Bureau (CIB) has trained specialists dedicated to the BSA/AML. These resources are used for all money transmitter examinations and are available for any other targeted reviews as may be necessary.

Our regular examiners also conduct BSA/AML examinations. During the examination of every money transmitter and check casher, a BSA/AML review is conducted. Because it is recognized

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that specialization in BSA/AML reviews is required, the Department is continuing its efforts to strengthen a dedicated team of BSA/AML examiners within CIB. However, because resources continue to be scarce, continued training of the general examination staff remains critical. For example, in August, a training class in examining money transmitters included a segment dedicated to BSA/AML.

And what happens if something is amiss? We have the power to punish, either publicly or privately. In New York, we interpret our banking law to give us the authority to apply and enforce the BSA/AML standards under our safety and soundness rules.

Licensees found to be deficient and in violation of the BSA/AML standard face supervisory action or suspension of operations, or both. Serious deficiencies and violations represent unsafe and unsound practices that in the most severe case could result in revocation of a license.

Fines levied by my Department in these cases have ranged from \$15,000 to \$8 million.

As recently as last March, the result of on-site examinations culminated in the money transmitters Transworld Transmitting Corp's and Rupauli Exchange, Inc's operations being suspended until their BSA/AML compliance programs were developed to our satisfaction along with an independent audit of the program. Both businesses were fined \$15,000.

The \$8 million case involved Western Union and is perhaps the best known. And, better yet, for the purpose of this hearing is a perfect cautionary tale.

Because we are the regulator for Western Union, we supervise and examine it. And unlike some of our counterparts in other states, we do have the capacity and expertise to conduct BSA/AML exams for these entities.

In the course of a regular examination, our examiner noticed that Western Union did not aggregate transactions for each customer across all of their locations. Under the USA PATRIOT Act, the IRS has been given the examination and enforcement authority over MSB businesses. But it was my Department that was in Western Union and able to spot the problem, not the IRS.

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This goes to my point that state regulators are the ones performing regular examinations of MSBs – it's in our mandate. FinCEN and the IRS should take advantage of this on-the-ground force. The IRS simply does not have the resources to perform BSA compliance examinations of the tens of thousands of MSBs, nor does doing this have any relation to the core mission of the IRS. For us, it is our core mission.

The Department held that Western Union had an obligation to ensure that transactions by the same party conducted at different agents of the money transmitter were being aggregated for the purpose of filing CTRs and detecting suspicious activities. Since Western Union would not, our examiners did conduct the aggregations and, lo and behold, suspicious activities became clearly apparent.

Still Western Union continued to maintain that they were not required to aggregate under the law.

Let me make it clear that we believe that under NY Banking Law, the department has the authority to make sure that its licensees are in compliance with all state and federal laws, including the BSA.

While we take this position, some other states do not. If the authority of the state regulators of MSBs to enforce this law were made explicit in the BSA, we believe more state enforcement resources nationwide immediately would be turned to this critical task.

Even though my Department holds that it has the authority to enforce the BSA, it is important that the BSA be interpreted by the proper federal authority, FinCEN.

On the Western Union case, we worked with FinCEN to get a ruling as to the correct interpretation of the BSA and they backed our position on this matter in an Advisory Opinion which appears on their Website today.

It's important to note here that as closely as we work with them, getting a response from FinCEN took months. It's clear to me that they lack the resources to deal with the many responsibilities given them by Congress. FinCEN must be able to perform its critical role in

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producing and disseminating interpretations, advisories, regulations and examination guidance, so that the rest of us can get on with the job of ensuring compliance with the BSA.

FinCEN must be given sufficient resources to dedicate to this fundamentally important task; otherwise financial institutions, both bank and non-bank, and state and federal regulators who have the will to comply with and enforce the BSA are operating without sufficient direction on how to do so.

We have followed up with Western Union, monitoring its compliance with the Department's enforcement order. The role of supervisory follow-up is critical to ensure that the corrective steps that have been ordered are taken and a proper control environment is established and maintained, so that BSA compliance gets on track at the licensee. This function is played by regulators of MSBs and is an important component to ensure BSA compliance. The IRS is not set up to provide this type of continuing oversight.

Following the imposition of the enforcement order, Western Union has devoted extensive managerial and financial resources to becoming a leader among MSBs in compliance with the BSA.

I know you look forward to hearing from them in the next panel.

In addition to the \$8 million fine imposed by my Department – the largest enforcement action to date against an MSB – FinCEN imposed a nationwide \$5 million penalty against the company.

The point here is that many MSBs operate across state lines. The efforts of a single state MSB regulator can alert FinCEN and IRS to multi-state noncompliance which they can then use to further enforcement and compliance efforts nationwide.

In order to build this more perfect world, we must repair the disconnect evidenced by the status quo – a total lack of coordination between the state and federal governments when it comes to enforcing the BSA/AML statutes for MSBs.

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In closing, a recent KPMG study has made the sober point that many banks are still unable to monitor financial transactions across international borders, despite all of the money they have spent on technology designed to help them spot trends and suspicious activity.

If banks continue to have trouble in this area, how are the MSBs to deal with their customers – a massive population that, for whatever the reason, does not use banks directly to move money around? No matter how minuscule the percentage of bad actors using MSBs for illicit purposes, there is the potential for massive damage.

We have the responsibility to protect our people, our businesses and our financial system. We also have the responsibility for keeping legitimate money flowing, unimpeded, to where it needs to go, but we must put a ring of protection around the portal.

We cannot afford to do less.