Testimony of

John J. Byrne

On Behalf of the

AMERICAN BANKERS ASSOCIATION

Before the

Banking, Housing and Urban Affairs Committee

United States Senate

On

"The Financial Industry's View of Regulatory Efforts in the Anti-Money Laundering Area"

April 26, 2005

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Mr. Chairman and members of the Committee, I am John Byrne, Director of the Center for Regulatory Compliance with the American Bankers Association (ABA). ABA appreciates this opportunity to discuss how the financial industry is addressing compliance with the USA PATRIOT Act as well as with all laws covering anti-money laundering (AML) obligations in this current regulatory environment. At the Committee's request, we will focus on how these challenges have impacted the banking industry's relationships with money services businesses (MSBs).

ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

ABA and our members continue to work closely with our government partners in the challenging area of detecting and reporting the myriad of financial crimes that involve money laundering and terrorist financing. Despite our mutual support for cooperation, there are a number of concerns regarding how to achieve compliance. These problems can best be seen in the immediate issue of MSBs.

We offer the following three observations:

1. Banks are exiting relationships with MSBs due to the severe lack of guidance as to what constitutes an acceptable due diligence program. Immediate direction is essential;

2. The lack of direction in the MSB area is emblematic of the overall problem with Bank Secrecy Act (BSA) oversight – the labeling of an entity as "high risk" without accompanying guidance on how to mitigate that risk; and,

3. Until the financial sector receives assistance in the form of guidance and clear examples of what constitutes suspicious activity, the volume of suspicious activity reports (SARs) will continue to skyrocket.

In order to address these issues, ABA recommends a series of steps similar to the themes in our January 20th joint letter sent together with the 50 state banking associations to all federal banking agencies, the Department of Treasury, and the Financial Crimes Enforcement Network (FinCEN). The letter is attached, but I would like to restate its three main points:

- There is a need for joint industry/government training of bankers and examiners on BSA/AML obligations and procedures that are expected in June;

- A BSA staff commentary, a list of answers to frequently asked questions, and/or centralized regulatory guidance to achieve consistency in BSA/AML interpretations in areas such as implementing proper risk assessment is needed; and,

- The establishment of a Bank Secrecy Act Advisory Group (BSAAG) subcommittee to look at the variety of issues arising from the SAR process, particularly the problem of defensive filing, is called for.

While the federal banking agencies have responded to our letter with a strong statement for the need for consistency in applying the requirements of the BSA, the current actions of examiners suggest that the policy of consistency has not yet been fully implemented.

Industry Efforts in Addressing AML/BSA/SAR Challenges

Mr. Chairman, ABA has worked together with the government to provide assistance to the industry on the ongoing challenges regarding compliance with the many requirements of BSA. Among other things, ABA holds an annual conference with the American Bar Association on money laundering enforcement, produces a weekly electronic newsletter on money laundering and terrorist financing issues, offers on-line training on BSA compliance requirements, and has a standing committee of more than 80 bankers who have AML responsibilities in their institutions. In addition, we have provided telephone seminars on important issues such as the one we address today, the banking of MSBs in the current confusing environment, and compliance with Section 326 of the USA PATRIOT Act. We plan to address the expected interagency BSA/AML examination procedures later this summer. The industry's commitment to deterring money laundering continues unabated, and we have trained hundreds of thousands of bankers since the passage of the Money Laundering Control Act in 1986. [1]

In addition to this training, ABA has been collecting examples from our membership on problems with BSA examination oversight. It is clear that communication to examiners on how to implement BSA oversight has been mixed at best, despite the good intentions of the agency representatives in Washington and around the nation. The hearing today focuses on the area where that lack of consistent communication has been the most profound – working with MSBs.

MSBs and Banks: Direction on Compliance is Confusing

As indicated in the letter of invitation for today's hearing, in dealing with MSBs, there is a need to have a "consistent and equal policy used to prevent potential abuse of the financial system while at

[1] A 2003 survey by ABA Banking Journal and Banker Systems Inc. found that Bank Secrecy/AML/OFAC was the number one compliance area in terms of cost in the banking industry. It is also interesting to note that in banks under $5 billion in assets, 75.6% of the employees said that compliance was not their only job.

the same time enabling that system to provide sound access to its services." In order to achieve that goal, the current state of confusion must end.

The industry certainly understands and appreciates the need to analyze the levels of risk involved with maintaining MSB relationships. The problem, however, is how much analysis is sufficient. At times, banks will appropriately exit relationships due to the risk inherent with a particular MSB. At other times, banks want to continue valued relationships. We know the importance of providing all segments of society with banking services. For some, remittances are an essential financial product and MSBs frequently provide the service.

Remittance flows are an important and stable source of funds for many countries and constitute a substantial part of financial inflows for countries with a large migrant labor force working abroad.

Officially recorded remittances received by developing countries are estimated to have exceeded $93 billion in 2003. They are now second only to foreign direct investment (around $133 billion) as a source of external finance for developing countries. In 36 out of 153 developing countries, remittances were larger than all capital flows, public and private.

Remittance flows go through both formal and informal remittance systems. Because of the importance of such flows to recipient countries, governments have made significant efforts in recent years to remove impediments and increase such flows. At the same time, however, there has been heightened concern about the potential for remittance systems, particularly those operating outside of the formal banking system, to be used as vehicles for money laundering and the financing of terrorism.

It is believed that the risk of misuse of remittance systems would be reduced if transfers were channeled through remittance systems that are subject to regulation by governments.

To address the risks, a two-prong approach is evolving – one prong involves efforts by governments to encourage the use of formal systems (such as banks) by lowering the cost and increasing the access of users and recipients to the formal financial sector. Such efforts should concentrate on the reduction of artificial barriers such as unnecessary regulatory standards that impose costs ultimately borne by consumers.

The second prong includes initiatives by governments to implement anti-money laundering standards for entities such as MSBs. These initiatives are progressing in the United States and, as we have heard from other witnesses, the MSB regulatory infrastructure is robust and effective.

An underlying challenge is that there exists in most countries a large pool of "unbanked" individuals. Such individuals are often accustomed to using both formal (and regulated) financial institutions and very informal (unregulated) financial services providers. Economic and social incentives that move this group towards "underground" financial services providers ultimately harm the interests of the unbanked, of law-abiding financial services providers, and of the general public. Moreover, the underground financial services providers may service law-abiding unbanked persons as well as criminals. Thus, governmental actions that discourage the unbanked from entering depository institutions may have the effect of also making anti-money laundering goals far more difficult to achieve. Therefore, it is the view of ABA that the current MSB-bank regulatory environment must change in order to advance the goals of reducing money laundering and combating terrorist financing.

If the environment does not change, the important services offered by MSBs will continue to be severely hampered by regulatory excess. While the federal banking agencies issued an interagency policy statement on March 30th, the promised guidance (not yet released as of this writing) supplementing the statement must be specific and be clearly communicated to the examiners.

The Current Regulatory Confusion is Having a Dramatic Negative Effect

On March 8th, I had the opportunity to co-chair a meeting of BSAAG on the MSB problem. For eight hours we heard 44 witnesses discuss dramatic examples of lost business, economic failures, and rampant regulatory confusion. The theme of confusion was echoed by all of the banks. For example, Alex Sanchez, head of the Florida Bankers Association told us:

> *Financial institutions are closing legitimate accounts. Particularly in the area of money services businesses or MSBs, financial institutions feel compelled to close their accounts. Most of these are the accounts of perfectly legitimate businesses. Many of them in Florida are businesses run by small entrepreneurs. They are gas stations, convenience stores, and grocery stores. They serve as a place where paychecks can be cashed. Some of them serve as agents of regulated money transmitters. These accounts are closed not because there is any evidence that they are engaged in improper activity, but because they fit into a regulatory profile.*

The Florida Bankers Association also surveyed its members and found that 58 percent have curtailed activities with MSBs and 83 percent experienced the change of attitude or approach of examiners conducting examinations in this area.

Another banker emphasized the value of small MSBs:

> *One of the common types of small businesses in our community is the small grocery store or convenience store. These are the businesses that often serve the immigrant and less advantaged community. These businesses are the connecting point for many in our society to the economic system. They are legitimate businesses serving a genuine need. Under the current regulatory scheme, we can no longer serve them.*

Finally, the problem was best illustrated by a recent agency training session on BSA that used a slide featuring the following text:

Two Important Things to Remember about MSBs:

- May be high risk for money laundering
- Play a vital role in the financial services of the U.S.

Mr. Chairman, this statement sends the ultimate mixed message.

FinCEN and the federal banking agencies are to be commended for working toward a guidance to address this policy morass. We urge the agencies to act swiftly and immediately inform the

examiners to adjust their review of how banks work with MSBs. As we finally improve this situation with MSB oversight, it is time to move to address overall BSA examination inconsistency.

Uniform PATRIOT Act/BSA/AML Examination Procedures Are Needed

ABA has previously emphasized that the banking agencies need to reach agreement on how the financial services industry will be examined for compliance under the PATRIOT Act and the other AML requirements. As we indicated at the time, "too often, institutions of the same approximate size, in the same geographic area and offering the same financial products are treated differently for compliance purposes. This should not continue."

There is formal movement to coordination of examination procedures by the agencies but the process is not complete and there are some outstanding issues. We will discuss one glaring problem – assessment of the adequacy of SAR programs, later in this testimony.

While we repeat our 2003 and 2004 calls for Congress to ask the regulatory agencies to report on efforts in this area, ABA has seen a commitment to consistency in 2005. For example, not only has FinCEN Director Fox expressed public support for uniform assessments, but he has also directed BSAAG to form a subcommittee on examination issues. This subcommittee, co-chaired by ABA and the Federal Reserve Board, has met several times to discuss the pending interagency examination procedures and we are meeting again on April 29th.

Mr. Chairman, uniform exam procedures will assist with the industry concerns about examination inconsistency and the continued threat of "zero tolerance" by some examiners. However, we strongly urge Congress to ensure that all banking agencies engage in industry outreach when the AML exam procedures are made public.

Lack of SAR Guidance Results in Unnecessary Filings

With the increased number of entities required to file SARs, as well as the heightened scrutiny by regulators on SAR policies and programs, it is essential for the regulatory agencies, law enforcement, and FinCEN to assist SAR filers with issues as they arise. This need is particularly obvious in the area of terrorist financing. This crime is difficult, if not impossible, to discern as it often appears as a normal transaction. We have learned from many government experts that the financing of terrorist activities often can occur in fairly low dollar amounts and with basic financial products (e.g. retail checking accounts). Guidance in this area is essential if there is to be effective and accurate industry reporting. The bottom line is that terrorist financing can only be deterred by government intelligence.

For money laundering and other financial crimes, government advisories and other publications are a critical source for recognizing trends and typologies. As the industry emphasizes in the April 2005 issue of the interagency-authored publication, SAR Activity Review, there are a number of examples of activities that represent reported financial crimes. This information is extremely useful for training purposes. As the private sector co-chair of the SAR Activity Review, I can assure you ABA supports the efforts of FinCEN and the participating agencies in crafting a publication that provides

necessary statistical feedback to the SAR filing community. The SAR Activity Review has provided a variety of examples of the characteristics of such diverse suspicious activity as identity theft, bank fraud, and computer intrusion.

We are pleased that the 2004 edition of the SAR Activity Review provided for the first time the summary characterization of all of the suspicious activity categories. This summary should assist filers in advancing their understanding of the reporting requirements.

As stated above, there are several problems affecting banks in the AML exam process related to SARs. ABA has previously mentioned the many examples of examiner criticisms received by our members in reviews of their SAR programs. Whether it has been criticism of the number of SARs that the institution has filed or the "second-guessing" by examiners as to why a SAR was not filed, this situation demands immediate attention.

In addition, banks have been reacting to the recent concerns echoed by the Federal banking agencies that threatened prosecutions for BSA regulatory matters is also adding to the increase in SAR filings. As the agencies emphasized in their April 18th letter to ABA and the state banking associations, the Federal banking agencies and FinCEN are working with the Department of Justice to better define the "appropriate role for criminal prosecutions of banks under the BSA."

We applaud these efforts and hope they succeed in ensuring that regulatory problems do not turn into criminal actions.

Moreover, regulatory scrutiny of SAR filings (and the recent civil penalties assessed against banks for SAR deficiencies) has caused many institutions to file SARs as a purely defensive tactic (the "when in doubt, file" syndrome) to stave off unwarranted criticism or "second guessing" of an institution's suspicious activity determinations. As FinCEN Director Bill Fox stated so eloquently in the April SAR Activity Review:

> *While the volume of filings alone may not reveal a problem, it fuels our concern that financial institutions are becoming increasingly convinced that the key to avoiding regulatory and criminal scrutiny under the Bank Secrecy Act to file more reports, regardless of whether the conduct or transaction identified is suspicious. These "defensive filings" populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns.*

We would like to commend Mr. Fox for addressing our third recommendation and creating a BSAAG subcommittee on SAR issues. We hope and expect that the subcommittee will tackle the issue of SAR confusion head on.

Mr. Chairman, our members share the concerns expressed by Mr. Fox but there are no other options to defensive SAR filings without improved examiner training. Our hope is that the examination procedures and a mechanism for receiving interpretations on SAR issues will result in returning suspicious activity reports to their original place – forms filed only after careful analysis and investigations with no second-guessing by regulators.

Conclusion

Mr. Chairman and members of the committee, ABA has been in the forefront of the industry efforts to develop a strong public-private partnership in the areas of money laundering and now terrorist financing. This partnership has achieved much success but we know that more can be accomplished. We commend the Treasury Department, banking agencies, and FinCEN for their recent efforts to ensure a workable and efficient process. ABA will continue our support for these efforts.

Thank you. I would be happy to answer any questions.

January 10, 2005

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Washington, DC 20429

Federal Reserve Board
Chairman Alan Greenspan
Board of Governors
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Office of the Comptroller of the Currency
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Ladies and Gentlemen:

The ABA and the undersigned state banking associations have been long-time partners with the Treasury Department and the federal banking regulators in the effort to prevent money laundering and, more recently, terrorist financing. We are proud of the commendations our industry has received from a number of agency and Administration officials, such as Treasury Under Secretary for Terrorism and Financial Intelligence, Stuart Levey, who stated: "The financial industry has been tremendously helpful in combating terrorist financing and is eager and willing to do more." However, we are concerned that our industry's efforts are being complicated, and in some cases undermined, by a lack of clarity in regulatory examination and enforcement.

While we recognize that there are individual instances where financial institutions may have fallen short and needed to improve their AML (anti-money laundering) and BSA (Bank Secrecy Act) programs and procedures, the lack of consistency in examination oversight and compliance guidance is a major theme of regulatory complaints received by ABA and the state banking associations.

In general, our members report that no standard appears to exist for a proper AML compliance program. What we hear from the regulatory leadership in Washington is often at odds with the information banks receive from field examiners. During conferences, seminars, and examinations throughout the country, bankers have heard language that

indicates a "zero tolerance policy" for AML deficiencies. With the millions of daily transactions in the banking industry, a zero tolerance threshold is simply unachievable, as has been recognized by Administration and regulatory officials in Washington.

Certainly the federal banking agencies and the Treasury Department understand that there is a strong "culture of compliance" in the U.S. banking industry. Our bankers want to work with regulators to address deficiencies wherever they occur, although it is difficult to do this when the standards are unclear and moving. Our compliance professionals are well trained in a variety of regulatory areas, but they are being overwhelmed by the sheer volume of obligations for regulatory compliance.

It must be emphasized that this massive regulatory burden has been so exacerbated by mandates such as Sarbanes-Oxley and the unclear rules on BSA that it is literally driving some community banks to sell to larger institutions. In addition, the difficulty of attracting individuals to serve on bank boards of directors has been increasing due to concerns about regulatory costs and the potential for punitive enforcement actions. It is clear that guidance and communication are essential.

One major area in need of guidance is the filing of suspicious activity reports (SARs). SARs, a major tool for law enforcement to investigate crimes against banks, are in danger of becoming routine filings that simply dilute FinCEN's database. The increase can be attributed to "defensive filing" by banks that fear regulatory criticism or, worse, enforcement actions because of failing to file a SAR. FinCEN Director William Fox has also recognized this problem and urged that BSA compliance be handled correctly by bank examiners. [2]

To achieve that goal, Director Fox has directed the Treasury's Bank Secrecy Act Advisory Group (BSAAG) to look at methods to improve the current examination process. ABA co-chairs this subcommittee and continues to compile examples of what we believe to be erroneous interpretations of the BSA and AML requirements by bank examiners. These examples will be used by the BSAAG subcommittee. We are pleased to note that one crucial goal – to achieve consistent, common examination procedures – is currently being pursued by the bank regulatory agencies through interagency procedures, due mid-year 2005. We respectfully recommend that this process be completed as quickly as possible.

In addition, ABA and the undersigned associations urge the Treasury Department and the bank regulators, to also consider:

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[2] Director Fox spoke to the American Bankers Association and American Bar Association in October 2004 and addressed defensive filing of SARs: "We all know this phenomenon is occurring – we have both empirical and anecdotal evidence we can cite. We have seen financial institutions file reports in ever increasing numbers – often upon the recommendation of their lawyers or risk management teams – when the facts as presented do not meet this standard. I suspect that this over compliance is occurring for a reason. It is occurring because financial institutions are – justifiably in my view – unwilling to accept the regulatory or reputational risk associated with an action by the government that would make it appear that the institution is soft on anti-money laundering or, even worse, on terrorist financing."

- joint industry/government training of bankers and examiners on BSA/AML obligations when the procedures are released;

- a BSA staff commentary, FAQs and/or centralized regulatory guidance to achieve consistency in BSA/AML interpretations; and

- establishment of a BSAAG subcommittee to look at the variety of issues arising from the SAR process, particularly the problem of defensive filing.

The banking industry remains committed to work with the government in any way possible to further our joint goal of fighting money laundering and terrorist financing. The banking industry has always been a willing partner in stemming the flow of illegal funds through legitimate financial institutions. Continued joint efforts in this area must, and will, continue. However, we urge the Administration and the regulatory agencies to address the inconsistency and uncertainty that the industry is facing. Thank you for considering our concerns.

Sincerely,

American Bankers AssociationMontana Bankers Association
Alabama Bankers AssociationNebraska Bankers Association

Alaska Bankers AssociationNevada Bankers Association

Arizona Bankers AssociationNew Hampshire Bankers Association

Arkansas Bankers AssociationNew Jersey Bankers Association

California Bankers AssociationNew Mexico Bankers Association

Colorado Bankers AssociationNew York Bankers Association

Connecticut Bankers AssociationNorth Carolina Bankers Association

Delaware Bankers AssociationNorth Dakota Bankers Association

Florida Bankers AssociationOhio Bankers League

Georgia Bankers AssociationOklahoma Bankers Association

Hawaii Bankers AssociationOregon Bankers Association

Idaho Bankers AssociationPennsylvania Bankers Association

Illinois Bankers AssociationPuerto Rico Bankers Association

Indiana Bankers AssociationRhode Island Bankers Association

Iowa Bankers AssociationSouth Carolina Bankers Association

Kansas Bankers AssociationSouth Dakota Bankers Association

Kentucky Bankers AssociationTennessee Bankers Association

Louisiana Bankers AssociationTexas Bankers Association

Maine Bankers AssociationUtah Bankers Association
Maryland Bankers AssociationVermont Bankers Association
Massachusetts Bankers AssociationVirginia Bankers Association
Michigan Bankers AssociationWashington Bankers Association
Minnesota Bankers AssociationWest Virginia Bankers Association
Mississippi Bankers AssociationWisconsin Bankers Association
Missouri Bankers AssociationWyoming Bankers Association