



Statement  
of

James E. Gilleran, Director  
Office of Thrift Supervision

Hearing

on

the Bank Secrecy Act

before the

Committee on Banking, Housing, and Urban Affairs  
United States Senate

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**STATEMENT OF JAMES E. GILLERAN  
DIRECTOR, OFFICE OF THRIFT SUPERVISION  
ON THE BANK SECRECY ACT**

**BEFORE THE  
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UNITED STATES SENATE**

**June 3, 2004**

**I. Introduction**

Good morning, Chairman Shelby, Senator Sarbanes, and members of the Committee. Thank you for the opportunity to testify at today's hearing on the Bank Secrecy Act (BSA), as amended by the USA PATRIOT Act (Patriot Act). My testimony provides an overview of the BSA and OTS's compliance responsibilities under the BSA and Home Owners' Loan Act (HOLA), describes our work to implement the Patriot Act and strengthen oversight of the BSA, and reports on the state of thrift compliance with the BSA and on how OTS responds to failures and deficiencies to comply with the Act. My statement also explains requirements for thrifts to file suspicious activity reports (SARs), and summarizes an ongoing GAO audit of the agency on BSA implementation by OTS.

OTS fully supports the goals and objectives of the BSA and the Patriot Act through policies, programs, and regulatory, supervisory, and enforcement initiatives. We have examiners who are well trained and experienced in reviewing thrifts for compliance with the BSA and the Patriot Act. Our examiners know the institutions we regulate well and are well-positioned to identify and correct BSA problems. The average OTS examiner has over 16 years of experience.

Our examiners have been using updated BSA examination procedures since October of last year. We have strengthened our oversight by issuing internal guidance to our examiners and external guidance to the depository institutions. We have also developed and provided substantial new training programs for our staff over the last two years, and increased the number of examiners who have been trained in BSA requirements and have developed proficiency in this area.

The number of OTS examiners capable of conducting BSA reviews has increased by over 80 examiners, or by approximately 75 percent from 2001 to the present. We now have more than 190 examiners trained in BSA compliance issues, and we will continue to train staff and add expertise to our examination corps in this

area in the coming year. We also shortened the examination cycle for BSA reviews since 2001, from a two to three year cycle to a 12 to 18 month examination cycle, or more frequently if circumstances require.

In addition, our field personnel communicate on a regular, on-going basis with OTS senior managers. Through frequent industry contact and ongoing supervision, OTS continually monitors industry BSA compliance efforts. We frequently consult with individual thrifts on their BSA compliance programs, such as reviewing changes in key personnel, unusual activity, or anomalous transactions that might warrant a field visit.

In our experience, the most effective way to uncover BSA and Patriot Act deficiencies is through the ongoing examination process. Violations are usually discovered in fissures within an institution's programs, controls or operations. Uncovering weaknesses in an institution's BSA compliance program requires experienced examiners who are familiar with the ongoing operations of the particular institutions they oversee as well as how various banking transactions are typically structured, industry best practices, and depository institution operations, generally.

BSA compliance review is necessarily risk-focused—the review is tailored to consider the potential risk of money laundering or terrorist financing in different business lines. Our examiners have broad exposure to an institution's entire business operation—its organizational structure, business activities, normal range of transactions, risk management practices, the quality of its management, and its internal control environment. Our examinations and follow-up reviews enable us to monitor corrections and improvements in, and ongoing compliance with BSA/AML requirements. Knowledge of, and familiarity with each institution's risk profile puts OTS in the best position to effectively monitor the BSA compliance programs and activities of the institutions we regulate.

## **II. Background of the Bank Secrecy Act and Compliance Overview**

The Bank Secrecy Act (BSA), enacted in 1970, requires financial institutions to file certain currency and monetary instrument reports and maintain certain records for possible use in criminal, tax, and regulatory proceedings. The BSA's purpose is to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity. Accordingly, the BSA requirements result in a paper trail of the activities of money launderers serving the interests of terrorists, drug traffickers, and other elements of white collar and organized crime.

Congress has amended the BSA several times over the years to strengthen its anti-money laundering (AML) and counter-terrorism financing purposes. The most

recent, and perhaps most significant, set of amendments is found in Title III of the USA Patriot Act. The Patriot Act adopted strong and far-reaching requirements intended to prevent, detect, and prosecute terrorism, terrorist financing, and international money laundering. It has resulted in several new regulations that have a direct impact on a thrift's BSA/AML compliance program.

Since its enactment, OTS has worked vigorously and diligently to implement the Patriot Act. As detailed below, OTS has been actively involved in crafting regulations implementing various provisions of the Patriot Act<sup>1</sup>, and in issuing related guidance and examination procedures. OTS has been examining and working with the institutions we regulate to ensure compliance not only with the letter of the law, but also the spirit of its intended purpose.

### **III. OTS's BSA Oversight Responsibilities**

The Home Owners' Loan Act (HOLA) authorizes OTS to require thrifts to comply with the BSA and provides very broad enforcement authority to compel this objective.<sup>2</sup> The HOLA mandates that OTS issue regulations requiring thrifts to adopt BSA compliance procedures. At each examination we conduct, OTS reviews the required procedures, documents its findings and describes any significant problems in the examination report. When a thrift fails to establish and maintain the required procedures, or fails to correct previously identified problems, our examiners and field supervisors are instructed to take enforcement action against the institution. In addition to the HOLA, we have enforcement authority under the Federal Deposit Insurance Act (FDIA), which also imposes AML recordkeeping requirements on thrifts and other insured depository institutions.<sup>3</sup>

To discharge our responsibilities under the HOLA and FDIA, OTS issued a BSA regulation that requires compliance with specific components of the BSA.<sup>4</sup> Our regulation also requires thrifts to comply with the Department of the Treasury's BSA regulations,<sup>5</sup> including requirements for Customer Identification Programs (CIPs), internal controls, testing for BSA compliance, and employee training on BSA/AML and related issues.

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1. This statement references three sets of regulations. These are OTS's BSA rule at 12 CFR §563.177; Treasury's BSA regulation at 31 CFR Part 103, which applies to savings associations; and the interagency Patriot Act regulations, which are a part of Treasury's BSA rule in Part 103, which apply to a wide range of financial institutions, including thrifts.

2. HOLA § 5(d)(6).

3. FDIA § 21.

4. 12 CFR § 563.177.

5. 12 CFR Part 103.

OTS has also adopted a suspicious activity report (SAR) regulation that requires thrifts to file a SAR with FinCEN and the appropriate federal law enforcement agencies when it detects a “known or suspected violation of Federal law or a suspicious transaction related to a money laundering activity or a violation of the [BSA].”<sup>6</sup> These requirements are described in more detail later in this testimony.

While OTS has broad enforcement authority to correct a deficiency or BSA violation, choosing the appropriate supervisory response involves the careful balancing of a wide range of factors and the informed exercise of professional judgment and discretion.

In our experience, the most effective way to resolve most BSA/AML compliance program deficiencies is as part of the overall examination process. We routinely require thrifts to undertake corrective action in the course of an examination. Addressing issues within the examination framework often results in a thrift promptly implementing necessary corrective action, and makes for fast and effective changes that we can immediately review. We believe that our examiners are in the best position to uncover problems with a thrift’s BSA/AML compliance program and to resolve them quickly with management. The relationship between the institutions we regulate and our examiners is extremely constructive.

It is our experience that most institutions appreciate the importance of BSA and the Patriot Act, and are committed to the concepts, goals, and objectives of these laws. We continue to work with thrift institutions to ensure that they have a strong, independent testing and verification process in place. Numbers bear out this contention. Since July of last year, we addressed BSA/AML compliance program deficiencies at 167 thrifts. Some of these deficiencies were self-reported by the institutions, but the vast majority were identified during OTS examinations. The combination of self-reporting and issues identified in examinations uncovered 342 BSA violations at these institutions, mostly of Treasury’s BSA regulations at 31 CFR Part 103. In all cases, management either agreed with the examiner’s recommendation and moved promptly to implement changes to fix the problem, or completed the recommended corrective action before the examination was completed.

When the examination approach fails to resolve a BSA problem or issue, OTS can take enforcement action under FDIA section 8 against a thrift and its related entities for engaging in an unsafe or unsound practice or violating a law, regulation, condition imposed in writing, or written agreement. Under this authority, OTS may (i) issue cease and desist orders, (ii) issue removal, suspension, and prohibition orders, and/or (iii) impose civil money penalties.

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6. 12 CFR § 563.180.

#### **IV. OTS Implementation of the USA Patriot Act**

##### **A. Key Provisions of the Patriot Act**

OTS often, in coordination with FinCEN and the other federal banking agencies (FBAs), has participated in numerous initiatives to issue regulations, policy guidance, and examination procedures to implement the Patriot Act. For example, OTS issued an extensive staff summary of the Patriot Act in March 2002.<sup>7</sup> This document informs institutions of the requirements of the Act and provides information on its implementation. In particular, it discusses the Patriot Act in three sections, as follows:

- The first section describes Patriot Act requirements that are applicable to all thrift institutions and that were effective immediately or in the near term, such as the information sharing requirements and the requirement that a financial institution produce records relating to its BSA/AML compliance program or its customers within 120 hours of a request from the appropriate FBA.
- The second section describes the new enhanced due diligence procedures for thrifts that engage in private banking or maintain foreign correspondent accounts.
- The third section discusses Patriot Act provisions of general interest, such as the authorization for Treasury to impose special measures with respect to particular institutions, jurisdictions, accounts, or transactions and the requirement that each thrift have a Customer Identification Program (CIP).

OTS also issued a Patriot Act Update in August 2002.<sup>8</sup> The update included important guidance on the new CIP requirements, information sharing with law enforcement, and new due diligence requirements for foreign correspondent accounts and private banking accounts. The update noted that OTS would begin reviewing for compliance with the provisions when the new regulations became effective, and urged institutions to carefully review the new regulations and their preambles, and implement the new procedures as required.

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7. OTS Notice: OTS Staff Summary of USA Patriot Act (March 20, 2002) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

8. CEO Letter 166 (August 5, 2002) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

## 1. Customer Identification Programs

The new CIP requirements, issued on May 9, 2003, by the Treasury Department, the FBAs, the SEC, and the CFTC, set forth procedures for verifying the identity of anyone who opens an account, and requires institutions to maintain records to verify a customer's identity, and to determine whether the customer appears on any list of known or suspected terrorists or terrorist organizations. An institution's CIP must include risk-based procedures designed to enable the institution to form a reasonable belief that it knows the identity of its customers. OTS has been examining institutions for CIP compliance since the requirements went into effect on October 1, 2003.

Simultaneous with the issuance of the new CIP rules, OTS issued two additional pieces of guidance<sup>9</sup>—*Customer Identification Programs: A Staff Summary and Answers to Questions* (the CIP Summary); and *USA PATRIOT Act Preparedness Checkup: A Framework for Achieving Compliance with the New USA PATRIOT Act Regulations* (the Checkup).<sup>10</sup>

The CIP Summary, the first guidance issued by a regulatory agency about the new CIP rules, alerted thrifts to the specific requirements of the new rules. The CIP Summary also specifies exactly what OTS is looking for when reviewing a thrift's CIP, and addresses important questions about the CIP rules.

The CIP Summary describes the types of accounts covered by the rule, who is a "customer" for purposes of the rules, and the specific requirements that a thrift's CIP must meet. The CIP Summary also:

- Notes the four pieces of identifying information that a thrift must obtain from a customer who opens a new account;
- Indicates the methods (both documentary and nondocumentary) by which a thrift can verify the identifying information;
- Discusses the recordkeeping requirements of the new rules;
- Highlights the requirements about checking government lists of suspected terrorists or money launderers;
- Notes that thrifts must be in compliance with the new rules beginning October 1, 2003; and

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9. CEO Letter 175 (May 9, 2003) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

10. Attachments to CEO Letter 175, see note 9, above.

- Emphasizes that OTS would begin examining for compliance during all examinations beginning on or after October 1, 2003.

The Checkup was issued the same day as the new rules and the CIP Summary. It remains the only checklist form of guidance about preparing for Patriot Act implementation issued by a regulatory agency. In the Checkup, OTS encouraged institutions to “ADApT” their current BSA/AML program to the new Patriot Act requirements:

- **Aalyze** their current program;
- **Develop** a comprehensive BSA/AML program, which includes a CIP that address all of the thrift’s business lines;
- **Apply** the revised program throughout the thrift’s day-to-day operations; and
- **Test** the new program through internal audits and testing to ensure that the program is functioning as intended.

The Checkup lists several questions a thrift should ask as it ADAPTs to the new Patriot Act requirements. For instance, when **Analyzing** its current program, a thrift should consider, among other things, how its business operations expose it to money laundering or terrorism financing risks. When **Developing** its new, enhanced BSA/AML program, a thrift should take a number of steps, including ensuring that the program addresses each of the new regulatory requirements and identify business operations that might require enhanced scrutiny.

When **Applying** its new program, a thrift should ask itself whether staff is informed of the new requirements, whether appropriate customer identification information collection and verification practices are taking place, and whether private banking accounts and foreign correspondent accounts are being handled correctly. Finally, when a thrift **Tests** the new program, the Checkup provides a number of factors for the thrift to review, including ensuring that internal audits or compliance reviews identify shortcomings in the BSA/AML compliance program and seek prompt corrective action, and determining whether staff and service provider implementation of the new regulatory requirements is keeping pace with the thrift’s operational needs. Our examiners are instructed to explore all of these issues when examining an institution’s Patriot Act compliance.

In January 2004, OTS, along with the other FBAs, the SEC, and the CFTC, issued another importance piece of guidance, “frequently asked questions” (FAQs) to



help explain the final CIP rule.<sup>11</sup> That document begins with a general description of the CIP requirements and emphasizes that a bank's CIP must include risk-based procedures for verifying the identity of each customer to the extent reasonable and practicable. The FAQs note that it is critical that each bank develop procedures to account for all relevant risks, including those presented by the types of accounts maintained by the bank, the various methods provided to open accounts, the type of identifying information available, and the bank's size, location, and type of business or customer base.

The FAQs also make clear that specific minimum requirements in the rule, such as the four basic types of information to be obtained from each customer, should be supplemented by risk-based verification procedures, where appropriate, to ensure that the bank has a reasonable belief that it knows each customer's identity.

The document also answers a number of common questions about the CIP rules, such as whether loans purchased from a car dealer are "accounts" (No) and whether a person who becomes a co-owner of an existing deposit account is a "customer" (Yes). The FAQs also consider whether a bank's foreign subsidiaries are subject to the rule (No) and whether a bank may keep copies of documents provided to verify a customer's identity even though not required to do so (Yes). The agencies are currently working on a second set of FAQs on the CIP requirements, which are now circulating for approval at the agencies and will be issued soon.

## 2. Information Sharing

Section 314 of the Patriot Act encourages cooperation and information sharing among financial institutions, regulators, and law enforcement. OTS has actively participated in developing and implementing these requirements.

On September 26, 2002, Treasury issued a final rule implementing the new information sharing requirements. In response to industry concerns about the regulatory burden of the requests for information, and after consulting with OTS and the other FBAs, on November 26, 2002, Treasury placed a moratorium on information requests from law enforcement. Treasury subsequently streamlined the process and lifted the moratorium in February 2003. Since then, institutions have been responding to requests for information from law enforcement.

Last October, OTS alerted thrifts to new examination procedures to review thrift compliance with the new requirements,<sup>12</sup> and we incorporated the new

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11. CEO Letter 188 (January 8, 2004) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

12. CEO Letter 183 (October 20, 2003) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

procedures into our overall BSA examination procedures. Those procedures include a review of the institution's procedures for promptly responding to law enforcement requests for information, documentation of any positive match with the requests, and copies of any vendor confidentiality agreements regarding services rendered pursuant to the requests. Examiners are also instructed to review copies of any SARs filed related to the information sharing process, as well as to review an institution's analysis or documentation where a SAR was considered, but not filed.

OTS also participates in quarterly meetings with FinCEN, the regulators, and representatives of law enforcement to discuss and further refine the information sharing process. Those meetings allow law enforcement to provide feedback to the regulators about how the information sharing process is working and for regulators to convey to law enforcement the views of financial institutions on how to improve the process. Items of discussion have included a breakdown of positive responses by type of financial institution and regulator, proposed enhancements to the various forms used in the process, and development of a secure, encrypted network to facilitate the exchange of information between law enforcement and financial institutions.

### 3. Foreign Shell Banks, Requests for Bank Records, and Summons Authority

OTS has also issued specific guidance on the Patriot Act provisions banning correspondent accounts for foreign shell banks, requiring financial institutions to produce records related to anti-money laundering compliance within 120 hours of an examiner's request, and providing that Treasury or the Attorney General may issue a subpoena or summons to any foreign bank that maintains a correspondent account in the U.S. and may request the bank to produce records related to that account, including records maintained abroad.

Treasury, through FinCEN and after consultation with OTS and the other FBAs, issued a final rule implementing these new requirements on September 26, 2002. Last October, OTS alerted thrifts to the new examination procedures to review thrift compliance with the new requirements.<sup>13</sup> Under those procedures, examiners are to evaluate an institution's policies and procedures for foreign correspondent accounts to determine whether they address the minimum requirements specified in the regulation, such as the responsible party for gathering the necessary information and the process for identifying foreign correspondent accounts. The procedures also require an examiner to, based on a risk assessment, sample foreign correspondent accounts, review the collection of requisite information and obtain any customer due diligence or other relevant information related to those accounts. We have incorporated those new procedures into our overall BSA examination procedures.

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13. CEO Letter 183 (October 20, 2003) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

#### 4. Other Significant Patriot Act Provisions

OTS also participates in a number of other ongoing working groups and projects related to specific provisions of the Patriot Act. For instance, Treasury consults with OTS, among others, when considering whether to impose special measures on a jurisdiction, institution, class of transactions, or type of account that the Department finds is of “primary money laundering concern.” To date, Treasury has imposed special measures on Nahru, Burma, and two Burmese banks, and has just issued a proposal to do so with regard to a bank in Syria.

OTS has been involved in developing new regulations implementing the Patriot Act requirements that financial institutions have specific due diligence procedures, including enhanced due diligence procedures, for correspondent accounts for foreign financial institutions or private banking accounts for non-U.S. persons. On July 23, 2002, Treasury, after consulting with OTS and the other FBAs, issued an interim rule imposing the section 312 requirements on banks and thrifts. Treasury is drafting a final regulation implementing section 312, and routinely consults OTS.

#### **B. Examination Procedures and Guidance**

In preparation for the October 1, 2003, compliance deadline for the new CIP requirements, OTS updated its entire BSA examination program. This revision included updating existing procedures and adding new sections to address specific Patriot Act requirements. We trained our examiners on the new procedures in mid-September 2003, and our examiners have been using the new procedures for all BSA examinations that commenced since October 1, 2003. Examiner reaction has been positive, with the examiners’ general perception that most institutions are taking the necessary steps to comply with the new Patriot Act requirements. After extensive field testing, we are in the final stages of formally incorporating the new procedures in our OTS Examination Handbook.

Under our comprehensive examination approach, many more examiners are now trained on conducting BSA examinations, which has expanded our capabilities immensely. We continually discuss and cover BSA and Patriot Act examination issues at staff conferences, examiner team meetings, and examiner education initiatives. In addition to our September 2003 training on the new procedures, we have included BSA/Patriot Act discussions in our Compliance I, Compliance II, and Advanced Compliance examiner schools. We provided internal training on the new BSA/Patriot Act requirements at our National Applications Staff Conference in May 2003 and our National Compliance Training for Senior Management program in June

2003. We also provide online and CD ROM study guides and training modules for our examiners.

We actively participate in training programs and industry conferences throughout the country. Besides the guidance we have issued directly to institutions, we have participated in numerous interagency BSA/Patriot Act seminars and town meetings with industry representatives in all of our Regions. We also participated in BSA/Patriot Act discussions at various officer and director conferences, such as the FDIC's Regional Directors conference, and numerous trade association conferences. These include conferences sponsored by America's Community Bankers, the California Bankers Association, the Chicagoland Bankers Association, the Florida Bankers Association, the Georgia Community Bankers Association, the Heartland Community Bankers, the Iowa Bankers Association, Iowa Community Bankers and Iowa Independent Bankers Association, the Maryland Bankers Association, the Missouri Bankers, the North Carolina Bankers Association, the Suncoast Bankers Compliance Association, and the Wisconsin Community Bankers, among others.

In implementing the new Patriot Act requirements and in examining thrifts for compliance under the new BSA procedures issued last October, OTS also has had the benefit of several recommendations made by the Treasury Department's Inspector General, who conducted an audit of OTS's enforcement actions taken for BSA violations. That audit report, issued September 23, 2003, and which covered the period January 2000 through October 2002, made certain recommendations to further enhance OTS's supervisory process and data collection efforts.

In response to these recommendations, OTS has issued both external and internal supplemental guidance on BSA/AML compliance programs and the enforcement of BSA obligations. This past March, OTS issued a regulatory bulletin that discusses OTS's authority under the BSA, details the specific regulatory and statutory requirements applicable to thrift operations in this area, and sets out general enforcement guidelines that OTS will follow for violations of the regulatory and statutory requirements.<sup>14</sup>

The bulletin also lists the special factors that OTS will consider when determining the appropriate enforcement action for BSA/AML violations, including the following:

- Whether the thrift has adequately corrected BSA/AML violations noted in a prior Report of Examination (ROE);

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14. Regulatory Bulletin 18-6 (March 31, 2004) (see [www.ots.treas.gov/bsa](http://www.ots.treas.gov/bsa)).

- Whether the thrift's BSA/AML compliance has deteriorated since violations were noted in the prior ROE, or there has been inordinate delay in making meaningful progress in addressing the violations;
- Whether the violations in fact constitute, or reflect a material risk of, money laundering, terrorist financing, or structuring to avoid reporting requirements; and
- Whether the thrift identified the weaknesses itself through its BSA testing, audit, or self-evaluation efforts and the thrift has independently instituted timely and adequate corrective action.

On April 5, 2004, we issued to our examiners new internal guidance elaborating on certain features of the regulatory bulletin. That guidance identifies specific BSA/AML violations that must be noted in examination reports, unless the thrift adequately corrects the violations during the examination period. The internal guidance provides further instruction on when a thrift will be considered to have "adequately corrected" a violation. The internal guidance also specifies that all institutions, regardless of asset size, must have BSA compliance programs that address all the regulatory requirements and are appropriate to the BSA/AML risks attributable to the thrift's risk factors, operational complexity, and market circumstances. Finally, the internal guidance provides more detailed instructions to examiners on documenting BSA/AML violations in the appropriate OTS database.

The guidance on entering BSA violations data into OTS's new database is part of an ongoing, multiyear project to enhance and update our examination reporting database that was begun in January 2000. The update, now completed, encompasses all examination areas, including examination of a thrift's BSA compliance program. Not only does our enhanced database enable OTS to more closely monitor a thrift's compliance as well as industry trends and areas of interest, the data it is producing verifies our conviction that the most effective way to resolve deficiencies in a thrift's BSA/AML compliance program is during the examination process.

Finally, also as suggested by the Inspector General, we have enhanced our supervisory review of the BSA examination process. Specifically, to assure BSA violation data accuracy, each examiner-in-charge is now responsible for ensuring that BSA violations are entered into the data system correctly. This is often supplemented with a second level review and each region will conduct periodic quality assurance reviews to further ensure accurate data entry. We have drafted procedures for including BSA examinations and the integrity of system data entry in our ongoing Examination Quality Assurance reviews. Those reviews are designed to test compliance with OTS's national standards for BSA examinations, including those

discussed in the new guidance. The initial review of examinations completed in the first quarter of calendar year 2004 will commence in the third quarter.

### **C. Assessment of Thrift Compliance with the BSA; OTS Enforcement**

The effective date for the updated procedures to conduct BSA examinations, October 1 of last year, coincides with the effective date for the most recent Patriot Act regulation, the CIP rules. Although we have been using these new procedures only a short time, we have received preliminary feedback from examiners and supervisors in the field.

That feedback is generally positive. We believe that the thrift industry, in general, is complying with the BSA and Patriot Act requirements. As in most areas of bank supervision, however, we continue to identify areas of weakness in some thrift institutions. We also periodically uncover significant problems at a small number of institutions. In these situations, we move quickly and forcefully to correct violations. We believe that our record of risk-based supervisory response to identified institutional weaknesses places OTS in an excellent position for ensuring that the thrift industry continues to meet its BSA/AML obligations.

We have identified some recurring problems related to basic BSA/AML requirements at some smaller institutions that have fewer resources to devote to compliance issues. The problems we see in these smaller thrifts are normally the same types we saw even prior to the Patriot Act. They generally involve the more administratively-intensive requirements of the BSA program elements. For example, some smaller thrifts have inadequate training programs or fail to conduct an annual audit of the BSA compliance program that is fully independent.

Generally speaking, smaller thrifts engaged in typical mortgage lending and FDIC-insured deposit taking in a local community tend to be exposed to a lower risk of money laundering as a result of the traditional nature of their operations. They tend to know their customers, have geographically limited operations, offer few or no international banking or private banking products and services, and conduct more streamlined, traditional banking operations focused on narrow, longstanding markets (normally mortgage lending). Even small institutions, however, are not free from the risk of money laundering activities and our reviews take that fact into consideration.

The BSA compliance program at a small thrift—which still should be risk-based—need not be as elaborate as a program at a large, international financial institution. While a BSA compliance program must include all regulatory components, how each component is satisfied can vary depending on the operational risk presented by a particular institution's business. We have made clear to the

industry and our examiners that all thrifts, regardless of size, must have BSA compliance programs that address all regulatory requirements and are appropriate to the BSA risks attributable to their operational complexity and market circumstances.

OTS has backed up that message by issuing a number of formal enforcement orders to ensure that savings associations comply fully with the requirements of the BSA. For example, in October 2003, OTS issued a comprehensive cease and desist order to a savings association requiring that it develop and implement effective BSA and AML programs, including procedures to ensure that SARs and CTRs are filed as required by law. OTS also fined the institution \$175,000 for its past violations. OTS is closely monitoring the institution's compliance with the order.

In another example, OTS recently issued a cease and desist order against an institution that had several problems with its BSA/AML compliance program. Those problems included failing to monitor large cash transaction activity in several commercial accounts, failing to file SARs, and failing to file CTRs. Examinations also revealed weaknesses in the required BSA training programs. The cease and desist order required the thrift to strengthen its BSA compliance program, with particular attention to its CTR filing obligation and ensuring that its designated BSA officer had sufficient resources to perform BSA responsibilities on a day-to-day basis.

In all, since we started using our new examination procedures last October, we have issued seven formal enforcement orders for BSA violations, including cease and desist orders, civil money penalties, and supervisory agreements. We also use the examination process to informally resolve a host of BSA/AML compliance issues. As I noted, since last July, we identified 167 thrifts with deficiencies in their BSA/AML compliance programs—all of the institutions either agreed to implement changes and moved promptly to do so, or completed the recommended corrective action before the completion of their examination. Finally, we are actively investigating several other possible violations of the BSA by thrifts, which may result in the issuance of other enforcement orders.

#### **D. Interagency Working Groups and Committees**

Cooperation with our fellow agencies is always important, and it is particularly crucial in the anti-money laundering context. Money laundering and the financing of terrorism are truly global issues, cutting across a wide range of business activities, financial institutions, and international boundaries. The continuing fight against money laundering and terrorism demands coordinated, consistent efforts on both the national and international level.

OTS and our federal banking agency counterparts largely work hand-in-hand in this effort. I have already mentioned the number of Patriot Act-related working groups and regulatory projects to which OTS, as well the other federal banking agencies, have contributed. Many of those projects continue, as the agencies, always in a concerted way, provide guidance and examination standards to the industry. A good example of such a continuing effort is the ongoing work to issue a second set of frequently asked questions about the Customer Identification Program rules.

OTS also participates in the Bank Secrecy Act Advisory Group (BSAAG). The BSAAG is a unique collection of representatives from law enforcement, regulators, and the private sector charged with responsibility for advising the Secretary of the Treasury on matters relating to the administration of the BSA. With the Patriot Act's expansion of the types of entities subject to anti-money laundering program requirements, the BSAAG's membership has also recently expanded to include representatives from a wide variety of new industries, such as automobile dealers, life insurance companies, and money service businesses.

Along with the other federal banking agencies and representatives from a number of law enforcement agencies, OTS is a member of the Bank Fraud Working Group. This forum enables participants to share information, and cooperate in identifying individuals engaged in fraud and trends involving fraudulent activities.

Even outside the formal working group context, cooperation between the federal banking agencies on BSA/AML matters is consistent and long-standing. For instance, OTS cooperates with FinCEN and law enforcement agencies when matters of mutual interest are uncovered in OTS examinations or reviews. OTS and FinCEN have worked together to investigate and remedy BSA violations through the issuance of parallel enforcement actions. OTS also has frequently assisted law enforcement agencies investigating possible criminal misconduct and has, on occasion, made its examiners available as testifying experts before grand juries.

#### **E. OTS's BSA Resources Webpage and Hotline**

To make information about the Bank Secrecy Act and Patriot Act easily accessible by thrifts and other interested parties, OTS maintains a page on its internet site with links to all the documents referred to in this testimony, including those related to CIP and other Patriot Act requirements, SARs, and recent announcements. The webpage also includes links to FinCEN and to the Office of Foreign Asset Control (OFAC). The OTS's BSA webpage can be accessed through OTS's Internet site at [www.ots.treas.gov](http://www.ots.treas.gov). OTS also maintains a Patriot Act hotline for thrifts to call with questions about their BSA responsibilities.



## V. Suspicious Activity Reports (SARs)

For many years, the BSA has authorized the Department of the Treasury to require any financial institution to report suspicious transactions relevant to possible statutory or regulatory violations. Even before the FBAs issued SAR regulations in 1996, thrifts and other depository institutions were required to file criminal referral and suspicious transactions reports. The Patriot Act did not change the basic SAR requirement.

OTS's SAR regulations require a thrift to file a SAR when it detects a "known or suspected violation of Federal law or a suspicious transaction related to a money laundering activity or a violation of the Bank Secrecy Act."<sup>15</sup> To reduce regulatory burden on filers, depository institutions and other filers submit SARs only to an IRS data center that maintains a unified SAR database on behalf of FinCEN and the FBAs. FinCEN presently is testing a system to permit direct, secure on-line filing of SARs. Currently, some filers still submit paper reports. Others deliver information electronically on tape or disk, which delays its inclusion in the database by approximately one month. When fully implemented, electronic filing will greatly improve the usefulness of the SAR database for regulators and law enforcement agencies.

Because the SAR database contains highly confidential information of known or suspected criminal activities, on-line access is restricted to the FBAs, certain other state and federal agencies, and to law enforcement agencies, such as the FBI and the Secret Service. Banks and thrifts may not disclose a SAR or its contents, and the banking agencies do not share SAR information with non-SAR users.

From 1996 through 2003, financial institutions filed nearly 1.3 million SARs. SARs related to thrifts account for less than 10% of all SARs. The total number of SARs filed each year has grown significantly. For the 9 months of 1996 after the SAR requirements took effect, there were 52,069 SARs filed. For 2003, this had grown to 288,343. Nearly half of all SARs filed since 1996 have related to BSA and money laundering violations. Check fraud is a distant second, with nearly 12 percent.

OTS staff members review SARs each month for possible enforcement action and to coordinate with law enforcement investigations. In addition, in preparing to conduct a periodic examination of a thrift, examiners review the SARs that relate to the thrift, and during the examination determine whether there is an ongoing problem that must be addressed.

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15. 12 CFR § 563.180.

SARs are valuable tools. For instance, information in SARs allows FinCEN to identify emerging trends and patterns associated with financial crimes, which is vital to law enforcement agencies and provides valuable feedback to regulators and financial institutions. Here at OTS, information in thrift-filed SARs has resulted in a number of enforcement orders, including cease and order orders and prohibition orders.

## **VI. General Accounting Office Review**

The General Accounting Office (GAO) has recently initiated two new reviews in this area. One involves a review of the implementation of the anti-money laundering provisions of the Patriot Act by the banking agencies and others. GAO specifically plans to review (i) the status of implementing the customer identification program and information sharing provisions, (ii) agency procedures for assessing compliance and enforcement, (iii) efforts to educate the industry about the new regulations, and (iv) the extent to which the agencies have revised and applied examination guidance.

The other review relates to BSA examinations and enforcement for depository institutions. GAO intends to study (i) how the banking agencies audit for BSA compliance, (ii) the number and nature of BSA violations since the late 1990's, (iii) how BSA violations are identified and addressed, (iv) consistency of BSA examinations, interpretation, and enforcement across the agencies, (v) the adequacy of the agencies' resources for BSA examinations and the new Patriot Act requirements, and (vi) the role of the Treasury Department in the agencies' examination programs and enforcement efforts.

Much of this testimony addresses what OTS has accomplished in the areas to be covered by the GAO reviews. We are working to provide GAO with the preliminary information they have requested and look forward to assisting them in their efforts in any way we can.

## **VII. OTS Recommendations to Enhance Existing BSA/Patriot Act Efforts**

We have identified several areas for consideration that we believe would enhance the existing BSA and Patriot Act efforts and initiatives. These are:

- Establishing better communications among the FBAs, FinCEN, the banking industry and law enforcement, particularly with respect to systemic BSA violations and developing trends. We encourage such exchanges of information through several means, including advisories, guidance, meetings and personal communications.

- Enhancing the flow of information between law enforcement and depository institutions. The information sharing process should be a two-way street. In order to review account records that might relate to terrorist financing, financial institutions need as much identifying information as law enforcement can provide. Additionally, law enforcement needs responses to its inquiries as quickly as possible from depository institutions. The FBAs can substantially assist in facilitating the collection and exchange of this vital information.
- Improving FBA coordination and BSA/AML awareness and training via a more formalized procedure within the Federal Financial Institutions Examination Council (FFIEC). This includes improving communications among the FBAs and FinCEN regarding known schemes to evade BSA/AML laws, as well as having FinCEN supplement BSA training programs within the FFIEC so that all the FBAs and FinCEN are consistent in the application of BSA/AML standards.

## **VIII. Conclusion**

We have always taken our responsibility to oversee compliance with the BSA seriously. The original focus of the BSA was to prevent criminal money laundering activities. Since the events of September 11, 2001, and the enactment of the Patriot Act, the focus of the BSA has expanded to include the war against terrorism.

OTS has redoubled its efforts under the BSA and the new Patriot Act requirements. We have:

- Helped educate the thrift industry through a variety of mechanisms;
- Provided additional training for staff;
- Greatly expanded the number of examiners who are reviewing BSA and Patriot Act compliance on an on-going basis;
- Halved the interval between BSA examinations;
- Developed and implemented enhanced scoping and examination procedures;
- Implemented a new BSA tracking and monitoring information system;
- Improved internal controls governing data collection, examination, and enforcement activities;
- Bolstered off-site BSA monitoring programs;

- Adopted more robust and stringent enforcement policies;
- Implemented a new BSA Quality Assurance audit program; and
- Improved internal communications and external communications and coordination with other regulatory agencies, Treasury, and law enforcement.

These actions collectively demonstrate our vigorous and diligent efforts to ensure maximum compliance with the intent and purpose of both the BSA and the Patriot Act. There is still more to be done. We pledge our continued efforts, look forward to your observations on these issues and await your questions.