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STATEMENT OF

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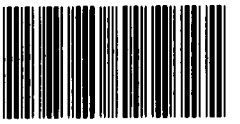
BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT AND RENEGOTIATION

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ON IMPLEMENTATION OF ~~THE~~

BANK SECRECY ACT'S REPORTING REQUIREMENTS



Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss our ongoing review of the implementation of the Bank Secrecy Act's reporting requirements. We initiated our review pursuant to your request at the conclusion of this Subcommittee's hearings last November on "Patterns of Currency Transactions and Their Relationship to Narcotics Traffic." While we still have some work to do, our review is far enough along to provide our interim observations to assist you in your oversight functions. We plan to issue a detailed report after we have had a chance to further develop our findings and conclusions and to consider recommendations appropriate for resolving any problems.

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The Bank Secrecy Act, formally entitled the Currency and Foreign Transactions Reporting Act (P.L. 91-508), was enacted in October 1970. It was intended to provide Federal law enforcement agencies with recordkeeping and reporting tools to investigate the financial resources connected with illegal activities, such as narcotics trafficking and tax evasion. The Act's recordkeeping requirements were designed to standardize the documentation and retention of all significant individual account transactions. Its reporting requirements were designed to document the movement of large amounts of cash, domestically and internationally, to help law enforcement trace illicit money transactions.

The Department of Treasury has overall responsibility for (1) initiating and coordinating the efforts of the various Federal bank regulatory and law enforcement agencies involved in implementing the Act, (2) assuring compliance with the Act's requirements, and (3) assuring that reports generated under the Act are disseminated.

Three reports are required under the Act:

(1) Domestic financial institutions generally must file a Currency Transaction Report (CTR)--Internal Revenue Service (IRS) form 4789--whenever they handle a currency transaction of more than $10,000.

(2) Individuals and certain legal entities generally must file a Report of International Transportation of Currency or Monetary Instruments (CMIR)--U.S. Customs Service form 4790--whenever they import or export more than $5,000 in currency or monetary instruments.

(3) Individuals subject to U.S. jurisdiction must file Treasury form 90-22.1 to disclose any interests in foreign financial accounts.

While we did some work on all three reports required under the Act, most of our work focused on IRS form 4789, the report of principal interest to the Subcommittee. The scope of our review, in terms of the number of agencies reviewed and locations visited, was broad. We met with headquarters and field officials of the following bank regulatory agencies: Office of the Comptroller of the Currency (OCC); Federal Deposit Insurance Corporation (FDIC); Federal Home Loan Bank System (FHLBS); Federal Reserve System (FRS); National Credit Union Administration (NCUA). We also met with officials of the following law enforcement and regulatory agencies: Bureau of Alcohol, Tobacco and Firearms (ATF); IRS; U.S. Customs Service; Department of Justice; Drug Enforcement Administration (DEA); Federal Bureau of Investigation (FBI); and Securities and Exchange Commission (SEC). Our review was performed primarily in Los Angeles, San Diego, and San Francisco, California; Jacksonville, and Miami, Florida; Atlanta, Georgia; New York City; Austin, Dallas, El Paso, Houston and San Antonio, Texas; and Washington, D.C. We (1) observed ongoing examinations and reviewed regulatory agencies' examination reports, (2) discussed compliance matters with financial institution and regulatory officials; and (3) reviewed and discussed with law enforcement agents the use of Bank Secrecy Act reports in specific criminal investigations.

Our observations today deal with the Subcommittee's stated interests regarding the (1) enforcement of compliance with the Bank Secrecy Act's reporting requirements, (2) dissemination to law enforcement agencies of reports generated pursuant to the Act, and (3) use and usefulness of these reports to law enforcement agencies in carrying out their investigative responsibilities.

Although the reports required by the Bank Secrecy Act were intended to be highly useful to law enforcement, today--ten years after its enactment--they are still largely untested and unknown tools in the law enforcement field. Moreover, problems surrounding Federal efforts to monitor and enforce reporting compliance by financial institutions have precluded accurately estimating the level of reporting compliance.

These conditions exist primarily because the Department of the Treasury has not administered the Act aggressively. Treasury has been slow in promoting the use of the Act's reports, in making them available to law enforcement agencies, and in assessing their usefulness. Treasury's failure to push the use of the reports delayed focusing attention on the problems which existed in enforcing compliance with the Act. These included (1) vague regulations which permitted broad interpretations by financial institutions and the bank regulatory agencies and (2) the generally cursory examination practices of the regulatory agencies.

Treasury has only recently taken initiatives to improve the implementation of the Bank Secrecy Act, particularly with respect to the usefulness of the reporting requirements. As a result, we cannot yet provide a comprehensive evaluation of the Act's usefulness as an investigative aid. This, of course, is a key question which needs to be answered before extensive efforts are put into measuring and enforcing compliance. Therefore, any evaluation of the effectiveness of the Act's reporting requirements or decisions regarding its future should be delayed until Treasury's recent initiatives have been adequately tested.

TREASURY HAS NOT AGGRESSIVELY IMPLEMENTED THE BANK SECRECY ACT

Although the Bank Secrecy Act mandated that implementing regulations be in effect by November 1971, for reasons unknown, Treasury delayed their issuance until July 1972. However, the constitutionality of the Act was in dispute until April 1974 when the courts upheld the constitutionality of the domestic currency reporting requirements. Three months later, IRS began enforcing the Act's domestic requirements. All in all, not counting the time associated with the legal challenges, Treasury and IRS had delayed enforcement by a year.

IRS and the U.S. Customs Service, which receive the CTRs and CMIRs, respectively, did not exchange this data until 1976. Customs attempted to exchange data in 1974 by providing IRS with CMIRs; but IRS did not agree to reciprocate with CTRs until 1976.

Treasury did not seriously emphasize administering the Bank Secrecy Act until 1977 after violations of the Act by a large New York bank had surfaced and hearings were held on the Act by a House Government Operations Subcommittee. The first attempt to disseminate Bank Secrecy Act data outside of Customs and IRS was not made until 1977 when Treasury established an agreement with DEA. This led to the formation of BANCO, a joint DEA-FBI task force to explore the financial aspects of drug trafficking in the Miami, Florida area.

Delays in establishing a formal organization to process and disseminate Bank Secrecy Act reports postponed effective implementation of the Act. Implementation did not really begin until July 1978 when a Reports and Analysis Unit (RAU) staffed by Customs and IRS personnel, was created for this purpose in Treasury's Office of the Assistant Secretary for Law Enforcement and Operations. In the Spring of 1979, the RAU was transferred to the Customs Service. Formal agreements to disseminate Bank Secrecy data to most law enforcement agencies were not signed until 1979.

It was not until 1980 that Treasury mandated Customs and IRS to assess the use of Bank Secrecy reports, and that all reporting data was computerized and retrievable

in a reasonable time -- one to three weeks. The system is still being upgraded. Projections are that a fully integrated currency data base will be in place by 1981.

This past summer, the Act's implementing regulations were revised to strengthen compliance. However, the regulations were proposed in 1978 and the need for stronger regulations was recognized as early as 1975.

Finally, Treasury has never made a priority commitment of resources to administer the Act. Only one Treasury employee is assigned daily responsibility for administering and coordinating efforts related to the Act.

The result has been delays in demonstrating the usefulness of Bank Secrecy Act data and in recognizing deficiencies in compliance monitoring efforts. I would now like to discuss these problems and some of the changes recently initiated to improve the Act's implementation.

THE USEFULNESS OF BANK SECRECY ACT REPORTS HAS NOT BEEN FULLY DEMONSTRATED

Many Federal investigators responsible for organized and white collar crime investigations are unaware of the Bank Secrecy Act or have had only limited experience using reports generated under the Act. While some law enforcement officials have doubts about the usefulness of the reports, other officials have demonstrated that the reports can be a useful investigative tool. However, the utility of the reports still has not been adequately tested.

Awareness and experience with Bank Secrecy Act information is limited

In some instances, GAO staff members provided investigators in the six regions we visited with their first orientation to the reports. In others, investigators were only recently notified by their headquarters of the procedures for requesting reports.

The Customs Service has had a currency investigation program since 1974, and its agents are the most familiar with Bank Secrecy Act reports. Yet, officials in the headquarters Currency Investigations Division and at the Miami district office, who have been involved in a cash flow investigation task force since July 1978, stated that they are only in the early stages of discovering the potential usefulness of the reports. The chief of the Reports and Analysis Unit stated that the currency investigation program did not attain priority status until the the Spring of 1978 when the Currency Investigations Division was created. Customs officials attributed delays in emphasizing currency investigations to the reluctance of Customs investigators to pursue narcotics-related violations. A 1973 reorganization relieved Customs of the responsibility and authority for conducting narcotics investigations.

In late 1979, the Currency Investigations Division began to hold week-long felony currency seminars for selected Customs agents. Three seminars have been held thus far and 10 others are planned. One Customs group supervisor said his agents were not really aware of the Bank Secrecy Act reports and how they could be used until he attended one of the seminars in November 1979.

IRS is another agency which was expected to benefit from the Bank Secrecy Act in pursuing tax evasion cases. However, in our April 1979 report 1/ and in our November 1979 testimony before this Subcommittee, we stated that IRS had had only limited success using the Act's reports to initiate taxpayer examinations and criminal tax investigations. Followup at six IRS district offices confirmed that the reports' usefulness in initiating criminal tax cases has not yet been fully demonstrated, although several agents did see value in the reports as a means of locating bank records once suspects have been identified. IRS has taken actions to improve its use of the reports in developing tax investigations, but these actions are too recent to evaluate.

1/ Better Use Of Currency And Foreign Account Reports By Treasury And IRS Needed For Law Enforcement Purposes (GGD-79-24, April 6, 1979)

Aside from Customs and IRS, DEA has received most of the Bank Secrecy information. Since July 1977, Treasury provided over 3600 reports to DEA, either through routine dissemination or in response to specific requests. Most dissemination has been to the joint DEA/FBI BANCO project in Miami. Agents in six DEA district offices made only a few requests for Bank Secrecy reports. Agents in the Dallas region were only recently informed of the procedures for requesting Bank Secrecy information. In New York, routinely disseminated reports are filed until requested by agents; however, such requests are seldom made.

Although FBI headquarters informed its field offices in January and in June 1979, of procedures for requesting Bank Secrecy information, special agents in six offices apparently made little use of the reports and frequently were unaware that the data was available. FBI officials in the Chicago and New York offices said no training or orientation on using the data had ever been provided.

The SEC requested access to the reports in March 1978, but to date has made little use of the information. For example, officials in New York had never heard of the Act.

ATF headquarters officials waited a year after gaining access to Bank Secrecy information to notify field agents of its uses and availability. ATF officials in Philadelphia, New York and Chicago were aware of the Act but had not made use of it. Officials in Los Angeles could not recall ever being notified of the Act.

Doubts Concerning the Utility of Bank Secrecy Act Reports

Numerous law enforcement officials we spoke with expressed reservations about the usefulness of Bank Secrecy Act reports. Specifically, they indicated that other investigative methods are preferable, the quality of the reports filed is questionable, and the Act's reporting requirements can be circumvented.

Some Federal law enforcement officials told us that Bank Secrecy data was not essential because once they have developed a specific criminal violation such as narcotics trafficking, they can generally identify related financial resources through such means as grand jury or administrative subpoenas. The following are some typical comments from law enforcement officials at various locations we visited.

--Once an alleged criminal violation has been established, subpoenas are the most direct way to proceed to obtain financial records.

--The routine investigation of a subject will normally locate the individual's financial assets.

--Bank Secrecy reports would rarely provide information which could not be obtained satisfactorily through subpoenas.

--Bank Secrecy reports have not been very useful in initiating criminal tax cases.

Many officials complained about the quality of the reports which are filed. Specifically, they stated that forms often are incomplete, illegible and/or poorly photocopied. Recognizing this problem, Treasury and IRS very recently established a program to better monitor the quality of reports filed by financial institutions.

A prevalent view among law enforcement officials is that the Bank Secrecy Act reporting requirements can be circumvented. They cited some circumstances in which multiple cash transactions below $10,000 were conducted in connection with alleged criminal activity to avoid detection. In other instances, foreign nationals and persons on law enforcement intelligence lists were exempted by banks from the Act's reporting requirements. Several IRS criminal investigators pointed out that businesses such as restaurants, race tracks and other retail establishments allegedly associated with organized crime could even be exempted under Treasury's revised regulations.

Bank Secrecy Act Reports Can Be Useful

Despite doubts expressed by some law enforcement officials about the usefulness of Bank Secrecy Act reports, others were able to describe various situations

where the reports have been useful. These related to:

--identifying investigative targets,

--determining the extent and location of financial assets,

--establishing secondary criminal violations, and

--developing stronger court cases.

In some instances, Bank Secrecy Act reports can be used to initiate investigations, while in others the reports can be used to identify previously unknown suspects. Customs officials provided us with the following examples.

--Two CTRs reflected that a foreign national deposited over $1 million cash in a three day period. Yet no CMIR was on record. Further investigation revealed the subject received narcotics money in the U.S. and allegedly passed it to foreign drug sources. Further analysis of CTRs showed the subject deposited approximately $3 million in cash in various U.S. banks.

--A review of CTRs revealed that the subject withdrew $300,000 in cash from a bank. A corresponding CMIR could not be located. An inquiry at the the bank revealed that the subject, a foreign national with no U.S. address, was to depart for his home country after leaving the bank.

In other cases, the data can provide information which helps investigators further develop their efforts against previously known investigative targets.

--In the two cases arising from the DEA/FBI BANCO operation which have been successfully prosecuted, the key investigative targets were previously known to DEA. However, DEA was not aware of the dimension of their operations until CTRs and subsequent investigation identified the large amounts of cash generated by their drug businesses.

--Review of CTRs by a financial investigation task force determined that over $1 million had been handled by a drug trafficker. DEA had two investigations on the individual, but without the CTR was unable to develop information concerning the extent of the individual's financial operations.

In several instances, law enforcement officials said that the data can help determine the extent and location of illegal financial resources. For example,

--An investigation initiated by a confidential source led to the discovery of over $3 million in currency. Using part of a name given by one of two foreign nationals who were suspects, Customs agents performed an extensive analysis of the CTR data file and identified about 200 CTRs related to the alleged criminal activity. They revealed about $74 million in a number of accounts in several banks in another section of the country. Seven additional suspects were identified despite the fact that most of the CTRs were not properly completed. A grand jury subpoena was obtained to gain access to additional bank records.

--After a jury was unable to reach a verdict on a class I drug violator, a financial investigations task force in another area of the country developed CTR-supplied information regarding a large cash transaction made by the defendant. The Federal prosecutor plans to retry the defendant later this year, believing that the new financial information will be very useful.

The Bank Secrecy Act provides substantial criminal penalties for noncompliance with its reporting requirements. If the noncompliance can be shown to be connected with any other Federal felony violation or illegal activity which involves more than $100,000 in a twelve month period, a criminal

penalty of not more than a $500,000 fine and/or five years imprisonment and a civil penalty of not more than the monetary value of the item not reported can be imposed. False statements or misrepresentations in reports may be punishable by fines of not more than $10,000 and/or imprisonment of not more than five years.

Recognizing the strong penalties for violating the Bank Secrecy Act in connection with other criminal activities, Customs' Office of Investigations has made felony currency cases an investigative objective. Often these cases are initiated on the basis of tips from confidential sources. Customs agents then ensure that the suspects are aware of the reporting requirement and are offered an opportunity to report. A case is made once failure to report is established. Customs and Justice Department officials provided the following examples of investigations of individuals for failure to file CMIRs.

--Department of Justice, Fraud Section attorneys use the CMIR filing requirement primarily to obtain convictions for illegal transportation of currency in connection with improper overseas payment cases. In eight such cases for the period February 1978 to September 1979, currency violations were charged and $443,670 in penalties was assessed under 31 USC §1059. Substantial fines were obtained in these cases because the currency violations were connected with other felony convictions.

--Through the cooperation of an informant, Customs agents learned of the plan of three individuals to transport $2 million, allegedly embezzled from a pension fund, out of the United States in two trips.

The informant provided information on one trip on which $375,000 was transported to a foreign country without filing a CMIR. The three conspirators were indicted for violation of a felony currency conspiracy (31 USC 1101 (a), 31 USC 1059 and 18 USC 371). The one conspirator in the United States was convicted and sentenced to 18 months in prison (15 months probation), and fined $10,000.

Information available through the Bank Secrecy Act or other financial investigative techniques which demonstrate significant and unexplainable income by defendants can help achieve more substantial sentences and higher bails. An Assistant U.S. Attorney in the Central District of California, told us that financial information was instrumental in influencing judges to impose substantial sentences on several major narcotic traffickers who were first offenders. For example

--Financial evidence showing that a trafficker spent more than $350,000 in two years while employed as a newspaper truck driver contributed to the imposition of a 17 year prison term and a $45,000 fine.

--After a man was arrested with a large quantity of cocaine, the prosecutor was able to use financial information to have bail set at $2.5 million.

Recent Treasury Efforts Should Test Usefulness of Bank Secrecy Reports

While it has been demonstrated that Bank Secrecy Act reports can be useful to law enforcement agencies in some instances, their overall utility in investigations of illicit financial

resources has not been fully and systematically tested. The Act may have great potential as an investigative tool, but implementation problems have prevented that potential from being realized.

However, operational improvements are underway. The Act's implementing regulations have been recently revised; the RAU continues to upgrade data files and is working to expand analytical capabilities; IRS has streamlined its processing of CTR forms and has plans to assure more complete reporting; and Treasury has relaxed its dissemination guidelines somewhat.

Additionally, financial investigative task forces were recently established in three U.S. Attorney offices to explore the utility of Bank Secrecy data as an investigative and prosecutive tool. Combining the skills and resources of several Federal law enforcement agencies working through investigative grand juries, these projects offer the most stringent test yet of the Act's value.

Given recent efforts to improve the use of Bank Secrecy data and the general lack of awareness and utilization of the data by investigators, we believe Congress has little choice but to await the completion of Treasury's initiatives before assessing the Act's utility.

Even then, however, it must be recognized that although Congress intended the Bank Secrecy reports to be highly useful to law enforcement agencies, they are only one tool

available to law enforcement. The reports, which provide a system of financial records, must be used in conjunction with other investigative techniques, such as surveillance, informants and subpoenas. Alone they will not resolve such problems as tax evasion and narcotics trafficking. Thus, the degree to which the Bank Secrecy Act reports are useful or essential to law enforcement may continue to be debatable. I would now like to discuss the enforcement of compliance with the Act's reporting requirements by the bank regulatory agencies.

LEVEL OF COMPLIANCE WITH THE ACT IS UNKNOWN; ENFORCEMENT PROBLEMS EXIST

Opinions vary on the level of compliance with the Bank Secrecy Act's reporting requirements and no precise measurement exists. Compliance monitoring and enforcement by bank regulatory agencies generally have been cursory. Recent changes may resolve some of these problems.

The Extent Of Compliance Is Unknown

No one knows the extent to which financial institutions are complying with the Act's reporting requirements. Treasury has no system to measure compliance. However, Treasury, the bank regulatory agencies, IRS and the SEC generally believe compliance is good although they acknowledge that some financial institutions may not be fully complying. On the other hand--not surprisingly--law enforcement agencies generally believe compliance is deficient and seriously detracts from the Act's usefulness.

Serious concerns about compliance were raised this past June during hearings on "Banks and Narcotics Money Flow in South Florida" before the Senate Committee on Banking, Housing and Urban Affairs. In those hearings, a former Assistant U.S. Attorney stated that, in the Miami area, there were multi-million dollar discrepancies between banks' total cash flows and the cash transactions accounted for by CTRs. Information presented during the hearings showed discrepancies of $25 million, $24.6 million, and $39 million between total cash deposits reported in 1979 by three banks to the Miami Federal Reserve Bank and cash amounts they reported on CTRs. OCC officials attributed such discrepencies, in some cases, to deposits by correspondent banks for which no CTRs are required.

According to the Chief of the RAU, the only study assessing the level of compliance by banks found that as many as 50 percent of the Nation's banks did not file any CTRs for the first 6 months of 1979. The RAU study matched a listing of the Nation's banks against CTR filings in the RAU data system. RAU officials recognized that the study had some deficiencies and that some smaller banks would not have any filings. However, they believed the study surfaced the existence of some compliance problems.

Treasury officials discounted the results of the study. They cited factors, such as (1) the wide discretion banks have had to exempt their customers from the reporting requirements and (2) possible gaps in the data base due to the failure of some financial institutions to include their identification numbers

on CTRs. Treasury's concerns highlight the difficulties in determining an overall level of compliance.

Initial Regulations Provided For Broad Interpretation

Treasury's initial regulations implementing the Bank Secrecy Act provided insufficient guidance on (1) who could be exempted as well as (2) reporting procedures for split transactions below $10,000.

Treasury's inadequate guidance, as well as the lack of familiarity with the reporting requirements at some financial institutions, produced wide variations in practices for reporting and exempting currency transactions. For example:

--Two New York City banks, each with assets in excess of $20 billion and with similar types of customers, had contrasting filing practices. One bank filed about 5,000 CTRs and exempted about 2,000 customers from reporting; the other filed about 2,000 CTRs and followed a practice of generally not exempting customers.

--A Florida Edge Act Corporation filed no reports and officially exempted no one, but instead recorded every reportable transaction in a log. It was subsequently determined that about 50 of the individuals in the log were allegedly involved in narcotics trafficking.

--Three Texas banks had contrasting policies regarding the Bank Secrecy Act. One exempted only commercial businesses from reporting; another exempted all customers and, in fact, recruited large cash deposits from foreign nationals across the Mexican border; a third exempted no customers but allowed them to split transactions so that a CTR would not have to be filed.

--One Florida bank had a "John Doe" on their exemption list.

--Three banks had varying exemption verfication practices. One Florida bank exempted customers only if bank management personally knew the individual. A New York bank exempted customers only after bank personnel obtained specific information concerning the nature of the customers' businesses. Another New York bank reviewed all exemptions on a 6 month basis to verify the need for the exemption.

The bank examiners generally did not question banks' exemption practices. Instead, they relied on the judgment of the banks' management.

In July 1980, Treasury revised its new regulations to, among other things, tighten the exemption provisions. The revised regulations restrict exemptions to domestic government entities, certain financial institutions and retail businesses. With respect to the latter, however, the revision does exempt businesses of the type that have been used as fronts by organized criminals. These include race tracks, vending machine companies, restaurants and bars.

The revised regulations should result in more consistent interpretation and reporting but will not necessarily assure compliance. Even today, however, some institutions cited for failing to file forms are not familiar with the Bank Secrecy Act's reporting requirements. Thus, there is a clear need for better compliance monitoring and for a continued effort to familiarize financial institutions with the Act's requirements.

Bank Regulatory Examinations Do Not Adequately Test Reporting Compliance

The bank regulatory agencies' examination procedures are inadequate to test compliance with the Bank Secrecy Act. At Treasury's request, the agencies have tested more extensive compliance verification procedures which have detected substantially more reporting violations than present procedures. However, the regulatory agencies have rejected adopting them because (1) they believe the test results did not justify the additional resources and (2) the test procedures involve auditing which goes beyond their responsibilities as examiners. However, the agencies are considering a less stringent, phased examination approach in lieu of the test procedures.

Present examination procedures are cursory

Officials at the bank regulatory agencies admit that their present examination procedures are insufficient to fully test reporting compliance. Basically, the examination procedures focus on interviewing bank officials using a checklist of questions. Some nonsystematic testing of internal controls, deposit/withdrawal records or exemptions may be done at the discretion of the examiner. However, the initial Treasury regulations fostered a cursory examination approach. They did not (1) require the banks to maintain

copies of CTRs and CMIRs, (2) provide criteria for determining exemptions, nor (3) require banks to maintain exemption lists.

As a result, the examination procedures detected few reporting violations. Of the 9,828 banks examined by the FRS, OCC and FDIC during calendar year 1979, only 128 institutions, or one percent, were cited for failure to file a CTR.

Test Procedures Detect More Violations

On February 12, 1980, in response to criticisms of the current procedures and at the Department of Treasury's direction, the three principal bank regulatory agencies agreed to test more comprehensive uniform compliance examination procedures. The uniform procedures are based on those used by the New York FRS district for the past four years. They include the following requirements:

--check the bank's internal control and internal audit procedures;

--assess bank's employee training;

--test at least two weeks of transactions to verify reporting or proper exemption practices;

--review the bank's process for granting exemptions;

--question suspect exemptions; and

--analyze currency flows in/out of the bank and its branches.

FRS tested the procedures in its New York, Atlanta, and San Francisco districts; and OCC and FDIC tested them in their Atlanta, Dallas, New York, and San Francisco districts. We observed test examinations in all four districts. The procedures left some discretion to the examiner so that attention was given to the transactions of some tellers within those branches with the most substantial cash flows. Additionally, in some banks, examiners did not review a full two weeks of transactions.

The test procedures did detect significantly more reporting violations than did the checklist procedure used in the past. Of 37 banks examined by FRS, 8, or 22 percent, were found to be in violation of the CTR reporting requirements as opposed to 1, or 3 percent, under the checklist procedure. Of 36 banks examined by FDIC, 5 or 14 percent, were in violation as opposed to 1, or 3 percent. Finally, of 11 banks examined by OCC, 3, or 27 percent, were in violation as opposed to none under the checklist procedure.

These results correspond with our analysis of reporting violations detected by FRS in calendar years 1976-1979. During this period, the New York Federal Reserve district--the only district to routinely employ the extensive examination procedures--accounted for 58 percent of the CTR reporting violations detected by the entire Federal Reserve System.

Reserve System. This result was achieved even though the New York district accounted for only 6 percent of the total FRS banks examined in the four year timeframe.

We found further evidence that the test examination procedures provided better opportunities for detecting reporting violations than the checklist procedure.

--An examiner commented in his report on the examination of a bank with about $100 million in assets that review of random samples of each teller's transactions for a two week period detected three customers who were neither on the exemption list nor filed CTRs. He said these violations would not have been detected if the examination had been confined to an interview with bank management. No reporting violations had been found in five prior examinations of the same bank.

--Examination of a bank with over $1 billion in assets disclosed 31 violations within a two week period for failure to file a CTR. The examiner considered bank management to be somewhat complacent with respect to the Act. In five prior examinations, the bank had never been cited for a reporting violation.

Bank Regulatory Agencies Reject Test Procedures; Opt for a Phased Examination Approach

The bank regulatory agencies have decided not to adopt the test examination procedures because they believe the results do not warrant the required level of effort.

Examiners described the violations they detected using the test procedures as clerical oversights not representing a pattern of noncompliance. These violations were detected

only with a substantial increase in effort. FDIC--the only agency to estimate the time devoted to checklist examinations of Bank Secrecy Act compliance--estimated that examiners expended an average of 17.4 hours per institution for the test procedures as compared to 2 hours per institution for prior examinations. FRS estimated that the test procedures doubled the examination time required while OCC could not estimate the size of the increase.

The bank regulatory agencies plan to adopt a phased or modular examination approach as an alternative to either the checklist or test procedures. The first phase would require a high level bank official to certify that the institution is in compliance with the reporting and recordkeeping requirements. In this phase the examiner would be required to determine whether the bank has a training program, compliance officer, and internal controls and written procedures to promote compliance.

If the bank fails phase one, the examiner proceeds to phase two which involves several specific questions concerning bank internal controls for assuring compliance with the Act. Only if the bank fails this step would the examination proceed to phase three which involves verifying sampled cash transactions against CTRs and exemption lists.

Bank regulatory officials believe this is an appropriate strategy and that it is in keeping with standard examination

principles. They contend that the proposed procedures, together with proposed internal training will signify to field examiners that the bank regulatory agencies are interested in assuring compliance with the Bank Secrecy Act reporting requirements.

How Much Examination Effort is Justified?

While we have some reservations concerning the phased examination approach the regulatory agencies propose to adopt, we recognize that questions exist concerning the justification for extensive application of the test procedures.

Our principal reservation concerning the proposed phased examination approach is that the first phase is much like the current checklist approach. Given staffing constraints and examination deadlines, an examiner very easily could reduce the proposed approach to a one-phase examination by conducting a cursory review and finding internal controls adequate. Obviously, the lack of reporting violations detected in the past does nothing to reassure us. Without the periodic verification of the reporting of some cash transactions, detection of banks with compliance problems would seem unlikely.

On the other hand, although the extensive test procedures might be useful on a selected basis, we question their nationwide application. Broad application of the procedures would require considerable additional resources by the bank regulatory agencies

without providing a statistically reliable estimate of reporting compliance. A test check of two weeks of transactions to verify CTR reporting does not provide a statistically reliable estimate of the level of bank compliance. A statistical sample would require that all cash or equivalent transactions greater than $10,000 be identified and that a sufficient number of those transactions be checked for compliance with the CTR reporting requirement. Most banks' ADP systems do not identify cash transactions. Therefore, examiners have been unable to use routine sampling techniques to determine the level of compliance at a given financial institution.

Presently there are no indications of wholesale noncompliance by financial institutions which would justify widespread adoption of the test procedures. The test procedures generally did not detect patterns of noncompliance. Using the extensive procedures, the New York Federal Reserve district detected the most reporting violations in the Federal Reserve System during the past four years. But in FRS' opinion none warranted referral to Treasury for civil or criminal action. We have some reservations, however, because the more extensive procedures lack statistical validity. Furthermore, the bank regulatory agencies generally have not aimed to establish patterns of noncompliance.

As stated earlier, we believe that the general nature of Treasury's initial regulations and the unfamiliarity of some banking personnel with the regulations have contributed to the widespread suspicions concerning the lack of reporting compliance. Treasury's recently published regulations which tighten the exemption requirements and IRS' recent efforts to monitor the quality of CTRs it receives should resolve some of the criticisms voiced by law enforcement. The results of these initiatives, as well as Treasury's efforts to improve the utility of the reports, should be assessed prior to significantly expanding the regulatory agencies' compliance monitoring efforts.

In the interim, we are willing to work with the Department of Treasury and the bank regulatory agencies to assist in developing procedures which will adequately test compliance and to target such procedures on banks with unusual reporting histories.

This concludes my prepared statement. My colleagues and I would be pleased to respond to any questions.