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MONEY LAUNDERING:

Civil Penalty Referrals for
Violations of the Bank Secrecy
Act Have Declined

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MONEY LAUNDERING:
CIVIL PENALTY REFERRALS FOR VIOLATIONS
OF THE BANK SECRECY ACT HAVE DECLINED

SUMMARY OF STATEMENT BY HAROLD A. VALENTINE
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In July 1991 the Subcommittee on Oversight, House Committee on Ways and Means, requested GAO to examine how Treasury's Office of Financial Enforcement (OFE) processes civil penalty referrals for violations of the Bank Secrecy Act. GAO reported in February 1992 on conditions at OFE and has updated some of the information in that report for the Subcommittee.

Enacted in 1970, the Bank Secrecy Act requires the recording and reporting of certain transactions exceeding \$10,000 that involve currency and monetary instruments. Violations of the act can result in criminal and/or civil penalties. Violations that have the potential for a civil penalty are referred to the Assistant Secretary of the Treasury for Enforcement by regulatory and enforcement agencies. The Office of Financial Enforcement was established in 1985 and is responsible for, among other things, making recommendations to the Assistant Secretary as to whether civil penalties should be assessed and, if so, the amount of the penalties.

The number of referrals made by regulatory agencies is declining: from a high of 136 in 1986 to 26 in 1991. GAO found that OFE has not processed civil penalty referrals in a timely manner. GAO analyzed over 50 referrals awaiting resolution and found periods of inactivity in many of the cases, ranging from several months to over a year. GAO also looked at 20 cases that were closed without a penalty assessment by a special Treasury task force and found that in 11 of the referrals, the statute of limitations had expired while the case was being processed.

OFE has recognized that lengthy processing times have been a problem and has taken steps designed to correct the situation, including acquiring additional staff and improving its case tracking system. In light of the decrease in the number of referrals being made, these steps should result in faster processing.

Mr. Chairman and Members of the Subcommittee:

We are pleased to have this opportunity today to discuss our work relating to the assessment of civil penalties by the Department of the Treasury for violations of the Bank Secrecy Act. As you know, the Bank Secrecy Act is a major weapon against money laundering. Because money laundering supports a wide range of illegal activities--basically any crime where profit is the primary motive--full and vigorous enforcement of the act is an essential component of this country's war on crime.

Treasury's Office of Financial Enforcement (OFE) is responsible for developing referrals received from other agencies and recommending civil penalties for failure to properly file the reports required by the Bank Secrecy Act. In July 1991 you asked us to review the Office's processing of referrals. Our testimony today will discuss the contents of our report (Money Laundering: Treasury Civil Case Processing of Bank Secrecy Act Violations, GAO/GGD-92-46, February 6, 1992). In addition, we have updated certain figures to reflect additional cases received and processed since our review.

From 1985 through June 10, 1992, OFE received 585 referrals for violations of the Bank Secrecy Act and recommended 49 penalties totaling \$21,743,380. The number of referrals received annually, however, as well as penalties assessed, has declined markedly since OFE began processing the referrals in 1985. We did not attempt to determine the reason for these declines. Instead, we focused on assessing how well OFE is processing referrals. In many of the referrals we looked at, we found lengthy periods of inactivity that delayed the decision on how to close the case. Recent management changes by OFE--as well as the decline in the number of referrals received--should help ensure that decisions are made and implemented in a more timely manner.

OFE'S ROLE IN ENFORCING THE BANK SECRECY ACT

Enacted in 1970, the Bank Secrecy Act and its implementing regulations require that reports be filed by

- financial institutions and certain businesses, such as casinos and money transmitters, on all currency transactions exceeding \$10,000; and
- individuals and institutions when moving currency or monetary instruments over \$10,000 into or out of the United States or who have a financial interest in, or signature authority over, bank accounts, securities accounts, or other financial accounts in a foreign country if they exceed \$10,000.

Violations of the Bank Secrecy Act can result in criminal and/or civil penalties depending upon the nature of the offense. Criminal investigations are primarily the responsibility of the

Criminal Investigation Division of the Internal Revenue Service (IRS) and are pursued through the federal court system. Civil penalties, however, are assessed by the Assistant Secretary of the Treasury for Enforcement. Assisting the Assistant Secretary is the Office of Financial Enforcement, which is responsible for, among other things, developing referrals of alleged civil violations of the act and making recommendations as to whether civil penalties should be assessed against individuals or financial institutions, their officers, employees and customers and, if so, the amount of the penalty. Penalties can range from \$500 for negligent violations and from \$25,000 to \$100,000 per willful violation.

OFE receives civil penalty referrals from IRS examination and criminal investigation activities and from bank regulatory and law enforcement agencies. It also receives "voluntary referrals" from the banks themselves. Once referrals are received at OFE they are logged in and key data on the cases are entered into a case tracking system that is used to identify the stage of processing. As a first step in processing, referrals are sent to the Criminal Investigation Division in IRS in order to determine if the referral should be handled as a criminal investigation or if there is already a criminal investigation underway. IRS has 120 days to make the determination.

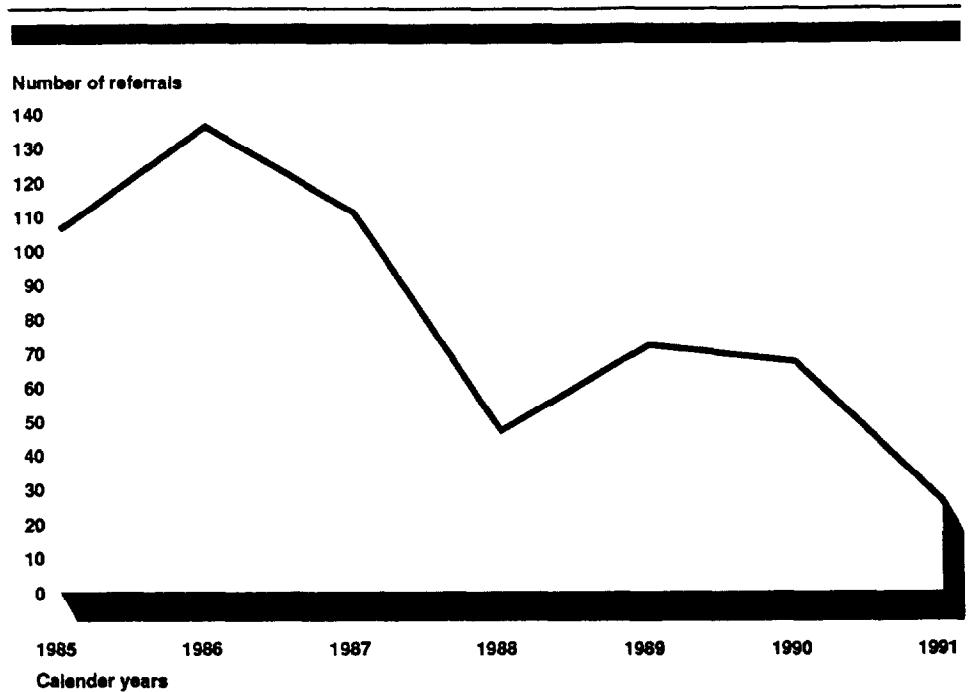
Once OFE has been notified that the referral does not merit a criminal investigation and that there is not a criminal investigation underway, the case is assigned to a specialist who determines if additional information is required concerning the subject of the referral or the circumstances of the violation. Treasury does not categorize violations as substantive or technical and has emphasized that it has a "zero tolerance" for violations of the act. Nevertheless, it does recognize that certain mitigating circumstances should be taken into consideration when deciding what action should be taken in response to referrals. For example, previous compliance examination reports on the subject business or institution might be requested from the agency making the referral. In some cases, OFE will contact the subject of the referral and ask for additional details as to how and why the violation occurred and what corrective action has been taken to prevent the violation from happening again.

On the basis of the information in the referral and that developed by OFE, a specialist in OFE will recommend one of three courses of action: close the case without contacting the subject of the referral, issue a letter of warning, or assess a penalty for some specified amount. After OFE's Director reviews and approves the recommended action, the Assistant Secretary for Enforcement is given the recommendation to act on.

OFE IS RECEIVING FEWER CIVIL PENALTY REFERRALS

Figure 1 shows the decline in the number of civil penalty referrals received by OFE from 1985 through 1991.

Figure 1: Referrals Received, 1985 - 1991



Note: As of June 10, 1992, OFE had received 20 referrals.

Source: GAO, derived from OFE data.

Table 1 shows OFE's overall civil penalty workload since 1985 when OFE was established.

Table 1: Civil Penalty Referrals Processed by OFE Through June 10, 1992

	1985	1986	1987	1988	1989	1990	1991	1992	TOTAL
Beginning inventory	3	100	159	192	180	194	158	137	
Referrals received	106	136	111	47	72	67	26	20	588*
Active cases	109	236	270	239	252	261	184	157	
Cases closed	9	77	78	59	58	103	47	16	447
Penalty assessed	9	15	11	5	4	2	1	2	49
Letter of warning	0	56	48	40	20	53	17	12	246
No contact	0	6	19	14	34	48	29	2	152
Ending inventory	100	159	192	180	194	158	137	141	

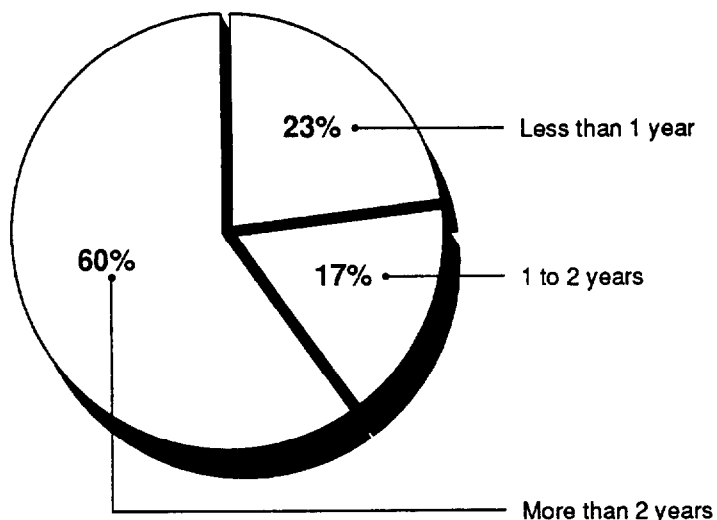
*Includes 3 referrals in beginning 1985 inventory.

Source: GAO, derived from OFE data.

Overall, the average time required to close the 447 cases was 1.8 years and ranged from 4 days to over 6 years. The average age of the 141 cases that were open as of June 10, 1992, was 2.4 years, including 2 cases that had been open for over 7 years.

Figure 2 has additional information regarding the age of open cases.

Figure 2: Age of Open Cases As of June 10, 1992



Open cases = 141

Source: GAO, derived from OFE data.

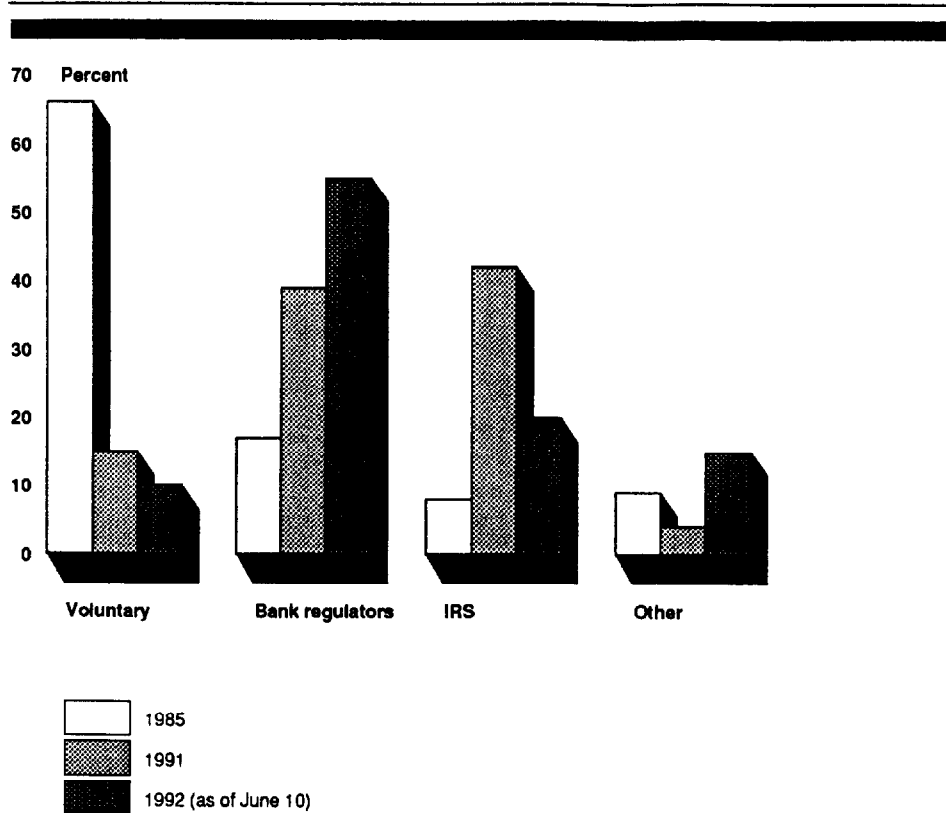
Forty-nine of the 447 cases closed since 1985, 11 percent, resulted in a penalty assessment. However, the number of penalties assessed--as well as the percentage of cases closed with a penalty--has steadily decreased since 1986, when 15 were assessed. OFE attributes this decrease to improved compliance with the reporting requirements resulting in less serious and blatant violations being referred.

About 55 percent of all cases closed since 1985 resulted in letters of warning being sent while 34 percent were closed with no contact. While the ratio of cases closed with a letter of warning to cases closed with no contact has been steadily decreasing over the past 7 years, OFE does not attribute any significance to this trend.

Most of the referrals received in 1985 were voluntary referrals. By 1991, however, referrals from bank regulators and IRS constituted the majority of those received.

Figure 3 has additional information on the source of referrals.

Figure 3: Sources of Referrals



Source: GAO, derived from OFE data.

CIVIL PENALTY REFERRALS WERE NOT BEING PROCESSED
IN A TIMELY MANNER

In January 1990, Treasury's Inspector General (IG) reported that as of February 1989, OFE had a "backlog" of 220 civil penalty cases--all of the open cases pending at that time. The report attributed the backlog primarily to a lack of staff and, to a lesser extent, insufficient priority given to processing the cases and inadequate written procedures. In September 1990, the Assistant Secretary testified before this Subcommittee that in response to the IG's report, a special interagency task force had been formed (5 specialists and 2 secretaries) and, working with the OFE staff already on board, had reduced the number of pending cases to about 100, what OFE considered a "normal" workload.

As can be seen from table 1, the number of cases closed during 1990 did increase substantially, due in large part to the efforts of the task force. However, as of June 10, 1992, OFE's inventory

of open cases was 141: 41 more than the workload considered normal.

Although we do not agree with the IG's report that all of the open cases are necessarily a backlog, we do agree with the overall conclusion of the report that OFE was not processing civil penalty cases in a timely manner. As requested by the Subcommittee, we did a detailed analysis of 20 of the open civil penalty cases at OFE: the 10 oldest cases and 2 cases chosen judgmentally for each year from 1987 through 1991. Because of staff turnover, we were not able to meet with OFE officials and staff who worked on the early stages of the cases to determine why certain actions were taken. On the basis of documents and material that were in the case folders, however, we were able to determine what actions were taken and when.

In 13 of the 20 cases we reviewed, we found periods of inactivity in which no action had been taken for several months; in some cases, no action had been taken for more than a year.

In some situations, specialists had made recommendations on how to proceed with a case but no action had been taken. For example, OFE received a referral in July 1985 concerning a bank in California found to have committed several reporting violations. In August 1988 IRS notified OFE that there was no criminal case open concerning the bank. In June 1990 the case was reviewed by a member of the task force mentioned earlier who recommended that because of subsequent violations noted by the referring agency, a penalty be assessed. The case was inactive until September 1991, when it was reviewed again and a recommendation made to close the case with no further action. We were told that this recommendation was rejected and that as of October 22, 1991, OFE had recommended assessing a penalty on the most recent violations. A prepenalty letter to the bank had been drafted but was unsigned.

Another referral was received in January 1987 and reported that a bank in the Southwest had failed to file 48 Currency Transaction Reports (CTRs) between 1982 and 1985. A June 1990 recommendation outlining available courses of action was not acted on and the case was inactive until July 1991 when a specialist recommended closing the case with a warning letter. On October 30, 1991, OFE closed the case with a warning letter.

In other cases, additional information requested by OFE had not been provided and OFE had not pursued these requests. For example, OFE received a referral on another Southwestern bank in April 1985 that had failed to file 67 CTRs between 1982 and 1984. In December 1986, OFE wrote the bank requesting additional details on the violation, a description of the changes made in the bank's program to ensure compliance, and copies of the reports that had been backfiled. Apparently, there was no

response since a recommendation was made in March 1989 to send the bank a certified letter asking for a response to the first letter. We could not tell if the certified letter was sent, but the next action taken on the case was a recommendation in July 1991 to close the case. The case was subsequently closed on November 27, 1991.

In another case, OFE received a referral concerning a check cashing business in June 1988. A September 1989 request to the business asking for additional details was answered the following month but was found to be unresponsive. Not until September 1990 did OFE request the information a second time--a delay of 11 months. The second response was received by OFE in January 1991 but not reviewed until June, when a penalty was recommended. In October 1991 OFE had drafted a letter informing the business of its decision.

In other cases, OFE had received the additional information it requested but had not acted on it. For example, in March 1990 OFE received a voluntary referral from a Midwestern bank reporting that it had improperly exempted 2 accounts and had failed to file special exemptions for 13 accounts. Additional information requested from the bank was subsequently received, and in February 1991 IRS notified OFE that there was no criminal case open. OFE took no further action on the case until October 1991, when additional information was requested. We were told that the inactivity was the result of the specialist assigned to the case having been reassigned.

In another referral involving a gambling casino, a November 1990 request for additional details from the casino was received in February 1991 but had yet to be acted on by October of that year.

IG'S REPORT HAD LITTLE IMPACT

In order to determine if case processing time had improved since the IG's report, we looked at an additional 34 civil penalty referrals received by OFE in the 1-year period ending July 31, 1991. In many of these cases, we found instances of several months elapsing before an action was taken. Some examples of these cases follow.

--In November 1990 a specialist recommended closing without contact a referral on a bank received in July 1990. The recommendation was not acted on until November 1991.

--In January 1991 an OFE specialist recommended closing without contact a referral made by IRS in September 1990 concerning a private business. The recommendation was not acted on until June 1991.

- A voluntary referral from a bank that was received in February 1991 remained inactive until June 1991 when OFE requested previous compliance examination reports.
- As of September 1991, a referral concerning a savings and loan received in January 1991 had not been acted on since February 1991 when a specialist prepared a memo evaluating the case.
- In February 1991, OFE was notified by IRS that there was no criminal case on a November 1990 referral made on a bank. The case was inactive until August 1991 when an evaluation was prepared recommending the case be closed without contact. As of December 31, 1991, the case was still open.
- A January 1991 recommendation that a referral received in December 1990 be closed without contact had not been acted on as of December 31, 1991.
- A March 1991 referral concerning a credit union had a letter drafted the same month requesting additional information from the institution. As of September 1991, there had been no additional activity.

THE EFFECT OF LENGTHY PROCESSING OF CIVIL PENALTY CASES

In 1991, 80 percent of all referrals received by OFE came from IRS, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation (42 percent, 15 percent, and 23 percent, respectively). Officials at these 3 agencies told us that in their opinion, civil penalty cases took an excessive amount of time to be closed. Officials at 2 of these agencies also told us that they believed--although it could not be proven or measured--that the lengthy processing times resulted in a decrease in enforcement efforts. Enforcement staff, we were told, are less likely to go to the trouble of making civil penalty referrals if they believe these efforts will not have any results. Officials at the third agency told us that although they were confident that their staff were still making civil penalty referrals where appropriate, lengthy processing times have the potential of decreasing the number of referrals made.

As demonstrated by figure 1, the number of civil penalty referrals received by OFE has been declining over the past several years. However, OFE and some enforcement personnel attribute this decrease to improved compliance with the reporting requirements as well as a better understanding of what the requirements are. To prove what impact the processing times have had, if any, on enforcement efforts was beyond the scope of our review.

Lengthy processing time can also affect the public's perception of the government's efforts to enforce the Bank Secrecy Act. For example, one publication specializing in money laundering issues, Money Laundering Alert, has described OFE's operations as "paralyzed," resulting in a decreased credibility of the federal government's efforts against money laundering.

We think it would be reasonable to assume that the effectiveness of any penalty as a deterrent to prevent future violations would be directly related to the length of time between the violation and the action taken. Given this assumption, lengthy processing times for civil penalty referrals could affect compliance with the Bank Secrecy Act.

Perhaps the most serious result of civil penalty cases remaining inactive for lengthy periods of time can be the expiration of the statute of limitations for the offense. We reviewed 20 of the cases that were closed without penalty during the period when the IG's task force referred to earlier was in operation. In 11 of these cases, the statute of limitations had expired on all or most of the violations while they were being processed.

STAFFING PROBLEMS AND WORKLOAD MANAGEMENT HAVE INCREASED PROCESSING TIMES

In commenting on the 1990 IG's report, the Assistant Secretary for Enforcement stated that he believed the only cause of the backlog was the "serious and long-standing" shortage of staff. We agree that OFE has had staff shortages--as well as management turnover and vacancy problems--in the past and that this has contributed to delays in processing civil penalty cases.

Prior to July 1990, there was 1 full-time specialist at OFE reviewing civil penalty referrals. At that time, a second specialist was hired followed by 2 additional specialists hired in April and July of 1991. During 1990 the Director of OFE was absent on maternity leave for 5 months and resigned in December 1990. That position remained vacant until May 1991 when the current Director was appointed. The Deputy Director's position was vacant from May through September 1991, and there was no Chief of the Compliance Section from December 1990 to July 1991.

Inadequate case management also contributed to the delays in processing civil penalty cases. OFE was not monitoring the cases to ensure that decisions had been reached, recommendations acted on, and requested information received or else followed up on. OFE needs to manage the processing of individual cases in a systematic fashion to identify what action is needed, establish a completion date for that action, and ensure that progress on the case is reviewed by that date. Without such a case management system, it is not possible to determine what the level of

staffing at OFE should be. We have been told by OFE's Director that the Office is aware of this problem and have taken steps to improve the situation. These steps include acquiring additional staff and refining the case tracking system so that cases are reviewed on a periodic basis to determine their progress. If successfully implemented, these changes--as well as the decrease in referrals being made--should result in a marked improvement in processing times. At the time of our review, however, the improvements had just been made and it was too early to measure the impact they would have on case management.

This concludes my statement, Mr. Chairman. We would be pleased to respond to any questions.