GAO
United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-276685

159525

October 30, 1997

The Honorable Spencer Bachus
Chairman, Subcommittee on General Oversight
and Investigations
Committee on Banking and Financial Services
House of Representatives

Subject: Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering

Dear Mr. Chairman:

This letter responds in part to your March 5, 1997, request that we review private banking activities in the United States and the vulnerability of such activities to money laundering. Although there is no generally accepted definition, private banking has been broadly described as financial and related services provided to wealthy clients. As agreed with your office, we are providing in this letter the information obtained to date in the areas outlined in your request letter: (1) the nature and extent of private banking activities in the United States, (2) regulatory efforts to monitor private banking activities and ensure that these activities comply with the Bank Secrecy Act (BSA), (3) policies and procedures of banks to ensure that their private banking activities comply with BSA, and (4) law enforcement perspectives on the vulnerability of international private banking activities to money laundering. As also agreed with your office, we are concentrating the remainder of our work on efforts of U.S. regulators to oversee the offshore private banking activities[1] of banks located in the United States.

Enclosure I contains the preliminary information we have obtained in the four areas in which you expressed interest. In summary, we observed that:

(1) There is no generally accepted definition of the products and services that make up private banking or who constitutes its clients. As a result, it is difficult to measure the extent of private banking with any precision. A 1996 overview of private banking issued by an industry publication provided

[1]Offshore private banking activities include activities such as establishing trusts or "shell" companies in financial secrecy jurisdictions like the British Virgin Islands or the Cayman Islands.

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information on 35 institutions surveyed with reported private banking assets ranging from $197 million to $300 billion.

(2) The Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) are to review BSA compliance of private banking activities as part of their overall BSA examinations of banks under their supervision. In addition to these overall BSA examinations, the Federal Reserve Bank of New York recently undertook a focused review of private banking activities in its district, including a review of banks' anti-money-laundering programs and "know your customer" policies.[2]

(3) All of the 11 banks we visited told us they had formal programs intended to ensure their compliance with BSA. These programs included such policies and procedures as identifying and reporting suspicious transactions and know your customer programs. Some bank officials we contacted expressed concern about regulatory oversight of know your customer policies noting that the lack of a formal regulation about such policies may contribute to inconsistencies in how the regulators review the area.

(4) Law enforcement views on the vulnerability of international private banking to money laundering varied. Some law enforcement officials indicated that private banking was no more vulnerable than any other banking area, while others stated that certain characteristics of private banking make the area more susceptible to money laundering.

In developing the information in this letter, we (1) conducted a literature search and spoke with representatives of research and publishing firms with some expertise in private banking and a private banking school; (2) interviewed officials of the Board of Governors of the Federal Reserve System and two Federal Reserve Banks, OCC, FDIC, and state banking departments in New York and Florida; (3) reviewed regulatory procedures for examining BSA compliance and selected examination reports; (4) interviewed key officials of 11 banks engaged in international private banking (6 domestic and 5 foreign-owned, selected because of the level of their private banking activities and their geographic locations in areas noted to be particularly vulnerable to money laundering) and 2 bank trade associations;[3] (5) reviewed bank policies and procedures related to BSA compliance at the banks we visited; and (6) obtained perspectives from several law enforcement agencies under the Department of the Treasury and the Department of Justice.[4] We also interviewed representatives of the El

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[2]Such policies enable the institution to understand the kinds of transactions that a particular customer is likely to engage in and to identify transactions that may be unusual or suspicious.

[3]The trade associations contacted were the American Bankers Association and the Institute of International Bankers.

[4]At the Department of the Treasury, we spoke with officials from the U.S. Secret Service, Financial Crimes Enforcement Network, U.S. Customs Service, and the Internal Revenue Service. At the Department of Justice, we spoke with officials from the Drug Enforcement Administration, the Federal Bureau of Investigation, and the Executive Office for U.S.

Dorado Task Force in New York and the High Intensity Drug Trafficking Area Task Force in Miami, which are interagency law enforcement groups set up to combat criminal drug-related and money laundering activities. We conducted our work in New York, NY; Miami, FL; San Francisco, CA; and Washington, D.C., between April and August 1997 and in accordance with generally accepted government auditing standards.

The Federal Reserve, FDIC, and OCC provided written comments on a draft of this letter. (See encls. II, III, and IV.) The three agencies generally agreed that the letter represents an accurate portrayal of private banking activities and the regulatory oversight of the area. FDIC provided additional information on current efforts to enhance its examination procedures to address private banking issues. OCC provided information on its efforts to combat money laundering, such as establishing a "task group" to provide a focal point for the agency's anti-money-laundering efforts. We also obtained oral comments of a technical nature from the Federal Reserve and OCC that have been incorporated in the letter where appropriate.

As agreed with you, unless you publicly release its contents earlier, we plan no further distribution of this letter until 8 days from its issue date. At that time, we will provide copies of this letter to the Ranking Minority Member of your Subcommittee and to the Chairmen and Ranking Minority Members of other House and Senate Committees with jurisdiction over banking matters, the Federal Reserve, OCC, and FDIC. We will also make copies of this letter available to other interested parties on request.

If you or your staff have any questions about the information in this letter, please contact me on (202) 512-8678 or Kane Wong, Assistant Director, on (415) 904-2000. Other major contributors to this letter are listed in enclosure V.

Sincerely yours,

Thomas J. McCool
Director, Financial Institutions
and Market Issues

Attorneys. We also spoke with assistant U.S. attorneys and other staff from the Southern District of New York, Eastern District of New York, and Southern District of Florida.

INFORMATION ON PRIVATE BANKING AND ITS VULNERABILITY TO MONEY LAUNDERING

NATURE AND EXTENT OF PRIVATE BANKING

Common agreement is lacking among private banking providers on exactly what products and services make up private banking or who constitutes its clients. However, private banking has been broadly defined as financial and related services provided to wealthy clients. Within this general definition, distinctions can be made between domestic and international private banking: domestic private banking involves services provided within the bank client's main country of residence, and international private banking involves services in countries outside the client's main country of residence.

Private Banking Products and Services

According to the Federal Reserve, the hallmark of private banking is the personal delivery of financial products and services to affluent clients. Although a few private banking providers limit their services to traditional trust administration, others offer an array of products and services that extend from basic banking products such as loans to investment counseling. These products and services may include deposit-taking; lending; mutual funds investing; personal trust and estate administration; funds transfer services; and establishing payable through accounts,[5] private investment companies,[6] or offshore trusts. Banking analysts observed that private banking providers have also been increasingly offering their wealthy clients more sophisticated products, such as risk management products, due to their clients' desire for higher returns and diversification of their assets.

Private Banking Clients

Private banking providers use varying thresholds for identifying wealthy clients. According to banking analysts, the threshold tends to be defined by the geographic market the provider serves. They noted that although some large banks located in metropolitan areas like New York may require $1 million to $5 million in investable assets, smaller community banks in more rural areas may require as little as $100,000 in such assets. According to a register of private banking providers,[7] the minimum amount required for opening an account ranged

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[5]Payable through accounts are transaction deposit accounts through which U.S. banking entities extend check-writing privileges to clients of a foreign bank.

[6]Private investment companies are "shell" companies incorporated in financial secrecy jurisdictions that are formed to hold client assets. Such companies are formed to maintain clients' confidentiality and for various tax- or trust-related reasons.

[7]Private Banking Register, 1996, Worth Magazine Supplement.

from $25,000 for an owner-managed private bank to $50 million for a long-established private banking provider that specialized in servicing the very wealthy.[8]

Industry studies suggest that some private banking providers have adopted more inclusive criteria for identifying their private banking clients as they have cast a wider net to include the emerging affluent. This trend is supported by a reduction of minimum account requirements. One private banking provider, for example, that once required $2 million in total investable assets has reduced this requirement to a $250,000 minimum to open a wealth management account. A large money-center bank, which once required $5 million in total investable assets, has started to accept private banking clients with $1 million. Another private banking provider, which previously had a $5 million minimum, has eliminated its minimum requirement altogether.

Data on Private Banking

Industry representatives, regulatory officials, and banking analysts we contacted were not aware of any comprehensive database available for determining the extent of private banking activities by banks or other financial institutions operating in the United States. Banking analysts explained that the private banking industry is hard to quantify with any degree of accuracy due to the difficulty involved in capturing data for an area that has not been clearly defined. One consultant pointed out that some small rural banks may be providing specialized services to their most wealthy clients but may not refer to these services as private banking, let alone track the extent of such activities.

It is also difficult to measure the extent of private banking because financial institutions do not consistently capture or publicly report such information. How private banking data are captured at a particular institution can be affected by differences in how they are structured to deliver private banking services. In some instances, private banking functions may represent the sole business of an institution, and, in these cases, data collection is not likely to be a problem. Private banking may also be performed by specific departments of a commercial bank, Edge Act corporation,[9] nonbank subsidiary, or branch or agency of a foreign bank. Although in many cases these departments may represent stand-alone private banking units, data on such matters as the extent of their private banking assets may not always be readily available. Finally, private banking may be conducted in multiple areas of an institution along with, for example, other commercial, retail, and financial services. In these instances, a banking analyst explained that it is highly unlikely that private banking data are separately reported.

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[8]A study of private banks conducted by KPMG Peat Marwick for the American Bankers Association found that private banking clients have, on average, a minimum investment account of $300,000, an annual income of $270,000, and a net worth of $2.3 million.

[9]An Edge Act corporation is a banking corporation that finances international commerce and is chartered by the Board of Governors of the Federal Reserve System.

Despite the difficulties involved in determining the overall extent of private banking, we found that all of the 11 banks we contacted had separate units specializing in private banking, and most were able to compile information on the amount of their total private banking assets. Their reported total private banking assets ranged from $586 million for an Edge Act corporation to $150 billion for a large commercial bank.

The most recent information we identified on private banking in the United States was a general overview of private banking providers published by Worth Magazine in 1996.[10] It showed that private banking providers in the United States represented a range of distinct institutions, each with its own culture, client mix, and philosophy. In addition to banks, they included such companies as asset-management firms and trust companies. Among other things, the overview presented brief profiles of 35 private banking providers and highlighted key differences among them. For example, total private banking assets of profiled providers ranged from $197 million for a relatively new entrant into the market to $300 billion for a large, established Swiss bank operating in the United States. Table 1 shows reported asset ranges and other selected features for private banking providers.

Table 1: General Overview of 35 Private Bank Providers Profiled by Worth Magazine

Selected features	Range of reported values in 1996
Minimum account	$25,000 to $50 million[a]
Private banking assets	$197 million to $300 billion
Years in private banking	5 years to 212 years[b]
Clients per "private banker"[c]	23 clients to 240 clients

[a]This range represents providers that had a minimum account requirement.

[b]This private banking provider represents one of the oldest banks in the United States that has been engaged in private banking services since 1784.

[c]Private bankers, also referred to as relationship managers, are assigned to private banking clients and are responsible for coordinating the institution's services for the benefit of the client.

Source: Private Banking Register, 1996, Worth Magazine Supplement.

[10]Private Banking Register, 1996, Worth Magazine Supplement.

REGULATORY EFFORTS TO MONITOR COMPLIANCE WITH THE BANK SECRECY ACT

The Federal Reserve, the Office of the Comptroller of the Currency (OCC), and the Federal Deposit Insurance Corporation (FDIC) are to review Bank Secrecy Act (BSA) compliance of private banking activities as part of their overall BSA examinations of banks under their supervision. These examinations are to focus mainly on the adequacy of banks' compliance programs and related internal controls as they pertain to BSA regulations. BSA regulations require all banks to develop a written compliance program that must be formally approved by the bank's board of directors.[11] During examinations, regulators are to review these programs to ensure that, at a minimum, they (1) establish a system of internal controls to ensure compliance with BSA, (2) provide for independent compliance testing, (3) identify individuals responsible for monitoring day-to-day compliance, and (4) provide training for appropriate personnel.

Examiners are also required to determine whether the bank's compliance program includes appropriate procedural guidelines for recording and reporting large currency transactions and for detecting, preventing, and reporting suspicious transactions related to possible money laundering activities. Regulators recognize that among the most important components of an institution's guidelines for detecting suspicious activity are know your customer policies. Such policies enable the institution to understand the kinds of transactions that a particular customer is likely to engage in and to identify transactions that may be unusual or suspicious. Although such policies are not required by regulation or statute, all three regulators have developed examination procedures to determine whether institutions have, in fact, implemented sound know your customer policies and procedures.

Although examiners are required to ensure that appropriate systems are in place to help prevent and detect money laundering, they are not specifically tasked with looking for actual cases of money laundering. Examiners are responsible for being cognizant of suspicious activities,[12] since such activities may be an indication of general noncompliance in an institution.[13] Examiners are also responsible for ensuring that suspicious activities that may be identified during an examination are properly reported.

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[11]See 12 C.F.R. §§ 21.21 (OCC), 208.14 (Federal Reserve), 326.8 (FDIC) (1997). The Bank Secrecy Act, contained in Pub. L. 91-508, is codified in subchapter II, chapter 53 of Title 31 United States Code.

[12]An example of a suspicious activity involves a customer who conducts periodic wire transfers from a personal account to financial secrecy jurisdictions, such as the British Virgin Islands or Cayman Islands, with no known legitimate purpose for such transactions.

[13]OCC officials explained that their procedures direct examiners, in some instances, to review bank documents for suspicious activity.

Federal Reserve Focus on Private Banking

The Federal Reserve Bank of New York (FRBNY) undertook an initiative on behalf of the Federal Reserve focusing on private banking. In 1996 and 1997, FRBNY conducted a review of private banking activities at approximately 40 domestic and foreign banking institutions located in its district. According to the Federal Reserve, the agency's heightened supervisory interest in the area reflected the growing target market for private banking, an increase in the reliance of banks on private banking as a source of income, and a related increase in competition. The Federal Reserve also indicated that examiners focused on assessing each bank's ability to recognize and manage potential reputational[14] and legal[15] risks that may be associated with inadequate knowledge of its clients' personal and business backgrounds, sources of wealth, and uses of private banking accounts. As part of this effort, examiners reviewed the banks' anti-money-laundering programs and their know your customer policies.

FRBNY officials explained that most of the banks reviewed had satisfactory anti-money-laundering programs for their private banking activities. They found a few programs to be exceptional, but they also found a few to be antiquated and potentially vulnerable to money laundering. Deficiencies identified in the private banking area centered primarily on poor internal controls and procedural weaknesses involving such problems as insufficient documentation and inadequate due diligence standards.[16] They also observed weaknesses in banks' management information systems that made it difficult to fully monitor clients' private banking transactions. A senior FRBNY official stated that, mainly, banks have been responsive to reported deficiencies and have developed procedures to address them. The official explained that FRBNY was in the process of revisiting the banks to verify that identified weaknesses were being effectively corrected.

FRBNY's private banking reviews also identified certain essential elements associated with sound private banking activities that were subsequently described in a recently issued paper.[17] According to the Federal Reserve, this paper was intended to provide banking institutions as

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[14]Reputational risk is the potential that negative publicity regarding a bank's business practices, whether true or not, will cause a decline in the customer base, costly litigation, or revenue reductions. A Federal Reserve official noted that this type of risk can arise, for example, when a bank wittingly or unwittingly deals with criminals, such as drug traffickers and money launderers.

[15]Legal risk arises from the potential that unenforceable contracts, lawsuits, or adverse judgments can disrupt or otherwise negatively affect the operations or condition of a bank.

[16]Due diligence in private banking generally refers to verifying the client's identity, determining the client's source of wealth, reviewing the client's credit and character, and understanding the type of transactions the client will typically conduct.

[17]Guidance on Sound Risk Management Practices Governing Private Banking Activities, July 1997, prepared by FRBNY on behalf of the Board of Governors of the Federal Reserve System.

well as the agency's examiners with guidance on the basic controls necessary to minimize risks and to deter illicit activities, such as money laundering. The Federal Reserve also plans to incorporate lessons learned from the private banking reviews into a new systemwide examination manual for private banking activities.

OCC Focus on Private Banking

OCC officials told us that they have informally highlighted private banking by placing emphasis on reviewing national banks' know your customer policies as they apply to the area. They also stated that OCC has directed more attention to BSA compliance programs covering national banks' fiduciary services that may, in some cases, be a major part of a private banking function. Finally, at the time of our review, OCC's Miami office was developing local guidelines for focusing examination attention on international private banking activities due to a perceived increase in the potential for money laundering through private banking. An OCC official explained that the private banking market, particularly in Miami, was rapidly expanding and becoming more competitive; and, as competition increases, they are concerned that internal controls, such as due diligence standards, may tend to be relaxed.

FDIC Focus on Private Banking

FDIC had no specific initiatives focused on private banking at the time of our review. Nonetheless, officials viewed private banking activities, specifically those that involved offshore accounts, as vulnerable to suspicious activities.

BANKS' POLICIES AND PROCEDURES FOR COMPLYING WITH BSA

We visited 11 banks engaged in international private banking activities. Officials from all of the banks told us they had formal programs for ensuring their compliance with BSA. These programs included policies and procedures for recording and reporting large currency transactions as well as for identifying and reporting suspicious activity. In addition, all the banks had know your customer policies. Bank officials told us that their BSA compliance programs were subject to review and independent testing by their internal auditors as well as by banking regulators. The banks also had designated compliance officers who were responsible for ensuring that staff adhered to the BSA compliance program and for training staff on their BSA-related responsibilities. Bank officials at 6 of the 11 banks we visited noted that they had compliance officers who were dedicated solely to the private banking area.

Most of the banks we contacted viewed know your customer policies as one of their most important means of preventing and detecting money laundering. Officials from 8 of the 11 banks we visited told us that they had developed such policies specifically for private banking. At least six of these eight banks had private banking know your customer policies that contained the following features:

- a requirement that private bankers identify the beneficial owner of the account (i.e., the person(s) who has actual control of the account);

- a policy whereby the opening of accounts for certain types of clients (e.g., politicians) or businesses (e.g., exchange houses) required senior management approval or was disallowed;

- a transaction-monitoring program to flag accounts over a given threshold; and

- a requirement that compliance officers either directly approve the opening of new accounts or review due diligence information before their banks open new accounts.

Industry Concerns

Some bank officials we contacted expressed concerns about the regulatory oversight of their know your customer policies. As we described earlier, although these policies are not required by regulation or statute, banking regulators are examining banks to determine if they have implemented sound know your customer policies and procedures.[18] Officials at 3 of the 11 banks we visited indicated that some regulators kept raising the standard for such policies in the absence of formal regulations. They also indicated that there were inconsistencies within, as well as among, the regulatory agencies regarding reviews of banks' know your customer policies. For example, some officials noted that FRBNY required banks to bring records on the beneficial owners of offshore accounts into the United States, but the Federal Reserve Bank of Atlanta did not. Some bank officials indicated that they were eager to see know your customer regulations, which they believed would provide them with much-needed guidance in the area and would help ensure that related regulatory oversight was consistent.

Officials at 6 of the 11 banks we visited were also concerned that securities broker/dealers were not subject to the same regulatory requirements covering suspicious activity reports (SAR)[19] or regulatory reviews of know your customer policies that banks are. Some indicated that this inconsistency created an "uneven playing field," particularly since broker/dealers may provide products and services similar to those of banks engaged in private banking.

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[18]As of September 1997, the Federal Reserve was in the process of developing know your customer regulations.

[19]Although securities broker/dealers are not currently required to file SARs, Treasury has encouraged them to report suspicious activity on a voluntary basis. The Securities and Exchange Commission and Treasury's Financial Crimes Enforcement Network (responsible for promulgating regulations under BSA) are working together to develop SAR regulations for broker/dealers, according to officials from both agencies.

LAW ENFORCEMENT VIEWS ON PRIVATE BANKING

Law enforcement views on the vulnerability of international private banking to money laundering varied. Some law enforcement officials indicated that private banking was no more vulnerable than any other banking area. They believed that all areas of banking, not just private banking, are vulnerable to money laundering and that all areas needed to be monitored. In contrast, other law enforcement officials stated that certain characteristics of private banking make the area more susceptible to money laundering and in need of greater attention from both a regulatory and law enforcement standpoint. According to these officials, some of the identified features of private banking that make the area more vulnerable include

- its perceived high profitability and intense competition, which can result in banks focusing more on profits than on the type of clients they accept;

- the high level of confidentiality associated with private banking products and services, especially offshore products for which it can be difficult to identify beneficial owners; and

- the close relationships of trust developed between relationship mangers and their clients in which the manager is likely to maintain the client's confidentiality at all cost.

Concerns Regarding International Private Banking

Some law enforcement officials said that one of the biggest problems they encounter in money laundering investigations involving international private banking is the inability to reconstruct an audit trail for prosecution purposes. They observed that to protect client confidentiality, banks tend to maintain documentation for offshore accounts in the offshore affiliate. For example, if a client invests in an offshore account or corporation, the private banker creates the originating documents then transfers the documents to the offshore affiliate. These law enforcement officials explained that this practice makes it difficult for investigators to reconstruct the audit trail for such offshore investments and to identify their beneficial owners. They suggested that transferring documentation that may serve as potential evidence in an investigation is unnecessary, because U.S. policy adequately protects the confidentiality of customer account information by making it available only when a federal investigation is under way.

Some law enforcement officials stated that relying on overseas sources to provide information for the investigation of money laundering cases is also a problem. In some countries, law enforcement officials are impeded by bank secrecy laws that preclude financial institutions from providing documents requested by U.S. law enforcement agencies. They are also hampered by other countries' laws that prohibit the provision of

requested information without proof that a U.S. judicial process has been initiated. A law enforcement official explained that this prohibition poses problems in cases where the information requested is needed to obtain a court order to start the judicial process in the United States. Finally, law enforcement officials noted that in some cases, information requested through established mutual legal assistance treaties[20] took an inordinate amount of time to obtain.

Concerns Regarding SARs

Some law enforcement officials expressed concerns that SARs were not being filed from private banking providers as often as these officials believed was warranted. They pointed to cases of money laundering through private banking providers in which these reports had not been filed. They suggested that this perceived laxness in filing SARs may result from limited enforcement efforts in the private banking area or from banks' views that they have an inherent conflict because they would be reporting suspicious activity that they have presumably allowed to occur. Some law enforcement officials said they believe that banks sometimes turn away potential private banking customers whose wealth is considered to be of a suspicious nature. In such instances, the officials said that banks may not see the need to submit SARs, since rejected customers do not pose any risk to the bank. Nevertheless, some law enforcement officials said reports of this nature could be very useful to them–for example, in identifying potential money launderers.

[20]Mutual legal assistance treaties are bilateral agreements that the United States has entered into with other countries that enhance international cooperation in criminal matters, including those involving money laundering.

ENCLOSURE II

COMMENTS FROM THE FEDERAL RESERVE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF BANKING
SUPERVISION AND REGULATION

October 15, 1997

Mr. Thomas J. McCool
Director
Financial Institutions and Markets Issues
U.S. General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

Thank you for the opportunity to comment on the GAO's draft report entitled "Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering".

We are pleased that the draft report presents an accurate portrayal of the private banking activities of banks and other financial institutions, and the federal banking agencies' oversight of this expanding aspect of the banking industry. We are equally gratified that the draft report includes a description of the extensive efforts undertaken by the Federal Reserve in the private banking area, and our leading role in developing examination procedures that are specially tailored for private banking activities, conducting targeted on-site examinations of numerous private banking organizations over the past two years, issuing "sound practice" guidance concerning private banking activities this past July, and drafting proposed "Know Your Customer" regulations that will provide instruction to the banking industry in an important aspect of their business.

In the event that Federal Reserve staff can provide any additional assistance to your efforts in the private banking area, please contact Mr. Richard A. Small, Assistant Director, at (202) 452-5235.

Sincerely,

Richard Spillenkothen
Director

cc: Mr. Kane A. Wong
Assistant Director
U.S. General Accounting Office

COMMENTS FROM THE FEDERAL DEPOSIT INSURANCE CORPORATION

FDIC
Federal Deposit Insurance Corporation
Washington, D.C. 20429
Office of Internal Control Management

October 15, 1997

Mr. Thomas J. McCool
Director
Financial Institutions and Markets Issues
General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

Enclosed is the FDIC's response to the General Accounting Office's draft report entitled "Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering". The response was prepared by the Division of Supervision, and specifically addresses the FDIC's focus on private banking.

If you need any additional information or have additional questions, please contact Howard Turner at (202) 736-0304.

Sincerely,

Vijay Deshpande
Director

Enclosure

cc: Nicholas J. Ketcha, Jr.
James D. Collins

ENCLOSURE III

PRIVATE BANKING AND ITS VULNERABILITY TO MONEY LAUNDERING

FDIC staff has reviewed the draft GAO report entitled Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering. The report succinctly addresses the issues surrounding this facet of banking, and the regulatory efforts to monitor Bank Secrecy Act (BSA) compliance in institutions that engage in this activity. We would like to offer the following comments in response to the report.

While the FDIC has no initiatives directed *specifically* at private banking activities, our current examination procedures do address certain transactions and characteristics associated with private banking, such as wire transfer activities, trust activities, and payable through accounts. A major focus of every BSA examination is the review of any "know your customer" policies and practices the bank may have in place. Any bank engaging in private banking activities should include specific account-opening and monitoring procedures dealing with this area in its policy. Additionally, examiners are trained to identify and report suspicious activities which may involve private banking customers, such as large deposits of like amounts or numerous wire transfers to/from offshore accounts.

FDIC has already identified the need to enhance existing BSA procedures to address private banking issues. Since July 1997, the FDIC has been working in concert with the Board of Governors of the Federal Reserve and the Office of the Comptroller of the Currency to revise existing BSA examination procedures. A proposed module was shared with the working group in September. The intent is to closely link examination procedures focused on "know your customer" and private banking.

A new trust examination manual has been drafted and will soon be distributed for use by our field examiners. In recognition that many private banking activities are tied with fiduciary services, the revised manual extends the review of such services to private banking departments, and includes discussions of BSA and suspicious activity reporting.

In addition to our examination coverage of private banking activities, we also have taken steps to include non-standard "know your customer" provisions in our approvals of applications by U.S. banks to establish offshore facilities. Such provisions require the applicant bank to have in place adequate "know your customer" policies and procedures for the facility's activities.

In summary, the FDIC does take seriously the potential for money laundering in private banking activities. We are working diligently to ensure that our examiners and regulated institutions are aware of this threat and are taking steps to put in place the necessary policies and procedures to monitor such activities and to deter money laundering through private banking and fiduciary activities.

COMMENTS FROM THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

October 28, 1997

Mr. Thomas J. McCool
Director, Financial Institutions and Markets Issues
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. McCool:

We have reviewed your draft audit report titled Private Banking: Information on Private Banking and Its Vulnerability to Money Laundering. The report was prepared to provide information obtained to date in response to a congressional request.

We concur with your conclusions that there is no generally accepted definition of private banking and that the regulators review private banking activities for compliance with the Bank Secrecy Act (BSA). You also report that banks expressed concern about regulatory oversight of "know your customer" practices. The banks are concerned that lack of consistent regulatory guidance may contribute to inconsistent supervision within and among regulatory agencies. We are particularly sensitive to that concern and, as a result, are committed to working with the other agencies to adopt a uniform set of guidelines and a consistent approach to enforcing "know your customer" requirements.

The OCC has a longstanding commitment to combating money laundering in the national banking system. For many years, the OCC has examined all aspects of banks' operations for potential Bank Secrecy Act violations and money laundering. In addition to ensuring that banks under our supervision have adequate compliance programs and adhere to the BSA, in appropriate circumstances the OCC refers potential civil BSA violations to the Financial Crimes Enforcement Network (FinCEN) in the Treasury Department and suspected criminal violations to the appropriate criminal law enforcement agencies.

The OCC has recently taken a number of actions in the anti-money laundering area. Along with the other bank regulatory agencies and law enforcement agencies, the OCC developed the new Suspicious Activity Reporting system and Suspicious Activity Report form. The new system became operational in April 1996 and makes it easier for all financial institutions to report potential violations of law or suspicious activity that may amount to money laundering. In September 1996, the OCC issued a new section of the Comptroller's Handbook for National Bank Examiners

ENCLOSURE IV

(Handbook) on Bank Secrecy Act compliance. The new Handbook section contains enhanced procedures designed to identify money laundering in accordance with the mandate in Section 404 of the Money Laundering Suppression Act. The procedures apply to all banking units of the institution being examined, including private banking. The Handbook section also contains guidance in areas such as "know your customer," wire transfer activity and payable through accounts.

Last spring, we established an OCC task group known as the National Anti-Money Laundering Group (Group) to provide a focal point for the OCC's anti-money laundering efforts. We have worked with the banking industry and law enforcement agencies to help identify banks that have been or may be targeted by money launderers and to develop examination procedures to address the reputation, transaction, and compliance risks that money laundering poses to national banks.

On an ongoing basis, the Group identifies and analyzes trends and emerging issues; exchanges information with OCC offices and other agencies; and notifies the OCC district offices of emerging risks, best practices, changes in anti-money laundering procedures and policies, high risk banks, and banks requiring immediate attention. In addition, the Group continues to review and evaluate examination procedures in all areas, including private banking. Your report acknowledges one example of the Group's efforts, the development of guidelines for examiners in the Miami area to address vulnerabilities associated with growth in private banking activity there.

The OCC also recently created the position of "Fraud Specialist" in each district office and in headquarters. In addition to serving as the OCC's central contact point for all fraud-related matters within their respective districts, the Fraud Specialists are also an integral part of the OCC's anti-money laundering efforts.

The OCC also continues to be a participant in several interagency working groups concerned with money laundering, including the Bank Secrecy Act Advisory Group and the newly formed Money Laundering Working Group. Recently we were named to chair a subgroup of the Money Laundering Working Group assigned to develop an interagency training program for examiners.

The OCC's recent efforts supplement the infrastructure that has been in place for a number of years in the OCC to detect money laundering -- specialized examination procedures, compliance examiners, fraud experts, and cooperation with other agencies. Preventing money laundering in the national banking system is a top priority for the OCC.

Thank you for the opportunity to review and comment on the draft report.

Sincerely,

Judith A. Walter
Senior Deputy Comptroller for Administration

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