Introduction

The regulatory burden on today's financial institutions has never been higher. Since 1999, the banking industry has had to manage the implementation of a new rule or a change to an old rule about every week and a half.[1] A sizable part of this burden revolves around the expansion of money laundering regulations whose history dates back even further. The original mission of the money laundering regulations was essentially to require banks to maintain certain records that would be useful for the government to support criminal and tax evasion investigations.[2] However, after the terrorist attacks of September 11, 2001, the mission changed.

Shortly after the attacks, the United States Congress significantly enlarged the scope of money laundering regulations to support intelligence and counterintelligence activities, and perhaps most importantly, to protect against international terrorism.[3] The mission of this new regulatory scheme is noble and worthy of pursuing, however, the unbridled expansion of the regulations has resulted in unintended consequences.

Currently, "the combined money laundering rules generate vast oceans of reports, leaving government officials responsible for reviewing those reports drowning in data."[4] In fact, the Financial Crimes Enforcement Network (FinCEN), the regulatory agency charged with overseeing the money laundering regulations, has expressed

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[1] Barbara A. McGuire, Mastering Compliance Mgmt. Through Org., ABA Bank Compliance Nov./Dec. 2004, at 22.

[2] 31 U.S.C. 5311 (referring to original 1970 declaration of purpose).

[3] Id. (original declaration of purpose expanded in 2001 amendment).

concern that the excessive data burdens intelligence analysis and impedes timely targeting of money laundering, terrorist financing, and other vulnerable transactions.[5] As a result of this data overload, the mission of bringing criminals and terrorists to justice is being hindered by the very regulations designed to catch them.

This frustration with the regulations is shared with the banking industry which has voiced significant concerns over the unduly burdensome nature of the regulations. Bankers have expressed that the "regulatory burden is not just a minor nuisance… it permeates every aspect of our day-to-day business, from frontline tellers to bank CEOs."[6] Unfortunately, the burden is oftentimes unnecessary.

This building wave of frustration from both the regulators and bankers alike is the result of an evolving regulatory mission that is inconsistent with the current regulatory framework. Historically, the framework has focused on recording millions of transactions. We currently ask this mass-transactional system to target, identify, and understand just a few transactions in order to intercept the plotting of criminal activity by a relatively small group of individuals. Our system is simply not designed for this task.

In order for the money laundering regulations to work, the laws must be changed to focus on suspicious activity and high risk transactions. Fortunately, some

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[4] Eric J. Gouvin, Bringing out the Big Guns: The USA Patriot Act, Money Laundering, and the War on Terrorism, 55 Baylor L. Rev. 955, 968 (2003) (discussing the effectiveness of money laundering regulation on the War on Terrorism).

[5] Robert Garver & Michele Heller, In Brief: FinCEN Seeks Streamlined Filing Process, Am. Banker, Sept. 5, 2002, at 3 (quoting FinCEN press release).

[6] Kenneth J. Clayton, Statement on behalf of the Am. Bankers Ass'n before the Subcomm. on Regulatory Reform and Oversight of the House Comm. on Small Bus., (Mar. 17, 2005).

relatively simple changes would greatly improve governmental effectiveness, reduce the regulatory burden on the banking industry and maintain the spirit in which the laws were enacted.

Unintended Consequences

Years of adding layers to the money laundering framework have resulted in unintended consequences. Most significantly, the layers have resulted in the generation of a large numbers of extraneous reports. "The flood of useless reports was hardly surprising given the incentives to over-report that are built into the law. The BSA imposed strict liability for failure to file appropriate reports. The institutions subject to BSA took that threat of liability very seriously. On the other hand, there was no liability attached to filing extraneous reports in good faith."[7]

Today, the money laundering rules leave government officials drowning in data. The FinCEN, a unit of the Treasury, estimates that thirty percent of the twelve million CTRs it received in 2001 were filed unnecessarily.[8]

According to a FinCEN press release, "These millions of excess forms have little value for law enforcement purposes and, we believe, impose substantial compliance costs for financial institutions… Also, excess filings burden our intelligence analysis and impede timely targeting of money laundering, terrorist financing, and other vulnerable transactions."[9]

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[7] Brown v. Nationsbank Corp., 188 F.3d 579, 589 (5th Cir. 1999) (discussing how immunity from state law claims encourages financial institutions to assist law enforcement).
[8] Garver & Heller, supra note 5, at 3.
[9] Id. (quoting FinCEN).

"This admission by FinCEN calls the whole BSA-style approach to money laundering into doubt. With the Patriot Act beefing up the reporting requirements and thereby generating even more CTRs and SARs, could the reporting system be paralyzed by an overload of, mostly useless, information?"[10]

Fortunately, even with this data overload, the government has experienced some success. The government has used the USA Patriot Act to "bring charges against Yehuda Abraham, an unlicensed money transmitter whose services where used by Hemant Lakhani, an individual attempting to sell shoulder-fired surface to air missiles to terrorists with the understanding that they were going to shoot down American commercial airliners."[11]

In addition, prosecutors have "secured convictions of individuals operating unlicensed money transmitting businesses that sent money from the United States to Iraq, Yemen, the United Arab Emirates, and India."[12]

Even with this success, some bankers think the government is "going to put more bankers in jail than terrorists."[13] While the sentiment in this statement is likely a reaction to several recent high profile enforcement actions, Herb Biern, associate director, Division of Banking Supervision and Regulation for the Federal Reserve Board, recently stated "that the lack of cooperation between law enforcement and the

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[10] Gouvin, supra note 4, at 969.

[11] U.S. Department of Justice, Report from the Field: The USA Patriot Act at Work 10 (July 2004) (discussing the effectiveness of the USA Patriot Act).

[12] Id at 11.

[13] Bank Director, discussing the BSA and the USA Patriot Act during an OCC exit exam, Montgomery Bank, Sikeston, MO. (2005) (source: Bank CEO Troy Wilson).

banking regulators is resulting in the 'criminalizing of Bank Secrecy Act administrative problems.'"[14]

Furthermore, Dan Stipano, acting chief counsel of the Office of the Comptroller of Currency (OCC) recently shared with bankers at the American Bankers Association/American Bar Association Money Laundering Enforcement Seminar on October 25, 2004, "that there is a new era after 9/11 and that BSA is now a matter of national security."[15] This new era of increased regulatory oversight of the BSA is demonstrated by the significant civil money penalty assessed against banks.

These civil money penalties are often times very costly for financial institutions. In May of 2004, the Department of the Treasury, through FinCEN, assessed a $25 million civil money penalty to Riggs National Corporation (Riggs), a six billion dollar publicly traded bank holding company based in Washington D.C.[16] In addition to violating the suspicious activity and currency transaction reporting requirements, Riggs willfully violated the anti-money laundering program requirement of the BSA and its implementing regulations. FinCEN stated "The violations Riggs engaged in were systemic – Riggs was deficient in designing a program tailored to the risks of its business that would ensure appropriate reporting, implementing the procedures it did have, and responding to classic "red flags" of suspicious conduct."[17] One fact FinCEN

[14] Treasury Secretary Vows Help on BSA Exam Concerns, ABA Bank Compliance February 2005 at 2.
[15] FinCEN Chief Denounces Defensive Filing of SARs, ABA Bank Compliance, Nov. 2004 at 2 (quoting Dan Stipano's presentation at the ABA/American Bar Association Money Laundering Enforcement Seminar on October 25, 2004).
[16] In the Matter of Riggs Bank, N.A., United States Dep't. of the Treasury Fin. Crimes Enforcement Network, No. 2004-01 (May 13, 2004) (discussing the assessment of civil money penalty).
[17] Id.

considered when assessing the penalty was the fact that Riggs failed to correct the violations cited in an earlier issued Consent Order between the OCC and Riggs.[18]

Just months after the Riggs settlement was announced, FinCEN assessed a $10 million civil money penalty against AmSouth of Birmingham, Alabama. In discussing the civil money penalty, William D. Lanford, Jr., Associate Director of FinCEN's Regulatory Policy and Programs Division stated, "Comprehensive Bank Secrecy Act compliance that enable financial institutions to identify and report suspicious activities are the foundation of our efforts to combat money laundering and protect our financial system. As this case reflects… we will take appropriate action to ensure compliance."[19]

One of the frustrations of those who use the regulations is there is a huge spectrum of examiner interpretations resulting in inconsistent supervision. The good news is that "The industry's message about Bank Secrecy Act examination inconsistencies has finally reached the movers and shakers in the Treasury Department. On February 9, 2005, Treasury Secretary John Snow told members of the Florida Bankers Association in Washington, D.C. that he has directed top officers in his department to confer with the bank supervisory agencies about concerns related to BSA examinations." [20] Both the OCC and the Office of Thrift Supervision, as well as FinCEN and the Office of Foreign Asset Control, are part of the Treasury Department.

Snow also expressed concern about the effect of the regulations on the overall transaction system. He said that "he recognized that banks had begun severing ties

[18] Id.

[19] Joint Press Release, Bd. of Governors of the Fed. Reserve Sys. and the Fin. Crimes Enforcement Network (Oct. 12, 2004) (discussing civil money penalty against AmSouth Bank of Birmingham).

with money services businesses after regulators began scrutinizing those businesses. Government officials are now worried that if money transfers can't go to banks they will only be more likely to seek illegal methods of shipping cash. The National Money Transmitters Association recently warned that up to 75 percent of the check-cashing and transfer firms in New York could soon go out of business."[21]

"The statements were welcomed by the American Bankers Association and bankers generally. Previously, on January 10, 2005, ABA and bankers associations from all fifty states and Puerto Rico wrote the Treasury expressing grave concerns about the inconsistencies in the BSA exam process, between examiners in the same agency as well as between agencies. In addition, the letter said that recent enforcement actions, and particularly the criminal prosecution of AmSouth, had dramatically raised the stakes for bankers. As a result, bankers have begun to file SARs defensively to avoid the risk of being second guessed by examiners. The anecdotal evidence of defensive filings has been borne out in the recently released SAR statistics."[22]

No standard appears to exist for a proper Anti-Money Laundering (AML) compliance program. What is often heard from the regulatory leadership in Washington is at odds with the information banks receive from field examiners. "During conferences, seminars, and examinations throughout the country bankers have heard language that indicates a 'zero tolerance policy' for AML deficiencies. With millions of daily transactions in the banking industry, a zero tolerance threshold is

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[20] Treasury Secretary Vows Help on BSA Exam Concerns, ABA Bank Compliance February 2005 at 1.
[21] Id.
[22] Id.

simply unachievable, as has been recognized by administration and regulatory officials in Washington."[23]

"In a separate meeting with OCC staff, OCC deputy chief counsel Dan Stipano told the Florida bankers the agency views bankers as willing partners, not adversaries. That said, however, there is no question that the bar has been raised for AML compliance, not just for bankers, but also for the regulators, as a result of 9/11 and the latest high-profile enforcement actions by the regulators and the Department of Justice."[24]

"When asked how banks can stay out of trouble, Stipano said banks must: make a serious commitment to AML Compliance; it can't be done on the cheap anymore…"[25]

Stipano's message is particularly troublesome for small community banks. The regulatory pressure is already incredibly high for these institutions. One of the difficulties is that the money laundering regulations are not the only regulations financial institutions must deal with. There are deposit and lending laws designed to protect consumers, there are safekeeping and information security laws to discourage identity theft, and there are laws issued by the Securities and Exchange Commission that are designed to help ensure strong internal controls.

Clearly this library of laws requires community banks to carry the heaviest regulatory load. In fact, community banks "face the real threat of being regulated right

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[23] FinCEN Eliminates Duplicate SAR Filing ABA and State Ass'n Protest Exam Inconsistencies, ABA Bank Compliance Jan. 2005 at 1.
[24] Treasury Sec'y, supra note 20, at 1.
[25] Id. at 2.

out of business."[26] "Nearly 8,000 of the nation's almost 9,000 banks have less than $500 million in assets, and 3,350 of the banks have fewer than 25 employees."[27]

"These community banks provide the banking services to people in small towns across America, yet these same community banks do not have the manpower to run the bank and to read, understand and implement the thousands of pages of new and revised regulations they receive every year."[28]

"To illustrate the magnitude of this burden on small banks, consider this: Each year the American Bankers Association publishes a reference guide that summarizes the requirements embodied in thousands of pages of regulations. This <u>**summary**</u> is **600 pages long** and will be even longer in the future to cover new responsibilities under the USA Patriot Act and expanded HMDA reporting requirements."[29]

This mounting regulatory burden has a detrimental impact on small businesses and the local communities that banks serve. "Based upon research done in the 1990's, the total cost of bank compliance is somewhere between $27 billion and $42 billion per year. This is an enormous figure, and does not include compliance costs associated with the USA Patriot Act, the Sarbanes-Oxley Act, and certain other new laws and regulations. If this burden could be reduced by 20 percent and directed to capital, it would support additional lending between $55 billion - $83 billion."[30] Reducing the regulatory burden would have a tremendously positive impact on our economy.

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[26] Clayton, supra note 6.
[27] Id.
[28] Id.
[29] Id.
[30] Id.

A closer look at the regulatory burden may provide some perspective. On one hand, one regulatory agency estimates that the process of maintaining and verifying the adequacy of an institutions BSA compliance program should take an average of two hours a year.[31] The reporting of time estimates is required by the Paperwork Reduction Act. Generally the estimates published receive little or no industry attention and even less feedback. Because these estimates can be grossly inaccurate, bankers have been encouraged to provide the regulators with the true amount of time they actually spend on compliance.[32]

On the other hand, financial institutions are claiming they do not have enough man power to even read all the regulations that are being issued. Looking at specific details may prove beneficial. Periodically FinCEN issues a statistical analysis of SAR submissions. These submissions note the following:

> Between April 1996 and June 30, 2004, depository institutions filed 1,451,139 SARs; The volume of SAR filings in the first six months of 2004 increased 25 percent over those filed during the same period in 2003; BSA/structuring/money laundering continued to be the leading characterization of suspicious activity on which institutions filed reports; Between January and June 2004, 7,023 SARs on identity theft were filed, a 122 percent increase in that activity over the previous six-month reporting period; and mortgage loan fraud increased 137 percent from the corresponding six-month reporting period.[33]

That is a lot of paper-pushing. The shear volume of reporting suggests that the burden estimates offered by the agencies are drastically understated. The agencies likely did not include the time that would have to go into systems redesigns, changes to

[31] Reg Burden Comments Needed on BSA Time Estimates, ABA Bank Compliance Jan. 2005 at 2.
[32] Id.

procedures, training and the collection and compiling of information necessary for proper reporting.

Because of the increasing demands on the system, "FinCEN is in the process of expanding its work force by ten percent, including a five-fold increase in compliance division staffing."[34] The added staffing will increase the infrastructure already in place to support these government-imposed compliance requirements. Unfortunately, few people understand the magnitude of the investment, both in human capital and technology. All of which leads to higher costs for everyone.[35]

There does appear to be some hope. The federal banking and thrift regulatory agencies have recently requested recommendations on how to reduce the burden of money laundering regulations. The "request is part of the agencies' effort to identify and eliminate regulatory requirements that are outdated, unnecessary or unduly burdensome..."[36] The recommendations outlined below may assist the government as they embark on this important task.

Recommendations

"In implementing the law of the land, cost-benefit calculations often require compromises and modifications."[37] Today, the United States finds its' money laundering regulations at a crossroads. Law enforcement agencies are against the odds in fighting the money laundering battle because they are searching for a needle in a

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[33] SAR Statistics Updated, ABA Bank Compliance Feb. 2005 at 3.
[34] Treasury Sec'y, supra note 20 at 1.
[35] Clayton, supra note 6.
[36] Fin. Inst. Letter FIL-8-2005, Reducing Regulatory Burden (Feb. 3, 2005).

haystack. Likewise, the banking industries' compliance professionals are being overwhelmed by the sheer volume of obligations for regulatory compliance.

The government struggles to avoid these unintended consequences. To be effective, regulators must attempt to discover permissible and more-efficient ways of doing their job.[38] Fortunately, the criticisms of the money laundering regulations have been heard in Washington and the agencies are starting to perform a self-evaluation.

"The Federal Reserve is working closely… with the staff of the Treasury Department responsible for anti-money laundering and terrorist-financing enforcement, as well as with other bank regulatory agencies and the Justice Department, to support a fair, effective, and consistent approach to Bank Secrecy Act compliance."[39] The self-evaluation is further supported by the government's recently submitted request for recommendations on reducing the regulatory burden of money laundering regulation.

The focus of this evaluation should be on improving the quality, not the quantity of reporting, recordkeeping and disclosure requirements. And it is this idea of quality versus quantity that weaves its way through the recommendations listed below:

<u>Require "Business Type/Occupation" documentation at account opening</u> – The Customer Identification Program requirements of the USA Patriot Act require institutions to obtain, at or near account opening, information similar to that requested on a CTR. Such information includes name, address, tax identification number, etc.

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[37] Alan Greenspan, Remarks before the Indep. Cmty. Bankers of Am. Nat'l Convention, San Antonio, Texas (Mar. 11, 2005) (via videoconference).
[38] Id.

One item that is included on a CTR that is not specifically required within the Customer Identification Program requirements is the documentation of the customer's Business Type/Occupation.

The Business Type/Occupation information is useful to both governmental agencies and depository institutions. The government could use this information to narrow their searches and focus their efforts on particular types of businesses or occupations.

Similarly, depository institutions could use the information as a starting point in their analysis performed to ensure their customer transactions are consistent with the nature of the customer's business or occupation. Furthermore, this information will allow depository institutions to better risk rate their accounts for money laundering risk. And finally, this information will be beneficial should the recommendations mentioned below be implemented.

<u>Replace daily CTRs with Monthly Cash Transaction Reporting</u> – The current provisions of the BSA require a CTR to be filed for any customer who performs a transaction or group of transactions with over $10,000 in cash in a single day. This results in the government receiving millions of CTRs each year. Most of these CTRs are meaningless to governmental investigations.

In addition, the CTR reporting requirements are generally known throughout American communities (including criminal communities). The result is people who

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[39] Id.

have nothing to hide are willing to conduct cash transactions with over $10,000. Those who do have something to hide simply do not perform any reportable transactions.

The overall result is a highly ineffective system that is labor intensive for both the government and depository institutions. Rather than try to capture criminals based on a single day's transaction, it would be more effective to look at trends that capture all of a customer's cash activity over a period of time (not just those transactions over $10,000). A report for any customer with cash transactions over $50,000 a month would not only capture the transactions of those who attempt to "smurf" or "structure", it would better assist governmental agencies in focusing in on those customers that pose the greatest risk to the United States. In addition, it would reduce the daily reporting burden for depository institutions.

Eliminate the one year CTR exemption waiting period – Under the current provisions of the BSA, depository institutions may elect to exempt certain customers from CTR reporting.[40] Before an institution can make such an exemption they must wait at least one year after the account is opened. The purpose of this waiting period is to give the institution time to better understand the customer.

The USA Patriot Act was enacted subsequent to the BSA exemption regulations. The Customer Identification Provisions of the USA Patriot Act require a similar understanding of the customer. However, under the USA Patriot Act this understanding must be obtained at or near the account opening.

As institutions already have the requisite understanding of the customer at or near account opening, the waiting period is duplicative under the current regulatory framework. The additional CTRs filed during the waiting period are simply making governmental investigations less efficient and are unnecessarily burdening depository institutions.

<u>Focus on Suspicious Activity Reporting</u> – When the BSA was originally enacted, the focus was on CTRs. It didn't take long before law enforcement officials determined that CTRs alone would not be effective. At one point in the BSA evolution, there was a box to mark on the CTR to signify whether the transaction in question was suspicious. Eventually, the government simply required filing of a separate SAR if a depository institution noted an unusual transaction.

In retrospect it would have been better to put the cart before the horse, or said another way, the SAR before the CTR. Under this inverted framework no CTR reporting would be required until the customer was deemed suspicious by the depository institution or until the depository institution was notified by government officials to start CTR reporting.

Of course under this framework CTR reporting would need to be confidential. However, this is easily overcome because the information requested on the CTR would be the same as that requested to establish a customer relationship under the Customer

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[40] 31 CFR 103.22.

Identification Program requirements of the USA Patriot Act, making confidential filing efficient and simple.

<u>Review and adjust reporting thresholds annually</u> – The BSA was enacted in 1970. With over three decades in operation, few adjustments have been made to the dollar thresholds that trigger reporting requirements.

An annual review of the thresholds would allow for the adjustment of such things as inflationary factors. More importantly, it would allow governmental agencies to adjust the thresholds based on their available resources and their law enforcement needs. For, if the government knows it does not have the resources to provide meaningful analysis of reports, it should be obligated to raise the thresholds to an appropriate level. Alternatively, should lower dollar reporting assist law enforcement needs the agencies should have the ability to modify the thresholds. Adjusting the thresholds would also provide the benefit of adding an element of surprise to anyone who is trying "smurf" or "structure" their transactions.

The BSA reporting thresholds have a direct impact on the efficiency of the governmental agencies and the reporting burden of depository institutions. An annual review of these thresholds will ensure that America is using its resources prudently and that the overall money laundering framework is performing as desired.

Conclusion

It is not easy to determine the proper balance between government regulation that is designed to protect the citizens of the United States and government regulation that restricts productivity and entrepreneurial endeavor. It is much easier to change government regulations that both hinder governmental agencies and simultaneously suffocate enterprise.

The current money laundering regulations hinder government agencies by barraging them with mountains of useless information. As a result, governmental agencies must mine deeper and longer to be effective at stopping criminals and terrorists.

These same regulations suffocate the banking industry by unduly burdensome compliance requirements. Compliance requirements that translate into higher costs for consumers, reduced availability of credit, and reduced economic expansion.

The recommendations outlined above will help facilitate the changes needed to transform the money laundering regulations from being transaction driven to one focused solely on suspicious activity and high risk transaction reporting. Not only will the recommendations provide higher quality information for regulators and law enforcement, but they will reduce the regulatory burden on the banking industry. Most importantly, the recommendations will maintain the original spirit in which the laws were enacted. As it was this spirit that did not buckle after September 11, 2001... The same spirit that has not faltered since 1776… And, the same spirit that burns bright in each American's heart today.