OVERSIGHT OF THE DEPARTMENT OF TREASURY

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BEFORE THE

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OVERSIGHT AND INVESTIGATIONS

OF THE

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OVERSIGHT OF THE DEPARTMENT OF TREASURY

Wednesday, June 16, 2004

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATION,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:07 p.m., in Room 2128, Rayburn House Office Building, Hon. Sue Kelly [chairwoman of the subcommittee] presiding.

Present: Representatives Kelly, Paul, Garrett, Oxley (ex officio), Gutierrez and Inslee. Also present were Representatives Royce and Sanders.

Chairwoman KELLY. [Presiding.] This hearing of the Subcommittee on Oversight and Investigations will come to order.

The war against terrorism is the single most important challenge facing the federal government today. Our task is made difficult by the insidious methods of our enemies and also by the bureaucratic inertia inherent in a fundamental reorganization of our government's priorities.

This hearing today is important because we will examine the specific difficulties faced by the Treasury Department in adapting to its new critical purpose in battling the illicit funding networks upon which our enemies rely.

It is evident that the fight against terror financing must go well beyond ensuring compliance with the Bank Secrecy Act, but this law is at the foundation of our efforts. When that law is flouted as egregiously as it was in the Riggs case, or as consistently as the inspector general suggests, then it is our duty to respond so that such failures are bad memories instead of perpetually looming possibilities. We cannot afford to ignore any problems in the system charged with the enforcement of our anti-money-laundering law.

I believe the fragmented nature of our anti-money-laundering system is structurally not capable of keeping pace with the demands of the war on terror. I believe that we ought to establish a single office dedicated to ensuring the compliance with the Bank Secrecy Act.

To those who would resist this proposal, I would hope that there is at least recognition of the need to establish a vigilant watch tower above the vast expanse of bureaucracies that are currently responsible for the Bank Secrecy Act. There must be a unifying center to our anti-money-laundering efforts.

Mr. Fox's recent proposals to strengthen FinCEN's role in BSA compliance, including the establishment of an examination pro-

gram office, are important steps in that direction. But if we are going to fully establish the integrated, accountable oversight regime we clearly need, FinCEN should be equipped not just for observation, but also for action.

FinCEN needs the compliance examination capabilities it currently lacks. Its efforts should be reinforced with criminal investigative powers that are largely absent from our anti-money-laundering system. Through FinCEN, although it has been given a statutory responsibility for the Bank Secrecy Act, it has few resources, and it is easily marginalized by the frontline regulators.

If you consider the 6-year lag between when the OCC first noticed problems at Riggs and when FinCEN was made aware of them, that is a tremendous lag. A clean money compliance force at FinCEN could unify our anti-money-laundering responsibilities and even broaden our efforts by examining financial sectors that currently have no regulator.

With the ability to deploy its own examiners to trouble spots and literally look over the shoulder of the regulators, FinCEN could ensure a strong focus on high-risk transactions, such as those that occurred under our own nose at Riggs with their Saudi clientele.

And as we read reports about the Saudi Embassy's continuing search for a bank to replace Riggs, the establishment of these new powers could provide greater certainty to our hopes that the era of free-wheeling, unregulated Saudi cash infusions to Islamic militants in our own country are over.

On a related note, I hope that Treasury will give serious consideration to the proposal made yesterday by the Independent Task Force on Terrorist Financing. Among its recommendations were that Congress enact a Treasury-led certification regime on terrorist financing that will annually report to Congress the efforts of their other countries to combat terror funding and would impose sanctions on countries that failed to perform up to standard.

A system like this could provide a useful lever in securing better cooperation from recalcitrant governments such as the Saudis who have facilitated the flow of funding to terrorist organizations, despite their protests to the contrary.

This administration has done a remarkable job in getting the Saudis to enact the reforms that we have seen recently, but we must never forget that we are dealing with a government that has been a chief financial supporter of the fanaticism that led to the murder of more than 3,000 people on September 11th.

I am also very deeply concerned by the circumstances surrounding the UBS case, in which flagrant mismanagement of a U.S. currency depot overseas resulted in our currency being shipped to countries currently under U.S. sanctions. While the Fed was clearly the frontline regulator responsible for the failure, we need to examine ways to ensure that the Treasury Department sanctions are enforced and that the ECI program is implemented properly.

I am interested in learning more about how OFAC and the other Treasury assets might be better utilized in the future.

On a final note, I am very interested in how Treasury intends to handle the pending expiration of the Terrorism Risk Insurance Act. While TRIA was designed as a temporary bridge to the devel-

opment of a functional private-sector terrorism insurance market, a recent study by the General Accounting Office concluded that there is not a sustainable marketplace for this coverage after the program expires.

In addition, the NAIC, representing 51 bipartisan state insurance commissioners, agrees that we must act this year to avoid the market disruptions that we are already beginning to see.

Given the state of the insurance marketplace and the continuing threat of terror, I believe it is in the best interest of the American people that we consider retaining a systematic approach in place to protect our country's economic security.

In fact, I recently sent a letter to Secretary Snow, signed by 183 of my colleagues, urging the Treasury Department to extend the make-available provision which expires at the end of this fiscal year and to support the overall continuation of this critical program.

There is broad, bipartisan support in this committee and in the House for doing so, and I hope to learn more from Treasury as to how they intend to handle this matter.

I thank you, and I look forward to today's testimony.

I want to just simply say that, without objection, all members' opening statements will be made part of the record.

And I turn to you, Mr. Gutierrez.

[The prepared statement of Hon. Sue W. Kelly can be found on page 44 in the appendix.]

Mr. GUTIERREZ. Thank you.

Good afternoon, and thank you very much, Chairwoman Kelly, for calling this hearing. We have been having a series of these oversight hearings, and this one about the Department of Treasury is very important. There are a number of areas of concern which I hope we can address today.

As you know, I have been very troubled by the actions of the OCC. I believe that their preemption rules issued earlier this year represent an unprecedented expansion of federal preemption authority without appropriate congressional authorization.

In February, the members of our full committee adopted these concerns as part of the committee's budget views and estimates, along with the fact that the OCC's budget did not increase to reflect its significant absorption of states' responsibilities.

This meant that it would either be inadequately funded to fulfill its mission—ensuring the safety and soundness of national banks and protecting the deposit insurance system—and its congressionally mandated functions, or that it would be giving short shrift to these new consumer protection duties it was taking over from the States.

None of these alternatives is acceptable.

Since that time, it has become clear that the OCC has not even been living up to its primary responsibility, which makes it even more illogical to give them additional responsibilities which are currently being ably performed by the States, especially since almost every instance where the OCC eventually took action against an institution—and I do mean eventually, because they have a long history of dragging their feet in a completely unacceptable way—in any case, in almost every instance where they eventually took

action against an institution, the initial problem was often brought to their attention by either the FBI or an attorney general or even the bank itself.

I am very glad that the inspector general is here today. And I am particularly interested in the report issued on May 28th regarding material loss reviews of failed institutions. I am disturbed by the OCC's significant supervisory weaknesses identified in that report, and I ask that it be made part of the record.

[The following information can be found on page 128 in the appendix.]

I trust that the I.G.'s office will also be conducting a thorough investigation of the Riggs matter so that we can determine why the OCC failed to discover wrongdoing, failed to act when the FBI and the press alerted them to the problem, and why the OCC failed to disclose material information to Congress when it testified on the matter before this subcommittee and the Senate.

I believe the OCC has proven time and time again that it needs more direct supervision from the I.G.'s office, Treasury and Congress.

To that end, I strongly support your efforts, Madam Chair, to crackdown on criminal activity in our financial system. And I cannot imagine why the OCC would not welcome the assistance, since they are clearly not excelling in this area.

But that is not enough. Not only does the OCC need additional assistance in the form of the I.G. and the State attorneys general and state banking supervisors enforcing against banks, but the OCC clearly needs stronger oversight and accountability from both Treasury and Congress.

Therefore I also intend to introduce legislation to make the OCC an appropriated agency so they can be more accountable to Congress for their actions. I hope my colleagues will support me in this effort.

Regarding other issues, I would like to hear about the investigation into the use of Treasury staff to analyze the tax-cut analysis and how that rhetoric ended up on the RNC Web page along with Secretary Snow's investment.

I will ask questions about these and other issues later in the hearing. And I yield back the balance of my time and thank the Chairwoman once again for calling this hearing. I am looking forward to the testimony of the witnesses.

Chairwoman KELLY. Thank you very much, Mr. Gutierrez.

Mr. Oxley, our Chairman?

Mr. OXLEY. Thank you, Chairwoman Kelly, for convening today's oversight hearing to review functions and activities of the Department of the Treasury, with Deputy Secretary Samuel Bodman; in particular, its efforts to deal with money laundering and terrorist financing.

Mr. Bodman, welcome to the committee. It is good to have you with us today, particularly on the issue of terrorism financing.

This subject continues to be an urgent one for all of us. Those who are current in their newspaper reading saw the recent news of a federal grand jury indictment of Nuradin M. Abdi, most recently of Columbus, Ohio.

This four-count indictment in the plot to attack a central Ohio shopping mall should remind us all of the seriousness of our work on these issues. Clearly, Mr. Abdi was being funded somehow. I doubt if he was working a 9-5 job.

And I would remind everybody that we are working to protect innocent Americans from murder. This mission will continue to require our complete dedication. Clearly, if terrorists can target Columbus, Ohio, they can target anyplace in our country.

Additionally today, I hope we will discuss recent and current activities of the Department, as well as talk about the status of the regulated financial sectors.

Clearly, we could spend endless hours reviewing issues within Treasury's charter, considering the breadth of Treasury's mission. With the focus on the jurisdiction of this committee, however, I hope you can share your thoughts on at least a few of these issues.

I look forward to your comments on the new Office of Terrorism and Financial Intelligence, as well as government-sponsored enterprises, the Office of the Comptroller of the Currency and the Office of Thrift Supervision.

In addition to the Deputy Secretary, we have with us today a panel of four distinguished public officials to talk about the pressing need for the effective collection, accurate integration and prompt analysis of information related to the movement of funds related to terrorist financing. So let me offer my thanks to our distinguished witnesses for their time and effort to appear and to answer our questions.

Again, my thanks to Chairwoman Kelly for her leadership on these important issues of oversight. And I yield back.

[The prepared statement of Hon. Michael G. Oxley can be found on page 46 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Chairman.

Mr. Inslee?

Mr. INSLEE. Thank you.

I just want to thank the Chair for being so diligent in giving this opportunity. It really is something that is very important.

Just a brief comment: I am looking forward to testimony about our current status, particularly the Saudi Arabia situation in regard to those families involved in the hijackings of September 11th and their exit from this country and our follow-up in that regard. So I look forward to that testimony.

Thank you.

Chairwoman KELLY. Thank you.

I want to go back to a bit of business here. So without objection, I ask that the I.G. report to which Gutierrez referred in his opening statement be placed in the record.

Without objection, so ordered.

Mr. Gutierrez?

Mr. GUTIERREZ. I simply ask unanimous consent that the gentlemen from Vermont, Mr. Sanders, should he arrive at the subcommittee, be allowed to be part of the committee proceedings.

Chairwoman KELLY. So moved.

Mr. Garrett, have you an opening statement?

Then let us proceed.

On our first panel, the subcommittee is pleased to have with us today the Deputy Secretary of the Treasury, Dr. Samuel Bodman.

President George W. Bush nominated Samuel Wright Bodman to be the Deputy Secretary of the Treasury on December 9, 2003, and the U.S. Senate confirmed him on February 12, 2004. Dr. Bodman previously served as the Deputy Secretary of the Department of Commerce beginning in 2001. A financier and executive by trade, with three decades of experience in the private sector, Dr. Bodman manages the day-to-day operations of the Cabinet agency.

Without objection, sir, your written statement will be made part of the record. You will be recognized for a five-minute summary of your testimony. Thank you so much for appearing here today.

STATEMENT OF HON. SAMUEL W. BODMAN, DEPUTY SECRETARY, DEPARTMENT OF TREASURY

Mr. BODMAN. Madam Chairman, Congressman Gutierrez and members of the committee, thank you for the opportunity to be here.

I have had the pleasure of meeting with Congresswoman Kelly as well as Chairman Oxley over the last couple of weeks, and I know that they, like I, view the Treasury Department and this committee as partners in the critical effort to safeguard our nation's financial system.

As requested, I have submitted testimony that addresses a number of issues that I was asked to comment on. I would be pleased to answer questions about those.

I would like to use my time in the oral testimony to touch on two major issues of interest to our Department: first, the Department's ongoing efforts to advance our campaign against terrorist financing; and secondly, and related, the Department's role in ensuring compliance with and enforcement of the Bank Secrecy Act.

The Treasury Department has broad authorities. It has relationships and expertise in the financial area. That is really the core of what we do.

As importantly, we have a cadre of dedicated and very diligent individuals who work very hard every day, along with countless others in the U.S. government, to fight the financial war on terror and to protect the integrity of our financial system.

We have very real and concrete successes that I have seen firsthand, having arrived just four months ago.

But as the recent attacks around the world demonstrate, our enemies are numerous, they are resourceful and they are continually adapting to new circumstances. We must do the same. We must use every tool at our disposal, including those in the financial realm.

The challenges we face require unwavering political will, active and continuous leadership by senior policymakers and sustained commitments from all of us.

We are in this fight for the long term and the Treasury Department must be organized to reflect that reality.

That is why the administration has collaborated with Congress to develop a new structure in Treasury, a high-profile office led by an undersecretary—it would be one of only three that would be in

the Department; there are two now—together with two assistant secretaries.

This office, the Office of Terrorism and Financial Intelligence, or TFI, as we call it, will bring together Treasury's intelligence, regulatory, law enforcement, sanctions and policy functions to cover this area.

The office has two major components. One assistant secretary will lead the Office of Terrorist Financing. Building on efforts already under way, this arm will function as our policy and outreach apparatus on the issues of terrorist financing, money laundering, financial crime and sanctions. It will continue to develop and help implement policies and regulations in support of the Bank Secrecy Act and the PATRIOT Act.

In the international arena, the office will advance international standards, conduct assessments, administer technical assistance and apply protective measures against high-risk jurisdictions.

The second assistant secretary will lead the Office of Intelligence and Analysis, or OIA. This office will ensure that Treasury properly analyzes relevant information to create actionable financial intelligence that the government can use effectively.

Meeting this essential mission will necessarily require increased coordination with other elements of the government, including law enforcement and regulatory agencies.

A word or two about resources: Secretary Snow has made a commitment to fund the personnel and related start-up costs for the TFI operation for the current and next fiscal year without requesting new money. And we will honor that commitment by reprioritizing existing funds.

At the same time, we will need to invest in substantial information technology and infrastructure systems to make TFI into a world-class organization, particularly on the intel side.

We are currently looking at just how much that will cost and what funding resources are available to us, such as Treasury's Asset Forfeiture Fund, in order to implement the systems for this new office as soon as possible.

You will hear more about the Department's activities in the TFI area from FinCEN Director Fox, OFAC Director Newcomb and IRS-CI Chief Nancy Jardini during the next panel.

Turning to the second topic, the related topic, the Department's efforts to ensure compliance with the BSA: The purpose of BSA, enacted in 1970, is to promote transparency and accountability in the U.S. financial system in order to preserve the integrity of that system and to protect it from criminal abuse.

Most recently, the PATRIOT Act strengthened and expanded BSA regulations to include enhanced due diligence and customer identification requirements, expanded information-sharing authorities and new industries subject to BSA obligations.

While Congress has placed the responsibility for complying with the requirements of BSA on the private sector, the businesses that fall under this framework, the Treasury is responsible for ensuring that the act is effectively implemented and administered. In other words, banks and other institutions are required by law to comply. We are charged with enforcing that compliance.

The Secretary has delegated responsibility for enforcement of this system to FinCEN. This includes the authority to pursue civil enforcement actions and monetary penalties.

However, in order for FinCEN to have the information necessary to assess compliance and to levy penalties, we rely on the regulatory oversight of eight different federal agencies to which the Secretary has delegated authority to examine institutions subject to the BSA.

Several of the eight, like the IRS, the OCC and OTS, are part of the Treasury Department, albeit with varying degrees of statutory oversight by the Secretary.

Others, like the FCC and the FDIC are fully independent agencies with no official relationship to Treasury. Therefore, the Secretary has no direct authority over them.

I say this not to imply a desire on the part of Treasury to exercise control over other agencies, but in order to make clear the operational realities of our current arrangement.

There are substantial benefits from this approach. This approach capitalizes on existing structures and on the unique expertise and examination capabilities of the regulatory agencies that already exist and are most familiar with specific financial industries.

However, there are also potentially serious risks associated with this kind of decentralized system, particularly in terms of transparency, accountability and timeliness. In other words, this type of system requires intense management.

In light of these challenges, and given recent events, the Secretary and I are directing a fresh look at the status of BSA compliance and enforcement across the U.S. financial system.

We are engaged in discussions with various regulatory agencies, both those within and outside the Treasury. We are discussing with them ways to monitor and evaluate their progress and their proficiency. We are considering methods to develop and enhance regular reporting and information-sharing.

We are working on matters related to examination policies and procedures; aggregate results of examinations across each of the regulated financial industries; deficiency trends in BSA and OFAC-related compliance; and enforcement actions contemplated in response to those deficiencies.

There are other challenges related to BSA implementation, and we are addressing those as well.

For example, the PATRIOT Act extended BSA reporting beyond the traditional banking system. There is much work to be done to be fully confident that those non-banking financial institutions are fulfilling their responsibilities.

FinCEN and the IRS have taken significant steps, for instance, in registering money service businesses. But the magnitude of the task of ensuring compliance in this area is enormous.

I would just reiterate that effective enforcement of BSA requires intense management and close coordination and communication among the regulatory agencies. Just today, for example, the bank regulators and FinCEN jointly issued guidance on accepting accounts from foreign governments and embassies.

It has long been the policy of the United States government that persons residing or working in this country should have access to

U.S. banking services. And we also have had the policy that financial institutions must comply with the Bank Secrecy Act.

These policies, in our view, are not in conflict. We believe that financial institutions can provide appropriate banking services while also satisfying the BSA.

Before I conclude, let me say that the Department's acting inspector general, Dennis Schindel, and his team continue to examine a wide range of issues related to BSA compliance. I appreciate their contributions to the Department's mission, and I am very pleased that Mr. Schindel will participate in the next panel.

Despite the challenges that exist, I do think that as a general matter the government and private sector have done a good job of developing and implementing the regulatory changes to the BSA following the passage of the PATRIOT Act. I would be happy to discuss these issues in greater detail.

I thank you for the opportunity to be here, and I hope that this will be the start, Madam Chairman, of an ongoing dialogue between our Department and this committee.

Thank you.

[The prepared statement of Hon. Samuel W. Bodman can be found on page 47 in the appendix.]

Chairwoman KELLY. Thank you very much, Dr. Bodman.

Yesterday, the Council on Foreign Relations Independent Task Force on Terrorist Financing released a report which recommended that Congress enact a Treasury-led certification process to put more pressure on foreign nations to combat the financing of terrorist organizations.

Do you agree that a certification process for foreign countries would help ensure a greater cooperation from our counterparts?

Mr. BODMAN. First, let me say that, looking at the report that was delivered as a whole, in general I am quite supportive of what the council had to say. They made observations, suggestions, particularly with respect to Saudi Arabia and the progress that the Saudis have made, on the one hand, and on the other hand, had made observations about what improvements should be made.

With respect to that particular recommendation, I would not want to respond at this particular point in time, Madam Chairman, until I had had an opportunity to study it or think it through.

I think that the general approach that I have always favored is one of trying to utilize resources that are already there and utilize the power of persuasion, as opposed to threats and as opposed to sanctions, and that those should only be used as a last resort.

And so it would be my observation that that would be an obstacle that would have to be overcome, at least in my mind, in order to reach support for that proposition.

Chairwoman KELLY. Thank you.

As you know, the OCC has reportedly been obstructing the Treasury I.G.'s ability to investigate national banks accused of criminal activities.

I am deeply concerned that the OCC previously misled this committee, whether intentionally or accidentally, in answering a question I asked about what happened to the examiners in charge of investigating Riggs and where they are now.

The person who testified failed to admit the troubling fact that the chief examiner in charge of Riggs from 1998 to 2002 is now working at Riggs as the vice president and chief risk officer.

I am especially disappointed that the OCC would disrupt the inspector general's efforts to review and strengthen antiterrorist financing efforts.

What is the Treasury Department doing to address this dispute?

And actually, I am going to ask you a follow-up right now, so you know it is coming. There seems to be a vacuum with regard to criminal investigative powers at the Treasury. And the OCC seems intent on making sure no one fills it. Couldn't the OCC attempt to thwart the I.G.'s efforts, undermine our total efforts against terror financing?

So I have asked you two questions: What are you doing to address it? And do you think that what the OCC is doing is in fact going to help undermine our efforts against terrorist financing?

Mr. BODMAN. Let me take the questions in the order that you asked them, Madam Chairman.

The first question, if I may, I will split that in half as well, because I believe there are two issues.

One, there is in fact a difference of opinion between the OCC and the inspector general. The acting inspector general is here, and he can speak to that when he is before you. But, as I understand it, there is a difference of opinion over the authority that does or does not exist at the I.G. to investigate alleged criminal behavior on the part of specific bankers.

The OCC, for very good reasons, is very jealous, guards very jealously its independence. It has received that independence from Congress in a bill passed by Congress, signed by the President some years ago. And it is that in my mind, raises the question from time to time about what specific authorities exist for the Secretary or for others who work for the Secretary in overseeing the affairs of the bureaus that report to the Treasury under his general oversight. So that is the issue there.

In terms of the specific question that came up with respect to a Florida bank, and that is where the controversy arose. And at the present time, the Office of the General Counsel in Treasury is working to adjudicate that matter and to make a determination as to where it stands.

I will tell you, from having met with our general counsel, that this matter is uncertain, has a good deal of uncertainty about it. And that is why it is taking them some time to work out the various matters related to it. We want to get it right. And it is something that they are working very hard on.

Your second question relates to your observation that there was a vacuum with respect to the criminal investigation activities within Treasury.

I would respectfully disagree with that. The Treasury has had, when you look at the Riggs situation and you look at other problems, UBS being another case in point, has had some failings with respect to the system as it is now practiced.

It is my view, that even with the current legislative framework that we have that there are opportunities to substantially improve the management of the system under the current authorities that

we have, such that we, I believe, can have a much more effective system.

As we go about doing this in the weeks and months ahead, I would expect to maintain contact with this committee and to report back to this committee as to how we are doing and what the issues are and if there is anything that we believe needs to be done that would more effectively further this.

This is a very high priority, it is a very high priority. It is not my only priority, I have to tell you, but it is a very high priority on the list of things that the Secretary gave me to do when I took this job starting four months ago.

Chairwoman KELLY. I believe that when you were here before, you testified that the IRS criminal investigation is the only entity within Treasury with a BSA criminal investigative authority.

I doubt very much that Riggs could have continued to flout the BSA last year with the OCC examiners on site if there was any real threat regarding criminal enforcement.

So I am not sure, but I think maybe it is a real mistake for them, the OCC, to be fighting a stronger criminal enforcement element in the Treasury.

Do you think this is going to impede the I.G.'s ability to investigate Riggs?

Mr. BODMAN. It strikes me that the issues related to Riggs relate to something that would certainly be fair game for the I.G. And Mr. Fox will speak to that. I hope that after we get FinCEN reorganized and itself focused with respect to its responsibilities in this area, that it would be fair game for them on an ongoing basis.

So I do not think the difference of opinion that exists vis-a-vis the Florida situation, I would not think that it would impede the I.G.'s ability to investigate the situation at Riggs.

I can tell you that we have had, following the publicity involving Riggs, following the meetings, frankly, that I had with you, Madam Chairman, and with Chairman Oxley over the last couple of weeks, we have had a series of meetings that have involved the Secretary himself, as well as myself and the members of the various bureaus that are involved in this, including FinCEN, including OFAC, including OCC, including OTS, about the need for there to be in place a system of evaluation, of monitoring, how good a job is being done by OCC, OTS, as well as these other agencies.

And that needs to be done on behalf of the Secretary by FinCEN. And they need to get themselves organized to do that, to think that through. Mr. Fox, I think, will be in a position to speak to that.

And because he, through this new TFI organization—and hopefully we get Mr. Levey confirmed and get him in place, which will bring, frankly, a great relief to me to have someone who can work on these issues full-time, that once we get that in place, he will be reporting up through Mr. Levey to me, and that I can then ask the questions that you are asking of me, I can put to the people who are doing the work full-time.

And when the Secretary asks me, which he has done, "Is Riggs an outlier, is Riggs a singularity," and my answer to him, Madam, is that I believe it is. I believe that, in general, the work that our regulators are doing with respect in the financial area is very good and it is very strong, but I do not have proof. I do not have a sys-

tem in place, that I am used to from my prior experience, in my prior business life, such that I have a group of individuals that work for me that can evaluate, monitor a new program.

And so that is what we need, that is what the Secretary needs, and that is what we are trying to create.

Chairwoman KELLY. I had hoped that if you are putting FinCEN in a place of responsibility of reporting to the Secretary, that you would give them both civil and criminal ability. I would think that they would need a complete panoply at their fingertips, and I hope that that will be considered.

Unfortunately, sir, we have been called for a group of five votes.

Oh, Mr. Chairman?

Mr. OXLEY. Thank you. I thank the Chairwoman. If you could just indulge me for a couple of minutes for some questions. I cannot return. And I did want to ask Mr. Bodman some questions.

Chairwoman KELLY. By all means.

Mr. OXLEY. Thank you.

Mr. Bodman, I have some questions on the BSA. How much money on an annual basis does IRS spend inputting, maintaining and warehousing BSA data?

Mr. BODMAN. I do not happen to know that offhand, Mr. Oxley. But I would be very pleased to get you the answer.

Mr. OXLEY. Thank you.

The Canada and Australia and other newer financial intelligence units have there own computer systems up and running because they think that is the most efficient method. Shouldn't FinCEN own and operate its own computers?

Mr. BODMAN. Right now, the information on BSA, as I am sure you are aware, sir, is collected in the IRS facility in Detroit. I understand that there have been differences of view within Treasury. And, here again, my approach has been to try to get IRS and FinCEN together.

The collection of information, which numbers hundreds of thousands of bits of information, and the auditing and certification of it, is something that is done, can be done, should be done, by a group of individuals. It can be done by the IRS; I believe it can be done effectively.

But it cannot be done without oversight in the same way that FinCEN needs to have oversight and access to the Secretary to get changes made if he or the organization is not satisfied with the quality of the work being done, that, therefore, he has access and that the place can be managed.

The problem, sir, that we have is that Treasury has not had a deputy in a year and a half, and there has not been a person who has been able to take the responsibility to see to it that issues of this sort are dealt with.

It may be that you are correct. It may be that FinCEN has to start from scratch and to create its own system and have its own clerical group to collect the information, do the data entry and so forth.

I would hope, sir, that we could avoid that and make use of resources that we already have.

Mr. OXLEY. Well, I appreciate your candor on that, although I do say that there is some evidence that other countries are quite suc-

cessful using that method of their own computer and information base. And obviously we will pursue this. And that is obviously one of the reasons why this series of oversight hearings that Ms. Kelly is so well doing is part of this process.

I thank you and yield back.

Mr. BODMAN. I appreciate your comments, sir. And we will certainly look into what those countries are doing. I, frankly, was unaware of it, and I will find out.

Chairwoman KELLY. Thank you very much, Mr. Chairman.

We are going to have to recess. We will, with luck, be back here somewhere in the vicinity of 3:15, 3:20. It depends on how rapidly these votes go. But the committee will stand in recess until such time as we are able to reassemble.

Thank you.

[Recess.]

Chairwoman KELLY. Another bit of business we are going to do here. I ask unanimous consent that the gentleman from California, Mr. Royce, be allowed to participate in today's hearing and be able to revise and extend his remarks. Without objection, so ordered.

I am sorry, Dr. Bodman, that we had to keep you here for this, but we will try to go fast. This subcommittee has looked closely at the concept of streamlining our efforts, which was also recommended by David Aufhauser when he was the general counsel at the Treasury.

In light of the recent failures at Riggs and UBS, wouldn't it be more efficient and effective if there were a centralized body in Treasury that had compliance and audit officers who could oversee the banking regulators and other targeted areas, as well as broaden our BSA compliance efforts to new areas that do not have financial regulators?

You kind of addressed that a bit in your testimony. I wonder if you would want to enlarge on that.

Mr. BODMAN. With all due respect to Mr. Aufhauser, whom I know and have great regard for, I would respectfully disagree, at least at this point in my learning curve at the Treasury.

It is my view that whenever government finds a problem—and to be sure, you have certainly defined a problem here, Madam Chairman, there is no doubt about that—there is a tendency to create a group to solve the problem. And that, of course, tends to lead to an ever-increasing size of the government.

I would believe that with a more intensive management regime, and particularly focusing on the effect I believe that FinCEN can have—you will get a chance to talk to Mr. Fox and hear what it is he has in mind subsequently—but I think you will find that there is plenty of room for improvement, plenty of opportunity to create the kind of environment that would make you proud as a congresswoman to have been, at this point in time, overseeing what we are doing.

So I would like to have a go at it and to see if we cannot use all of these resources. We have all of these people who have devoted their lives and they have great expertise and know these institutions. And I would like to try to make use of them.

And by training them and training their staffs and expanding and making sure that we have a way of verifying that OCC or

OTS, whoever it is, is doing what it is they are supposed to be doing, that has, frankly been the missing link, is having an outside observer, outside evaluator, outside monitor of what is going on.

So that is what I would prefer to do. At least, that is one man's view.

Chairwoman KELLY. That takes me back to some of your prior testimony when you were here before, because at that time when I asked a question of you, you indicated that some of your concern was, at that time, the fact that the OCC and the OTS are not funded by the regulated community, but instead are funded by outside sources, that that might weaken the Treasury Department's sway over their bureaus in their own department.

I am just thinking that if we had a compliance force that is within Treasury that has a greater oversight on these entities, that it might strengthen Treasury's ability to ensure that they are performing up to standard.

Certainly, Mr. Gutierrez picked that up. And he is obviously going to offer legislation to alter the structure so that these two come under the oversight surveillance of Treasury.

Basically, I think what it is we see, at least Congress, my committee, seems to see that we have a patchwork enforcement program, and there is no true center of gravity here.

So if we leave the regulators to their own devices, as we have seen, can be kind of problematic, because clearly they have not seen anti-money-laundering as being one of their main responsibilities and at least as important as their safety and soundness responsibilities. And now it is. And now we have to face that and focus on that.

So I am just going to go back to the original question: Don't you think a compliance force in Treasury that has a greater oversight over all of the eight entities, wouldn't that strengthen Treasury's ability to ensure that they are performing up to the standards that they, themselves, are requiring?

Mr. BODMAN. Let me start with the areas where I agree with you, ma'am.

One, if you leave anybody to function on their own, without outside supervision, without another pair of eyes looking at what they are doing, any institution, you are asking for trouble. Even corporate executives have found ways to create lots of trouble. So, therefore, you and I are in agreement on that.

The question is: Is there a way to take what we have now and to make it work? That is really what it gets down to. And I would agree with you that what we have been doing heretofore has been wanting. We have problems. I mentioned before that I cannot tell the Secretary, if asked, that Riggs is an outlier, or UBS is an outlier, because we do not have a mechanism for ascertaining that.

Now, when you and I talked before, and when I first met you, we chatted, and I did allude to the fact that OCC and OTS have specifically written legislation that precludes the Secretary from entering into the discussions on any matter that comes before those bodies.

It then gets down to a definition of what the word "matter" means. That is almost a direct quote out of the FIRA, the Financial

Institution Restoration Act. And it is therefore a question of how that act links with other kinds of legislation that govern this area.

I also mentioned, you were quite right, your memory is quite accurate, that both OTS and OCC have means of financing themselves outside the normal authorization, appropriation techniques and are funded by their licensees, their clientele, if you will.

And, therefore, both of those tend to loosen the authorities that the Secretary specifically, the Department generally, has over those institutions. And we try to respect that, because that is the law.

I think it is important, however, to note that we do have some—I have learned something since I saw you, and I continue to learn on this, and that there may be in the delegation process under the BSA that the Secretary undertook vis-a-vis FinCEN that, where the Secretary, back in the 1970s when this delegation of responsibility was initially made, that in connection with that, there may well be the opportunity for FinCEN to perform exactly the function that you would like performed.

And that is what I would like to hold out as an opportunity, rather than go through the exercise of trying to either get new legislation or new regulation. It may be that what we have now can be made to work. And so that is what I meant; I would like to try that and then work with you and your committee and report back as to how we are doing. That is what my hope would be.

Chairwoman KELLY. Thank you.

I wanted to ask one quick question about the TRIA situation. Given that some insurance contracts are being written right now that extend beyond the expiration of TRIA, and Treasury is not going to be reporting to Congress on this until June of 2005, do you agree that with the GAO finding that there is a mismatch between the policy calendar and the commercial insurance cycle?

Mr. BODMAN. There is a mismatch. But I have been in the insurance business, at least part of my life in the insurance business, and I have great confidence in the industry to be able to price that.

As you know, we are hopefully in the final stages of the make available study and that that hopefully in the near term will be announced, the decision on that will be announced by the Secretary. And then we have a report due, as you mentioned, next June.

And I am not prepared to comment on extending this until we know more. And hopefully, as we go through this exercise of learning more and determining whether the GAO study is correct or not—I am not in a position, at least as I sit here, to tell you that I agree or disagree with what the GAO had to say.

Chairwoman KELLY. I want to simply place in your mind the fact that I had a conversation with someone who came to me and said, "I want to buy a $4 million building in a city. I cannot do that because the mortgage people will not give me my mortgage because I cannot get terrorism reinsurance extending through the life of the mortgage."

I am hearing this problem from the real estate people, universities, hospitals, museums. It goes on and on and on. It is a very broad spectrum of our economy that is being affected by the lack of certainty with regard to what Treasury's going to do or what this government is going to do about TRIA.

It is extremely important, I believe, so that it does not move as a dislocator in this present economic structure, that we get some certainty with regard to TRIA. And I am sure you know where my personal prejudice is on that.

I thank you very much for answering my questions. And I turn to Mr. Gutierrez.

Mr. GUTIERREZ. Thank you.

Mr. Bodman, at a recent G-8 summit in Sea Island, Georgia, and Summit of the Americas earlier this year, the Bush administration made a commitment to reduce by half, by 50 percent, the cost of remittances to consumers by the year 2008. The communiques referred to efforts to promote competition, use financial literacy efforts and help people join the financial mainstream.

Can you please outline for the subcommittee the specific policies the administration will adopt to promote competition in the remittances industry and other specific efforts that will lead to reducing the cost by 50 percent by the year 2008?

Mr. BODMAN. Yes, sir, I would be pleased to talk to you about that.

First, we do have an Office of Financial Education that has been active, those of us in the Department have been active during—I believe I am correct that April was Financial Literacy Month. And we were all out on the road all over the country working on this matter.

There is also within the government a group of governmental agencies that are all involved in financial education. We formed them into a financial education advisory group. I have met with them. So we are very active in that area.

To be more specific in answering your question, the goal of reducing by half the cost of remittances comes, I believe—I was not involved personally in setting the agenda at Sea Island, but I believe it must have come from the experiences of the Inter-American Development Bank, which has been specifically successful in reducing the cost of remittances from the United States to Latin America, including the Caribbean, with specific focus on Mexico.

And there it has been done largely by being very aggressive with the financial community and making it known to them that there was opportunity there. It turns out that the very high fees that were being charged in the early days, some 15 percent I think as an order of magnitude, were there because only one company was serving that market. And the IDB worked hard, others worked hard in order to develop that. And that has now come from 15 percent down to 7 percent.

They, within IDB and with respect to Latin America, have——

Mr. GUTIERREZ. Well, let me just say, Mr. Bodman, maybe you could submit in writing for the committee the specific policies that the administration is going about specifically to reduce, what steps are going to be taken to achieve it by 2008. Because it still costs you $14.95 to send $100, Western Union or MoneyGram.

And we still do not know what the cost of the transaction truly is, since we do not know what the exchange rate is. You know, you and I, we get a great exchange rate when we are down vacationing somewhere in Latin America, because we use our card from our bank. Well, do not think that the other companies have the same

exchange rate when you walk into an exchange company, a remittance company.

Mr. BODMAN. We will be happy to give you a specific policy——

Mr. GUTIERREZ. Let me ask you——

Mr. BODMAN. If I could just reiterate, sir, if I may. Forgive me for interrupting you, but I do want to reiterate that at least my understanding is that the cost of remittances from the United States to Latin America now averages 7 percent, not 15 percent.

It started out at 15 percent, your number is quite right, 14 percent, 15 percent. It is now 7 percent, on average.

Mr. GUTIERREZ. But when Western Union and MoneyGram got sued, it could be as high as 19 percent.

Mr. BODMAN. That could be.

Mr. GUTIERREZ. Well, it was. We checked it on a daily basis. It was easy to check. You send $100. You call the hotel in Mexico City. You see what the exchange rate at the hotel was. You see how many pesos arrived for your $100. Voila, 19 percent.

Mr. BODMAN. I understand, sir.

Mr. GUTIERREZ. And we have not done anything specifically, legislatively or from a matter of public policy to put the MoneyGrams and the Western Unions in check, other than obviously get trial lawyers, thank God they exist, to sue them in court and embarrass them to change their policies.

But anyway, let me ask you a specific question about an area where Treasury is going to have an opinion. Recently Ranking Member Frank and others asked banking regulators whether it is permissible under current regulations to provide CRA credit to regulated financial institutions for offering of low-cost remittances services.

The regulators agree that this is possible. Do you support this effort? And what will the Treasury Department do to encourage financial institutions to enter the remittances market so they can offer lower-cost alternatives to consumers?

I guess the point being that the cheapest way is to get rid of the middle people and to get people into financial institutions and give them what I imagine you and I have—maybe you do not have an ATM card, but I imagine you have one, I have one. And that is really the cheapest way to send money. So we get ATM card, send it down to our brothers, sisters, family members. And they go to a local financial institution, $1.25, $1.50, $2, they can pull out $200.

As you can see, we can get it down to 1 percent, and we can get the best exchange rate possible, which is the bank rate that you are getting from your bank.

What about using this as a CRA criteria, how do you see that, and giving them credit for that?

Mr. BODMAN. I cannot speak to the CRA issues, sir. I would be happy to examine that and give you some specific written response to your question.

I would reiterate that the way the IDB has been successful is to introduce competition for exactly the reasons that you mentioned. And they have been successful.

And it is not down to 1 percent, but their goal is to get it down to 3 percent. And they have done it strictly through, just as you

suggested, sir, encouraging and making it known that one can make a lot of money——

Mr. GUTIERREZ. Well, I will tell you what. Then maybe we would agree that if we could encourage—since the money flows from here to there and not vice versa, the billion dollars a month goes from the United States to Mexico, for example, and 30 percent of the gross national product of Guatemala and El Salvador, even sometimes more, comes from here to there.

Maybe if Treasury would adopt the position and encourage financial institutions and encourage the regulators and support us in this effort, so that when somebody is getting their CRA evaluation they get credit for having gone out to the community and offered measures that allow remittances cost to be lowered.

Suggestion. You can get back to us in writing on it.

Mr. BODMAN. Be happy to, sir.

Mr. GUTIERREZ. Thank you.

Last thing, just a small question. Maybe you will be able to answer this one.

Is it true that the internal Web at Treasury is still very vulnerable to hackers and that the documents in former Secretary O'Neill's book are still readily available to hackers through Treasury's Web?

We understand that there are a lot of problems in security over at Treasury on the Web site. Does the problem really exist? And, if it does, what are you doing to correct the security issues there?

Mr. BODMAN. There are problems with respect to the security of the IT systems at Treasury, sir. One of my first acts when I arrived four months ago was to order that the chief information officer of the Department report directly to me. Within a month, the person who was the CIO chose to resign and has left.

Yesterday morning was the first day of work of our new chief information officer, a man named Ira Hobbs. He has 22 years of experience, having worked at the Department of Agriculture. He is a very gifted man, very experienced man.

I met with him this morning with all of the bureau heads, as well as with the heads of all the Department offices. His first assignment is to deal with the questions related to the security of the Department's IT operation. It has my——

Mr. GUTIERREZ. Is he doing it all on his own? Are you hiring outside people?

Mr. BODMAN. No, we have people in the Department who are capable of dealing with information security. We have a CIO office.

Mr. GUTIERREZ. I guess since the last guy left after getting the message to take care of this after three months and the new guy just started, I think you said yesterday or today——

Mr. BODMAN. That is right.

Mr. GUTIERREZ.—and it has not been fixed, maybe we should look externally to fix it.

Thanks a lot for the answer.

Mr. BODMAN. Thank you.

Chairwoman KELLY. Thank you, Mr. Gutierrez.

Dr. Bodman, I understand that you have a time limit in appearing before this committee. I wonder if you have the ability to allow me to at least let Mr. Royce and Mr. Garrett have at least a two-

minute time period with which to ask questions. Is that going to be possible for you?

Mr. BODMAN. I do have a meeting back at the Department. But I would certainly want to entertain questions from both of the Representatives.

Chairwoman KELLY. Thank you very much.

Well, then I call on you, Mr. Garrett.

Mr. GARRETT. Thank you. Then I will get right to it, and I thank the Secretary here for being with us.

Based upon your testimony, one of the objectives you say of the Department, of course, is for those who are living and working in the United States to have access to financial services.

And on reading your testimony, you were saying that Treasury's job is to make sure that private-sector institutions fulfill their legal responsibilities. And it is noted that the BSA places the actual responsibility for compliance in several different areas on the private sector, one of which is for checking the identity of customers to financial services.

We have had a number of hearings on money laundering, terrorism, use of our financial services. And one of the things that came out of that is easy access to the banking, financial institutions was one of the critical weaknesses that the terrorists exploited back on September 11th, and that is one of the areas that is being focused on in the future.

I have a piece of legislation in right now, Financial Customer Verification Improvement Act, that goes to this point, because under the system that we have existing is that individuals are able to use documentation issued not by this government or any entity in this government, but by outside governments, most specifically consular cards.

And that would seem to fly in the face of everything that we are trying to do and the responsibilities of private institutions, as far as identifying the customers who are coming into those financial institutions.

What is the Department doing to try to address this problem? And why, up to this point in time, have we not limited the ability to use those cards?

Mr. BODMAN. It is the Department's view, sir, that those decisions are best made by the institutions in question and not by the bureaucracy of this department. This is a highly technical question related to the capability of any document being used to demonstrate that the person carrying the document is represented by that document.

Having lived my life at the Commerce Department before I came over here, I can tell you that they are doing the technical work on this. And we, the U.S. government, have a couple of years of work to even set the standards for being able to do that for our own employees. It is going to be a major undertaking to do that.

Treasury, I think wisely, I can tell you, as a newcomer, took the position that these decisions are best made by the institution that has to form the judgment, does this card represent the individual who is carrying it and does the information that is provided by that individual match up with the card?

Mr. GARRETT. Since I do not have much time, who would be using that card, other than an illegal individual, immigrant?

Because if you were anyone other than an illegal immigrant into this country, you would have some form of other legal identification—passport, visa, work permit or something of that sort.

So is there anyone who would be using that type of card that is not an illegal immigrant?

And my second question: If that is true, isn't it incumbent upon Treasury to make that known to the private institutions, that only illegal immigrants are the individuals who will be using those cards?

Mr. BODMAN. If Treasury believed your proposition, then I would guess that there may be an obligation of Treasury to inform people. But, in my judgment, there are plenty of people who are not illegal immigrants that would be using cards. People do not like carrying their passports around in order to identify. Even U.S. citizens who are living abroad, members of government, have identification cards that they use to identify themselves when they are living abroad.

So I think that there are lots of people that would have these cards, because for convenience, it is a way, just like a driver's license—the primary way we have of identifying ourselves as we go about our day-to-day lives here including getting on aircraft is a driver's license.

You can then query what the ability is to counterfeit the driver's license, depending on which state it might come from. You have different quality driver's licenses and so on.

So, I mean, this is very complicated, what you are onto, and I think an important issue. But the technology of it is a very important part of it.

And I do think that, if I may say so, sir, the claim that only illegal immigrants would be using such a card is, in my judgment, incorrect.

Mr. GARRETT. I guess, it is not that they would be the only ones who may be using it, but they would be the only ones who have an exclusive need for it, whereas anyone else would have some other form of identification.

And if Treasury is charged to make sure that the banks are making the best possible approach to verify, then perhaps there should be some responsibility say that other identification should first be demanded.

Well, my time is up. And I thank you very much.

Mr. BODMAN. Thank you for your comments, sir.

Chairwoman KELLY. Thank you.

Mr. Royce.

Mr. ROYCE. Madam Chairwoman, I would like to begin by commending your leadership, in particular, on combating terrorism finance. And I think you have used your position on this committee and in this Congress to very diligently pursue this matter, and I am appreciative.

As I have said before, and nothing has changed to alter my thinking, I am greatly concerned about how this government is set up to fight the way Islamic terrorists are financing their engines of hate and murder.

I think the Treasury Department needs to be the lead agency for fighting terror finance. As I see it, the Treasury needs to have first-rate capabilities in three distinct areas: in financial intelligence, in compliance, in enforcement. If one of the components is missing, then the other two become much less effective.

I applaud the current efforts of Treasury to build up its resources. But today I think it is fair to describe the Department's compliance resources as scarce.

And I think it is fair to say that its financial intelligence unit's ability to provide actual information is certainly not there yet. And as a result, we have seen some enforcement, but clearly not enough.

And I think the argument that we do not want to overspend in this area is not a very credible one with me, because this is the one area where government, frankly, needs to be spending money right now to protect property and to protect human life. And if we were to do a calculation on 9/11, it would be in the hundreds of billions of dollars. And so I did not quite understand that response, in response to some comments that former Deputy Secretary Aufhauser had made before.

But let me say that I applaud your efforts, Mr. Bodman. And I am very encouraged to have someone with your proven management skill and expertise at the Treasury.

That being said, I think that the Treasury, and you in particular, should have the central role fighting terror finance. And I would like to learn more from you today about Treasury's role on the NSC's Policy Coordinating Committee on Terror Finance on the PCC.

In your appearance before the Senate Banking Committee in April, you were asked about the PCC. And in answering the question, you said that Treasury did not need to chair the PCC. And I must tell you that I am troubled by Treasury's position in this regard.

One of the things I hope to do is to get you to check some of your premises and maybe rethink some of your positions. Mr. Garrett asked you a rather pointed question.

I want you to think about what would happen if we have another 9/11 and we find out that falsified documents like the ones he worries about were used by those here illegally in this country by, let's say, another deputy of Osama bin Laden to carry out an attack.

I would like you to think about the fact that many of us believe that Treasury was supposed to be the lead agency in the war on terror finance. And I thought that you were supposed to be the person accountable in the government. And I think that, just like Defense runs combat and State runs diplomacy, I cannot understand how it should not be that Treasury would not run the war on terror finance.

I understand that this battle requires that all governmental agencies work closely together, but that is the case in all major undertakings in government.

In my view, we need clear, visible leadership. I do not think the NSC is the place for that. The NSC has not spent any time up here testifying on these issues to the American people.

And I would like to give you the chance to voice your views on this subject, but afterwards, I would just like you—like I try to do. After 9/11, I tried to check a lot of my premises about the way in which government was organized to handle some of these challenges. And I just urge you to think about how we could reorganize Treasury.

And I know that may put a lot more responsibility and certainly additional resources into Treasury. But we have a chair of this committee that is dedicated to try to rethink some of the fundamentals. And my intent here is to, over time, enlist your support in helping us do that.

Mr. BODMAN. Well, I am not sure where to start, sir.

First, I believe that we are showing visible leadership with respect to the war on terror, terrorist finance, for the reasons that I have already commented on, some of the suggestions of the Chairperson.

I will take your suggestion. I will rethink my positions, if that is what you have asked me to do, I will certainly do that. I would do that anyway. Frankly, this is a major responsibility, and I would tell you, based on our experiences to date, our system is less than perfect. We do have holes in the system, and we are attempting to deal with them.

There are a number of hurdles that have to be overcome. I will not bother you with trying to enumerate them. Just suffice it to say that they are there, and we are attempting to deal with them.

I do not consider the chair of the PCC to be a hurdle. We have very good relations. I think it is a good thing, frankly, that the NSC is taking, that the White House is taking strong role in this, a leadership role. We have an active role. We are deeply involved in the deliberations of that committee, which meets every couple of weeks.

More importantly, we have a counterterrorism security group that meets almost every day, four, five days a week, every morning. And a number of my colleagues are involved with that, in looking at specific threats that are here and looking at the financial aspects of that. These are matters where specific issues are brought up and are dealt with on a day-by-day basis, and we are deeply involved in that as well.

So I am quite proud of the work that has been done by the people of this department, and I would not want to leave here without saying that to you.

Having said that, I would reiterate, there are barriers, there are issues. I mentioned some of these before to the Chairwoman. And as you requested, sir, I will reassess my thinking——

Mr. ROYCE. And think also about the economic argument there, or the budgetary argument about resources, because the risk premiums, frankly, paid in our financial markets as a consequence of 9/11 are very high.

And I would argue that it would be well worth the investment to put more resources into Treasury for your efforts on financial intelligence and compliance and enforcement. And I would be up here asking for those resources and finding ways that you can really be the lead agency in this battle against terror finance.

And I thank you for your appearance here today.

And, Madam Chair, thank you again for all you do on this committee.

Chairwoman KELLY. Thank you very much, Mr. Royce.

I agree with what Mr. Royce has been saying here. We need to get the resources to you, sir. We need to get whatever you need for you. And we stand willing to do that.

Our concern, I think, is pretty clear. It is that the agencies that are currently under control of the Treasury are not really communicating very well, or enough, with each other, and that there is right now a lack of strong leadership from a centralized office with not only civil, but criminal regulatory ability.

I hope you will think through what can be done to rapidly centralize and make more precise the oversight ability of Treasury. And I emphasize "rapidly." We do not have the luxury of time when it comes to terror and terrorism's response into this nation of ours. The sooner we get this done, the better. We stand willing to help you in any way possible.

And with that said, I want to thank you very much for your appearance here today.

The Chair notes that some members may have additional questions for the panel which they may wish to submit in writing. So without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

I thank you, Dr. Bodman, especially for your indulgence of a few more minutes here and for the time that you have spent here with us today. We look forward to working with you, sir. Thank you so much for giving us your time.

With that, you are excused.

Mr. BODMAN. Thank you very much.

Chairwoman KELLY. While this panel is leaving, I will introduce the second panel. We have with us witnesses from FinCEN, OFAC, the IRS and the acting Treasury inspector general.

William J. Fox was appointed by Treasury Secretary John Snow to be the fourth director of the Financial Crimes Enforcement Network on December 1, 2003. Prior to his appointment as FinCEN's director, Mr. Fox served as Treasury's associate deputy general counsel and acting deputy general counsel.

Since September 11, 2001, he has also served as the principal assistant and senior adviser to Treasury's general counsel on issues relating to terrorist financing and financial crime.

Mr. Fox was recognized for his work on these issues with a meritorious rank award in October of 2003.

We have Mr. R. Richard Newcomb. He is the director of the Office of Foreign Assets Control, OFAC, the agency within the U.S. Treasury Department that is responsible for implementing and enforcing economic sanctions and embargo programs ordered by the President.

Following the terrorist attacks of September 11, 2001, OFAC is the primary U.S. government body responsible for implementing economic sanctions to isolate and impede terrorists and their support networks.

Since assuming this position in January of 1987, Mr. Newcomb has played a leadership role in ensuring that these programs are

fully and effectively developed, implemented, administered and enforced.

We have Ms. Nancy Jardini, she is chief counsel of investigation at the Internal Revenue Service. In January of this year, IRS-CI, as it is called in shorthand, is the agency's law enforcement division.

Ms. Jardini is the first woman in CI's 85-year history to lead the organization. She directs a nationwide staff of about 4,500 employees, including more than 2,900 special agents. CI special agents investigate and assist in the prosecution of criminal tax, money laundering and narcotics-related financial crime cases.

And finally we have Mr. Dennis S. Schindel. He is the acting inspector general of the Department of Treasury. Mr. Schindel has been with the Department of Treasury since 1972.

Prior to his designation as the acting inspector general, Mr. Schindel was the deputy inspector general assisting the inspector general, providing leadership and direction to the Office of the Treasury of Inspector General since March of 2001.

I thank you for your appearance before the subcommittee.

Without objection, your full written statements will be made part of the record. And you will each be recognized for a five-minute summary of your testimony.

Thank you so much.

Let us begin with you, Mr. Fox.

STATEMENT OF WILLIAM J. FOX, DIRECTOR, FINANCIAL CRIMES ENFORCEMENT NETWORK, DEPARTMENT OF THE TREASURY

Mr. FOX. Thank you, Madam Chairman, Congressman Gutierrez and distinguished members of this committee.

I appreciate the opportunity to appear before you today to discuss our vision for the Financial Crimes Enforcement Network. This is my first opportunity to appear before a House committee. And I would like you to know that I consider it a great honor.

We very much appreciate your leadership and the commitment of the House Financial Services Committee, particularly this subcommittee, on the important issues that are the focus of today's hearing.

We also appreciate the diligent work of your staff, both majority and minority. They have been great to work with. And, in my view, they are serving you very well.

I have a prepared statement, which we have submitted. And I will try to keep these remarks very brief.

Madam Chairman, I was appointed FinCEN's fourth director in December 2003. Before I came to FinCEN, I was the principal assistant to David Aufhauser, as he led the Treasury Department and the government on issues relating to the financing of terror.

Working with David, I quickly gained a very keen appreciation for the importance of what has been referred to as the financial front of this war. That importance can be stated quite simply: Money does not lie.

A good part of the time, financial intelligence is actionable intelligence. It can be extremely useful for identifying, locating and capturing terrorists and defining their networks. And, just as impor-

tant, financial intelligence can lead to effective, strategic action that stops or disrupts the flow of money to terrorists and their networks, which in turn serves to halt or impede terrorists operations.

The Financial Crimes Enforcement Network is right in the middle of these two aspects of exploiting financial information.

The women and men of FinCEN have been learning about, understanding and exploiting financial information for almost 14 years. My job is clear: to lead FinCEN in a direction that ensures we are the gold standard when it comes to collecting, understanding, analyzing, employing and disseminating financial information to combat terrorism and financial crime.

Let me tell you what I found my first 180 days on the job. I found an agency populated with highly motivated employees with diverse and, in many ways, specialized talents and skills who are very dedicated to FinCEN and its mission.

But I have also found an agency facing many significant challenges. Let me highlight a couple of specifics.

An important and fundamental challenge facing FinCEN relates to the security and dissemination of the data we have been charged with safeguarding, the data collected under the Bank Secrecy Act. FinCEN must ensure that this data is properly collected, is kept secure and is appropriately, efficiently and securely disseminated to law enforcement, intelligence and regulatory agencies.

This is one of FinCEN's core responsibilities. We believe our BSA Direct Project, which is discussed at length in my statement, will address many of these issues. In my view, this project is critical to our future success.

Another of FinCEN's core responsibilities relates to the administration of the Bank Secrecy Act. As you know, FinCEN is the delegated administrator of the Bank Secrecy Act. Through that delegation, FinCEN is answerable to the Secretary of the Treasury for ensuring that the ultimate goals of that act are achieved.

While we eagerly accept this responsibility, the responsibility is not ours alone. The federal bank regulators, as well as other agencies such as the Securities Exchange Commission, the Commodities Future Trading Commission and the Internal Revenue Service, have been delegated responsibility to supervise and examine financial institutions for Bank Secrecy Act compliance.

Indeed, presently, implementation of the Bank Secrecy Act's regulatory regime involves eight different federal agencies and three SROs. This unusual structure is both a strength and a weakness. The weaknesses are obvious and sometimes are clearly manifested.

To diffuse responsibility across so many bureaucracies can cause, and indeed on occasion has caused, inconsistency in application, lack of clarity of purpose and, most importantly, diffusion of accountability.

However, if managed properly, we believe this structure could also be a strength, because it builds upon existing expertise, knowledge base and examination functions of regulators who know their industries best. The structure leverages resources where resources would otherwise be completely insufficient and possibly duplicative.

I view it, Madam Chairman, as my responsibility to work with my colleagues in these agencies to help manage this structure in

a manner that builds on our strengths that our diverse partners bring to the table.

In other words, administration of the Bank Secrecy Act in this context really means oversight—exercising oversight coordination and ensuring consistency of application.

In my view, of all the challenges facing FinCEN, there are no challenges as important as the proper and appropriate implementation of the Bank Secrecy Act regulatory regime. We have several ideas on how to better manage and coordinate the implementation of this regime, and we have outlined those in my written statement, so I am not going to recite them again here.

What I want you to know, Madam Chairman, is that I clearly understand how important this set of issues is to the success of our country's anti-money-laundering and counterterrorist financing efforts.

The implementation of this risk-based regularity system is a delicate matter that demands balance, consistency and clarity. The cornerstone of the Bank Secretary Act, suspicious activity reporting, requires financial institutions to make judgment calls. If we fail in properly implementing this regime, if we get it wrong, then the system will fail.

For example, if as regulators we are either too aggressive or too passive in supervising and examining the financial industries that we regulate, there could be two equally unacceptable outcomes.

Compliance should not be about second-guessing individual judgment calls on whether a particular transaction is suspicious. If we are overzealous in our supervision and examination, financial institutions, as conservative institutions, will merely defensively file on anything and everything to protect themselves from regulatory risk.

If, on the other hand, we are too lax when it comes to ensuring institutions are implementing these programs, proper reporting will not be generated.

Either scenario represents a failure.

Madam Chairman and distinguished members of this committee, you should know that you have my commitment, and the commitment of the women and men at FinCEN, to do all in our power to ensure the implementation of this critical regulatory regime does not fail.

Again, Madam Chairman, we appreciate the committee's continued support and your focus on these critical issues. I hope our presence here today will add to this important conversation.

I will be happy to answer any questions that you may have.

[The prepared statement of William J. Fox can be found on page 57 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Fox.

Mr. Newcomb?

STATEMENT OF RICHARD NEWCOMB, DIRECTOR, OFFICE OF FOREIGN ASSETS CONTROL, DEPARTMENT OF THE TREASURY

Mr. NEWCOMB. Madam Chairman, thank you for the opportunity to testify on the Office of Foreign Assets Control's efforts to combat terror support networks, which forms an important part of the

Treasury Department and our government's national security mission.

I will begin with an overview of our overall mission and conclude with our strategies for addressing the threat of international terrorism.

The primary mission of the Office of Foreign Assets Control is to administer and enforce economic sanctions against targeted foreign countries and groups and individuals, including terrorists and terrorist organizations, narcotics traffickers, who pose a threat to the national security, foreign policy or economy of the United States.

We act under the general presidential wartime and national emergency powers, as well as specific legislation, to prohibit transactions and freeze assets subject to U.S. jurisdiction.

Economic sanctions are intended to deprive the target of the use of its assets and deny the target access to the U.S. financial system in the benefit of trade, transactions and services involving U.S. markets.

We currently administer and enforce some 28 economic sanctions programs pursuant to presidential and congressional mandates. These programs are crucial elements in preserving and advancing the foreign policy and national security objectives of the United States and are usually taken in conjunction with diplomatic, law enforcement and occasionally military action.

Our historical mission has been the administration of sanctions against target governments that engage in policies inimical to U.S. foreign policy and national security, including regional destabilization, severe human rights abuses and repression of democracy.

Since 1995, the executive branch has increasingly used the statutory powers to target international terrorist groups and narcotics traffickers. Many so-called country-based programs are part of the U.S. government's response to the threat posed by international terrorism.

The Secretary of State has designated seven countries—Cuba, North Korea, Iran, Libya, Iraq, Sudan and Syria—as supporting international terrorism. Three of these countries are subject to comprehensive economic sanctions: Cuba, Iran and Sudan. Comprehensive sanctions have been imposed in the past against Libya, Iraq and North Korea.

In addition, effective May of this year, the President issued a new executive order which prohibits specific types of transactions with Syria, due to its continued support for terrorism and other reasons.

OFAC administers also a growing number of list-based programs, targeting members of government regimes and other individuals and groups whose activities are inimical to U.S. national security and foreign policy interests. In addition to our terrorism and narcotics trafficking programs, these include sanctions against persons destabilizing the western Balkans and against the regimes in Burma and Zimbabwe.

OFAC also administers programs pertaining to nonproliferation, including the protection of assets relating to disposition of Russian uranium and trade in rough diamonds.

OFAC as an organization has grown over the past 18 years from an office with about 10 employees administering a handful of programs to an operation of 144 employees with some 28 programs.

To accomplish our objectives, we rely on good, cooperative working relationships with other Treasury components and other federal agencies, particularly the State and Commerce Departments and Justice Department, law enforcement agencies, the intelligence community, domestic and international financial institutions, the business community and foreign governments.

We are an organization which blends regulatory, national security, law enforcement and intelligence into a single entity with many mandates but a single focus: effectively implementing economic sanctions programs against foreign adversaries when imposed by the President or the Congress.

In order to carry out our mission, the organization is divided into 10 divisions with offices in Miami, Mexico City, Bogota and, soon to be opened this summer, an office in Manama, Bahrain.

Our licensing, compliance and civil penalties divisions serve as OFAC's liaison with the public and figure prominently in promoting the transparency of our operations.

Our enforcement division provides crucial liaison with law enforcement community, while our international programs and foreign terrorist divisions are primarily devoted to narcotics and terrorism programs and the preparation of evidentiary material to support our designation process.

Briefly, I would like to talk about our vision for the future and the important challenges we face at the Office of Foreign Assets Control.

In order to meet the increasing demand placed on us and to fulfill our multiple missions against governmental and organizational targets, particularly a recent critical role in countering international terrorism and narcotics trafficking, we are seriously addressing several specific challenges facing our component divisions.

For example, our civil penalties division is expanding the transparency of our civil penalty enforcement process by developing an automated system to report enforcement actions.

Our compliance division is in the process of building new customer interaction capabilities with a state-of-the-art automated telephone system, enhanced hot-line capabilities and improved Web-based forms to allow the public to transmit detailed live transaction data for our real-time analysis and response.

We expect that the new automated reporting systems we are developing will allow financial institutions and others to provide more quickly comprehensive information on interdicted transactions.

We are building a new specially designated national database that will allow wide access to declassified target information and permit our analysts to directly link from the name on our SDN list to underlying declassified evidentiary material for easier access.

We intend in the near future also to make a new data feature available on our Web site that will allow users of our specially designated nationals list to more easily shop for information that is tailored to their specific compliance needs.

Madam Chairman, I would like to thank you and the committee for giving me the opportunity to speak on these issues. This con-

cludes my oral remarks today, and I am very pleased to answer any questions you may have.

[The prepared statement of R. Richard Newcomb can be found on page 89 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Newcomb.

Now, Ms. Jardini?

STATEMENT OF NANCY JARDINI, CHIEF, CRIMINAL INVESTIGATION, INTERNAL REVENUE SERVICE

Ms. JARDINI. Thank you very much, Madam Chairman.

It is a pleasure for me to be here with my colleagues from FinCEN, OFAC and the Treasury Inspector General's Office to discuss our work and our interactions with one another.

I also very much appreciate the opportunity to highlight the unique and specialized skill of the Internal Revenue Service Criminal Investigation Division and discuss our efforts to investigate financial fraud and money laundering wherever it occurs.

The fundamental mission of criminal investigation, or CID, as it is known, is to serve the American public by detecting and investigating criminal violations of the Internal Revenue Code and related financial crimes, most importantly money laundering.

To that end, we recruit only individuals who have an educational background in accounting and business and, through rigorous training, shape them into law enforcement professionals who are experts in forensic accounting, financial investigations and computer forensics. These highly skilled special agents are devoted to following the money in tax and money-laundering and related investigations that involve sophisticated schemes and complex transactions that span the globe.

The unique sophistication of our special agents is in demand throughout the law enforcement community, because we add value to every financial investigation. These are precisely the same skills that make such a valuable contribution in unraveling organized crime, narcotics trafficking and global terror financing networks.

In addition to bringing significant technical expertise to these investigations, there is often an important nexus between tax crimes, Bank Secrecy violations, money laundering and terrorism.

Indeed, money laundering is tax evasion in progress. It is criminals hiding their ill-gotten gains from the authorities, most particularly the IRS. Just as corporate executives, drug kingpins and terrorists employ various methods to move money, the IRS is using various means to detect them.

One of those is to exploit effectively the Bank Secrecy Act. We in CI lead 41 suspicious-activity report review teams nationwide. These teams are comprised of federal, state and local law enforcement officials who evaluate between 12,000 and 15,000 SARs each month.

In addition, last year alone, just the criminal investigation division of the IRS spent over $60 million evaluating BSA data, which led to over 1,000 investigations in the criminal arena.

Another unique analytical contribution CID is making in the financial crimes arena is the counterterrorism project that we are piloting in Garden City, New York. When fully operational, the center will use advanced analytical technology and data modeling of

tax and other information, such as the wealth of information contained in BSA data, to support ongoing joint investigations and proactively identify potential patterns and perpetrators.

The center analyzes information not available to, nor captured by, any other federal law enforcement agency.

So far, the lead development center has helped identify individuals, entities and relationships between them previously unknown to law enforcement.

As an example, the lead development center began compiling and analyzing financial data that culminated in the linking of several individuals and businesses, some of whom are or were under criminal investigation, one with ties to Al Qaida.

With no identifiers other than listed names, the center established significant connections to individuals and businesses potentially involved in illegal activities, including international heroin smuggling and Iraqi artifacts smuggling.

The scope of this criminal enterprise was previously unknown prior to the analytical work done by CI at the Garden City Lead Development Center.

Because this type of financial analysis is not duplicated in any other law enforcement agency, we are encouraged and enthusiastic about the unique contribution we are able to make.

In conclusion, the men and women of IRS-CI, some of the most skilled financial investigators in federal law enforcement, are proud of the role we have had in these successes. For all of us, it is one of the great rewards of public service.

We thank you for inviting us here today. And I welcome your questions. Thank you.

[The prepared statement of Nancy J. Jardini can be found on page 71 in the appendix.]

Chairwoman KELLY. Thank you very much.

Mr. Schindel.

STATEMENT OF DENNIS SCHINDEL, ACTING INSPECTOR GENERAL, DEPARTMENT OF THE TREASURY

Mr. SCHINDEL. Thank you, Madam Chairman, for the opportunity to testify.

In your invitation letter, you ask that I address several issues. Briefly, they include BSA compliance efforts by the various regulators, OCC and OTS oversight of BSA compliance by banks and their private banking and trust operation, usefulness of the FinCEN database, and concerns we have resulting from our review of the OFAC sanctions program.

Let me say that oversight of Treasury's role in combating terrorist financing is among our highest-priority work. In fact, we designated it as one of Treasury's six most significant management challenges.

While Treasury takes its BSA responsibilities seriously, in almost every area we have audited, we have identified problems significant enough to impact Treasury's ability to effectively carry out its role in combating terrorist financing and money laundering.

I will briefly highlight our work.

With regard to BSA compliance by the regulators, our work is limited to OCC and OTS. In one of our early audits issued in Janu-

ary 2000, we reported that OCC needed to improve BSA compliance exams. We found that many of the exams in our sample lacked sufficient depth to adequately assess a bank's compliance. Over half the exams we reviewed did not have documentation to determine whether an adequate BSA exam was conducted.

We also reported that OCC rarely referred BSA violations to FinCEN and that OCC procedures did not require examiners to review SARs filed by the banks.

More recently, we issued a report in September of 2003 on BSA enforcement actions at OTS. We found that OTS was not aggressive in taking enforcement actions against thrifts in substantial non-compliance with BSA requirements.

Specifically, while OTS examiners identified substantive BSA non-compliance at 180 of 986 thrifts that they examined, OTS issued written enforcement actions against only 11. For most of the thrifts, OTS exercised moral suasion and relied on thrift management to comply with the BSA requirements. We found that that approach did not work more than 30 percent of the time. And in some instances, subsequent BSA exams found that compliance actually got worse.

On the issue of oversight of BSA compliance in private banking and trust operations, we completed an audit at OCC in November of 2001. We found that OCC needed to focus greater attention on private banking and trust operations when conducting BSA compliance exams.

In 60 percent of the exams we tested, OCC examiners did not cover the bank's private banking operations. Even where OCC did include private banking and trust operations in their BSA compliance exams, more than 30 percent of the time the examiners did not fully comply with OCC's own BSA examination guidelines. Exams often lacked sufficient testing of high-risk transactions commonly associated with money laundering.

With regard to the subcommittee's questions on FinCEN's database, we completed two audits on the accuracy and reliability of the FinCEN database for SARs and we have one in process. These audits have consistently shown that the SAR database lacked critical information, included inaccurate information or contained duplicate SARs.

In the more recent audit, which we issued in December 2002, we found that regulatory and law enforcement officials generally felt that the database was useful. However, they indicated that its usefulness would be enhanced if it contained more complete and accurate SAR data.

We found that incomplete or inaccurate data resulted because filers disregarded instructions, did not always understand the violations or were concerned with personal liability. We made several recommendations to include more editing, more mandatory fields, more feedback to filers, revisions to the SAR form and more efforts to eliminate duplicate SARs in the system.

Before I discuss my concerns with OFAC's foreign sanctions program, I want to briefly comment on some limited work that we have done on referrals to FinCEN.

In October of 2002, we issued an audit report on FinCEN's efforts to deter and detect money laundering in casinos and its re-

lated enforcement actions. IRS is responsible for BSA compliance exams of casinos. Overall we found that FinCEN was inconsistent and untimely in its enforcement actions against casinos for BSA violations referred to them by IRS.

At the time, FinCEN was embarking on a new enforcement approach focused on fostering casino compliance through education and outreach. IRS officials apparently did not fully agree with several aspects of this approach, but their disagreements were not resolved.

We reported our concern that IRS might be reluctant to refer future BSA violations to FinCEN. Our concern was subsequently reiterated by the Treasury inspector general for tax administration in a report that they issued in March of 2004.

The last area the subcommittee asked me to address was my concerns with OFAC's foreign sanctions program. In April 2002 we reported that OFAC was limited in its ability to directly monitor financial institution compliance with foreign sanction requirements. While OFAC devotes considerable effort to increasing awareness of the foreign sanctions requirements, like FinCEN, OFAC is dependent on the regulators to examine for compliance.

Our tests have found gaps in the regulators' testing for compliance with OFAC sanctions requirements. While most of the exams included some coverage of compliance with OFAC's sanction requirements, almost none of them included transaction testing. Transaction testing is the most effective way to determine whether a prohibited transaction was allowed in violation of an OFAC sanction order.

Also, because OFAC is not a bank supervisory agency, it cannot dictate the requirements of how institutions ensure compliance. We found that the extent of foreign sanction compliance efforts varied among the various financial institutions.

In conclusion, I would like to make a few observations. While the BSA compliance process is dependent on many federal and non-federal regulators, ultimately it is Treasury's responsibility, primarily through FinCEN, to ensure that there is adequate compliance and law enforcement is getting what they need. In this regard, Treasury can do a better job.

The universe of BSA filers is expanding. This will result in disbursing BSA compliance monitoring among even more regulatory bodies. One of FinCEN's challenges has been ensuring that the regulators of these various BSA filers provide adequate and effective BSA compliance monitoring.

To this end, FinCEN's approach has been focused on consensus-building, rather than leading, an approach that has met with limited success. I believe that for the current regulatory structure to work, it must be effectively managed through a cohesive effort that transcends the stovepipes of the individual regulators.

FinCEN needs to take a more aggressive leadership role in that effort and require from all those involved in the regulatory structure an approach that, while risk-based, is thorough and intolerant of non-compliance. FinCEN also needs to be more engaged in analyzing the results produced by the various regulators so that it can be more proactive in addressing gaps in compliance monitoring.

This type of approach would also apply to programs for which OFAC is responsible, since it also relies on other regulators to administer its programs. The newly created Treasury Office of Terrorism and Financial Intelligence, to which FinCEN and OFAC will report, can perhaps be the vehicle to pull all this together and establish a regulatory structure for BSA and the OFAC sanction programs that is strong, effective and accountable.

I would be pleased to answer any questions the subcommittee may have.

[The prepared statement of Dennis S. Schindel can be found on page 112 in the appendix.]

Chairwoman KELLY. Thank you very much, Mr. Schindel. I appreciate the fact that you are speaking very strongly here. And I hope that the people sitting in this panel with you will take your reports back. And perhaps, Mr. Fox, since he is new at the agency, will read that report and take it to heart.

Mr. Fox, in light of the failures at Riggs Bank and UBS, what do you think? Do you think it would be beneficial if FinCEN had a compliance and audit team that could oversee the banking regulators and then broaden our BSA compliance efforts into those new areas?

Mr. FOX. No question, Madam Chairman.

Chairwoman KELLY. No question, yes or no?

Mr. FOX. No question, yes.

Chairwoman KELLY. You think you would really like——

Mr. FOX. I would like to tell you, I mean, that is part of our plan. I mean, we have new leadership in our regulatory programs division. And one of the things we are doing is standing up what we are calling an examination program unit that is really meant to more aggressively oversee and ensure that the regulators, the disparate regulators that are out there ensuring this act is complied with, are actually doing their job and making sure of it.

I think that is important on a couple levels. Again, one of the great challenges, Madam Chairman, I think is to ensure consistency in this area. I have seen, since I have been director of FinCEN, even differences in approach between bank regulators, not to mention, you know, differences in approach between bank regulators and SEC and maybe the SEC and an SRO.

You know, each regulatory agency brings with it a history and a culture that cause inconsistencies. So we have to work very hard to make sure that that is minimized as much as possible.

But I could not agree with you more. And it is a plan that we have.

Chairwoman KELLY. Does FinCEN currently have the authority to actively examine the frontline BSA regulators and to conduct spot checks on their performance? I mean, I really do not know. Do you have that?

Mr. FOX. Well, as I understand this, ma'am, the Bank Secrecy Act—the authority to supervise and examine these institutions has been delegated to various agencies by the Treasury. The responsibility for administering the Bank Secrecy Act has been delegated by the Secretary to FinCEN.

Generally, when you delegate an authority, you retain that authority as well. And if you read the delegation that is in our regulations, it has been in place since 1972.

You know, it is pretty broad. I mean, the Secretary of the Treasury still, and now FinCEN because of that, still retains a lot of authority here.

So we are certainly going to test that and make sure that the regulators are performing.

We are thinking of various things, things like requiring reports; going in and actually finding out about how they are conducting these examinations; conducting joint examiner training; ensuring that examination procedures are consistent and actually make BSA as important maybe as safety and soundness.

So we are very keen to do that. And we think we have the authority right now to be able to do that.

I will tell you if we learn soon that we do not, we will be back to you, and I will be back to the Deputy Secretary. Because I do not think we can do an effective job administering the act without that.

Chairwoman KELLY. Mr. Fox, do you think you are going to need some more personnel to do that in FinCEN? Do you have enough people to do what you have outlined?

Mr. FOX. No. But, you know——

Chairwoman KELLY. Well, that was the short answer.

Mr. FOX. What we are going to do honestly is—you know, one of the things that we are trying to do at FinCEN right now is to really re-look at what it is FinCEN is supposed to be doing and maybe redirect some of the assets that we are working on some things that maybe we should not be doing.

For example, I think that is why our technology projects are so important to us, because I think that will free up some people that we can redirect and put on programs like this.

And I was not part of the budget process for either this year or next year. But you can be assured that in future budget processes that we are going to be asking for additional help in that regard, again because I think you simply need human bodies to be able to do this work.

Chairwoman KELLY. Thank you.

Mr. Schindel, I would like to go to you. As you probably know, I recently sent you a letter asking that you examine the regulatory environment that allowed the failure at Riggs to occur. I specifically asked you to look at relevant OCC documents that I have not been allowed to view.

Do you anticipate that this dispute that is going on with OCC will interfere with your efforts to review those documents and to examine the conduct of the OCC personnel in the Riggs case?

Mr. SCHINDEL. The short answer is that I do not.

When there was an article that came out a week ago that quoted the comptroller, Mr. Hawke, as indicating that they were doing a lessons-learned review and also looking into whether there was undue influence on the lead examiner as a result of him subsequently taking a job with Riggs bank, when I read that, I immediately contacted our counsel and our head of investigations and asked that they reach out to OCC and let them know that we did

not think it would be appropriate for them to investigate whether there was undue influence, that that was in our domain.

We received assurances that we would get their full cooperation in conducting such an investigation, and we have opened up that investigation.

Chairwoman KELLY. And so you feel that you will be able to see those documents?

Mr. SCHINDEL. Yes.

Chairwoman KELLY. Do you have any time line for how long this overall review is going to take?

Mr. SCHINDEL. I really do not. We have just initiated it.

Chairwoman KELLY. But you are doing the review, not OCC. It is not an internal review.

Mr. SCHINDEL. Correct. OCC is still, I believe, continuing with their lessons learned review of Riggs and their examination of it. And I am not saying that that is inappropriate, and that is probably a good thing for them to do.

We will probably, if we have the resources, come in behind that effort and take our own look at it using what they have developed.

Chairwoman KELLY. From what I understand, there are some other things, investigations, that are going on where OCC is simply not cooperating. I wonder if you would be good enough to explain those circumstances and discuss what information you are being blocked from getting access to.

Mr. SCHINDEL. Well, primarily we had initiated a couple efforts to engage in looking at potential bank fraud activities and a couple bank failures, one in particular involving Guarantee National Bank in Tallahassee, Florida.

It was our understanding that there were some concerns regarding OCC's access to information from the bank. And we were concerned that this presented a possible obstruction of the bank examination process.

We were down at that bank to join the FDIC as they engaged in the process of closing down that bank so that we could join that effort and look at that issue in particular. OCC reached out to the assistant U.S. attorney in Tallahassee and raised concerns that we did not have an appropriate jurisdiction. And the AUSA was, I guess, concerned enough that it raised a question that they requested that we step off joining that investigation until that could be sorted out.

And as you know, Dr. Bodman has indicated that this whole issue of our jurisdiction, we are hoping to resolve it through the Treasury counsel.

Chairwoman KELLY. What do you think the implications are of the effort by the OCC to block this?

Mr. SCHINDEL. Well, I understand that they have some concerns about their responsibilities to protect the Right to Financial Privacy Act data that we might have to obtain in investigations like this or other investigations we might do.

We just do not feel that our access to Right to Financial Privacy Act information is a matter of concern. We think we have access to that information. And we hope to get that resolved.

Chairwoman KELLY. I want to just pursue one follow-up here. Is the OCC's resistance in cooperating with you, the Treasury inspec-

tor general, an isolated instance? Or are there other cases besides these that I have raised, that I happened to know about?

Are they not cooperating with investigations by other inspectors general or with law enforcement as well?

Mr. SCHINDEL. Well, we would be the only inspector general that would be conducting investigations regarding OCC. I cannot speak to their level of cooperation with the FBI or the Justice Department on other bank fraud cases that those law enforcement agencies are engaged in.

But there has been at least one other bank investigation that we were involved in, in the Midwest where they also, again, reached out to the AUSA's office and raised questions about our jurisdiction. And, similarly to the Tallahassee situation, we were asked to step off of that investigation.

Chairwoman KELLY. Dr. Bodman did not indicate that he had any real time line on this. Do you have any kind of an idea how quickly this is going to be resolved?

Mr. SCHINDEL. I do not. I know that we have formulated the issues, both my office and OCC, for the general counsel that we think need to be answered. The general counsel has now pushed back to both us and OCC to provide some additional information on those issues.

So it is being worked. I would say it is somewhat slow from my perspective. But, I am sure, I am confident that it is going to get resolved.

And one thing I can tell you is I will keep this committee informed on the outcome.

Chairwoman KELLY. Good, thank you. We would appreciate that.

Mr. Newcomb, I just wanted to ask you a question about UBS. The UBS-ECI contracts, there are indications that we have found that the Fed saw hints of OFAC-related problems at UBS early in the ECI program. And they had some conversations with the bank early on.

Were those concerns communicated to OFAC? And with that hint of there possibly being problems, shouldn't OFAC have been involved right away?

Mr. NEWCOMB. Madam Chairman, the Federal Reserve Bank of New York brought this to our attention when they first saw currency moving in the Iraq situation, post-invasion, when dollars were moving from countries nearby. And they began an investigation which led to UBS.

They notified us very shortly thereafter, last summer, July of 2003. And they were faced with a situation where the bank was deliberately telling them stories which were not true. And not only were they not true, there seems to have been an attempt to falsify what was, in fact, told.

They kept us informed. And then in the winter of last year, in January, they gave us information of what had taken place. And before a penalty was rendered against UBS, the general counsel of the Federal Reserve Bank of New York and executive vice president came and spoke with us, laid out what he intended to do, the $100 million penalty.

That was a penalty for a foreign institution. It was an institution over which we do not have jurisdiction. There is a continuing mat-

ter that I cannot talk about where there may have been U.S. involvement that we are continuing to work with the Justice Department, U.S. Attorney's Office to determine if in fact there was any U.S. involvement.

Important thing here that I want to stress is, following that meeting we had with the general counsel of the Fed, I have met on three occasions with the Fed, and we have a program in place as a direct result of seeing the possibilities of these ECI contracts being abused in this manner and are planning a compliance visit to all eight of the ECI institutions beginning next month and then expanding that to other financial institutions, the largest 15 or so financial institutions that, though they are not ECI contractors and even though they may not be subject to U.S. jurisdiction, because they do have branches operating in the United States, we are going to be providing visitations to them with the possibility of follow-up audits wherever we have jurisdiction.

So the situation is being addressed in a very robust manner.

Chairwoman KELLY. Thank you very much.

I am going to come back to this in a minute. But I understand Mr. Sanders, who has joined us, has an amendment that is going on the floor, so I am going to yield some time to him.

Mr. SANDERS. Thank you very much, Madam Chair, for allowing me to say a few words. I am not on this subcommittee. And I will be brief.

Chairwoman KELLY. Well, with unanimous consent, we approve of your presence here today.

Mr. SANDERS. Well, I appreciate that. And I am going to just go forward in one line of questioning and be as brief as I can.

Madam Chair, last September I offered an amendment to the fiscal year 2004 Treasury-Transportation appropriations bill that would prohibit the Treasury Department's proposed regulations regarding cash balance payments from taking effect for one year. That amendment passed Congress and was signed into law.

And yesterday, to its credit, the Treasury Department finally withdrew those proposed regulations for good. Now I wish that that was the end of the story, but unfortunately, it is not, which is why I am here right now.

During the consideration of my amendment, an IBM lobbyist e-mailed a document on Treasury Department letterhead that stated that the Treasury Department strongly opposed this amendment. But according to the Treasury Department, in an article that appeared in The Wall Street Journal, they never released this document and, "It appeared to be doctored."

Madam Chair, no one is surprised when important issues involving hundreds of billions of dollars generate a lot of controversy. But the distribution of phony documents purporting to be from the Treasury Department goes beyond even the loose ethical rules that are sometimes followed here in Washington.

Doctoring Treasury Department documents is a violation of the law and should be prosecuted to the fullest extent possible.

When Secretary Snow appeared before the full committee, he pledged to look into this matter and immediately referred it to the Inspector General's Office.

Six months later, we are still awaiting a report from the inspector general on how their investigation is going.

Madam Chair, it is my understanding that the Inspector General's Office has a draft report on this investigation that has been sitting on someone's desk for months.

It is my understanding that this report may confirm that the IBM lobbyists and the Tax Benefits Council at Treasury violated the law by doctoring Treasury Department's documents and releasing non-public information.

It is also my understanding that the Inspector General's Office may have recommended that the individuals involved be prosecuted but that the U.S. attorney at the Justice Department declined to prosecute.

Essentially, what I would like to ask Mr. Schindel, if I might, I have some questions that I would like to ask you, if I may, Madam Chair.

Mr. Schindel, were Treasury Department documents opposing my amendment doctored?

Mr. SCHINDEL. Yes.

Mr. SANDERS. If so, who doctored those documents?

Mr. SCHINDEL. The IBM employees involved.

Mr. SANDERS. Is it a violation of the law to doctor Treasury Department documents?

Mr. SCHINDEL. Yes, it is.

Mr. SANDERS. And what is the penalty for doctoring documents in a case like this?

Mr. SCHINDEL. Well, I think the penalties probably—I cannot speak specifically to that. I am sure there is a wide range of penalties.

But as to whether there will be prosecution of that issue, is something we are still vetting with the U.S. attorney's office.

Mr. SANDERS. Does the Treasury Department regard this as a serious offense?

Mr. SCHINDEL. I believe they do.

Mr. SANDERS. Did the Inspector General's Office recommend that individuals be prosecuted for doctoring those documents.

Mr. SCHINDEL. We have not made a specific recommendation yet. You are correct to say there is a draft report. It is being reviewed by my head of investigations with the investigator to be sure that we have covered all aspects. There are several aspects of this investigation involving IBM employees, lobbyist employees and Treasury employees.

Mr. SANDERS. That was my next question. Did anyone at the Treasury Department assist lobbyists in doctoring these documents? If so, who was that?

Mr. SCHINDEL. We are continuing to look into that. And that is one part of the investigation, and that is all going to be thoroughly included in our final investigative report.

I would not rule out the possibility that there is additional work that may need to be done after my head of investigations has gone over this with the investigator. We feel we are close to wrapping that investigation up, but it is in essence still ongoing.

Mr. SANDERS. It is my understanding that a report on this investigation has been drafted——

Mr. SCHINDEL. Correct.

Mr. SANDERS.—and has been sitting on someone's desk at the Inspector General's Office for a number of months.

Mr. SCHINDEL. Well, that part I would disagree with. And I can tell you it has not been sitting on my desk. But the head of our office of investigations has that draft and is currently going over it with the investigator. They have reached back out to the U.S. attorney's office to make sure that we have thoroughly vetted all the issues with them and that they would fully consider all the aspects of prosecution action that could be taken in this case.

Mr. SANDERS. When this report is finished, will you provide a non-redacted to me as well as the Chairwoman and Ranking Member of this subcommittee?

Mr. SCHINDEL. Sir, it is my understanding that we have clear authority to provide an unredacted copy of that report to the chairs of the various committees that have jurisdiction, but not to individual members.

Mr. SANDERS. Not to the member who authored the amendment in which there was doctoring of documents?

Mr. SCHINDEL. I understand your frustration with that issue, but the guidance that we are operating under does not take into account those unique situations.

The redacted version of the report, I would hope, would not be so heavily redacted that if you were to receive that copy that you would not be able to fully understand what was involved, who did what and what the results of the investigation——

Mr. SANDERS. Just two more questions. Do I understand that you will provide a non-redacted copy to the Chairwoman?

Mr. SCHINDEL. Yes.

Mr. SANDERS. Maybe the Chairwoman would be so kind as to allow me to peek in and take a look at it.

My last question is, this really has dragged on. And can you give me, give the committee a sense of when you are going to have your final report?

Mr. SCHINDEL. I would hope that we would have the final report out within the next two months.

Mr. SANDERS. Okay, thank you very much, Madam Chair.

Chairwoman KELLY. Thank you. Thank you, Mr. Sanders.

I am going back to you, Mr. Newcomb. You have mentioned a couple of things that I have found very interesting in light of a book that I happen to be reading. You talked about the commodities that are being utilized for money transfer and money laundering.

This is a huge field. The whole business of terrorist financing and money laundering and money transfer is a huge field.

All of you sitting at this desk actually have indicated in what your statements have been how difficult it is. And especially you, Ms. Jardini, talked about the need for these highly specialized people who are in fact doing forensic work with regard to the financial ends of things.

Mr. Newcomb, I would assume that you have people in your agency doing that kind of work as well.

I would put to you a question, and that is whether or not you have enough people and if you have enough resources to cover the

enormity of what this task is. We must get our arms around it. We must face down the ability of terrorists to fund the evil that they would fund.

Do you have enough people? Do you have enough resources to do this job?

Mr. Newcomb, I want to ask you that. And then I am going to go to Ms. Jardini and Mr. Fox.

Mr. NEWCOMB. Madam Chair, that is a difficult question to answer, in this regard. We are doing our job. We administer 28 programs, and we are fully employed in all of the divisions that we operate under, such that we are able to implement what we are mandated to do.

You could always do more with more people; if we had more people, we could do more. That follows.

It is a large mission. There are terrorists organizations operating worldwide, in the Middle East, North Africa, East Africa, South America, Southeast Asia and other places.

One thing we have sought to do in order to, forgive the expression, create a force multiplier is we have worked with the U.S. combatant commands and the military where we have people physically on location in six of the combatant commands working on the general staff of those organizations. That is one way to create additional positions.

I would certainly be able to say if I had more people, there is more we can do. You can always do more with more people.

But in terms of what we have, we are delivering a product that serves the Treasury Department and achieves our mandate.

Chairwoman KELLY. I just want to do a follow-up there. Do you think that the notification requirements of FinCEN and OFAC are functioning adequately?

Mr. NEWCOMB. Excuse me, Madam Chairman, what notification requirements are you referring to?

Chairwoman KELLY. Well, in light of the UBS and the Riggs situations, and in light of some of the other things that you and I know are happening out there, do you think you have adequate notification requirements?

Mr. NEWCOMB. This is a situation where, when the Fed found out about it, I am told by senior officers of the Fed, they notified us immediately. They did not know until they knew, and when they found out they were in touch with us. It was foreign jurisdiction that was located.

But just so we have learned a lesson from this, we have created a robust monitoring system, not only with the ECI contracting parties worldwide where we are going to begin with visitations to their senior officers, and then with follow-up audits in conjunction with the Fed to make sure those contractual commitments are met. We are following that in that regard.

As far as non-ECI banks, there are literally hundreds of banks that can move currency on behalf of the Federal Reserve Banks. So we need to cover that as well.

Certainly as a lesson learned, we have heard about this and we are moving forward with all due speed to take this situation in hand, so that even though, as in this situation, we did not have ju-

risdiction, we are seeking to extend jurisdiction we do have as broadly as possible.

I hope that answers your question. If not, I will be happy to come back again and try to——

Chairwoman KELLY. I think that is a good indicator.

I am going to go back to the other question I had, which now I am going to ask Ms. Jardini, and that is whether or not you have the resources and the people that you need to do your job right now.

Ms. JARDINI. Thank you, Madam Chairman, for asking that question.

The President's 2005 budget provides for the largest hiring year ever in CI history, and we hope that it will be adopted as written. If it is passed, we will be hiring over 400 new special agents and over 200 analysts who will be assisting us in doing the important work we are going in tracking terrorist financing, as well as our overall tax administration mission.

I would like to point out to you that IRS-CI has never turned down a Treasury request and never will turn down a Treasury request to lead or to participate in any important terrorist financing investigative initiative. We have freely and generously given of our resources because of the importance of that mission and because of the strong leadership that Treasury has provided in that arena.

Furthermore, 97 percent of the terrorism investigations we are involved with we do in conjunction with our partners in federal law enforcement, primarily the joint terrorism task forces at the Justice Department and FBI.

Our work in that area is specifically governed by an MOU that we have with the FBI which outlines that our specifically talented and technical special agents should be deployed only in those cases where our expertise is most needed. And that really has been a very successful partnership.

Of the 270 open investigations that we have, 120 of those are pending at the Justice Department for prosecution. The remainder that are open and that we are actively working, 60 percent of those cases have a Title 26 tax crime involved in them; 30 percent are pure tax; 30 percent are tax and money laundering; and the final 40 percent are pure money laundering.

In addition, 25 percent of those cases involve BSA data; 18 percent of those cases involve charities, 990 tax returns and information received from the tax-exempt and government entity section of the IRS.

So we are very, very pleased with the direction that we have taken, our work in this area, and believe that with the addition of the desperately needed 408 special agents and 200 analysts we hope to receive in fiscal year 2005, we will be able to target those strategically to apply to our mission most effectively.

Chairwoman KELLY. Good. Thank you.

Mr. Fox?

Mr. FOX. Madam Chairman, to go back to your original question about some of the complexities relating to money laundering, particularly as it relates to trade-based money laundering or commodities-based money laundering, again I find myself in complete

agreement with the Chair. This is a very complex area and a very difficult area.

And it is an area that we are focusing on quite heavily at FinCEN.

I would like to see, as I said in my written statement, our analysts to spend a great deal more time on more complex matters and maybe a little less time on direct tactical support to law enforcement.

As Ms. Jardini has indicated, you know, I think what we are finding is that law enforcement entities out there have sort of gotten it when it comes to finance. They understand how important finance is. And I think they are developing tactical intelligence, analytic capabilities for financial information.

And it seems to me that as law enforcement agencies do that—that is a very good thing, in my view, by the way—as they do that, that frees FinCEN up to maybe take it to a higher level or focus on things that are not being focused on. And we plan to do that.

And commodities-based money laundering and trade-based money laundering is an area that is very important. We are working very closely with the Bureau of Immigration and Customs Enforcement and other entities to try to get a handle on this.

Chairwoman KELLY. I thank you.

I really thank all of you for being here today and for your patience.

The Chair notes that some members may have additional questions for this panel which they may wish to submit in writing. So, without objection, the hearing record will remain open for 30 days for the members to submit written questions to these witnesses and to place their responses in the record.

I cannot thank you enough for your very patient answering of our questions.

And, Mr. Schindel, I hope to hear more from you soon.

Thank you. With that, this hearing is ended.

[Whereupon, at 5:21 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 16, 2004

Statement of Chairwoman Sue Kelly
Subcommittee on Oversight and Investigations
"Oversight of the Department of Treasury"
June 16, 2004

The war against terrorism is the single most important challenge facing the federal government today.

Our task is made difficult by the insidious methods of our enemies, and also by the bureaucratic inertia inherent in a fundamental reorganization of our government's priorities.

This hearing today is important because we will examine the specific difficulties faced by the Treasury Department in adapting to its new, critical purpose in battling the illicit funding networks upon which our enemies rely.

It is evident that the fight against terror financing must go well beyond ensuring compliance with the Bank Secrecy Act, but this law is at the foundation of our efforts.

When that law is flouted as egregiously as in the Riggs case – or as consistently as the Inspector General suggests – it is our duty to respond so that such failures are bad memories instead of perpetually looming possibilities.

We cannot afford to ignore any problems in the system charged with the enforcement of our anti-money laundering law. I believe the fragmented nature of our anti-money laundering system is structurally not capable of keeping pace with the demands of the war on terror.

I believe we ought to establish a single office dedicated to ensuring compliance with the Bank Secrecy Act.

To those who resist this proposal, I would hope that there is at least recognition of the need to establish a vigilant watch tower above the vast expanse of bureaucracies that are currently responsible for the Bank Secrecy Act.

There must be a unifying center to our anti-money laundering efforts.

Mr. Fox's recent proposals to strengthen FinCEN's role in BSA compliance, including the establishment of an Examination Program Office, are important steps in that direction.

But if we're going to fully establish the integrated, accountable oversight regime we clearly need, FinCEN should be equipped not just for observation but also for action.

FinCEN needs the compliance examination capabilities it currently lacks. Its efforts should be reinforced with criminal investigative powers that are largely absent from our anti-money laundering system.

Though FinCEN has been given statutory responsibility for the Bank Secrecy Act, it has few resources and is easily marginalized by the front-line regulators.

Consider the six-year lag between when the OCC noticed problems at Riggs and when FinCEN was made aware of them.

A clean money compliance force at FinCEN could unify our anti-money laundering responsibilities and even broaden our efforts by examining financial sectors that currently have no regulator.

With the ability to deploy its own examiners to trouble spots and literally look over the shoulder of the regulators, FinCEN could ensure a strong focus on high-risk transactions, such as those that occurred under our own nose at Riggs with their Saudi clientele.

And as we read reports about the Saudi Embassy's continuing search for a bank to replace Riggs, the establishment of these new powers could provide greater certainty to our hopes that the era of free-wheeling, unregulated Saudi cash infusions to Islamic militants in our own country are over.

On a related note, I hope that Treasury will give serious consideration to the proposal made yesterday by the Independent Task Force on Terrorist Financing.

Among its recommendations were that Congress enact a Treasury-led certification regime on terrorist financing that would annually report to Congress the efforts of other countries to combat terror funding, and would impose sanctions on countries that fail to perform up to standard.

A system like this could provide a useful lever in securing better cooperation from recalcitrant governments such as the Saudis, who have facilitated the flow of funding to terrorist organizations despite their protests to the contrary.

This administration has done a remarkable job in getting the Saudis to enact the reforms we have seen recently, but we must never forget that we are dealing with a government that has been a chief financial supporter of the fanaticism that led to the murder of more than 3,000 people on September 11th.

I am also deeply concerned by the circumstances surrounding the UBS case in which flagrant mismanagement of a U.S. currency depot overseas resulted in our currency being shipped to countries currently under U.S. sanctions.

While the Fed was the front-line regulator responsible for this failure, we clearly need to examine ways to ensure that Treasury Department sanctions are enforced and that the ECI program is implemented properly. I'm interested in learning more about how OFAC and other Treasury assets might be better utilized in the future.

On a final note, I am very interested in how Treasury intends to handle the pending expiration of the Terrorism Risk Insurance Act (TRIA).

While TRIA was designed as a temporary bridge to the development of a functional, private sector terrorism insurance market, a recent study by the General Accounting Office concluded that there is not a sustainable marketplace for this coverage after the program expires. In addition, the NAIC, representing 51 bipartisan state insurance commissioners, agrees that we must act this year to avoid the market disruptions we are already beginning to see.

Given the state of the insurance marketplace and the continuing threat of terror, I believe it in the best interest of the American people that we consider retaining a systematic approach in place to protect our country's economic security. In fact, I recently sent a letter to Secretary Snow, signed by 183 of my colleagues, urging the Treasury Department to extend the make available provision which expires at the end of this fiscal year, and to support the overall continuation of this critical program.

There is broad, bipartisan support in this committee and in the House for doing so, and I hope to learn more from Treasury as to how they intend to handle this matter.

Thank you, I look forward to today's testimony.

Opening Statement

Chairman Michael G. Oxley

Committee on Financial Services

Subcommittee on Oversight and Investigations
"Oversight of the Department of the Treasury"
June 16, 2004

Thank you, Chairwoman Kelly, for convening today's oversight hearing to review functions and activities of the Department of the Treasury with Deputy Secretary Samuel Bodman, and, in particular, its efforts to deal with money laundering and terrorist financing.

I am pleased that Deputy Secretary Bodman has been able to join us today for this opportunity to address Treasury's critical role in the war against terrorist financing.

This subject continues to be an urgent one. Those who are current in their newspaper reading saw the recent news of a federal grand jury indictment of Nuradin M. Abdi, most recently of Columbus, Ohio. This four-count indictment and the plot to attack an Ohio shopping mall should remind us all of the seriousness of our work on these issues.

Clearly, Mr. Abdi was being funded somehow, and I would remind everybody that we are working to protect innocent Americans from murder. This mission has required and will continue to require our complete dedication.

Additionally today, I hope we will discuss recent and current activities of the department, as well as talk about the status of the regulated financial sectors.

Clearly we could spend endless hours here reviewing issues within Treasury's charter, considering the breadth of Treasury's mission. With a focus on the jurisdiction of this Committee, however, I hope you can share your thoughts on at least a few of these issues. I look forward to your comments on the new Office of Terrorism and Financial Intelligence, as well as government-sponsored enterprises; the Office of the Comptroller of the Currency; and the Office of Thrift Supervision.

In addition to the Deputy Secretary, we have with us today a panel of four distinguished public officials to talk about the pressing need for the effective collection, accurate integration, and prompt analysis of information related to the movement of funds related to terrorist financing.

So, let me offer my thanks to our distinguished witnesses for their time and effort to appear and to answer our questions. Again, my thanks to Chairwoman Kelly for convening this hearing. I yield back the balance of my time.

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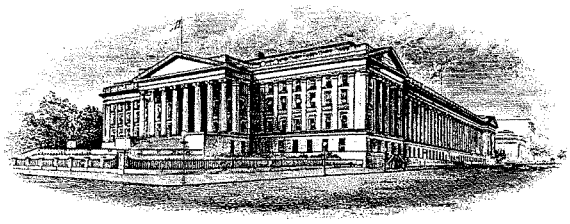

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL DELIVERY
June 16, 2004

Contact: Molly Millerwise
(202) 622-2960

Written Testimony of
Samuel W. Bodman, Deputy Secretary
U.S. Department of the Treasury

Before the House Financial Services Subcommittee on Oversight and Investigations

I. Introduction

Madam Chairman Kelly, Congressman Gutierrez and Members of the Committee, thank you for inviting me to testify before you today. As you have requested, I plan to address a number of specific Treasury issues in my statement, and would be pleased to address any other issues during my testimony.

The Treasury Department is currently undertaking significant steps to advance our campaign against terrorist financing and financial crime, largely through the creation of the Office of Terrorism and Financial Intelligence. We are also addressing a number of significant regulatory and oversight issues associated with compliance and enforcement of the Bank Secrecy Act. Secretary Snow has asked me to focus a considerable amount of my time on these important matters, and I welcome this opportunity to explain our progress and vision for moving forward in meeting these challenges.

Treasury has broad authorities, relationships and expertise in the financial arena. As importantly, we have a cadre of dedicated and diligent individuals who work hard every day – along with countless others in the U.S. government – to fight the financial war on terror and to protect the integrity of the financial system.

We have had very real and concrete successes in fighting this war, but as the recent attacks around the world demonstrate, our work must continue at an even higher pace. Our enemies are numerous, resourceful, and dedicated, and they continually adapt to the changing environment. We must do the same, using every tool that we have. We also recognize that, unfortunately, we are in this fight for the long term. And so the Department must be organized to reflect that reality.

II. The Office of Terrorism and Financial Intelligence

The dynamic and long-term challenges that we face in the war on terror will require unwavering political will, active and continuous leadership by senior policymakers, and sustained commitment from all of us. This is precisely why the Administration has collaborated with Congress to develop a new Treasury structure: a high profile office led by an Under Secretary – one of only three in the Department – and two Assistant Secretaries. This office, called the Office of Terrorism and Financial Intelligence (TFI), will bring together Treasury's intelligence, regulatory, law enforcement, sanctions, and policy components.

The creation of TFI will augment Treasury's efforts in several ways. First, it will allow us to better develop and target our intelligence analysis and financial data to detect how terrorists are exploiting financial systems and to design methods to stop them and their financial infrastructure. Second, it will allow us to better coordinate aggressive law, sanctions and regulatory enforcement programs, working with other components of our government and the private sector, and using important new tools provided by Congress to Treasury under the USA PATRIOT Act (Patriot Act). Third, it will help us continue to develop the strong international coalition required to combat terrorist financing, in part by facilitating the development and exchange of financial information that supports our requests for collaborative action. Fourth, it will ensure accountability and help achieve results for this essential mission

TFI will have two major components. One Assistant Secretary will lead the Office of Terrorist Financing. This office will build on the functions that have been underway at Treasury over the past year by developing, organizing, and implementing U.S. government strategies to combat terrorist financing and financial crime, both internationally and domestically. In essence, this will be the policy and outreach apparatus for the Treasury Department on the issues of terrorist financing, money laundering, financial crime, and sanctions. This will mean increased coordination with other elements of the US government, including law enforcement and regulatory agencies.

This office will continue to represent the United States at international bodies dedicated to fighting terrorist financing and financial crime such as the Financial Action Task Force and will increase our multilateral and bilateral efforts in this field. We will use this office to create global solutions to these evolving international problems, attacking financial crime and safeguarding the financial system by advancing international standards, conducting assessments, administering technical assistance and applying protective measures against high risk jurisdictions. In this regard, we will also have a more vigorous role in the implementation of measures that can affect the behavior of rogue actors abroad.

Domestically, the office will be charged with continuing to develop and implement our government's national money laundering strategy as well as other policies and programs to fight financial crimes. It will continue to develop and help implement our policies and regulations in support of the Bank Secrecy Act and the Patriot Act. We will further increase our interaction with federal law enforcement and continue to work closely with the criminal investigators at the IRS to deal with emerging domestic and international financial crimes of concern. Finally, this office will serve as a primary outreach body – to the private sector and other stakeholders – to

ensure that we are maximizing the effectiveness of our efforts.

A second Assistant Secretary will lead the Office of Intelligence and Analysis (OIA). The overall purpose of this office is to ensure that the Treasury Department properly analyzes relevant intelligence – adding our own unique expertise and capabilities – to create actionable financial intelligence that Treasury and rest of the U.S. Government can use effectively. We recognize that OIA must focus its efforts on filling any gaps in intelligence targets and on adding value and expertise – not on duplicating the efforts of other Federal agencies. Our priorities will include identifying and attacking the financial infrastructure of terrorist groups; assisting in efforts to identify and address vulnerabilities that may be exploited by terrorists and criminals in domestic and international financial systems; and promoting stronger relationships with our partners in the U.S. and around the world.

In determining the structure of OIA, we first focused on meeting our urgent short-term needs. Accordingly, we have already assembled a small team of analysts to closely monitor and review current intelligence threat reporting. These analysts, who are sitting together in secure space in the Main Treasury building, are ensuring that Treasury can track, analyze any financial angles, and then refer these threats to relevant Treasury and U.S. government interests for appropriate action.

In the near term, the Department plans to further develop our analytical capability through OIA in untapped areas, such as strategic targeting of terrorist financial networks. We also plan to analyze trends and patterns and non-traditional targets such as hawalas and couriers. In order to accomplish these goals, we are in the process of hiring several new analysts as well as considering drawing on additional resources from OFAC and FinCEN. In addition, enhancing our working relationships with other agencies will be a key job for the new Assistant Secretary.

Overall, the twin components of TFI will complement the important work being done by the Department of Justice, the Department of Homeland Security, the State Department, and the various intelligence and law enforcement agencies, and will be fully integrated into established task forces and processes.

I would like to underscore this point. It is impossible to overstate the importance of coordinating the assets, resources and expertise of the Treasury and other government agencies in our mission to identify, disrupt and dismantle terrorist and other criminal networks. Since 9/11, the Treasury Department, together with departments and agencies across the federal government, has made unparalleled strides in coordinating its efforts towards creating a seamless front in the war on terror. However, we are continuing to look for ways that can improve our management of Treasury authorities and resources to facilitate information-sharing and coordination across the Department and the government as a whole to safeguard the financial system from terrorist and criminal abuse. The creation of TFI will help us advance these interests.

We are in the process of working out the budget for TFI and its impact on the rest of the Department. For both fiscal years 2004 and 2005, we believe that we will be able to re-prioritize existing resources in order to fund the personnel and other related start-up costs for the operation. We expect to hire up to 15 new personnel for the remainder of 2004, as well as additional staff

during 2005. At the same time, we have realized that we will likely incur information technology and infrastructure costs to make TFI, and especially OIA, into a world class organization. We are currently looking at other possible funding sources, including the Asset Forfeiture Fund and reprogramming authorities, and will work with OMB and the Congress to resolve this issue.

III. Treasury's Regulatory Authorities under the BSA and Associated Compliance Issues

Another area that I would like to discuss is Treasury's responsibility to protect the integrity of the financial system by administering the Bank Secrecy Act (BSA), as enhanced by Title III of the Patriot Act. When Congress enacted the BSA in 1970, it charged the Secretary of the Treasury with the responsibility for enforcing compliance with the law. For the last three decades, Treasury has satisfied this responsibility by relying on a diverse group of existing regulators – by delegating to them the authority to actually examine the institutions subject to BSA requirements.

In light of recent events, Secretary Snow and I are taking a fresh look at this arrangement. There have been some clear benefits. We have been able to maximize our government's existing resources and have been able to capitalize on the unique expertise and examination capabilities of the regulatory agencies most familiar with the specific financial industries. But there are also some clear risks. Without sufficient attention and control, this decentralized approach may devolve into a situation where there is a lack of transparency, accountability, and timeliness. This is a potentially serious problem, and it is one that the Secretary and I are committed to addressing.

I am going to take a few minutes to discuss the current structure, and then describe for you some of the things that we are doing to evaluate its effectiveness.

The overall purpose of the original BSA – and its subsequent modifications -- is to promote transparency and accountability in the U.S. financial system in order to preserve its integrity and to protect it from criminal abuse. When originally passed in 1970, the BSA simply mandated that covered institutions identify the source, volume and movement of large amounts of currency and other monetary instruments into or out of the United States or being deposited in U.S. financial institutions. Since that time, the Congress has amended the BSA on numerous occasions in light of the ongoing development of our financial system and evolving criminal abuses of that system. For example, in 1992, Congress amended the Act to authorize the Treasury to require institutions to report suspicious activities – so called suspicious activity reports or SARs -- regardless of whether they met a certain monetary threshold. In 2001, the Patriot Act strengthened and expanded BSA regulation to include enhanced due diligence and customer identification requirements, expanded information sharing authorities, and new industries subject to BSA regulatory obligations.

It is worth noting that the BSA places the actual responsibility for compliance – for filing appropriate reports, for checking the identity of its customers, for having a sufficient system in place - on the private sector institutions that fall under its framework. Treasury's job is to make

sure that those private sector institutions fulfill their legal responsibilities – in other words, to enforce compliance.

According to Treasury regulations and orders, the Secretary has delegated the overall authority for enforcement and compliance of this system to one of Treasury's bureaus, the Financial Crimes Enforcement Network (FinCEN). The Director of FinCEN retains the authority from the Secretary to pursue civil enforcement actions against financial institutions for non-compliance with the BSA and the implementing regulations. FinCEN has been empowered to assess civil monetary penalties against, or require corrective action by, a financial institution committing negligent or willful violations.

The Secretary has also delegated the authority to examine institutions to determine BSA compliance to eight separate federal regulators:

The Board of Governors of the Federal Reserve System
The Office of the Comptroller of the Currency (OCC)
The Federal Deposit Insurance Corporation (FDIC)
The Office of Thrift Supervision (OTS)
The National Credit Union Administration (NCUA)
The Securities and Exchange Commission (SEC)
The Commodity Futures Trading Commission (CFTC)
The Internal Revenue Service (IRS)

Each one of these regulators has a distinct group of institutions for which they are responsible:

- the Federal Reserve Board covers state chartered banks that are members of the Federal Reserve System;
- the OCC covers nationally chartered banks;
- the FDIC covers non-Federal Reserve System member banks;
- the OTS covers federally chartered thrifts;
- the NCUA covers federally insured credit unions;
- the SEC covers securities broker-dealers and mutual funds;
- the CFTC covers futures commission merchants and futures introducing brokers; and
- the IRS covers primarily money service businesses and casinos outside of Nevada.

We have made significant strides lately – for example, registering thousands of MSBs in the last few years, but the magnitude of the task of ensuring compliance in this area is enormous.

In trying to coordinate this overall structure, it is important to keep in mind the varying levels of independence of each of the participating regulators. I mention this not because the Department has any desire to exercise full control over all of these other agencies – which we certainly do not -- but simply to make clear the operational realities of the current arrangement. FinCEN and the IRS are bureaus of the Treasury, and like most of the other Treasury bureaus, the Secretary has a significant degree of direct authority over them. OCC and OTS are also Treasury bureaus, and are subject to the general oversight of the Secretary. However, Congress has provided them a level of independence from Departmental involvement for various functions of those agencies,

such as specific matters or proceedings, including agency enforcement actions. Finally, the Federal Reserve, FDIC, NCUA, SEC, and CFTC are agencies over which the Secretary has no direct authority at all.

As I already mentioned, Secretary Snow and I are in the process of reviewing the system in its entirety. We are considering whether any systemic changes that should be made in order to ensure that we are in a position to successfully carry out Treasury's duties. To this end, we have hosted a series of meetings on this topic. Two weeks ago, I brought together some of the relevant Treasury components – FinCEN, the Office of Thrift Supervision, and the Office of the Comptroller of the Currency, and OFAC to discuss that question. We talked about ways of improving the transparency of compliance and enforcement efforts by developing and enhancing regular reporting and information sharing on: examination policies and procedures; aggregate results of examinations across each of the regulated financial industries; deficiency trends in BSA compliance; and enforcement actions contemplated in response to these deficiencies. Some of this reporting already occurs, but it is sporadic and not comprehensive. Such enhanced transparency should assist us in harmonizing the administration of the BSA across the financial system and in responding to compliance and risk trends with appropriate guidance to the regulatory community.

At that meeting, I was encouraged to hear that OTS Director Jim Gilleran, who is the current chair of the Federal Financial Institutions Examination Council (FFIEC), plans to use that body to re-emphasize the importance of BSA compliance. I also understand that William Fox, the Director of FinCEN, will be invited to participate with that regulatory group. This is important, as the Secretary has delegated to FinCEN his responsibility for ensuring BSA compliance across the banking system.

Earlier this week, Secretary Snow hosted a principals-level gathering of all of the banking regulators. Secretary Snow and I expressed serious concerns about our ability to vouch for the effectiveness of the current system. We discussed the need for regular reporting and information sharing. We also began exploring possible ways that to build a sustainable process and capacity to validate the effectiveness of the regulators' compliance programs. To the extent that there are administrative or legal barriers that we encounter, we will identify them and then see how we can resolve them.

In focusing on these issues, we are also relying on the useful work done over the past few years by the Treasury Inspector General and by the Treasury Inspector General for Tax Administration. Their reports have identified some deficiencies, and have outlined some steps to improve the system. We are currently analyzing the reports, seeing what additional measures they recommended still need to be taken, and working with them to address our concerns.

Ensuring that the banks and other financial institutions comply with provisions of the Bank Secrecy Act is only one part of the equation. It is equally important that we make the best possible use of this reporting in order to protect the financial system and to attack those who use the system for unlawful or improper purposes. Shortly after arriving at Treasury, I learned that there were some historical problems with the administration of BSA data – as FinCEN has the responsibility for making sure the system works, but the IRS actually handles the data collection

and dissemination. I immediately brought in IRS Commissioner Everson and Director Fox to resolve any issues. In the short term, IRS has committed to fulfilling FinCEN's requirements for the data, and in the longer term, the Department will remain committed to constructing BSA Direct, an updated electronic system for efficiently analyzing and retrieving relevant data.

We are also exploring the idea of more electronic filing. There are currently only a small percentage of suspicious activity reports and currency transaction reports that are filed electronically, and there are numerous benefits of increasing the share of electronically filed reports. Just like in the tax system, electronic filing means faster and less expensive processing, as well less chance of error. I recognize that increased electronic filing could impose a burden on many of the less sophisticated filers, and so we will evaluate both costs and benefits as we move forward.

In administering the BSA, Treasury uses various mechanisms to maintain relationships between the private sector, law enforcement, and other regulatory agencies. These include rule making processes, interagency working groups, joint task forces, detailed liaisons, cross-training seminars, conferences and outreach events. These mechanisms coordinate the development, implementation, and administration of BSA policies across the field of effected federal agencies, the industries they supervise, and the criminal justice system.

A good example of this can be seen in the workings of the Bank Secrecy Act Advisory Group (BSAAG), a congressionally chartered group that is chaired by the Treasury Department. This group, which is comprised of regulatory, law enforcement and private sector representatives, meets on a regular basis to discuss issues of concern in the administration of the BSA. At the group's most recent meeting – about 4 weeks ago – I asked them to assist me in evaluating the effectiveness of BSA compliance generally. I understand that a subset of the group has been looking at this question, and I am looking forward to hearing and discussing their initial findings.

While there is always more work to be done, I do think that as a general matter, the government and the private sector have done a good job of developing and implementing the regulatory changes to the BSA following the passage of the Patriot Act. One good example, for instance, is the implementation and effectiveness of Section 314(a) of the Patriot Act.

Broadly speaking, Section 314(a) authorizes law enforcement to request information about suspected terrorists and money launderers from U.S. financial institutions, and financial institutions to communicate among themselves about such targets. Given the size of the U.S. financial system, this authority posed an enormous implementation challenge. Yet, pursuant to the relationship mechanisms described above, Treasury has worked with the private sector, law enforcement and the regulatory community to develop, implement and administer a comprehensive and effective Section 314(a) process. Under revised procedures, law enforcement sends 314(a) requests through FinCEN, customarily on a batched basis issued every two weeks, and financial institutions have two weeks to respond back to FinCEN with any matches and an identified point of contact for appropriate law enforcement follow up. In administering this process, FinCEN maintains an electronic database of 314(a) contacts for over 26,000 financial institutions, demonstrating overwhelming initial compliance with 314(a) contact requirements by the financial sector.

Most importantly, the 314(a) process has achieved significant results for law enforcement. For example, between April 1, 2003 and April 26, 2004, IRS-CI submitted 16 requests to FinCEN pertaining to 66 individuals and 17 businesses. These requests generated 646 positive matches with over 1274 financial institutions. Since Section 314(a)'s creation, the system has been used to send the names of 1,547 persons suspected of terrorism financing or money laundering to over 26,000 financial institutions, and has produced in 10,560 matches that were passed on to law enforcement. These results suggest substantial compliance with 314(a) across the financial sector, generating substantial leads for law enforcement.

Before concluding, I would like to briefly address issues of concern regarding the Terrorism Risk Insurance Act, Government Sponsored Enterprises and financial education.

IV. Terrorism Risk Insurance Act of 2002 (TRIA)

Congress enacted TRIA in the fall of 2002 to address disruptions in the market for commercial property and casualty terrorism risk insurance caused by the terrorist attacks of September 11, 2001. TRIA establishes a temporary Federal program of shared public and private compensation for insured commercial property and casualty losses resulting from acts of terrorism covered by the Act. Treasury has the chief responsibility for implementing TRIA and has issued regulations, created and staffed the Terrorism Risk Insurance Program office, and begun mandated studies and data collection efforts. It is important to note that as Treasury has moved through the rule making process, the program from the beginning has been, and continues to be, fully operational. Treasury still has some important tasks to complete, including the required determination by September 1, 2004, as to whether TRIA's "make available" provisions should be extended into 2005 – the third year of the program. Treasury is now in the process of developing a base of information from which the Secretary can make this required determination. Another remaining task is to report to Congress by June 30, 2005, on specific issues associated with the Act, including the effectiveness of the program and the likely capacity of the property and casualty insurance industry to offer insurance for terrorism risk after expiration of the Program.

On May 5th, Treasury published a request for comment in the Federal Register to solicit views from all interested parties as to whether the make available provision of the Terrorism Risk Insurance Act should be extended through the life of the program. The comment period ended on June 4th, and we are now analyzing the approximately 180 comments that we received.

V. Government Sponsored Enterprises

Our nation has a world-class system of housing finance. Unfortunately, we do not have a world-class system of supervision of the housing government sponsored enterprises (GSEs), even though the importance of the housing financial system that the GSEs serve demands the best in supervision to ensure the long-term vitality of that system. Therefore, the Administration has called for a new, first class, regulatory supervisor for the three housing GSEs: Fannie Mae, Freddie Mac, and the Federal Home Loan Banking System. This new supervisor should have all

the powers and tools necessary to oversee the activities of housing GSEs with the goal of promoting the continued strength and vitality of the housing finance markets. The Administration has set forth several elements that must be included in any GSE regulatory reform bill in order for the supervisory system to be credible. These elements – which were set forth in testimony presented to this Committee last fall by Secretary Snow and former Secretary Martinez – include: (1) broader authority for HUD to set and enforce meaningful housing goals; (2) independent funding and litigation authority; (3) control over both minimum and risk based capital; (4) receivership authority; and (5) authority to review and approve or reject new and existing activities.

At the same time, the Administration will continue to review what existing authorities can be exercised to improve supervision. However, exercise of existing authorities cannot replace need for legislation to correct deficiencies in those existing statutory authorities.

VI. Treasury's Office of Financial Education

The Committee has also asked that I address what the Department is doing in the area of financial education. The Department of the Treasury has established an Office of Financial Education to promote access to financial education programs that help Americans obtain practical knowledge and skills to make informed financial choices throughout their lives. The Office carries out this mission in several ways: coordinating the federal effort on financial education, performing public outreach to increase awareness, setting standards to help raise the effectiveness of financial education programs, and brokering relationships between those who need and those who provide financial education.

The Department leads the Financial Literacy and Education Commission, a group of twenty federal government agencies charged with improving the level of financial education in the country. Congress created the Commission last year, as part of the Fair and Accurate Credit Transactions Act. The Commission has held two meetings this year, the most recent one on May 20, which was attended by many of your staff. Significant progress has been made toward the establishment of a toll free hotline for financial education as well as towards a financial education website to help the public find information about financial education resources and programs. The website and hotline will provide more convenient access to public information on financial education. The Commission has also heard from a number of public and private sector organizations, something which will help it to formulate a national strategy for financial education.

In addition, the Treasury Department maintains a highly visible public profile through testimony before lawmakers on Capitol Hill, public speaking engagements and newsletters.
The OFE has also developed standards by which to evaluate and highlight successful financial education programs throughout the country and communicates those standards by awarding certificates of recognition to exemplary programs which meet those standards. The standards are available in the OFE newsletter and on the OFE website. This effort also enables the honored programs to achieve greater esteem and participation within their respective communities.

VII. Conclusion

I thank you for the opportunity to be here today. The Treasury Department is charged with enormous responsibilities in attacking terrorist financing and financial crime, and in protecting the integrity of our financial systems. TFI and the other developments that I have discussed will improve Treasury's ability to meet these challenges.

I look forward to your comments and questions. And I hope this will be the start of an ongoing dialogue with this Committee as we move forward with this important effort, and with the rest of Treasury's activities.

Thank you. I will be happy to answer any questions.

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STATEMENT OF WILLIAM J. FOX
DIRECTOR
FINANCIAL CRIMES ENFORCEMENT NETWORK
UNITED STATES DEPARTMENT OF THE TREASURY

BEFORE
HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

JUNE 16, 2004

Chairwoman Kelly, Congressman Gutierrez, and members of the Subcommittee, thank you for this opportunity to appear before you today to discuss the mission of the Financial Crimes Enforcement Network (FinCEN) and the important role it plays in the Department of the Treasury and the United States government's efforts as a whole to understand, detect, and prevent financial crimes and terrorist financing. Although this is my first time as a witness before this Subcommittee, I have followed the committee's leadership on issues relating to terrorist financing and money laundering and am very honored to appear before you today.

I became FinCEN's fourth director on December 1, 2003. Before I came to FinCEN, I was working as the principal assistant to the General Counsel of the Treasury Department on issues relating to terrorist financing, which were issues that occupied a great deal of my time. Coming from the Department, I understood, to a large extent, the nature of FinCEN's responsibilities and what it was doing to carry out the obligations imposed by these responsibilities. In these six months, I have done a great deal of listening and learning from inside and outside of FinCEN. I have met extensively with the law enforcement and intelligence communities that we serve and the financial industry that we help regulate. I have met with and listened to the staffs of interested committees in the Congress – including this committee. I have met with some of my counterparts in foreign governments and communicated with many more; and, of course, I have had a continuous dialogue and received tremendous support from those at Treasury – including Secretary Snow, Deputy Secretary Bodman, and Deputy Assistant Secretary Zarate.

Now, six months later I believe I have a clear idea of what FinCEN's mission means in real terms -- the challenges FinCEN is facing in carrying out its obligations; what needs to be done to meet those challenges and how FinCEN's mission supports the Department of the Treasury's efforts to safeguard the nation's financial system. Let me begin with a discussion of our mission and its attendant responsibilities. I believe it is essential to have a clear understanding of FinCEN and its role in preventing financial crime to understand how its ability to fulfill its obligations will be enhanced under the Office of Terrorism and Financial Intelligence.

FinCEN is charged with helping to safeguard the financial system of the United States from being abused by criminals and terrorists. FinCEN works to accomplish its mission through: (1) administration of the Bank Secrecy Act – a regulatory regime that provides for the reporting of highly sensitive financial data that are critical to investigations of financial crime; (2) dissemination of the data reported under the Bank Secrecy Act to law enforcement and, under appropriate circumstances, the intelligence community; (3) analysis of information related to illicit finance – both strategic and tactical analysis; and, (4) education and outreach provided to law enforcement and the financial industry on issues relating to illicit finance. FinCEN has many attributes that are key to understanding the agency:

- *FinCEN is a regulatory agency.* FinCEN has an obligation to administer the Bank Secrecy Act, the principal regulatory statute aimed at addressing the problems of money laundering and other forms of illicit finance, including terrorist financing. It is responsible for shaping and implementing this regulatory regime and, in concert with the functional bank regulators and the Internal Revenue Service, for ensuring compliance with the regime. The agency is also charged with protecting the integrity and confidentiality of the information collected under the Bank Secrecy Act.

- *FinCEN is a financial intelligence agency.* While not a member of the intelligence community, FinCEN is responsible for ensuring the efficient and timely collection, maintenance, analyses and dissemination of financial information critical to investigations of illicit finance.

- *FinCEN is a law enforcement support agency.* While FinCEN has no criminal investigative or arrest authority, much of our effort supports the investigation and successful prosecution of financial crime.

- *FinCEN is a network.* We are not directed to support one agency or a select group of agencies. We make our information, products and services available to all agencies that have a role in investigating illicit finance. In fact, we network these agencies. Our technology tells us when different agencies are searching the same data and we put those agencies together – avoiding investigative overlap and permitting the agencies to leverage resources and information.

FinCEN fits perfectly in the Department of the Treasury, possibly even more so after the Homeland Security reorganization than before that reorganization. The creation of the Office of Terrorism and Financial Intelligence within Treasury only enhances that fit. FinCEN will be able to help "operationalize" Treasury's policy priorities on these important issues and our operational analytic work will complement the analysis that will eventually be done in the newly created Office of Financial Intelligence. I believe this coordinated effort will lead to a greater emphasis and understanding of money laundering, terrorist financing and other forms of illicit finance not only at Treasury, but

within the United States, and that will make us all safer. FinCEN will also benefit from the Department-wide, policy-coordinating role this office will provide.

I. Background

By virtue of a delegation order from the Secretary of the Treasury and a statute passed as part of the USA PATRIOT Act, FinCEN is charged with the responsibility of administering the regulatory regime of the Bank Secrecy Act. Among other things, we issue regulations and accompanying interpretive guidance; collect, analyze and maintain the reports and information filed by financial institutions under the Bank Secrecy Act; make those reports and information available to law enforcement and regulators; and ensure financial institution compliance with the regulations through enforcement actions aimed at applying the regulations in consistent manner across the financial services industry. FinCEN also plays an important role in analyzing the Bank Secrecy Act information collected to support law enforcement, identifying strategic money laundering and terrorist financing trends and patterns, and identifying Bank Secrecy Act compliance issues.

FinCEN was created as an office within Treasury in 1990. Its original mission was focused on analysis – both tactical and strategic – of data collected under the Bank Secrecy Act along with other financial data. Treasury's Office of Financial Enforcement (OFE) was originally responsible for the administration of the Bank Secrecy Act regulatory regime. In 1994, Treasury merged OFE into FinCEN and delegated the responsibility to administer the regulatory regime to FinCEN. Treasury sought to link the analytical functions with the administration of the regulatory regime that dictated the information that financial institutions were required to record and report. Adding responsibilities for administering the regulatory regime strengthened and expanded FinCEN's analytical and intelligence abilities.

While FinCEN is responsible for ensuring compliance with the Bank Secrecy Act regulatory regime, FinCEN does not itself examine financial institutions for compliance. Instead, FinCEN taps the resources and expertise of other Federal agencies and self-regulatory organizations by relying on these agencies to conduct compliance exams, through delegations of authority that largely predated FinCEN. Examination responsibility has been delegated to other federal regulators as follows:

- *Depository Institutions* – The Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration have been delegated authority to examine the depository institutions they regulate for Bank Secrecy Act compliance.

- *Securities Broker-Dealers, Mutual Funds, and Futures Commission Merchants/Introducing Brokers* – FinCEN has delegated examination authority to the Securities and Exchange Commission and the Commodity Futures Trading Commission, and relies on their self-regulatory agencies

(such as the NASD, the NYSE, and the NFA) to examine these entities for compliance.

- *Other Financial Institutions* – The Internal Revenue Service (Small Business/Self-Employed Division) has been delegated responsibility for examining all other financial institutions subject to Bank Secrecy Act regulation for compliance, including, for example, depository institutions with no federal regulator, casinos, and Money Services Businesses (MSBs).

Even in the absence of examiners, FinCEN has an important role in supporting the examination regime created through our delegations. FinCEN's role involves providing prompt Bank Secrecy Act interpretive guidance to regulators, policy makers and the financial services industry, and ensuring the consistent application of the Bank Secrecy Act regulations across industry lines, most notably through the rule-making process and subsequent guidance. We promote Bank Secrecy Act compliance by all financial institutions through training, education and outreach. We support the examination functions performed by the other agencies by providing them access to information filed by financial institutions in suspicious activity reports, currency transaction reports, and other Bank Secrecy Act reports. We also facilitate cooperation and the sharing of information among the various financial institution regulators to enhance the effectiveness of Bank Secrecy Act examination and, ultimately, industry compliance.

FinCEN has retained the authority to pursue civil enforcement actions against financial institutions for non-compliance with the Bank Secrecy Act and the implementing regulations. Under the Bank Secrecy Act, FinCEN is empowered to assess civil monetary penalties against, or require corrective action by, a financial institution committing negligent or willful violations.

Generally, FinCEN identifies potential enforcement cases through (1) referrals from the agencies examining for Bank Secrecy Act compliance; (2) self-disclosures by financial institutions; and, (3) FinCEN's own inquiry to the extent it becomes aware of possible violations. Referrals from the examining agencies are regularly made to FinCEN. It should be noted that under Title 12, the banking regulators have authority to enforce certain regulations that fall under that statute as well as under the Bank Secrecy Act, such as the requirement that depository institutions have anti-money laundering programs. In addition, the Internal Revenue Service has authority to enforce certain Bank Secrecy Act requirements including the IRS/FinCEN Form 8300 reporting for non-financial trades and businesses, and the Report of Foreign Bank and Financial Accounts by individual and entities.

II. FinCEN's Counter-Terrorism Strategy

The single, most important operational priority for FinCEN is counter-terrorism support to law enforcement and the intelligence community. To emphasize the importance of this work we have improved and are now implementing a comprehensive counter-terrorism strategy that draws from our analytic support to law enforcement, our

regulatory tools and expertise, and our international networking capabilities. We believe the implementation of this strategy will strengthen our focus and ensure that FinCEN is more active and aggressive rather than reactive on issues relating to terrorism. The strategy has five basic components.

A. *Analysis of Terrorist Financing Suspicious Activity Reports*

FinCEN analyzes suspicious activity reports for both tactical and strategic value. At the tactical level, we are implementing a program in which every report that indicates a connection to terrorism is immediately reviewed and validated and then analyzed with other available information. This information will be packaged and referred to the Terrorist Threat Integration Center (TTIC), FBI-TFOS, and other relevant law enforcement. Moreover, this information will be stored in a manner that facilitates its access and availability for analysis.

At the strategic level, we are also devoting analysts to studying Bank Secrecy Act data and all other available information to gain an increased understanding of methodologies, typologies, geographic patterns of activity and systemic vulnerabilities relating to terrorist financing. These analysts will focus on regional and systemic "hot spots" for terrorist financing, studying and analyzing all sources of information. Such focus, which produced the study mandated by the Congress on Informal Value Transfer Systems, can significantly add to the knowledge base of law enforcement. For example, we have begun a process to comprehensively study illicit trade in diamonds and other precious stones and metals and the links to terrorist finance. Although this initiative is currently underway, in order to fully implement it, we will need to upgrade analysts' security clearances and obtain equipment appropriate for the handling of national security information.

B. *USA PATRIOT Act Sections 311 and 314 Implementation*

Some of the new tools afforded us through the USA PATRIOT Act are proving to be invaluable in the war against terrorist financing, particularly Section 314 of the Act. FinCEN also has initiated a program to provide the analytic, regulatory and legal resources needed to support effective implementation of Section 311 by the Treasury Department. While this program captures targets involved in money laundering and other illicit finance, I have directed my staff to give priority to the pro-active targeting of those financial institutions and jurisdictions that are involved, wittingly or unwittingly, in the financing of terror. This prophylactic measure goes to the very heart of FinCEN's mission – to safeguard the financial system of the United States from money launderers and the financiers of terror.

Building on a successful pilot program that we began with the Bureau of Immigration and Customs on a 314(a) money-laundering request, FinCEN is now dedicating several analysts to apply this program to all 314(a) terrorism requests. Specifically, the analysts will run all 314(a) terrorism-related requests against Bank Secrecy Act data concurrent with these requests being sent to financial institutions.

Based on this initial data review, the law enforcement requester will then be able to request a more in-depth analysis if desired. I will provide additional details on this valuable tool later in my testimony.

C. *International Cooperation and Information Sharing*

FinCEN will increase the exchange of terrorist financing investigative and analytical information with other foreign financial intelligence units around the world. We are implementing a program where FinCEN will automatically request information from relevant financial-intelligence-unit counterparts as part of any terrorism-related analysis project. As part of this program, we are also upgrading our response to incoming requests for information from financial intelligence units by providing appropriate information and analysis from all sources of information.

D. *Terrorism Regulatory Outreach*

We will continue our work in improving our ability to provide information to the regulated community to better identify potential terrorist financing activity. One area of particular focus will be money services businesses. Money services businesses continue to require more attention and resources, and FinCEN will undertake an initiative to educate segments of the industry most vulnerable to terrorist abuse. These segments include small businesses that typically offer money remittance services, check cashing, money orders, stored value products and other informal value transfer systems. As we learned from the attacks of September 11th, funds used to finance terrorist operations can be and have been moved in small amounts using, for example, wire transfer, traveler's check and automated teller machine services. I have directed FinCEN's Office of Regulatory Programs and the Office of Strategic Analysis to enhance our outreach program to include: training on how terrorists have used and continue to use money services businesses; the reason for and importance of the registration requirement for money services businesses; and the importance of complying with the reporting requirements of the Bank Secrecy Act, especially suspicious activity reporting. We are planning to streamline suspicious activity reporting for small money services businesses with a simplified form.

E. *Analytic Skill Development*

As a general matter, I have directed that FinCEN make training of personnel the highest human resource management priority. The top priority of this new program will be analytic skill development relating to terrorist financing. We plan to begin by seeking reciprocal opportunities for terrorist finance analytic skill development within law enforcement, the Egmont Group, the intelligence community and the financial industry. This initiative is intended to build a foundation for continuous improvement of our analytic assets through: cross training and diversification; production of joint terrorist-financing threat assessments and other reports; and, understanding intelligence processes and the international context of terrorist financing, as well as the financial industry perspective. In addition, we will need to support training focused on financial forensics,

language skills, and geographically targeted studies that focus on culture, infrastructure and other unique aspects of a particular region.

I believe the full implementation of this strategy will materially assist the Department of the Treasury and the United States in addressing the financing of terror. Approaching this problem in a systemic way with dedicated resources is, in our view, the best way to make this strategy a success.

III. FinCEN's Near Term Challenges

As I mentioned before, FinCEN is facing a number of significant challenges. Because each of these challenges affects FinCEN's effectiveness in contributing to the important issues addressed at this hearing today, I would like to raise these challenges with the committee.

A. Security and Dissemination of Bank Secrecy Act Information

As the administrator of the Bank Secrecy Act, there is no duty I view as critical as the effective collection, management and dissemination of the highly sensitive and confidential information collected under that Act. If FinCEN does nothing else, it must ensure that data are properly collected, are secure and are appropriately and efficiently disseminated. This is FinCEN's core responsibility.

Regarding security of information, recent press reports have reported the unauthorized disclosure of suspicious activity reports. Such disclosures simply cannot be tolerated, as they undermine the entire reporting program. Those who report this information will become increasingly reticent to file what amounts to a confidential tip to law enforcement if they believe their report will end up on the front page of the *Washington Post* or the *Wall Street Journal*. The release of this information by those to whom it was entrusted threatens everything that we all have worked so hard to build. I know I do not have to convince this Subcommittee of the importance of this reporting system. It has yielded, and will continue to yield, information that is critical to the investigation of money laundering and illicit finance. I also wish to assure this Subcommittee and the American people that FinCEN is acutely aware of the privacy interests implicated in this reporting and the need to guard against inappropriate disclosure of such information. Unauthorized disclosure of information will be immediately referred to law enforcement for investigation and dealt with as severely as the law permits. Our international partners who inappropriately disclose information we have entrusted to them will jeopardize our agreements to share information with them.

However, this issue goes deeper than unauthorized disclosures. In my view, FinCEN must change the way it houses and provides access to information collected under the Bank Secrecy Act. Currently, our data are accessed by most of our customers through an outmoded data retrieval system. This system does not have the robust data mining capabilities or analytical tools we employ at FinCEN. This has led many of our customers to ask for wholesale copies of the data, or direct access to the data in a way

that will not permit us to perform our responsibilities relating to the administration and management of the data. This is not simply a question of employing better technology. It is a matter of sound governance. FinCEN cannot permit this inability to control the data we are charged with managing to continue. Accordingly, we must create a system that provides robust data mining and analytical tools to our customers in law enforcement and that preserves our ability to: (1) effectively administer and secure the information; (2) network those persons who are querying the data to prevent overlapping investigations and encourage efficient use of law enforcement resources; and, (3) develop and provide adequate feedback to the financial industries we regulate, which will ensure better reporting. That system is called "BSA Direct."

When fully implemented, BSA Direct will make available robust, state-of-the-art, data mining capabilities and other analytic tools directly to law enforcement. We plan to provide all access to these data through BSA Direct, working with our law enforcement customers to ensure their systems extract the maximum value from the Bank Secrecy Act reporting. We will be exploring ways to enable these agencies to integrate the Bank Secrecy Act reporting with their other systems while maintaining, and even improving our ability to audit and network the use of the data and obtain feedback concerning their value. This system will provide us the capability to discharge our responsibilities relating to the administration of these sensitive data: security and access control, networking, and feedback. This system will also significantly enhance our coordination and information sharing abilities, as well as our ability to safeguard the privacy of the information. We have already started work on this system. Based on preliminary studies, we estimate that this system will cost approximately $6 million to build. We are in the process of developing BSA Direct with resources in the FY2005 request and the forfeiture fund.

B. *Enhancing FinCEN's Analytical Capabilities*

Another challenge FinCEN is facing relates to its analytic capabilities. In my view, FinCEN must move away from its current emphasis on data checks and data retrieval, and move its analytic resources toward more robust and sophisticated analysis. FinCEN had moved to data checks and data retrieval in response to criticisms about turn around times on often simple requests for information. Now, as our systems improve, our customers will be able to retrieve data themselves, which will give FinCEN more time and resources for analysis.

I believe that FinCEN can and must provide value through the application of our focused financial analytic expertise to mining information and providing link analyses that follow the money of criminals and terrorists, or identify systemic or geographic weaknesses to uncover its source or the existence of terrorist networks. For example, in addition to providing geographic threat analysis for law enforcement, FinCEN has been studying systemic trends in money laundering and terrorist financing. We were instrumental in bringing the black market peso exchange system to the forefront of policy decisions, and we are focusing on other trends and patterns that we now see emerging in the global market. I recently made a trip to Dubai to participate in the growing dialogue on the potential use of diamonds and other commodities for illicit purposes, including

money laundering and terrorist financing. This is part of our focus on and study of what may be another iteration of money laundering and terrorist financing – commodity-based systems.

In my view, while FinCEN has some of the best financial analytic talent in the United States government, the challenges we face require us to further develop that talent to enable the full exploitation and integration of all categories of financial information – well beyond Bank Secrecy Act information. I have directed FinCEN's managers to concentrate on training, as well as the hiring of new, diverse financial analytic expertise.

C. Enhancing FinCEN's Technology

As I have mentioned, information sharing is critical to our collective efforts to detect and thwart criminal activity and that is why I believe enhancing our technological capabilities is extremely important. Section 314(a) of the USA PATRIOT Act allows law enforcement to query United States financial institutions about suspects, businesses and accounts in money laundering and counter terrorism investigations. FinCEN facilitates this interaction between the financial industry and law enforcement by electronically sending law enforcement requests to various banks who in turn check their records and relay the information back to FinCEN to then provide to the requestor. This saves law enforcement time and resources. We are currently enhancing the Section 314(a) electronic capabilities to allow for the originating request to be made to FinCEN via a secure website. This system is an example of how critical technology is to our law enforcement counterparts.

We must continue to work to enhance the development of the BSA e-filing system—a system that permits the electronic filing of reports required under the Bank Secrecy Act. This system was developed and brought on-line under a very tight legislative deadline. FinCEN received the E-GOV award for its work on this system. Filing these forms on-line is not only more efficient; it will help eliminate some of the data errors and omissions.

As of April 19, 2004, 1.2 million Bank Secrecy Act forms had been electronically filed through this system. We now support nearly 1,100 users, which include 15 of the top 25 filers of Bank Secrecy Act information. These top 25 filers accounted for approximately 50% of all Bank Secrecy Act forms filed in fiscal year 2003. While this is all good news, the bad news is that the current number of forms filed electronically remains quite small on a percentage basis. The 1.2 million forms filed represents only approximately 5% of the universe of all Bank Secrecy Act reports filed. I have directed our PATRIOT Act Communications System team to reach out to the financial industry and determine what needs to be done to convince them to file electronically. As we learn about what is holding institutions back from filing, I have directed our team to work closely with system developers to build the system stability and tools necessary to improve the overall percentage of filing.

FinCEN presently lacks the capacity to detect Bank Secrecy Act form filing anomalies on a proactive, micro level. BSA Direct, which will integrate Bank Secrecy Act data (including currency transactions reports, currency transaction reports by casinos, and currency transaction reports by casinos – Nevada) into a modern data warehouse environment, will include tools to flag Bank Secrecy Act form filing anomalies for action by FinCEN and/or referral to appropriate authorities. In the meantime, FinCEN is developing a request to the Internal Revenue Service's Detroit Computing Center to provide periodic exception reports on financial institutions whose Bank Secrecy Act form filing-volume varies beyond prescribed parameters during prescribed time frames. While we will not be able to conduct the sophisticated monitoring that will be available with BSA Direct, this interim step should produce an alert in the event of a catastrophic failure to file forms, as was experienced in the Mirage case in which the Mirage Casino in Las Vegas failed to file over 14,000 currency transaction reports in an 18-month period.

D. Enhancing FinCEN's Regulatory Programs

The administration of the regulatory regime under the Bank Secrecy Act is a core responsibility for FinCEN. Given the nature of our regulatory regime – a risk-based regime – our partnership with the diverse businesses in the financial services industry is the key to our success. The industry's cooperation with FinCEN in implementing many of the provisions of the USA PATRIOT Act has strengthened the foundation of our efforts to safeguard the financial system from criminal abuse and terrorist financing. I have met with many of our industry partners in the last several months, both old and new, and I have been struck with how concerned they are that the information they provide is helpful and that it is being reviewed and used. In turn, FinCEN is committed to enhancing the guidance they need as they strive to meet the requirements and objectives of new regulations.

The challenge before FinCEN on this issue is simple: we must ensure the remaining regulatory packages required by the USA PATRIOT Act are completed and implemented. Moreover, as we work with our regulatory partners to implement this regulatory regime, we must provide constant feedback and guidance. We have asked the industry to create anti-money laundering programs that are risk-based – custom tailored to each institution based upon the business in which that institution engages and the customers that institution has. We must find ways to help the industry define that risk. Development of secure web-based systems that will foster the communication discussed above is a step in the right direction. But we must continue to find new and better ways to reach out to the industry. They understand the threat money laundering and illicit finance poses to our financial system and they are willing to help.

Perhaps the most significant challenge lies in ensuring that financial institutions are appropriately examined for compliance. As you know, we have issued and will continue to issue anti-money laundering program regulations that will bring new categories of businesses under this form of Bank Secrecy Act regulation for the first time. This reflects the judgment of this Committee embodied in the USA PATRIOT Act, as well as ours, that to effectively guard against money laundering and the financing of

terrorism, we must ensure that industries with potential vulnerabilities are taking reasonable steps to protect themselves.

But the expansion of the anti-money laundering regime comes with the additional responsibility and challenges of examining thousands of businesses for compliance. We have relied on the Internal Revenue Service to examine those non-bank institutions. The addition of the insurance industry and dealers in precious stones, metals, and jewels, two categories of financial institutions for which we will shortly issue final anti-money laundering program regulations, will themselves stretch the resources of agencies responsible for examination. We must find ways to ensure that these regulatory programs are implemented in a fair and consistent manner that is focused on achieving the goals of the Bank Secrecy Act. Although difficult, this is an issue that must be resolved.

E. *Improving Coordination Among our Regulatory, Industry & Law Enforcement Partners*

Coordination among the regulators, industry, and law enforcement is the lynchpin of effective Bank Secrecy Act compliance. Since the passage of the USA PATRIOT Act, cooperation has only improved. On our side, we have developed a much closer working and collaborative relationship with the regulators on all aspects of Bank Secrecy Act administration. This has been reflected in the process of developing the new regulations, conducting outreach and training for the industry, and focusing on specific compliance issues. Indeed, provisions of the Act such as the customer identification section required that FinCEN and the regulators issue regulations jointly.

With respect to examinations, last month the Bank Secrecy Act Advisory Group formed a subcommittee devoted to identifying ways to better ensure examination consistency among the various regulatory agencies and industries. Representatives from industry, the regulatory agencies, and law enforcement will participate. This subcommittee is yet another vehicle through which FinCEN and the regulators can address the range of examination issues with the common goal of enhancing compliance on a national basis.

In this context and elsewhere, we will all have to identify creative ways to facilitate continued cooperation. Some ideas that I hope to explore with my colleagues include:

- *Identification of Common Compliance Deficiencies*

Better identification of compliance issues revealed through the examination process on an interagency scale is an essential aspect of enhancing the overall effectiveness of the Bank Secrecy Act regulatory regime. FinCEN must play a key role in facilitating that process by encouraging the regular sharing of common compliance deficiencies uncovered by the regulators. Summaries of deficiencies identified in financial institutions will expose areas to be addressed, interpretive questions to be answered, or even inconsistencies with the regulations themselves. Based on this information, FinCEN and the regulators would be able to focus its outreach and guidance efforts on emerging, possibly systemic problem areas affecting one or more financial

industries. Similarly, regulators would be able to better focus their examination resources on such areas. This data would also enhance the ability of FinCEN and the regulators to target their examinations and develop strategic examination goals across industry lines.

- *Creation of an Examination Program Office*

Within FinCEN's regulatory office, we will create a new program office devoted solely to the Bank Secrecy Act examination function. Currently, the affected substantive program area handles examination related issues on an ad-hoc basis. For example, individuals responsible for the Money Services Business program have taken a primary role in working with the Internal Revenue Service to develop and enhance their examination regime. The new structure will consolidate all examination support functions and better enable FinCEN to provide the necessary support to regulatory agencies conducting Bank Secrecy Act compliance exams. As an initial priority, FinCEN plans to focus on assisting the Internal Revenue Service in its examination function, particularly in light of the new regulations that FinCEN has and will issue to bring thousands of additional businesses under the Bank Secrecy Act anti-money laundering program provision.

- *Joint Examiner Training*

As a complement to the established mechanisms through which the regulators train their examiners, we will explore joint training opportunities that will afford FinCEN the opportunity to supplement the training provided with programs specifically targeted toward our Bank Secrecy Act compliance goals, including the possibility of our participating in multi-agency, anti-money laundering training at the Federal Financial Institution Examination Council.

We have done such training already. For example, FinCEN has conducted joint training of Internal Revenue Service examiners on various Title 31 and USA PATRIOT Act requirements in recent IRS Examiner training classes. FinCEN also will be conducting training at an upcoming meeting of Internal Revenue Service supervisory level personnel who have Bank Secrecy Act examination responsibility. By training at the supervisory level (training–the-trainer), FinCEN can leverage its limited resources to help ensure that IRS Bank Secrecy Act supervisory personnel deliver the appropriate message concerning the content of Bank Secrecy Act examinations to the Internal Revenue Service field examinations staff.

F. *Enhancing FinCEN's International Programs*

FinCEN's international initiatives and programs are driven by a stark reality: finance knows no borders. Next year will mark the tenth anniversary of the founding of the Egmont Group. The Egmont Group is an international body of "financial intelligence units" – entities, which, like FinCEN, are charged with the collection and analysis of financial information to help prevent money laundering and other illicit activities. The Egmont Group has achieved remarkable growth since its inception in 1995. Membership has risen from six charter members to eighty-four.

The Egmont Group serves as an international network, fostering improved communication and interaction among financial intelligence units (FIUs) in such areas as information sharing and training coordination. The goal of the Group is to provide a forum for FIUs around the world to improve support to their respective governments in the fight against financial crimes. This support includes expanding and systematizing the exchange of financial intelligence information, improving expertise and capabilities of personnel employed by such organizations, and fostering better and more secure communication among FIUs through the application of technology.

Egmont's secure web system permits members of the group to communicate with one another via secure e-mail, posting and assessing information regarding trends, analytical tools, and technological developments. FinCEN, on behalf of the Egmont Group, maintains the Egmont Secure Web. Currently, seventy-six of the eighty-four members (90%) are connected to the secure web site. I am very pleased to announce that FinCEN will launch a new and more efficient secure web site for Egmont in June. We expect this new site will generate more robust usage, which will enhance international cooperation between members.

FinCEN has played a significant role in the growth and health of the Egmont Group, and it maintains bilateral information sharing agreements with financial intelligence units around the world. However, in my view, this program has not received the priority it should have in recent times. Merely because of the simple statement I made earlier – that finance knows no borders – we must step up our international engagement with our counterparts around the world. Our plan is to do three principal things:

1. Lead the Egmont Group to begin focusing on actual member collaboration. Egmont members should be collaborating in a more systemic way together to address issues relating to terrorist financing, money laundering and other illicit finance at both a tactical and strategic level.

2. Enhance the FinCEN analytical products we provide to our global counterparts when asked for information. Today, we are principally providing the results of a data check. We think we owe our colleagues more. As noted before, we will also be making more requests for information and analysis from our partners – particularly when the issue involves terrorist financing or money laundering.

3. Foster exchanges of personnel with financial intelligence units around the world. We have already begun discussions with certain counterparts about such an exchange, and we are hopeful we can begin this program soon. The benefits of this type of exchange are obvious. It is the best way we can learn together how to address a truly global problem.

FinCEN will also enhance its support for Treasury policy officials' work in the Financial Action Task Force (FATF) and FATF regional bodies. We will continue our

work with the State Department in the drafting and editing of the "International Narcotics Control Strategy Report." Finally, we will continue our important efforts on financial intelligence unit outreach and training. Recently, we conducted, in conjunction with the United Arab Emirates, a South Asia FIU Conference for Afghanistan, Bangladesh, India, Maldives, Pakistan and Sri Lanka.

Additionally, FinCEN has given its support and participation to the "3 + 1" Working Group on terrorist financing in the Tri-border Area. The issues of information sharing and the bolstering of FIUs in the participating states of Argentina, Brazil and Paraguay are critical issues for the U.S. delegation to the "3+1" Working Group led by the Department of State's Office of Counter-Terrorism.

IV. ***Conclusion***

Mr. Chairman, I appreciate the Subcommittee's continued support as we endeavor to enhance our contributions to the war on financial crime and terrorist financing. This concludes my remarks today. I will be happy to answer your questions.

WRITTEN STATEMENT OF
NANCY JARDINI
CHIEF, CRIMINAL INVESTIGATION
INTERNAL REVENUE SERVICE
BEFORE THE
COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS
UNITED STATES HOUSE OF REPRESENTATIVES
June 16, 2004

Good Morning Madam Chairman, and distinguished members of the subcommittee, I appreciate the opportunity to be here today to discuss the Internal Revenue Service Criminal Investigation Division's (CI) work and the IRS' efforts involving the Bank Secrecy Act. I would also like to thank your subcommittee staff members who assisted us during the preparation of this hearing.

CI Mission

Criminal Investigation is the IRS law enforcement component charged with enforcing the criminal provisions of the Internal Revenue Code and related financial crimes. When CI was formed in 1919, IRS Special Agents were *only* responsible for investigating criminal violations of the Internal Revenue Code. Over the years, our financial investigative expertise has been recognized and increasingly sought by prosecutors and other investigative agencies and, as a result, our investigative jurisdiction has expanded to include money laundering and Bank Secrecy Act criminal violations.

The fundamental mission of CI is to serve the American public by detecting and investigating criminal violations of the Internal Revenue Code and related financial crimes. Many of the "badges of fraud" in tax investigations are identical to those in money laundering investigations. These include the extensive use of nominees, currency, multiple bank accounts, layering of financial transactions through multiple entities, and the movement of funds offshore. Therefore, the same financial investigative skills required to conduct complex tax cases can be readily adapted to money laundering investigations. This is especially true in intricate financial investigations involving the movement of untaxed funds offshore to tax haven jurisdictions. Tax evaders conceal their activities through the use of offshore bank accounts, layering of financial transactions, foreign corporations, and trusts. CI's statutory authority for money laundering, coupled with the financial expertise of its special agents, has made it possible to disrupt and dismantle criminal organizations employing complex financial transactions to launder illegal proceeds. Today CI is assisting in the war on terrorism by utilizing similar techniques to uncover terrorist financing.

Strategic Priorities

The Criminal Investigation strategic plan is comprised of three interdependent programs: Legal Source Tax Crimes; Illegal Source Financial Crimes; and Narcotics Related Financial Crimes. Within these three programs, special agents utilize all statutes within CI's jurisdiction, the grand jury process, and various enforcement techniques to combat tax, money laundering and currency crime violations. Direct investigative time for these programs is as follows:

Fiscal Year 2003

Legal Source Tax Crimes: 42%
Illegal Source Financial Crimes: 41%
Narcotics related financial Crimes: 15%
*Counterterrorism: 4%

Current fiscal year statistics, through April 2004 are:

Legal Source Tax Crimes 44%
Illegal Source Financial Crimes 39%
Narcotics related Financial Crimes 15%
*Counterterrorism 4%

Note: Percentages do not equal 100%; the remaining time is spent on reviewing information items or other non-case-related work such as protective details.

*Counterterrorism is a subset of the three programs but most time falls under illegal source income.

The Face of CI

CI is comprised of nearly 4,200 employees located throughout the United States and in seven foreign posts of duty. The workforce consists of 2,750 special agents and the remaining employees are tax fraud investigative aides, investigative analysts, compliance support assistants and various other administrative support personnel.

If the President's fiscal year 2005 budget proposal for the IRS is adopted, CI will hire 408 additional special agents and over 200 support personnel. This would be the largest hiring effort in CI history.

For more than 85 years, CI has solved complex tax and other financial crimes from Al Capone to John Gotti, Heidi Fleiss to Leona Helmsley, from corporate fraudsters to fraud promoters. In addition, CI investigates anti-tax militants and international terrorists.

The IRS special agent's combination of accounting and law enforcement skills are essential to investigating sophisticated tax, money laundering, and financial crimes. By collecting and analyzing financial records and tracing offshore transactions designed to hide assets, we document the source and ownership of funds whether they are

controlled by a tax evader, a drug trafficker, corrupt corporate executive, or a terrorist. This rigorous investigative process provides the experience that makes the IRS special agent unique and a formidable opponent to the financial criminal.

Our special agents are uniquely trained and skilled, possessing particularly strong accounting, financial and computer skills. CI is the only federal law enforcement agency that has a minimum accounting and business educational requirement for all prospective special agents. Once hired, they endure a rigorous 26-week training course at the Federal Law Enforcement Training Center (FLETC), in Glynco, Georgia, that includes general criminal investigation techniques, as well as intensive training in forensic accounting and financial investigations. In addition, CI special agents routinely benefit from specialized anti-terrorist financing training designed and provided by the Department of Justice's Counterterrorism prosecutors. Their unique training and skills enable CI agents to analyze complex, often unusual, financial transactions, and easily equip them to investigate corporate fraud, organized crime and terrorism financing.

Of the 2,750 special agents, 100 are computer investigative specialists. Computer Investigative Specialists (CIS) use specialized equipment and techniques to preserve digital evidence and to recover financial data, including data that may have been encrypted, password protected or hidden by other electronic means.

As the incidence of computers found during enforcement actions has risen from 5% to 95%, the reliance on CIS agents to secure and analyze digital data has grown as well. In the past, agents might find a single personal computer; now they encounter multiple computers, often linked together in a network, each having the capacity to hold several truckloads of documents. For example, during fiscal year 2003, CIS agents seized more than 85 terabytes of digital information through warrants. To put that into context, the entire contents of the Library of Congress can be contained within 16 terabytes.

The CIS agents secure the data, filter it by eliminating programs and other files of non-evidentiary value, and then return the critical information to the investigating agent. The agent can then electronically review evidence, which is much faster than the manual paper procedures used in the past. This technique, together with the scanning of paper documents, puts the entire investigation in a digital format that allows the investigation team and prosecutors to locate items of interest, move files among themselves and digitally present evidence in today's electronic courtrooms.

Investigative Jurisdiction

In addition to our primary jurisdiction, which is set forth in Title 26 of the United States Code (Internal Revenue Code), CI also has investigative jurisdiction involving other financial-related statutes. Beginning in 1970, Congress enacted a number of laws that led to greater participation by CI in the financial investigative environment. The Currency and Foreign Transactions Reporting Act of 1970 (Bank Secrecy Act); The Comprehensive Crime Control Act of 1984; The Anti-Drug Abuse Acts of 1986 and 1988; Crime Control Act of 1990; The Annunzio-Wylie Anti-Money Laundering Act of 1992; The Money Laundering Suppression Act of 1994; The Antiterrorism and Effective Death Penalty Act of 1996; The Health Insurance Portability and Accountability Act of

1996; and the USA PATRIOT Act of 2001 all developed and refined the existing anti-money laundering and anti-terrorism laws under Titles 31 and 18 of the United States Code.

Additionally, IRC, Section 6050 I, requires anyone involved in a trade or business, except financial institutions, to report currency received for goods or services in excess of $10,000 on a Form 8300.

The combination of tax, money laundering and bank secrecy act statutes enables IRS to identify and investigate tax evasion cases involving legal and illegal income sources. Ultimately, this versatility leverages IRS' ability to be a major contributor to many important national law enforcement priorities.

IRS and the Bank Secrecy Act (BSA)

The Currency Transaction Report (CTR) came into existence with the passage of the Currency and Foreign Transactions Reporting Act, better known as the Bank Secrecy Act (BSA), in 1970. By 1975 only 3,418 CTRs had been filed in the United States.

When the first version of the CTR was introduced the only way a suspicious transaction of less than $10,000 was reported to the government was if a bank teller called an agent and provided the information. This was due, primarily, to the concern by financial institutions about the Right to Financial Privacy. On October 26, 1986, with the passage of the Money Laundering Control Act, the Right to Financial Privacy was no longer an issue. As part of the Act, Congress had stated that a financial institution could not be held liable for releasing suspicious transaction information to law enforcement. As a result, the next version of the CTR had a suspicious transaction check box at the top. This was in effect until April 1996 when the Suspicious Activity Report (SAR) was introduced.

Currency reporting has changed since its introduction in 1970. There are now several different requirements for several different types of financial institutions as well as non-financial institutions. During calendar year 2003, nearly 14,000,000 currency forms were filed within the Currency Banking and Retrieval System (CBRS) at the IRS Detroit Computing Center.

The Department of Treasury is aware of the need to ensure appropriate coordination among its regulatory and enforcement components to ensure the most effective anti-money laundering and anti-terrorist financing infrastructure possible. Included in these overarching responsibilities is the need to ensure effective BSA compliance and enforcement.

In December 1992, the Department of Treasury delegated responsibility to the IRS for ensuring non-banking and financial institutions, not monitored by another federal agency, are in compliance with the BSA. These institutions include Money Service Businesses (MSBs), casinos, and non-federally insured credit unions. Under the delegation, IRS is responsible for the identification of MSBs and educational outreach on the requirements under the BSA. The IRS is also responsible for the examination of these institutions suspected of noncompliance. The IRS performs these compliance

functions along with its criminal enforcement role.

The processing and warehousing of BSA documents into the Currency Banking and Retrieval System (CBRS), including FBARs[1], CTRs [2], 8300s[3] and SAR[4]s, are also the responsibility of the IRS. All documents entered into the CBRS (approximately 14 million annually) are made available to other law enforcement and regulatory agencies in addition to IRS. However, the IRS is the largest user of the CBRS.

The total projected IRS costs for BSA for fiscal year 2004 is $132 million for both compliance and enforcement.

To meet our obligations under 31 CFR 103.57(b) and Treasury Delegation Order 15-41 we ensure that certain financial institutions (FIs) are in compliance with their recordkeeping and reporting requirements under the Bank Secrecy Act.

This is accomplished by a balanced civil and criminal program that includes:

- Identifying financial institutions (FIs) under IRS jurisdiction,
- Identifying those FIs that are actively involved in or facilitate money laundering and seek ways to end this activity,
- Conducting BSA compliance examinations to identify or uncover potential areas of noncompliance, money laundering trends, patterns, schemes, and forwarding the information for use in enhancing the National Anti-Money Laundering Strategy developed by the Departments of Treasury and Justice,
- Undertaking an aggressive effort to assist FIs for which IRS has jurisdiction in understanding their role in combating money laundering and to voluntarily meet their obligations under the BSA,
- Actively participating in coordinated multi-agency anti-money laundering initiatives such as GTOs, HIDTAs, HIFCAs, and SAR Review Teams designed to disrupt and dismantle money laundering organizations,
- Securing information on currency transactions which should have been reported or recorded and make available to law enforcement and other interested parties, and
- Utilizing and evaluating various currency transaction reports as authorized for tax compliance activities.

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[1] Foreign Bank & Financial Account Report (FBAR)
[2] Currency Transaction Report – (CTR) FinCEN Form 104 and FinCEN Form 103 (filed by casinos)
[3] Report of Cash Payments Over $10,000 Received in a Trade or Business (IRS and FinCEN form 8300)
[4] Suspicious Transaction Reports – filed by financial institutions when there is suspicious activity, as determined by the financial institution.

IRS' civil and criminal outreach efforts include State, and national associations affiliated with financial services industries. We provide keynote speakers, conduct seminars and provide educational programs relating to check cashers, bankers, tax practitioners, fraud examiners, corporate security personnel and bank security officers. This outreach and our efforts to contact money service businesses is a significant part of our program to identify and educate MSBs regarding their requirements to register their business with both the state and federal government.

IRS has approximately 358 civil examiners assigned to the anti-money laundering program. These examiners are currently conducting 5,576 examinations. In addition to the examination of non-banking financial institutions (NBFI), civil examiners also conduct reviews for compliance with the currency reporting requirements of Section 6050I of the Internal Revenue Code. As of March 31, 2004, the IRS NBFI database reflected over 88,000 potential NBFIs. From September 30, 2000 through May 2004, IRS has closed 13,288 examinations and conducted 5,940 registration examinations.

Usefulness of Bank Secrecy Act Data

The combined currency information in the Currency Banking and Retrieval System is extremely important for tax administration and law enforcement. The information provides a paper trail or roadmap for investigations of financial crimes and illegal activities, including tax evasion, embezzlement, and money laundering. IRS Criminal Investigation special agents and Assistant U.S. Attorneys can cite case after case where the in-depth review of information contained in one or more of these currency reports have led to a significant guilty plea, conviction, or asset forfeiture action.

IRS civil examiners access BSA documents to assist in on-going examinations. The CBRS database is also used to assist in providing information on most cases prior to examination and BSA information is included in all IRP documents. In addition, the CBRS database is used to identify cases for potential examination. For example, in many of our offshore trust schemes a search of CTRs can produce a literal 'wealth' of information.

Federal and state law enforcement agencies also find the CBRS data useful as evidenced by their participation in each of the 41 IRS hosted Suspicious Activity Report Review Teams (SAR-RT) located throughout the country in our 35 field offices. Nationwide approximately 300-345 law enforcement personnel are assigned, either full or part-time, to the SAR-RTs. These teams evaluate and analyze the SARs for case development and field office support. Each month, these SAR-review teams throughout the country review approximately 12,000-15,000 SARs.

Following are some examples of cases that either originated from BSA data or where BSA data served as a roadmap to confirming the crime:

CTRS Identify Employment Tax Fraud

A few Suspicious Activity Reports (SARS) can lead investigators to ambitious tax evasion schemes. In one such case a president of a construction company engaged in a sophisticated scheme to impair and impede the IRS in the ascertainment and collection of income taxes and employment taxes, file false personal and corporate tax returns and commit currency transaction violations.

During a three-year period the construction company was paid over $41.8 million for work performed on major construction projects. The president of the company subsequently wrote checks made payable to an associate's firm for over $16 million dollars of work ostensibly performed on the same projects. However, over $8 million dollars of the checks were deposited in the president's personal accounts. Later, the president and others conspired to withdrawal $7.6 million in cash with the specific intent to prevent the filing of Currency Transaction Reports (CTRs). Court records documented that over $2.8 million was withdrawn from the account on 299 non-consecutive business days.

The cash withdrawn from the accounts was subsequently used to pay workers in cash, thereby evading employment taxes. This investigation also led to the uncovering of a $6.5 million kickback scheme involving two executives of an auto part supply business.

Dealership Files False Form 8300

A former employee of a now-defunct used automobile dealership pleaded guilty to taking part in a complex money-laundering scheme intended to exchange drug sale proceeds for luxury vehicles. The employee pled to conspiracy to commit money laundering, obstruction of justice and two counts of money laundering. The charges carry a combined maximum penalty of 65 years in prison and a $1 million fine.

One of the subjects admitted to helping create false invoices, financing and other documents to disguise customer identities and the true nature of financial transactions. The dealership was suspected of selling vehicles to known narcotics dealers and filing false Form 8300's in order to disguise the true purchaser of the vehicles.

Structuring Transactions

A pair was sentenced for financial crimes relating to money lending and check cashing business. The pair was sentenced after pleading guilty to conspiracy to violate federal law and structuring financial transactions to avoid federal currency reporting requirements. They were charged in an indictment, which included among other charges, a violation of 18 U.S.C. 1960, Operating An Illegal Wire Transmitter Business. The pair operated a money lending and check cashing business in which they extended loans and cashed checks at specified interest rates and fees. They deposited the receipts from their business into several bank accounts, which were held in the names of other individuals. They made over $3 million in cash withdrawals from the accounts, which they split up into multiple transactions conducted at several different banks and branch offices.

Foreign Bank Account Records (FBAR)

IRS executed a seizure warrant to seize $6,976,934.65 from a foreign bank's correspondent bank in New York, NY. This money represented the illicit proceeds of an offshore internet gambling operation owned and operated from the country of Antigua. The owner maintained the funds in an account with the foreign bank. The money was seized from the New York correspondent bank pursuant to Title 18, USC Section 981(k) that was enacted as part of the USA PATRIOT Act.

Analysis of BSA Filings Leads to Tax Fraud Conviction of Convenience Store Owner

The owner of several convenience stores, specializing in the sale of cigarettes and other tobacco products, was sentenced to serve 12 months in prison, 12 months probation and pay a fine of $15,000. The sentence was a result of a guilty plea to one felony count of filing a false tax return. The target pled guilty to willfully filing a false Federal Income Tax Return for the year 1995, which materially under reported the income that the defendant had earned from his business. The defendant had been operating these businesses with his spouse as a partnership since 1995. The investigation documented that the target failed to report partnership income totaling approximately $452,839 for a three-year period. The defendant used these funds to purchase a home for cash and to purchase stock worth approximately $200,000. During the course of this investigation, SARs and CTRs filed on the target and his business were reviewed which described either large or structured currency deposits. These BSA filings provided leads of additional income for the target. This case was initiated as an offshoot of another investigation that began after the review of numerous CTRs that were deemed suspicious by the financial institution.

Suspicious CTR Filings Lead to Import Company Owner's Tax Evasion & Money Laundering Convictions

A business owner who operated a business that distributed various types of cooking oils to restaurants and retail stores was sentenced to 24 months in prison, 36 months of probation and fined $5,000. This sentence resulted from a conviction on four counts of tax evasion, four counts of filing a false tax return and five counts of unlawfully structuring currency transactions. The target was convicted for structuring a series of transactions at two financial institutions by making cash deposits in amounts of less than $10,000, which represented a portion of his customers' cash payments of $20,000 or more.

This investigation was initiated when a financial institution directly contacted IRS special agents and provided six CTRs with the 'suspicious' block checked, detailing six currency transactions conducted at the bank by the business operator. Evidence developed from the BSA filings led the agents to execute search warrants at the subject's personal address and business location.

According to court documents, in 1996, the target deposited over $1.3 million in cash deposits of under $10,000. During that year, the subject made 134 cash deposits of $9,800, one cash deposit of $9,600 and one cash deposit of $9,000. In 1997, he deposited over $1 million in cash deposits of under $10,000, consisting of 113 deposits of $9,800, two deposits of $9,006, seven deposits of $9,005, three deposits of $9,000, one deposit of $8,600, and two deposits of $8,000. The target failed to report business gross receipts of $124,000 in 1994, $166,000 in 1995, $220,000 in 1996, and $112,000 in 1997, which resulted in a tax loss to the government of over $250,000. The tax charges were related to the target's 1994, 1995, 1996 and 1997 federal individual income tax returns.

SAR Leads to Former Bank Official's Sentencing on Fraud Charges

A former bank vice president and commercial loan officer, who defrauded a financial institution, was sentenced to 30 months in prison, five years supervised probation and ordered to make restitution of approximately $415,000. This case was initiated from SARs filed by the institution that detailed the bank officer's activities. The sentence resulted from a guilty plea by the subject to one felony count each of money laundering and the misapplication of bank funds. According to court papers filed the target misused her position to process fraudulent loans at the bank and then converted the proceeds of the loans for her own and other family members' use. The subject prepared loan documents in 12 separate loans, falsely stating the name of the borrower and/or the purpose of the loan, and then approved the loan in her capacity as a vice president of the bank. The gross amount of the loans was nearly $1 million and the net loss to the bank exceeded $495,000. Agencies participating in this investigation include the IRS-CI and the FBI.

SARs Identify Money Laundering of Proceeds from the Sale of Marijuana

Four individuals involved in the distribution and sale of marijuana were sentenced to prison terms ranging from 12 to 21 months followed by up to 36 months probation. This investigation was initiated from the analysis of two SARs filed by two separate financial institutions, regarding the deposits of cash to the target's bank accounts. Many of the deposits were for amounts under $10,000 and structured to avoid the currency reporting requirements. The structured transactions were conducted by depositing cash on consecutive days, making several deposits on the same day, and spreading the deposits among bank accounts at different institutions.

These sentences resulted from guilty pleas by the targets on one count each of money laundering for the manner in which they handled between $350,000 and $600,000 in funds traceable to marijuana trafficking. According to court papers filed, two of the defendants structured cash derived from the sale of marijuana into various accounts and then transferred the funds by check, wire transfer, or cash to the other two targets, operators of a concert promotion and nightclub business. These individuals subsequently used this business as a way to launder the money from the marijuana distribution business, disguising the money as legitimate business receipts and mixing it with proceeds from promotions and concerts. Agencies participating in this investigation include the IRS-Criminal Investigation, the FBI and a local police department.

As these examples reflect, the CBRS data is often the key piece of information that leads to the conviction of the criminal and stops an on-going crime. Many of these crimes would have gone undetected had it not been for the currency transaction report or the suspicious transaction report and the call from an alert banker.

Working with the Financial Institution Industry through Improved Technology

As financial investigators and income tax auditors, the agents of the IRS regularly seek access to bank records pertaining to taxpayers' financial transactions. Revenue agents conducting civil audits require bank records to verify transactions and reconcile financial records to bank account records. Criminal Investigation's special agents seek access to bank records in most of its investigations in order to "follow the money" as they track targets' financial transactions. The Internal Revenue Code permits both revenue agents and special agents to issue administrative summonses to banks and other financial institutions to obtain records, and prosecutors and special agents conducting grand jury investigations may issue grand jury subpoenas requiring banks to produce account holder transactional information. Today, most institutions provide paper copies of checks and other items in response to subpoenas and summonses.

Responding to subpoenas and summonses require financial institutions to maintain compliance offices within their home offices and branches. The statutory rate set to reimburse banks for complying with compulsory process does not cover the cost of maintaining those offices and searching for, copying, and producing requested records.

Criminal Investigation is currently working with several banks and banking industry organizations to develop a process by which both CI and the banks can centralize summons and subpoena requests and compliance. Implementation of those procedures will provide CI with faster response time and reduce the banks' production costs. These procedures may well serve as a model for all law enforcement agencies that would substantially reduce the costs banks incur each year to comply with government requests for transactional information.

IRS Bank Secrecy Act Partners at FinCEN

Currently IRS assigns both civil and criminal investigation senior analysts to act as the Liaisons to the Financial Crimes Enforcement Network (FinCEN). These individuals deal with issues ranging from the case support supplied by FinCEN to strategic implementation and interpretation issues pertaining to the Bank Secrecy and USA PATRIOT Act. Some activities include:

- During FY 2003, IRS-CI submitted a total of 373 requests to our FinCEN representative for research pertaining to 1,307 subjects for ongoing tax and money laundering investigations. Information requested included the search of commercial databases and law enforcement systems.

- IRS and FinCen jointly establish the priorities for types of nonbank financial institutions to be examined.

- In addition, CI maintains a database at FinCEN which houses information

pertaining to CI's Title 18 and 31 non-grand jury cases, which is used as a law enforcement database resource by the FinCEN analysts. Any positive hits from this database are disseminated to CI field office agents. The FinCEN database houses all requests for research received by FinCEN from Federal, State, Local and International sources. This database is only available at FinCEN.

FinCEN also generates proactive reports from their research of information derived from the Bank Secrecy Act. During FY 2003, FinCEN provided sixty-four proactive reports, which were forwarded to the appropriate CI Field Office.[5] Also during FY 2003, FinCEN provided an additional eleven proactive reports relating to terrorism[6], which were forwarded to our headquarters office for further review[7].

During the fiscal year (2004), CI's pilot project Garden City Counterterrorism Lead Development Center has received 101 potential terrorism investigative leads from FinCEN.

FinCEN also coordinates with the eighty-four Financial Intelligence Units (Meeting the Egmont Definition), in scores of countries around the world. To assist ongoing investigations, FinCEN has set up procedures with these Financial Intelligence Units to obtain public, law enforcement and financial information from these respective entities. During the fiscal year 2003, IRS-CI submitted twenty-three requests and during the current fiscal year CI has submitted thirty Egmont requests. CI has also received during the fiscal year 2003, eighty-three significant foreign case information referrals generated from requests submitted to FinCEN by foreign Financial Intelligence Units[8]. These referrals were forwarded to the appropriate CI field office.

IRS and the USA PATRIOT ACT

Several sections of the USA PATRIOT ACT impact investigative activities of IRS. Some specific examples include:

- **Internet Service Provider**

  Of specific benefit to IRS CI have been the provisions of the Act clarifying and modifying law enforcement's ability to obtain digital evidence from Internet service providers (ISPs). Investigations requiring information from ISPs often involve providers far removed from the site of the investigation or providers located in more than one jurisdiction. The sections providing for nationwide service of search warrants to ISPs (Sec. 220 of the Act), giving nationwide effect to orders authorizing pen registers and trap and trace devices (Sec. 216), expanding the categories of information obtainable via subpoena (Sec. 210), and allowing the use of search warrants to obtain stored voice mail messages (Sec. 209), have all eased the burden of obtaining and serving process in IRS cases.

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[5] In FY 04 through April 26, 2004, FinCEN has referred thirty-one proactive reports.
[6] In FY 04 through April 26, 2004, FinCEN has referred seventy-one proactive reports relating to terrorism.
[7] Tips from FinCEN Financial Institution Hotline have also been forwarded to HQ since August 2003. In FY 03, seventeen tips were referred and to date in FY 04 sixty tips were referred by FinCEN.
[8] In FY 04 through April 26, 2004, FinCEN has referred thirty-seven foreign cases referrals.

- **Bulk Cash Smuggling**

  Bulk cash smuggling became a criminal offense under Title 31 with the enactment of the USA PATRIOT Act, outlined in Section 371 of the Act. Codified in 31 U.S.C. §5332, this new statute prohibits any person, with the intent to evade a currency reporting requirement under 31 U.S.C. § 5316 (*i.e.*, Report of International Transportation of Currency or Monetary Instruments (CMIR)), to conceal more than $10,000 in currency in any fashion, and to transport, or attempt to transport, such currency into or out of the United States.

  Prosecution recommendations by IRS for violations of this statute may be considered but only within the confines of a money laundering investigation, where the source of the currency can be reasonably determined to be derived from "specified unlawful activity" (SUA).

IRS has had a substantial increase in case initiations and prosecution recommendations utilizing this statute, Title 18 USC §5332.

- **Prohibition of Unlicensed Money Transmitting Businesses**

  Section 373 of the Act amends Title 18 USC 1960 (Prohibition of Unlicensed Money Transmitting Businesses). A person violates Title 18 USC §1960 if he or she knowingly conducts, controls, manages, supervises, directs or owns all or part of an unlicensed money transmitting business that effects interstate commerce by:

  a. Operating without a state license; or
  b. Failing to comply with MSB (Treasury's) registration; or
  c. Transferring money knowing the funds transmitted were criminally derived or promote/support some unlawful activity.

  CI's jurisdiction over 18 USC §1960 is ancillary jurisdiction derived by extension through Treasury Directive 15-42 which gives CI jurisdiction over offenses having a tax nexus or Bank Secrecy Act nexus under 31 USC §5311 et seq.

IRS has had a significant increase its use of 18 USC §1960.

- **Sharing Information regarding transactions that may involve terrorist activity**

  Section 314(a) of the ACT authorizes federal law enforcement agencies to utilize the existing communication resources of FinCEN to establish a link between their respective agencies and over 26,000 financial institutions for the purpose of sharing information concerning accounts and transactions that may involve terrorist activity or money laundering.

  During the time period of April 1, 2003 through April 26, 2004, CI submitted

sixteen requests to FinCen pertaining to sixty-six individuals and seventeen businesses. These requests generated six hundred forty-six positive and fifty-one inconclusive matches with twelve hundred and seventy four financial institutions.

- **Summons or subpoena on a foreign bank that has a correspondent account in the US**

  Utilizing section 319 (a) of the ACT CI has participated in two investigations wherein approximately $3.5 million in funds was seized from accounts held at correspondent banks in the United States. Subsection (a) of Section 319, provides that when a criminal deposits funds in a foreign bank account and that bank maintains a correspondent account in the United States, the government may seize and forfeit the same amount of money in the correspondent account.

- **Financial institutions required to establish anti-money laundering programs**

Section 352 of the Act required all financial institutions, as defined by the Bank Secrecy Act, to establish an anti-money laundering program within six months of the passage of the USA PATRIOT Act.

- The IRS currently employs roughly 358 field examiners (including managers) in its Anti-Money Laundering (AML) program. The examiners are in dedicated AML groups, are supervised by AML trained managers and work full time in the AML program. Approximately 50 additional FTEs provide support to the examiners, including workload identification. Working in collaboration with FinCEN, community outreach is conducted to ensure Money Services Businesses are aware of their requirements under the BSA. The IRS is currently working with FinCEN to amplify their efforts to meet the challenges of extending BSA oversight to a number of industries under the BSA regulatory jurisdiction of the IRS.

- In anticipation of the additional examination requirements under Sec. 352 of the Patriot Act, the IRS SBSE Division requested an additional 100 FTEs in the FY04 budget. 70 of these positions have been funded by FinCEN and have been in place since FY03 examining Money Services Businesses (MSBs) for compliance with the new provisions as well as compliance with the SAR filing requirements. The remaining FTEs that were received in the request will be used to examine the compliance programs in the insurance industry and precious metals industry once the final regulations are effective. The precious metals industry has been one where the IRS has always maintained a presence under Sec. 6050 I of Title 26. Currently, we have a known population of roughly 4000 jewelry businesses, with a potential of another 25,000.

- The IRS is already working with FinCEN in formulating the examinations for the three operators of credit card companies that now have responsibilities for compliance program under Sec. 352.

- There are approximately 1600 insurance companies that will have a requirement under Sec. 352. In anticipation of the examination of these industries, as well as other industries that may be coming under Sec. 352, the IRS already is planning ahead to identify and address noncompliance in these areas. The IRS will be working with the industry and with FinCEN to identify risk in the insurance industry. Criteria for a risk based approach for the identification of MSBs, which includes the analysis of information in the Currency and Banking Retrieval System is already in place. In an effort to work with the Money Service Businesses, the IRS is moving to centralized examinations of these entities. The IRS, in collaboration with FinCEN, has also developed the framework that will give us the opportunity to work with the state regulators, thus, leveraging our resources.

Sharing our knowledge with others

In addition to our financial investigative work, CI is also working with many foreign governments to train their investigators in the area of money laundering, financial investigative techniques, and terrorist financing. We are an active member of the Department of State led Terrorist Finance Working Group and we work in conjunction with the Department of State and other governmental and law enforcement agencies to provide a broad array of financial investigative training to foreign governments related to money laundering and financial crimes. In addition, CI also provides training jointly with the Department of Justice.

We are working in partnership with Treasury's Office of Terrorism and Financial Intelligence (TFI), the Office of Foreign Assets Control (OFAC), and the Financial Crimes Enforcement Network (FinCEN) to leverage all of the tools and skills of the Department of Treasury most effectively.

Some specific current training conducted jointly with the Department of State and other law enforcement agencies such as the Bureau of Alcohol, Tobacco, Firearms, and Explosives (ATF), FBI, Drug Enforcement Agency (DEA), and Immigration and Customs Enforcement (ICE) includes:

- Financial Investigative Techniques course at the International Law Enforcement Academies in Bangkok, Budapest, and Gaborone;

- Joint Terrorism Finance Training conducted by FBI and CI in the United Arab Emirates, Pakistan, Malaysia, Colombia , Turkey, Qatar, Jordan, and Indonesia; and

- Department of State, International Narcotic and law Enforcement Affairs training is scheduled to be conducted in Egypt, Paraguay, and Brazil later this year.

Terrorist Financing Investigations and Iraqi Repatriation

Historically, our agents' financial investigative skills have enabled them to conduct complex investigations involving a wide range of crimes. Currently, our agents apply

these skills to investigations involving terrorist financing activities involving:

- The leadership and members of extremist groups who have committed tax, money laundering, or currency violations;
- Persons engaged in fundraising activities to support terrorism, especially if tax exempt organizations are being utilized; and
- Terrorism investigations involving complex, extensive or convoluted financial transactions.

In addition, our work with OFAC has increased dramatically since the Department of Treasury's "trace and chase" activities began with the search for Iraqi assets. We are working closely with the Department of Treasury and OFAC in their efforts to recover Iraqi assets so that they can be used for the reconstruction of Iraq. CI is also working with the Terrorist Financing Working Group comprised of numerous intelligence, law enforcement, and regulatory agencies to review the proposed anti-money laundering and anti-terrorist financing laws being drafted for Iraq.

Since 2003, 11 IRS special agents have been deployed to Iraq – in four separate rotations. However, total efforts regarding repatriation of Iraqi assets involved 33 different trips around the world – including Jordan, Syria, Switzerland, Saudi Arabia, Qatar and others – involving 20 different agents who are supported by two senior analysts in Washington.

IRS CI spends about four percent of our direct investigative time on counterterrorism investigations. (About 140 special agents and 20 support staff). Our Garden City Lead Development Center is dedicated to analysis of data pertaining to counterterrorism and is currently staffed with 12 analysts and one supervisor.

Some other CI efforts and partnerships focused on the investigation of terrorism financing include:

- Treasury Working Group on Terrorist Financing and Charities – Both CI and IRS civil division Tax Exempt/Government Entities.
- SAR Review Teams – designed to analyze and evaluate all suspicious activity reports filed through CBRS.
- Interpol – The CI Liaison to the US national Central Bureau of INTERPOL assists CI field offices and other Federal, state and local law enforcement officers in obtaining leads, information and evidence from foreign countries.
- Defense Intelligence Agency Center (DIAC) (known as the Fusion Center).
- High Intensity Drug Trafficking Area (HIDTA).
- Anti-Terrorism Advisory Council established by the Attorney General.

- Joint Terrorism Task Forces (JTTF) - On a national level CI is embedded with FBI on both the JTTFs and Attorney General's Anti-Terrorism Advisory Council, concentrating on the financial infrastructure and fundraising activities of domestic and international terrorist groups.

- The High Intensity Money Laundering and Related Financial Crime Area (HIFCA) Task Forces. HIFCAs analyze Bank Secrecy Act and other financial data and analyze potential criminal activity, including terrorist financing. Twenty-six percent of our 150 open terrorism-financing investigations are the result of, or involve, Bank Secrecy Act data.

- Representation in FBI's Terrorist Financing Operations Section (TFOS).

Technology and Terrorist Financing Investigations

In addition to our participation on these groups, we also make a unique contribution to counterterrorism efforts through the use of our computer investigative expertise. IRS has a unique software tool used by international, domestic, federal, state and local intelligence agencies. This software tool has the capability of analyzing multi terabytes of data in multiple languages, including Farsi. We have used this tool successfully in numerous investigations – from computers seized in abusive tax schemes to those found in caves in Afghanistan.

IRS' Terrorist Financing Lead Development Center

Experience gained during the last two years has identified areas where CI can have a greater impact addressing terrorism related financial issues without duplicating the efforts of other law enforcement agencies. CI is piloting a counterterrorism project in Garden City, New York, which, when fully operational, will use advanced analytical technology and leverage valuable income tax data to support ongoing investigations and pro-actively identify potential patterns and perpetrators.

The Garden City LDC was established in July 2000 to assist field offices in ongoing income tax and money laundering investigations. Due to the unique application of the skills and technology deployed to develop investigations at Garden City, it has been converted to focus exclusively on counterterrorism issues.

When fully implemented, CI's efforts at the Counterterrorism LDC will be dedicated to providing nationwide research and project support to CI and JTTF terrorist financing investigations. Relying on modern technology, the Center is staffed by CI Special Agents and Investigative Analysts, in conjunction with experts from the IRS' Tax Exempt/Government Entities (TE/GE) Operating Division. Together these professionals research leads and field office inquiries. Using data from tax-exempt organizations and other tax-related information that is protected by strict disclosure laws, the Center analyzes information not available to, or captured by, any other law enforcement agency. Thus, a complete analysis of all financial data is performed by the Center and disseminated for further investigation.

This initiative supports the continuation of CI's response to domestic and international terrorism, and ensures efficient and effective use of resources through advanced analytical technology by subject matter experts. Analytical queries and proactive data modeling assist in identifying previously unknown individuals who help fund terrorist organizations and activities, with particular focus on the use of purported charitable organizations, hawalas, wire remitters, and other terrorist funding mechanisms.

Terrorism Investigative Statistics

Since October 1, 2000, IRS CI has conducted 372 terrorism investigations in partnership with other law enforcement agencies. Over 100 investigations have resulted in indictments. Of the 270 open investigations, 120 have already been referred to the Department of Justice for prosecution. Of the remaining 150 terrorism investigations currently being worked by IRS CI Special Agents:

- 56% involve tax violations;
- 97% involve participation with other agencies;
- 26% either were results of, or involve, Bank Secrecy Act data; and
- 18% involve purported charitable or religious organizations

IRS International Activities

- Aside from CI's association with domestic joint terrorism task forces, CI also participates in the international arena. Through efforts developed by the Department of Treasury, CI participates in the newly created Joint Terrorist Financing Task Force in Riyadh, Saudi Arabia along with local Saudi investigators. Through this task force, agents from FBI and Criminal Investigation have gained unprecedented access to Saudi accounts, witnesses, and other information. The task force agents both provide and receive investigative lead information on various terrorist-financing matters. This initiative supports the continuation of CI's ability to identify and investigate those who use U.S. organizations and financial institutions to fund terrorist activities.

- CI is a permanent member of the US Delegation to the Financial Action Task Force (FATF) and its Caribbean equivalent (CFATF). We also helped draft the recently revised 40 recommendations that set the standards for best practices to be adopted by countries to combat money laundering.

- CI has participated in the assessments of numerous Middle Eastern, South American, and European countries anti-money laundering laws, policies, and procedures. As a result, during Fiscal Year 2004, CI will participate in follow up anti-terrorism and anti-money laundering training with the FBI in countries such as Saudi Arabia, Thailand, Egypt, Pakistan, United Arab Emirates, Oman, Qatar, Bahrain, and others.

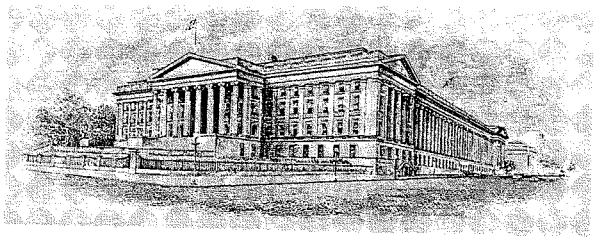
- Our liaison to the US national Central Bureau of INTERPOL has provided urgently needed identifying information to the OFAC in terrorist related actions.

Conclusion

Today we carry on our 85-year tradition of solving financial crimes in concert with our other partners in the Department of Treasury and the rest of law enforcement, and we do that by following the money. Just last month, IRS Commissioner Everson participated in a ribbon cutting ceremony in New York to mark the opening of a new joint agency strike force devoted to dismantling consolidated priority organizational targets (all types of organized criminal activity.)

CI's achievements are the result of a collective effort and are a tribute to what can be achieved when government works together. I am proud of the role that the Internal Revenue Service and CI, in particular, have played in achieving those successes. It is one of the great rewards of public service.

Madam Chairman, I thank you for this opportunity to appear before this distinguished subcommittee and I will be happy to answer any questions you and the other committee members may have.



DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

EMBARGOED UNTIL DELIVERY
June 16, 2004

Contact: Molly Millerwise
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Testimony of R. Richard Newcomb, Director
Office of Foreign Assets Control
U.S. Department of the Treasury

Before the House Financial Services Subcommittee on Oversight and Investigations

I. Introduction

Madame Chairman, members of the Committee, thank you for the opportunity to testify on the Office of Foreign Assets Control's efforts to combat terrorist support networks which forms an important part of the Treasury Department and our government's national security mission. It's a pleasure to be here, as we discuss Treasury's new office and its role in these areas. Please allow me to begin with an overview of our overall mission and conclude with our strategies for addressing the threat of international terrorism.

II. OFAC's Core Mission

The primary mission of the Office of Foreign Assets Control ("OFAC") of the U.S. Department of the Treasury is to administer and enforce economic sanctions against targeted foreign countries, and groups and individuals, including terrorists and terrorist organizations and narcotic traffickers, which pose a threat to the national security, foreign policy or economy of the United States. OFAC acts under general Presidential wartime and national emergency powers, as well as specific legislation, to prohibit transactions and freeze (or "block") assets subject to U.S. jurisdiction. Economic sanctions are intended to deprive the target of the use of its assets and deny the target access to the U.S. financial system and the benefits of trade, transactions and services involving U.S. markets. These same authorities have also been used to protect assets within U.S. jurisdiction of countries subject to foreign occupation and to further important U.S. nonproliferation goals.

OFAC currently administers and enforces 27 economic sanctions programs pursuant to Presidential and Congressional mandates. These programs are a crucial element in preserving and advancing the foreign policy and national security objectives of the United States, and are usually taken in conjunction with diplomatic, law enforcement and occasionally military action.

OFAC's historical mission has been the administration of sanctions against target governments that engage in policies inimical to U.S. foreign policy and security interests, including regional destabilization, severe human rights abuses, and repression of democracy. Recent programs in the Western Balkans, Zimbabwe, Sudan, and other regions reflect that focus. Since 1995, the Executive Branch has increasingly used its statutory blocking powers to target international terrorist groups and narcotics traffickers.

Many "country-based" sanctions programs are part of the U.S. government's response to the threat posed by international terrorism. The Secretary of State has designated seven countries – Cuba, North Korea, Iran, Libya, Iraq, Sudan and Syria - as supporting international terrorism. Three of these countries are subject to comprehensive economic sanctions: Cuba, Iran, and Sudan (1997). Comprehensive sanctions have been imposed in the past against Libya, Iraq, and North Korea. In addition, effective May 12, 2004, the President issued a new E.O. prohibiting specific types of transactions and exportations and importations to and from Syria due to its continued support for terrorism, its occupation of Lebanon, its pursuit of weapons of mass destruction and missile programs and its undermining of the United States and international efforts to stabilize and reconstruct Iraq.

OFAC also administers a growing number of "list-based" programs, targeting members of government regimes and other individuals and groups whose activities are inimical to U.S. national security and foreign policy interests. In addition to OFAC's terrorism and narcotics trafficking programs, these include sanctions against persons destabilizing the Western Balkans and against the regimes in Burma and Zimbabwe. OFAC also administers programs pertaining to non-proliferation, including the protection of assets relating to the disposition of Russian uranium, and to trade in rough diamonds.

III. Administration and Transparency

Organization

OFAC has grown over the past eighteen years from an office with ten employees administering a handful of programs to a major operation of 144 employees administering 27 programs. A large percentage of OFAC's professional staff have had prior professional experience in various areas of the law, finance, banking, law enforcement, and intelligence. To accomplish its objectives, OFAC relies on good cooperative working relationships with other Treasury components, federal agencies, particularly State and Commerce, law enforcement agencies, the intelligence community, domestic and international financial institutions, the business community and foreign governments.

OFAC is an organization which blends regulatory, national security, law enforcement, and intelligence into a single entity with many mandates but a single focus: effectively implementing

economic sanctions programs against foreign adversaries when imposed by the President or the Congress. In order to carry out OFAC's mission, the organization is divided into ten divisions, with offices in Miami, Mexico City and Bogotá and soon to open this summer an office in Bahrain. OFAC's operations are also supported by attorneys in the Office of Chief Counsel (Foreign Assets Control). Two divisions are primarily devoted to the narcotics and terrorism programs, while others, primarily the Licensing, Compliance and Civil Penalties Divisions, are geared toward interaction with the public. It is these latter Divisions that primarily serve as OFAC's liaison with the public and figure prominently in promoting the transparency of OFAC's operations. Finally, OFAC's Enforcement Division provides crucial liaison with the law enforcement community.

Licensing Division

OFAC's licensing authority serves to "fine tune" or carve out exceptions to the broad prohibitions imposed under sanctions programs, ensuring that those transactions consistent with U.S. policy are permitted, either by general or specific license. For example, working closely with the Department of State, the Licensing Division played a critical role in issuing specific licenses to facilitate humanitarian relief activity by U.S. non-governmental organizations in the wake of the Bam earthquake in Iran. The primary focus of OFAC Licensing involves the country-based programs, primarily Cuba and Iran. Major areas of activity include issuing advisory opinions interpreting the regulations; processing license applications for exports of agricultural products, medicine and medical devices to Iran and Sudan pursuant to the Trade Sanctions Reform and Export Enhancement Act of 2000; license applications pertaining to travel and activities involving Cuba; applications to unblock funds transfers blocked by U.S. financial institutions; and the preparation of numerous legal Notices continuing statutory authority for OFAC's programs and semiannual reports to the Congress on their administration. Licensing activity involving the list-based programs centers primarily on the authorization of payment for legal services provided to blocked persons. OFAC's Miami Office, which coordinates Cuba travel licensing, compliance and enforcement matters, also reports primarily to the Licensing Division.

The Licensing Division reviews, analyzes and responds to more than 25,000 requests per year for specific licenses covering a broad range of trade, financial and travel-related transactions, including those related to the exportation and importation of goods and services and the provision of humanitarian and banking and financial services. It also provides written and oral guidance to the public and private sectors on the application of OFAC's regulatory programs to specific facts and circumstances. Redacted versions of interpretive rulings prepared by the Licensing Division are published on OFAC's website. During FY 2003, the Licensing Division made substantial progress in reducing the overall response time to incoming correspondence, primarily through a net increase of staff of 11 FTEs and conversion to an Oracle database and the use of that database for effective case management. The Licensing Division is also currently implementing a new integrated voice response system to more efficiently handle the large volume of calls it receives from the public.

Compliance Division

OFAC Compliance adds a unique dimension to the war against terrorists and against other sanctions targets. Working with the regulatory community and with industry groups, it expeditiously formats and makes information public through appropriate channels in appropriate formats to assure that assets are blocked and the ability to carry out transactions through U.S. parties is terminated. It is always aware that "time is of the essence" and, if a new enemy were to appear tomorrow, OFAC is confident that it would be able to implement a new sanctions program within 24 hours even in a crisis environment. Our Compliance team is "in the trenches," so to speak, and provides a unique service through its toll-free telephone "hotline" giving real-time guidance on in-process transactions. As a result of its efforts every major bank, every major broker-dealer, and more and more industry professionals use software to scan and interdict transactions involving sanctions targets. OFAC's hotline averages 1,000 calls per week with at least $1 million and sometimes as much as $35 million in appropriately interdicted items each week. Recently, for example, OFAC worked with a US bank to block a wire transfer for close to $100,000 originating from a suspect and going to an organization associated with a Specially Designated Global Terrorist organization which we had named.

OFAC uses multiple formats and multiple platforms to get information out on its targets and - its programs - including on our website which now has over 1,000 documents, over a million hits per month, and over 15,000 email subscribers--so that banks, broker-dealers, and others can stop transactions in mid-stream.

OFAC's Compliance Division also runs more than 100 training sessions per year around the country and follows up with cases based on regulatory audits and blocked and rejected items which have resulted in 4,250 administrative subpoenas, 3,500 warning letters, and hundreds and hundreds of referrals for Enforcement or Civil Penalties action over the past five years.

Its positioning within the Treasury Department provides OFAC's Compliance with an invaluable capability to dialogue with and oversee industry groups as diverse as banking and securities, exporters and importers, travel service providers, insurers, and even credit bureaus and retailers.

Civil Penalties Division

OFAC's Civil Penalties Division acts as the civil enforcement arm of OFAC by imposing civil penalties for violations of OFAC programs. Penalties range from $11,000 to $1.075 million. Since 1993, the Division has collected nearly $30 million in civil penalties for sanctions violations and has processed more than 8,000 matters.

The Division reviews evidence and determines the appropriate final OFAC penalty action -- either a settlement, a penalty imposition, or the decision not to impose a penalty. It also grants requests for an agency hearing before an administrative law judge (ALJ) in cases under the Trading With the Enemy Act (TWEA). Four ALJs have contracted with OFAC to hear such cases. In addition to ALJ hearings and the administrative civil penalty process, OFAC's Civil Penalties Division resolves civil enforcement cases in conjunction with criminal prosecutions by the Justice Department. OFAC also enters into global settlements of violations in forfeiture

actions brought by the U.S. Customs and Border Protection (CBP) and works closely with CBP's Office of Regulations and Rulings and the Fines, Penalties and Forfeitures Offices nation wide.

The Civil Penalties Division publishes information on completed settlements and penalty impositions on OFAC's Penalties Disclosure Website. Providing additional transparency, as recommended by the Judicial Review Commission, OFAC has published in the Federal Register its Enforcement Guidelines with Penalty Mitigation Guidelines.

Enforcement Division

OFAC Enforcement concentrates on providing advice and assistance concerning criminal investigations and investigates civil violations of OFAC's regulations and statutes.

- **Criminal investigations.** OFAC Enforcement officers provide expert advice and assistance to Assistant United States Attorneys and criminal investigators from the FBI, Bureau of Immigration and Customs Enforcement (ICE) and the Department of Commerce's Office of Export Enforcement (OEE) in the investigation of suspected criminal violations of OFAC programs. The FBI has primary investigative authority for terrorism cases, while ICE conducts most investigations dealing with trade-related transactions. OFAC's long-standing and close relationship with ICE, and its predecessor office the US Customs Office of Investigation, has continued after the transfer of Customs to the Department of Homeland Security ("DHS"). This relationship works very well. ICE has field offices nationwide, covering all ports of entry, and agents assigned as attaches for overseas investigative coverage. ICE agents, along with inspectors from the CBP at DHS, have seizure authority at U.S. ports and they are the front line of OFAC's efforts to interdict unlicensed goods being exported to, or imported from, sanctioned countries or persons. Since 1995, there have been approximately 68 cases that resulted in criminal enforcement action for TWEA and the International Emergency Economic Powers Act ("IEEPA") violations.

- **Civil Investigations.** The Enforcement Division conducts civil investigations as a result of voluntary disclosures, informant information, internal research by OFAC staff, and referrals from ICE and other agencies. The Division currently has more than 2600 civil cases opened. These cases range from complex export, reexport and other trade transactions, to violations of OFAC Cuba travel restrictions. Most such cases result in an internal referral to the Civil Penalties Division for the possible imposition of civil penalties.

- **Domestic Blocking Actions.** OFAC officers serve blocking notices and work to ensure the blocking of assets of entities in the United States that are designated under the Foreign Terrorist, Narcotics and country programs. These actions are accomplished with the assistance of special agents from the FBI and ICE as needed.

- **Law Enforcement Outreach Training.** OFAC provides sanctions enforcement training to ICE agents and CBP inspectors on a monthly basis through in-service training courses at the Federal Law Enforcement Training Center and at field offices and ports nation-wide. We have also provided training presentations to agents and analysts at FBI Headquarters and at the FBI Academy at Quantico, VA.

Transparency and Outreach

In January 2001, the Judicial Review Commission on Foreign Asset Control submitted its final report to the Congress, making several recommendations with respect to OFAC. While some were specific to the Foreign Narcotics Kingpin Designation Act and OFAC's designation authority generally, others pertained to the "'transparency" of OFAC's operations and decision making standards in order to facilitate greater understanding of, and compliance with, the sanctions laws [OFAC] administers." In response to the Commission's report, OFAC and the three Divisions described above have taken several measures to enhance the transparency of OFAC's operations. Central to this initiative is the use of OFAC's website, administered by the Compliance Division, which currently contains more than 1,000 documents, including 96 program brochures, guidelines and general licenses, 12 industry brochures, and over 200 legal documents. Website usage statistics indicate in excess of 1.3 million hits per month. OFAC also publishes reports, speeches, and Congressional testimony on its website. Included among the reports are quarterly reports to the Congress on the administration of the licensing regime pertaining to the exportation of agricultural products, medicine and medical devices to Iran, Sudan, and, until recently, Libya. OFAC's Terrorist Assets Reports for 2001 through 2003 are also available.

Interpretive rulings in redacted format prepared by the Licensing Division are published on the website, extending the benefit of what had previously been private guidance. OFAC has also published 95 questions of general applicability frequently asked by the public about OFAC and its programs.

Publication of various OFAC guidelines is also an important component of the transparency initiative. Along with the Enforcement Guidelines, OFAC has issued comprehensive application guidelines pertaining to the authorization of travel transactions involving Cuba. These guidelines were instrumental in reducing a backlog of license applications in this category from more than four hundred cases to fewer than one hundred, with a current average processing time per application of fewer than nine days. OFAC also issues a circular setting forth the regulatory program governing travel, carrier and funds forwarding services provided in the context of the Cuba embargo.

Responding to one of the Judicial Review Commission's recommendations, OFAC, wherever possible, has issued its regulations in the Federal Register as interim final rules allowing for public comments.

Finally, there are listings on the website for more than 100 sanctions workshops in the near future. These workshops provide a significant outreach to the financial and other communities OFAC regulates, further promoting transparency of agency operations.

IV. OFAC's Designation Programs

Designations constitute the identification of foreign adversaries and the networks of companies, other entities, and individuals that are associated with them; as a result of a person's designation

pursuant to an Executive orders ("EO") or statute, U.S. persons are prohibited from conducting transactions, providing services, and having other dealings with them. Generically, those who are placed on OFAC's public list are referred to as "Specially Designated Nationals" or "SDNs." Typically, SDNs are the instrumentalities and representatives that help sustain a sanctioned foreign government or adversary and commonly include the financial and commercial enterprises, front companies, leaders, agents, and middlemen of the sanctions target. In the terrorism programs, they are known as SDGTs, SDTs and FTOs; in the narcotics programs they are SDNTs for the Colombian cartels and Tier I and Tier II SDNTKs under the Kingpin Act. In the country programs, they are SDNs.

OFAC's International Programs Division and Foreign Terrorist Programs Division are the offices which research and identify these targets for designation.

Legal Authorities

International Emergency Economic Powers Act

In January 1995, the President first used his IEEPA authority to deal explicitly with the threat to U.S. foreign policy and national security posed by terrorism, declaring a national emergency with respect to terrorists who threaten to disrupt the Middle East Peace Process. This action, implemented through Executive Order 12947, expanded the use of economic sanctions as a tool of U.S. foreign policy to target groups and individuals, as well as foreign governments. During the late 1990s, IEEPA authorities were used to issue additional Executive Orders imposing sanctions on al Qaida and Usama bin Ladin and entities or individuals that are owned or controlled by, act for or on behalf of, or that provide material or financial support to al Qaida or Usama bin Ladin.

Following this model, in October 1995, the President announced the concept of using EO 12947 as a model for targeting significant foreign narcotics traffickers centered in Colombia, i.e., the Colombian drug trafficking cartels. That IEEPA program, implemented in EO 12978 with the identification by the President of four Cali Cartel drug kingpins, has expanded into a key tool in the fight against the Colombian cartels. As of today, 14 Colombian drug kingpins, 381 entities, and 561 other individuals associated with the Cali, North Valle, and North Coast drug cartels have been designated as Specially Designated Narcotics Traffickers ("SDNTs") under EO 12978.

Authorities in Response to September 11th.

The President harnessed the IEEPA powers and authorities – as well as his authority under the United Nations Participation Act – in response to the terrorist attacks of September 11. On September 23, 2001, President Bush issued Executive Order 13224, "Blocking Property and Prohibiting Transactions with Persons Who Commit, Threaten to Commit, or Support Terrorism" declaring that the grave acts of terrorism and the threats of terrorism committed by foreign terrorists posed an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States. EO 13224, as amended, authorizes the Secretaries of the Treasury and State, in consultation with the Department of Justice and the Department of

Homeland Security, to implement the President's authority to combat terrorists, terrorist organizations and terrorist support networks systemically and strategically.

This order prohibits U.S. persons from transacting or dealing with individuals and entities owned or controlled by, acting for or on behalf of, assisting or supporting, or otherwise associated with, persons listed in the Executive Order. Those designated and listed under the Executive Order are known as "Specially Designated Global Terrorists" (SDGTs). Violations of the EO with respect to SDGTs are subject to civil penalties; and if the violation is willful, persons may be criminally charged. The Executive Order also blocks "all property and interests in property of [designated persons] that are in the United States or that hereafter come within the United States, or that hereafter come within the possession or control of United States persons[.]"

To date, the U.S. has designated 375 individuals and entities as SDGTs pursuant to EO 13224. More than 270 of these entities are associated with either al Qaida or the Taliban which provides the basis to propose these names to the UN 1267 Sanctions Committee for inclusion on its consolidated list of individuals and entities the assets of which UN member states are obligated to freeze in accordance with relevant United Nations Security Resolutions (UNSCRs) including resolutions1267 and, most recently, 1526. The United States has worked diligently with the UN Security Council to adopt resolutions reflecting the goals of our domestic executive orders and obligating UN member states to freeze terrorism related assets.

Rolling FTOs into SDGTs Makes War on Terrorist Infrastructure Global

On November 2, 2001, the U.S. took an additional significant step when the Secretary of State, in consultation with the Secretary of the Treasury and the Attorney General, utilized the new authorities in EO 13224 to designate 22 Foreign Terrorist Organizations (FTOs) as Specially Designated Global Terrorists (SDGTs). This action expanded the War on Terrorism beyond al Qaida and the Taliban and associated individuals and entities to include Hamas, Hizballah, the FARC, the Real IRA and others. This action created a truly global war on terrorism and terrorist financing and demonstrated the USG's commitment to continue and expand its efforts against all terrorist groups posing a threat to the United States, its citizens, its interests, and its allies. Currently, there are 37 FTOs which are also designated as SDGTs.

Foreign Narcotics Kingpin Designation Act

Building on the successes of the Colombian narcotics traffickers program, in December 1999 Congress enacted the Foreign Narcotics Kingpin Designation Act (Kingpin Act), originally introduced by Senators Coverdell and Feinstein and modeled on IEEPA and OFAC's Columbia SDNT program. It provides a statutory framework for the imposition of sanctions against foreign drug kingpins and their organizations on a worldwide scale. Like its terrorism and narcotics Executive Order-based predecessors, the Kingpin Act is directed against individuals or entities and their support infrastructure, not against the countries in which they are imbedded. Since the first list of kingpins was issued, 48 foreign drug kingpins, 14 derivative companies, and 52 derivative individuals have been designated. These totals are in addition to the 14 Colombian Principal Individuals that have been designated as Colombian Specially Designated Narcotics Traffickers [SDNTs] pursuant to E.O. 12978.

Antiterrorism and Effective Death Penalty Act

In 1996, Congress passed the Antiterrorism and Effective Death Penalty Act ("AEDPA"). AEDPA makes it a criminal offense to: (1) engage in a financial transaction with the government of a country designated as supporting international terrorism; or (2) provide material support or resources to a designated Foreign Terrorist Organization (FTO).

Thirty-seven FTOs are currently subject to OFAC-administered sanctions. These FTOs have been designated by the Secretary of State in consultation with the Secretary of the Treasury and the Attorney General. Under the AEDPA and OFAC's implementing regulations, U.S. financial institutions must maintain control over all funds in which an FTO has an interest and report the existence of such funds to OFAC. OFAC works with State and Justice on FTO designations, and with the financial community, the FBI, State, and other Federal agencies in implementing the prohibitions of the AEDPA.

Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001

The Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 (the USA "PATRIOT Act"), passed in October 2001, amends IEEPA to provide critical means and authority to OFAC to counter terrorist financing and their support structures. The Act has enhanced OFAC's ability to implement sanctions and to coordinate with other agencies by clarifying OFAC's authorities to block assets of suspect entities prior to a formal designation in "aid of an investigation." This critical authority helps prevent the flight of assets and prevents the target from engaging in potential damaging behavior or transactions. In addition, the PATRIOT Act explicitly authorizes submission of classified information to a court, in camera and ex parte, upon a legal challenge to a designation. This new PATRIOT Act authority has greatly enhanced our ability to make and defend designations by making it absolutely clear that OFAC may use classified information in making designations without turning the material over to an entity or individual that challenges its designation.

OFAC'S Counter Narcotics Program

OFAC's Mission Against Foreign Drug Cartels

One of the primary missions of OFAC/IPD officers is to investigate, through both "all-source" research and extensive field work with U.S. law enforcement agents and Assistant U.S. Attorneys, and compile the administrative record that serves as the OFAC case to designate significant foreign narcotics traffickers and their networks of front companies and individuals pursuant to the Specially Designated Narcotics Traffickers (SDNT) program pursuant to EO 12978 and the Foreign Narcotics Kingpin Designation Act ("Kingpin Act").

Interagency Coordination

In its capacity to administer and enforce economic sanctions against foreign narcotics traffickers, both traditional drug cartel and narco-terrorist targets, OFAC's International Programs Division

(OFAC/IPD) works extensively with other U.S. agencies in the law enforcement and intelligence communities, as well as the President's Office of National Drug Control Policy. OFAC/IPD officers regularly are requested to train DEA's financial investigators on OFAC's authorities to designate and block foreign drug cartels' financial networks under EO 12978 and the Kingpin Act. In addition, OFAC/IPD officers have also provided presentations for various ICE, FBI, U.S. Attorney's offices, the Department of Justice, and the Department of Defense on OFAC narcotics and other sanctions programs and how they can work jointly with a U.S. criminal investigation. OFAC continues to expand its relationships with U.S. law enforcement, including ICE, DEA, FBI, IRS Criminal Investigation and U.S. Attorney's Offices, and with other agencies including the Department of State, Department of Defense, and Central Intelligence Agency. While some formal interagency coordination is established by executive order or legislation (the Kingpin Act), in the day-to-day execution of these programs, interagency cooperation is the result of experienced OFAC/IPD officers working closely with other U.S. criminal investigators. These working relationships have led to several successful sanctions designation actions over the past few years.

OFAC's Enforcement Division and its International Programs Division have distinct but complementary relationships with the federal law enforcement community. OFAC/IPD is focused on investigations and research leading to designations, whether worked independently or jointly with federal law enforcement agencies and task forces, U.S. Attorneys offices, or other USG agencies. In the programs that OFAC enforces against foreign narcotics trafficking cartels and drug kingpins, OFAC/IPD has been working with the Department of Justice and DEA since 1995, with a significant contingent of OFAC/IPD personnel cleared to work at DEA headquarters. Over the years those working relationships have substantially broadened, bringing OFAC to the point where OFAC/IPD officers, both in the field and at headquarters, including OFAC's Attaché Offices in Bogotá and Mexico City, regularly work with OCDETF task forces, multiple U.S. Attorneys' offices, DEA, ICE, IRS–CI and the FBI, on cases and broader operations of mutual interest. This integrated operating method not only provides OFAC/IPD with better background information and evidence for its targets, but also makes OFAC's expertise in the business and financial structuring by the cartels available as a resource to law enforcement and intelligence agencies. This appropriate close working relationship with law enforcement provides a successful conduit for the sharing of information between law enforcement agencies and OFAC/IPD.

Since September 11, 2001, OFAC has played an integral role in the terrorism-related investigations being conducted throughout the law enforcement community. To coordinate efforts and actions, OFAC has detailed a full time liaison to the FBI's Terrorist Financing Operations Section (TFOS) and a weekly liaison to the Terrorist Screening Center (TSC) and participates on their interagency enforcement teams. Information obtained through close interagency coordination has been crucial in "making the case" to designate particular targets domestically and internationally. Information developed by OFAC has also proven useful for investigations being conducted by TFOS, TSC and other U.S. law enforcement agencies.

The Kingpin Act

Pursuant to section 804(a) of the Kingpin Act, the Secretaries of Treasury, State, and Defense, the Attorney General, and the Director of Central Intelligence must consult and provide the appropriate and necessary information to enable the President to submit a report to Congress no later than June 1 each year designating additional Kingpin Tier I targets. OFAC/IPD is responsible for coordinating the interagency process for the Kingpin Act.

On May 29, 2003, President Bush announced the names of 7 foreign persons that he determined were significant foreign narcotics traffickers, or kingpins, under the Kingpin Act. These new drug kingpins included 3 foreign groups – a Colombian narco-terrorist guerrilla army (the Revolutionary Armed Forces of Colombia or "FARC"), a Colombian narco-terrorist paramilitary force (the United Self-Defense Forces or "AUC"), and a Burmese drug trafficking ethnic guerrilla army (United Wa State Army or "UWSA"). These were the first designations of narco-terrorist groups under the Kingpin Act. The FARC and the AUC had previously been named as Foreign Terrorist Organizations by the State Department and designated as Specially Designated Global Terrorists by OFAC pursuant to EO 13224.

On June 1, 2004, President Bush announced the names of 10 foreign persons that he determined were significant foreign narcotics traffickers, or kingpins, under the Kingpin Act. These new drug kingpins included 8 individuals involved in the Mexican, Jamaican, Peruvian, Indian, and Afghanistan drug trade and 2 Mexican groups – the Arellano Felix Organization and the Carrillo Fuentes Organization. This action underscored the President's determination to do everything possible to pursue drug traffickers, undermine their operations, and end the suffering that trade in illicit drugs inflicts on Americans and other people around the world, as well as preventing drug traffickers from supporting terrorists. Concurrent with the President's Kingpin designations, OFAC blocked, in furtherance of investigation, the Peruvian airline company, Aero Continente, six other companies, and six other individuals connected to the newly named Kingpin, Fernando Zevallos.

OFAC prepares and designates "Tier II" narco-terrorist leaders under the Kingpin Act. On February 19, 2004, OFAC/IPD took action against leaders and key figures of two narco-terrorist organizations in Colombia, the FARC and the AUC. Nineteen leaders of the FARC and eighteen key figures of the AUC plus three AUC front companies were added to OFAC's list of "Tier II" individuals and entities designated under the Kingpin Act. These Kingpin Tier II designations reinforce the reality that the FARC and the AUC are not simply terrorist/guerrilla organizations fighting to achieve political agendas within Colombia. They are part and parcel of the narcotics production and export threat to the United States, as well as Europe and other countries of Latin America.

Specially Designated Narcotics Traffickers

Since the inception of the Colombia program in 1995 under Executive Order 12978, OFAC/IPD officers have identified 956 businesses and individuals as Specially Designated Narcotics Traffickers ("SDNTs") consisting of fourteen leaders of Colombia's Cali, North Valle, and North Coast drug cartels.

- **North Valle Cartel links to the AUC.** In October 2002, OFAC coordinated the designation of a Colombian cartel kingpin with the FBI. A joint investigation by OFAC/IPD and the FBI Miami field office led to the SDNT action against Colombia's North Valle cartel leader, Diego Leon Montoya Sanchez and a network of front companies and individuals in Colombia in conjunction with an FBI criminal asset forfeiture action in South Florida. Diego Leon Montoya Sanchez is closely associated with the AUC, a Colombian narco-terrorist organization.

- **Continued Actions against the Cali Cartel.** Since 2002, OFAC/IPD has worked jointly with the U.S. Attorney's Office for Middle District of Florida and Operation PANAMA EXPRESS, a multi-agency drug task force based in Tampa, Florida. A two-year investigation by OFAC/IPD officers in conjunction with the PANAMA EXPRESS task force led to the March 2003 SDNT action against two new Cali Cartel leaders, Joaquin Mario Valencia Trujillo and Guillermo Valencia Trujillo, and their financial network of 56 front companies and individuals. Joaquin Mario Valencia Trujillo is indicted in the Middle District of Florida and was recently extradited to the U.S. from Colombia.

  In 2003, OFAC/IPD investigations focused on Cali cartel leaders, Miguel and Gilberto Rodriguez Orejuela. In February 2003, OFAC/IPD designated 137 companies and individuals comprising a complex financial network in Colombia and Spain controlled by Miguel and Gilberto Rodriguez Orejuela. This action exposed and isolated a parallel network of Cali cartel front companies established to evade OFAC sanctions. In March 2003, OFAC/IPD officers targeted a Colombian money exchange business and a prominent Colombian stock brokerage firm, which facilitated the Cali cartel network's financial transactions. In October 2003, OFAC/IPD designated 134 new front companies and individuals including a network of pharmaceutical companies extending from Colombia to Costa Rica, Ecuador, Panama, Peru, and Venezuela, with ties to financial companies in the Bahamas, the British Virgin Islands and Spain. These SDNT actions were the result of a three-year investigation by OFAC/IPD officers and the OFAC Attaché – Bogota.

These actions under the SDNT and Kingpin Act programs reflect the increasing cooperation, coordination and integration among the U.S. counter-narcotics agencies in the battle against international narcotics trafficking and narco-terrorism. On March 3, 2004, the U.S. Attorney for the Southern District of New York issued a joint statement with the DEA New York field office and the OFAC Director announcing the indictment of two of Colombia's most important drug kingpins, Gilberto Rodriguez Orejuela and Miguel Angel Rodriguez Orejuela, leaders of the notorious Cali Cartel, under Operation DYNASTY, a joint investigation involving the U.S. Attorney's Office for the Southern District of New York, DEA, OFAC, and Colombian authorities. Both Cali cartel leaders were designated under EO 12978 as Colombian cartel leaders in October 1995. The indictment charges the Rodriguez Orejuela brothers with money laundering conspiracy based largely upon the predicate offense of violating the IEEPA as a result of the drug kingpins' efforts to defeat OFAC's designations of many of their companies as SDNTs.

OFAC's Counter-Terrorism Program

Foundations of Terrorist Financing and Support

The threat of terrorist support networks and financing is real, and it has been OFAC's mission to help identify and disrupt those networks.

There is much we know about how radical terrorist networks were established and still thrive. OFAC's research has disclosed the overall framework of the support structures that underpin the most prominent Islamic extremist movements throughout the world. "Deep pocket" donors in the Middle East provide money either to terrorist groups directly, or indirectly through trusted intermediaries and non-governmental organizations (NGOs), including charities. These NGOs can, in turn, use the money to provide funding and logistical services directly to terrorist groups, including transportation, cover employment, and travel documentation. They also provide support indirectly by using the funds for public works projects -- wells, social centers, and clinics -- to reach disaffected populations susceptible to radicalizing influences. These projects also often include extremist religious schools, which serve as fertile recruiting grounds for new members of terrorist groups.

The terrorist networks are well-entrenched and self-sustaining, though vulnerable to U.S., allied and international efforts. Looking forward, please allow me to explain how we have arrived at this view and present the strategy, being implemented in coordination with other components of the Treasury Department and other Federal agencies including the Departments of Defense, State, Justice, Homeland Security, the FBI, IRS Criminal Investigation, the intelligence community and other agencies, to choke off the key nodes in the transnational terrorist support infrastructure.

Research and Evidentiary Preparation

The primary mission of officers within OFAC's Foreign Terrorist Programs Division is to compile the administrative record or "evidentiary" material that serves as the factual basis underlying a decision by OFAC to designate a specific person pursuant to EO 13224 or other counter-terrorism sanctions authorities that triggers a blocking of assets and a prohibition on US persons from dealing with the designated party. OFAC officers conduct "all-source" research that exploits a variety of classified and unclassified information sources in order to determine how the activities or relationships of a specific target meet the criteria of the EO. As the implementing and administrating agency for EO 13224 and other related programs, OFAC coordinates and works with other US agencies to identify, investigate and develop potential targets for designation or other appropriate USG actions. Officers use their considerable expertise to evaluate available information in the critical process of constructing a legally sufficient evidentiary record.

More broadly, OFAC officers compile research on multiple targets to build a comprehensive schematic of the structure of particular terrorist network. They then employ a "key nodes" methodology to identify these high value targets within them that serve critical functions. OFAC

believes that by eliminating these key nodes or high value targets the network would be disabled because without them the network would not receive sustaining services such as recruitment; training; logistical, material, financial, or technological support; and leadership. OFAC selects specific targets to recommend for designation based on the potential to cripple or otherwise dramatically impair the operations of the overall network by economically isolating these nodes. Economic sanctions are most effective against key nodes such as donors; financiers (fundraisers, financial institutions, and other commercial enterprises); leaders; charities; and facilitators such as logisticians. OFAC already has targeted key nodes in terrorist networks in several areas of the world including groups in Southeast Asia and various parts of Africa. OFAC is currently engaged in new research on groups in the Middle East, including Iraq, and the Caucasus.

A completed OFAC evidentiary record on a particular target is submitted first for legal review, then to the Executive Office of Terrorist Finance and Financial Crimes, where OFAC officers work with that office to prepare the package for the Policy Coordinating Committee (PCC). The PCC determines whether the USG should designate a particular entity or should pursue alternative legal or diplomatic strategies in order to achieve U.S. interests. As part of the PCC process, OFAC's designation proposal will usually be vetted by the consultative parties specified by the EO.

In addition to the evidentiary package, OFAC and other Treasury officers work with the interagency community to draft an unclassified Statement of the Case (SOC) which serves as the factual basis for the public announcement of a designation. The State Department uses it to pre-consult with countries which are directly impacted by a proposed US action and to urge them to designate at the same time as the USG. Upon a USG determination to designate, the SOC is used to notify host countries and the UN of an impending US action. It is also used to propose the inclusion of the target on the consolidated list of the UN 1267 Sanctions Committee of those individuals or entities associated with al Qaida or the Taliban.

UN and Bilaterally Proposed Designations

Whenever an individual or entity is proposed for inclusion on the UN 1267 consolidated list by another country through the UN or is proposed to the USG bilaterally, OFAC, and when appropriate the Department of State, is responsible for preparing the administrative record. In order to designate a target proposed to the UN by a Member State or by another government bilaterally to the USG, OFAC (or when appropriate State) must develop an administrative record that would support a domestic designation under E.O. 13224 as described above. Quite often, due to a difference in legal authorities and the type of or lack of information provided by a proposing country, this process may require several discussions with the initiating party and often requires further coordination through the UN and with other countries in order to obtain sufficient information to meet domestic legal criteria.

Other Counter-terrorism Activities

OFAC's role in the counter-terrorism arena is not limited to preparing designations, although this often serves as a key component of its other activities. The transnational nature of terrorism support networks requires engagement with allies and routine information sharing. OFAC's

direct engagement with allies on terrorism support infrastructure began with officials from Saudi Arabia, Kuwait and the UAE in June 1999. Information and understandings developed from this and other OFAC trips to the region significantly contributed to formulating some of the strategies employed today.

Direct Treasury and OFAC engagement with foreign allies' counterparts provides an opportunity for OFAC to gather information, apply pressure, request support, or offer assistance. In some cases, Treasury may seek joint action with an ally in an effort to disrupt or dismantle an organization. In other instances, OFAC may use the threat of designation to gain cooperation, forcing key nodes of financial support to choose between public exposure of their support for terrorist activity or their good reputation.

Of course, OFAC also collaborates extensively with other elements within the Treasury Department. In particular, I want to mention our excellent relationship with IRS Criminal Investigation. This relationship has been especially important and productive in carrying out the Treasury Department's authority under Executive Order 13315, which blocks the assets of Saddam Hussein and other senior officials of the former Iraqi regime. For many months now, OFAC has been coordinating almost daily with Washington-based IRS-CI agents to guide the efforts of IRS-CI agents on the ground in Iraq to identify the ill-gotten assets of Saddam and his cronies. OFAC's partnership with IRS-CI on this issue has developed important investigational leads that would have been impossible if our organizations had not been so closely synchronized.

Significant OFAC Designations Pursuant to EO 13224

The result of OFAC's research and coordination efforts over the past three years has been several significant designations of charities, terrorist financiers, and financial support networks.

OFAC Actions against Terrorist-Supporting Charities:

- **Holy Land Foundation (HLF).** OFAC/IPD worked closely with the FBI prior to 9/11 to designate this charity located in Richardson, Texas. HLF was a financial supporter of HAMAS, a terrorist group originally designated in January 1995 pursuant to Executive Order 12947. The FBI Dallas field office specifically sought OFAC's involvement in its investigation and an OFAC/IPD officer became part of the North Dallas Terrorism Task Force. As a result of this close coordination, on December 4, 2001, OFAC designated the Holy Land Foundation pursuant to EO 13224 and EO 12947. This designation was upheld in U.S. Federal district court, affirmed on appeal, and on March 1, 2004, the Supreme Court denied HLF's petition for certiorari in HLF's challenge to its designation. Additionally, Section 501(p) of the Internal Revenue Code was enacted as part of the Military Family Tax Relief Act of 2003 (P.L. 108-121), effective November 11, 2003. Section 501(p)(1) suspends the exemption from tax under section 501(a) of certain organizations, including those designated as a terrorist organization or foreign terrorist organization. Section 501(p), as a result, suspended HLF's tax exempt status (effective on the date of enactment of this section or the designation, which ever is later in time). This suspension continues until all designations and identifications of the organization are rescinded under the law or Executive Order under which such designation or identification was made.

- **Benevolence International Foundation (BIF) & Global Relief Foundation (GRF) Blocking in Aid of Investigation.** On December 14, 2001, the Treasury blocked pending investigation (BPI) the property of both BIF and GRF, two Islamic charities in Chicago, Illinois and the first such action under EO 13224. After the December 2001 BPI action, OFAC continued to work with other components of the Treasury and the FBI, SFOR in the Balkans, the Department of Justice, and the intelligence community to obtain additional information which led to the designation of GRF on October 17, 2002 and BIF on November 18, 2002 pursuant to EO 13224. On February 25, 2003 the civil lawsuit filed by BIF against the U.S. was voluntarily dismissed with prejudice and without costs. On November 12, 2003, the Supreme Court denied certiorari in GRF's appeal of the denial of its motion for preliminary injunction. As a result of the OFAC designation, IRS suspended the tax-exempt status of both BIF and GRF.

- **Al Haramain Foundation.** Treasury has worked closely with other U.S. Government agencies and Government of Saudi Arabia in order to coordinate the bilateral designation of six branches of this prominent Saudi charitable organization. The Bosnian and Somali branches were designated on March 11, 2002, the Pakistani, Indonesian, Kenyan, and Tanzanian branches were designated on January 22, 2004 and, most recently, the Albanian, Afghani, Bangladeshi, Ethiopian and Netherlands branches, as well as Al Haramain's former leader Aqeel Abdulazia Al-Aqil, were designated on June 2, 2004.

OFAC Actions against Terrorist Financial Networks:

- **Al-Barakaat network.** OFAC identified the Al-Barakaat Network as a major financial network providing material, financial, and logistical support to Usama Bin Laden, al Qaida, and other terrorist groups. On November 7, 2001, the President announced the designation of the Al-Barakaat Network pursuant to EO 13224. This action was taken in coordination with the predecessor to the Department of Homeland Security's ICE, the then Treasury Department's US Custom's Office of Investigation, which executed simultaneous search warrants at the time of designation. As a result of that action, Barakaat's cash flow was severely disrupted and the Emiratis closed down Barakaat's offices in their territory, froze its accounts, and placed several individuals under an informal house arrest. Since the designation, six Barakat-related individuals and entities were removed from the list upon demonstrating and ensursing that they were no longer engaging in the activities for which they were originally designated.

- **Nada-Nasreddin / al Taqwa network.** OFAC coordinated with U.S. law enforcement and intelligence community, and worked closely with its foreign partners in the Caribbean and Europe to target al Qaida supporters, Yousef Nada and Ahmed Idris Nasreddin. OFAC designated them and related companies in November 2001 and August 2002 pursuant to EO 13224, significantly disrupting another network.

- **Wa'el Hamza Julaidan.** OFAC identified Julaidan as a senior figure in the Saudi charitable community, who provided financial and other support, to several terrorist groups affiliated with al Qaida operating primarily in the Balkans. OFAC worked with other U.S.

Government agencies and the Government of Saudi Arabia to coordinate a bilateral designation of Julaidan on September 6, 2002.

OFAC's Key Node Strategy

Over the past year and a half, OFAC has sought to take a more systematic approach to evaluating the activities of major terrorist organizations in various regions. This approach has focused on identifying "key nodes" discussed above, which when targeted and economically isolated can cripple a terrorist network's ability to function.

To implement this approach, OFAC staff has established collaborative relationships with several Department of Defense agencies and combatant commands in order to gain wider access to information critical to developing evidentiary records in support of designations. Working with DOD Commands and other DOD agencies provides OFAC and its DOD partners a force multiplier that brings together a variety of counterterrorism tools and resources. This will be an important model of inter-agency coordination as well as strategic vision for the Treasury Department as a whole, as we move toward greater integration and amplification of our intelligence and analysis functions in the Office of Intelligence and Analysis.

- **Jemmah Islamiyah (JI) / Southeast Asia.** In October 2002, OFAC began a joint project with the U.S. Pacific Command (USPACOM) and other DOD elements that identified terrorist support networks in Southeast Asia and selected key nodes, or priority targets, in these networks. The project's geographic scope included Indonesia, the Philippines, Malaysia and Singapore, and eight terrorist or Islamic extremist groups. The project focused special attention on the al Qaida-affiliated JI, the Abu Sayyaf Group (ASG), and the Moro Islamic Liberation Front (MILF), because of their relative importance in the region and threat to U.S. interests. The project identified the key leaders, fundraisers, businessmen, recruiters, companies, charities, mosques, and schools that were part of the JI support network. OFAC has sought to expand on this model through collaboration with other DOD agencies including the combatant commands. These efforts have included:

- **The Horn of Africa.** OFAC analysts have worked with DOD agencies, including analysts from the Office of Naval Intelligence (ONI), to fully identify the terrorism support infrastructure in the Horn of Africa. In this region, shipping and related drug smuggling activities appear to be strengthening the terrorism infrastructure. In coordination with our interagency partners, we were able to identify some of the key leaders, charities, and businesses that appear to be critical to the overall functioning of the network. In January 2003, the U.S. took joint action with the Government of Saudi Arabia against two of these key targets--the Kenya and Tanzania offices of the Saudi-based Al-Haramain Islamic Foundation.

- **North Africa.** In August 2003, I visited the U.S. European Command headquarters (USEUCOM) and met with the Chief of Staff, to begin a joint project including USEUCOM, OFAC officers, and other DOD elements to identify terrorist support networks in the North Africa region and key nodes within this network. The geographic scope of this project includes Morocco, Algeria, Tunisia, Libya, Mauritania, and Mali, and nine terrorist

or Islamic extremist groups and their support networks. At the inception of this project, the Director of USEUCOM's Intelligence Directorate indicated that this region posed the most serious threat in USEUCOM's area of responsibility and asked OFAC to devote available resources to the project. The recent Madrid bombings and the suspicion that North African terrorists may have been involved illustrates the reality of the threat these groups pose not only to the stability of the region but the interests of the U.S. and our allies.

- **Caucasus.** In January 2004, the USEUCOM Chief of Staff visited OFAC and was briefed on an OFAC initiative to identify terrorist groups and their support networks in another region of USEUCOM's area of responsibility. The Chief of Staff invited an OFAC analyst to USEUCOM's Joint Analysis Center in Molesworth, England, to work with a regional analyst there to further develop information on terrorist activity in the region. The outcome of the week-long visit was that it confirmed our preliminary analytical conclusions of terrorist activity and support. We are now in discussion with a DOD element, USEUCOM, and a U.S. Government agency to pursue a collaborative effort to refine our understanding and determine if the initiative justifies the commitment of limited resources for the ultimate exercise of OFAC sanctions or other appropriate U.S. Government authorities against priority targets we may identify.

- **Additional Initiatives.** In March of this year, OFAC was invited to brief the Headquarters North American Aerospace Defense Command (NORAD) and U.S. North Command (USNORTHCOM) Interagency Coordination Group (JIACG) on the subject of OFAC authorities under Executive Order 13224 and OFAC efforts against terrorism. In addition, the U.S. Southern Command (USSOUTHCOM) has also contacted my office and expressed an interest in an OFAC analyst detailed to the USSOUTHCOM JIACG. OFAC continues to explore collaborative opportunities with both of these commands.

These efforts have been so successful that, in December 2003, the Office of the Secretary of Defense requested the detail of six OFAC employees to the headquarters of six DOD combatant commands. As a result, we hope to detail OFAC analysts with the U.S. Central Command (USCENTCOM) and U.S. Special Operations Command (SOCOM) in the near future.

OFAC Attaché Offices and Foreign Counterparts

OFAC's ability to successfully pursue counter-narcotics and counter-terrorism missions has been greatly enhanced by assigning OFAC officers to attaché and liaison positions abroad with several US embassies and military commands

- **OFAC Bogotá office** coordinates OFAC sanctions programs in Colombia and conducts research on Colombian drug cartels and narco-terrorists. The OFAC Attaché and Assistant Attaché in Bogota serve as the liaison with U.S. Embassy elements and Colombian government agencies and have established solid relationships with the Colombian banking and private sectors. OFAC/IPD officers travel regularly to Colombia and have extensive knowledge of Colombian drug cartel finances.

- **OFAC Mexico City office** coordinates OFAC sanctions programs in Mexico. The OFAC Attaché in Mexico serves as the liaison with U.S. Embassy elements and Mexican government agencies.

In addition, OFAC's Attachés have established good working relationships with foreign counterparts in Colombia and Mexico which has supported U.S. interests in choking off drug cartel and narco-terrorist finances through both joint investigations and actions. For example, Colombian companies designated by OFAC/IPD to the SDNT list are many times the targets of subsequent Colombian criminal asset forfeiture investigations.

- **OFAC's Liaison Officer at the US European Command** (USEUCOM) serves as OFAC's representative to the USEUCOM Joint Interagency Coordination Group, as well as to targeting groups established by USEUCOM. The liaison also coordinates joint projects underway between USEUCOM and OFAC elements and travels regionally to provide support to other OFAC programs, including the effort to block the assets of Persons Indicted for War Crimes in the former Yugoslavia.

- **OFAC's Manama office** is nearing completion of its physical construction and is slated to have an attaché assigned to it this summer. The attaché Bahrain will be responsible for establishing relations with local government bodies engaged in counter-terrorism efforts and of investigating a variety of terrorist support issues throughout the Arabian Gulf.

V. OFAC's Vision for the Future

In order to meet the increasing demands placed on OFAC as it fulfills its multiple missions against governmental and organizational targets, particularly its recent critical role in countering international terrorism and narcotics trafficking, OFAC is addressing specific challenges facing its component divisions described above.

Civil Penalties

- The Civil Penalties Division is expanding the transparency of OFAC's civil penalty enforcement by developing an automated system to report enforcement actions. The Division also seeks to meet the fiscal controls required by the Department and is designing computerized interfacing with the financial offices of the Department. On the enforcement front, the Division is concentrating its resources on major cases across OFAC's sanctions programs in order to have the greatest enforcement impact.

Compliance Division

- OFAC Compliance is in the process of building new customer interaction capabilities, with a state-of-the-art automated telephone system, enhanced hotline capabilities, and improved web forms to allow the public to transmit detailed live transaction data for our real time analysis and response. We expect that the new automated reporting systems we are developing will allow financial institutions and others to provide OFAC more quickly with comprehensive information on interdicted transactions.

- Compliance is building a new Specially Designated Nationals database that will allow enterprise-wide access to declassified target information and permit analysts to directly link from a name on the SDN list to the underlying declassified evidentiary material for easy access.

- Compliance intends, in the near future, to make a new DataMart feature available on the OFAC website that will allow users of OFAC's Specially Designated Nationals list to more easily "shop" for information that is tailored to their specific compliance needs.

Licensing Division

- OFAC's Licensing Division plans to further increase the efficiency with which license applications and requests for interpretive rulings are processed, with a goal of no longer than a two-week turnaround for submissions, which do not require review and clearance outside the Division.

- Licensing intends to develop enhanced capabilities for scanning and e-mail connectivity to facilitate review and clearance of licensing submissions requiring interagency consultation, with the ultimate goal of developing a web-based system with interagency access to avoid the need to transmit material altogether.

- The Division also plans to develop and publish on OFAC's website "treatises" on the various categories of commercial and financial transactions subject to OFAC's jurisdiction. These treatises will discuss OFAC's licensing practices with regard to the application of OFAC's regulations to those transactions. Redacted versions of the Division's interpretive rulings will be appended to the relevant treatise, providing comprehensive guidance and promoting consistency and transparency with respect to subjects ranging from trade issues and financial instruments and services to ownership and control and acquisition and divestiture.

- Licensing will continue supporting OFAC's regulatory implementation function by participating in the preparation of draft regulations and promoting their timely clearance and publication.

Enforcement Division

- Enforcement will build on and improve upon OFAC's existing relationships with federal law enforcement agencies, principally the FBI, ICE, Customs and Border Protection, Commerce Office of Export Enforcement and Offices of the United States Attorney, to enhance the criminal enforcement of OFAC sanctions programs.

International Programs (Counter-Narcotics) Division

- OFAC's continuing counter-narcotics designation program objectives are to identify, expose, isolate, and incapacitate the business and financial infrastructures and penetrations into the legitimate economy of foreign narcotics kingpins and drug cartels, as well as their agents

and functionaries. OFAC will continue to develop its working relationships with federal law enforcement agencies, U.S. Attorneys' offices, intelligence community elements, military commands, and select foreign enforcement and counter-narcotics units on a global basis.

- OFAC will continue to develop operational relationships in the field and at headquarters with Federal law enforcement agencies, U.S. Attorneys' offices, Intelligence Community elements, and military commands. This includes more personnel to work with OCDETFs and other operational task forces and more training of the other government components in OFAC narcotics designation programs.

- OFAC also plans to increase its participation in narcotics fusion and targeting centers and related interagency programs.

Foreign Terrorism Programs Division

- OFAC plans to continue to expand its efforts to impede the activities of terrorist organizations utilizing the key nodes methodology. This will be done in concert with the new Office of Intelligence Analysis (OIA), as the Treasury Department works to integrate its analytical work product with all components of Treasury and the intelligence community. The new OIA will work with OFAC to monitor all relevant intelligence which can be used to further OFAC's mission. OFAC, using this information as well as other sources and its own research, will continue to develop the structure of terrorist groups and their support networks and to identify and isolate key nodes within them that serve critical functions, building upon and continuing the work with the military commands.

- OFAC will seek to detail OFAC officers to six DOD combatant commands for periods of two years to exploit the unique DOD resources and abilities to identify terrorists, terrorist groups, and their support networks, including DOD analytic resources, data collection, and most importantly local knowledge.

IT Challenges

Improving OFAC's Information Technology capabilities remains one of the greatest challenges to enhancing OFAC's ability to pursue its mission. OFAC could enhance current analytical capabilities by utilizing more advanced and available information technologies and advanced communications capabilities. Communication and cooperation with participating unified military combatant commanders and civil agencies has shown great promise in sharing information resources to identify terrorist targets, non-state enemies that function within worldwide terrorist networks demands closer coordination by U.S. government agencies and military in the diplomatic, economic, intelligence, and law enforcement domains. To enhance its capabilities, OFAC is pursuing the following communication systems and technologies that would enable the coordination and integration that is critical for agencies, military forces, and coalition nations to effectively fight in this new war:

- **Database Application.** OFAC could improve its ability to share and store information with the development of an internal database application. This application would reside on the

"classified" networks and allow OFAC analysts to store and analyze information. This information could be shared, as appropriate, through classified communication networks and provide participating partners (Intelligence Community, Military Commands, and Law Enforcement Agencies) with substantive targeting information.

- **Enhanced electronic communication.** This includes the establishment of a multi-media infrastructure using the Defense Messaging System cable communications servers, web servers, secure email, and data servers using Public Key Infrastructure (PKI) and FORTEZZA national security information assurance for both the Joint Worldwide Intelligence Communication System (JWICS) and the Secret IP Router Network (SIPRNET) enclaves. Establishing connectivity to the DOD interoperability of secure voice and data during periods of heightened protection requiring rapid analytical reporting between military and civil agencies.

- **Establishment of a robust e-mail system and database infrastructure.** OFAC will establish a robust e-mail system and database infrastructure for the exchange of Sensitive But Unclassified (SBU) information with the U.S. and international partner law enforcement community. This infrastructure would take advantage of emerging technologies with respect to repudiation with digital signature, authentication, and PKI information assurance protections. The access of law enforcement databases (NLETS, TECS, etc) for the cross-analytical work required between intelligence and law enforcement sensitive data. This enhanced communications capability will allow OFAC to exploit "open to government" information sources.

- **Developing Secure Video Teleconferencing (SVTC) capabilities.** OFAC is in the process of developing and enhancing its SVTC capbilities on both the JWICS for intelligence and SIPRNet for sanitized information of a law enforcement nature. Completion of construction on OFAC's Secure Video Teleconferencing facility will allow officers in Washington to communicate and work more effectively on joint projects involving civil agencies and U.S. military and coalition forces. Ensuring the collaborative strategic planning of a host of entities in the conduct of counter-terrorism and counter-narcotic missions.

- **Better Communication Utilizing SIPRNET and ADNET Enclaves.** Both the International Programs Division (counter-narcotics) and the Foreign Terrorist Programs Division (counter-terrorism) will seek to improve their electronic communication with the law enforcement community by utilizing systems as SIPRNET and the Anti Drug Network (ADNET).

Increased OFAC Cooperation with Foreign Counterparts

- OFAC's trips to target areas and its discussions with its counterparts in other countries have afforded OFAC the opportunity to work with these partners and provide guidance on the sanction strategies it currently employs. In all these, and future efforts, Treasury, working in coordination with other U.S. government agencies including the State Department, will take advantage of OFAC contacts and work abroad to increase cooperative efforts and expand its

interaction with other government counterparts in order to deal with common threats against the United States and our allies.

Madame Chairman, I would like to thank you and the Committee for the opportunity to speak on these issues. This concludes my remarks today. I will be happy to answer your questions.

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STATEMENT OF DENNIS S. SCHINDEL

ACTING INSPECTOR GENERAL

DEPARTMENT OF THE TREASURY

BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

JUNE 16, 2004

Madam Chairwoman Kelly, Ranking Member Gutierrez, and Members of the Subcommittee, thank you for the opportunity to testify in this hearing on "Oversight of the Department of the Treasury." In your letter of June 4, 2004, you asked that I specifically address the following areas: (1) the results of our study of Bank Secrecy Act (BSA) compliance efforts by the Office of Thrift Supervision (OTS), Office of the Comptroller of the Currency (OCC), the Internal Revenue Service (IRS), and other regulators; (2) my opinions regarding OCC and OTS oversight of private banking practices and trust accounts in the area of BSA compliance; (3) whether the Financial Crimes Enforcement Network (FinCEN) database is in a form that permits efficient use by other agencies; and (4) any concerns I may have from our study of the Office of Foreign Assets Control (OFAC) foreign sanctions program.

My testimony will cover each of those areas. First, I would like to provide some background about my office. We provide independent audit and investigative oversight of the Department of the Treasury which includes numerous Departmental offices and activities as well as the 8 non-IRS bureaus. Our oversight includes Treasury's financial institution regulators—OCC and OTS, as well as FinCEN and OFAC. The Treasury Inspector General for Tax Administration (TIGTA) provides audit and investigative oversight of the IRS, another bureau with significant BSA regulatory responsibilities.

I consider our oversight of Treasury's role in combating terrorist financing, money laundering, and other financial crimes to be among our highest priority work. In fact, we designated this area as one of Treasury's 6 most significant management challenges. Accordingly, we have conducted a number of audits over the past several years as our limited resources have allowed. We started conducting audits in this area well before September 11, 2001. A list of these audits is provided as an appendix to my statement. We also currently have several audits in process. While it is evident from our work that Treasury takes its responsibilities very seriously, in almost every area we have audited we have identified problems significant enough to impact Treasury's ability to effectively carry out its role in combating terrorist financing and money laundering. This role is not only important for fighting crime and preserving the integrity of our financial institutions, but in the wake of September 11th, it has become increasingly vital to help preserve our national security.

Having said that, I must add that we have not been able to comprehensively audit all the important pieces that comprise Treasury's responsibilities in this area, nor have we been able to provide timely follow up to ensure previously identified problems were corrected. Moreover, our ability to oversee this important area going forward will be even more limited as a result of the divestiture of 70 percent of our resources to the Department of Homeland Security. We are now a small office of less than 100 and while we consider this area to be high priority, we have a number of statutorily mandated audits and many other high priority Treasury programs and operations to cover.

BSA Compliance Efforts at OTS, OCC, IRS, and Other Regulators

In discussing the results of our audit work in this area I want to reiterate that we do not have audit oversight or investigative authority over the IRS. Oversight of the IRS is the responsibility of TIGTA. We also do not have oversight of the other regulators such as the Federal Reserve or the Federal Deposit Insurance Corporation (FDIC). However, we have discussed our work with TIGTA and the other regulators' Offices of Inspector

General (OIG) and, in fact, a recent BSA audit that FDIC's OIG performed was patterned after the work that we had done at OTS.

In one of our earlier audits (January 2000), we reported that OCC needed to improve its BSA compliance exams. At that time, we found that many of the BSA compliance exams in our sample lacked sufficient depth to adequately assess a bank's compliance. Specifically, in 38 of the 82 examinations we reviewed, OCC examiners did not perform a complete BSA compliance exam – that was more than 45 percent of the exams we sampled. Of the exceptions, we found that: (1) for 17 examinations, OCC examiners failed to review one or more available bank-generated reports useful in identifying suspicious activity, such as the incoming and outgoing wire transfer logs; (2) for 10 examinations, OCC either did not follow-up on indicators of suspicious activities, perform sufficient review of high-risk accounts, adequately follow-up on prior examination exceptions, or take action when prior exceptions continued to exist; and (3) for the other 11 incomplete examinations, the weaknesses ranged from not verifying a banks' hiring process to not citing a bank for an incomplete BSA policy. In addition to incomplete examinations, we found that, for 44 of the 82 examinations – more than 50 percent of the exams we sampled – examiner workpaper documentation was insufficient to determine the extent or the adequacy of the BSA examination. We attributed the incomplete examinations to two major factors. First, OCC examiners relied on bank management and/or the bank's internal audit function instead of performing their own reviews. Second, OCC seemed to emphasize timely completion of examinations, at the expense of more complete examinations.

We made two other important observations in that report:

- OCC rarely referred BSA violations found by its examinations to FinCEN to assess monetary penalties. Over an 11-year period through 1998, OCC had referred only 53 BSA cases to FinCEN, or an average of less than 5 cases a year. No BSA violations were referred to FinCEN in 1997. We have some

additional observations on referrals to FinCEN that we will be discussing later in this testimony.

- OCC procedures for BSA examinations at community banks did not require examiners to review suspicious activity reports (SAR) filed by the bank. For large banks, a review of filed SARs was only required in certain circumstances. Filling this gap in BSA examination procedures would serve to strengthen OCC's BSA compliance program. An analysis of SAR information would enable OCC examiners to determine (1) whether the bank was filing SARs, (2) whether the bank filed SARs timely, and (3) whether the volume of SARs filed by the bank seemed low given the characteristics of the bank.

In response to our findings, OCC committed to communicating the results of our audit to its examiners, issuing additional guidance, and monitoring compliance with BSA examination procedures through periodic quality assurance reviews. However, OCC did not fully commit to reviewing SAR filings as a standard BSA examination procedure. Instead, it planned to adopt new procedures that would place "greater emphasis on SAR reporting." We have not followed up on this work. It should also be noted that the scope of this audit did not include a review of the adequacy of OCC enforcement actions for BSA violations.

We did, however, recently (September 2003) look at OTS' enforcement actions for BSA violations. The overall results of that audit showed that OTS was not aggressive in taking enforcement actions when thrifts were found to be in substantial non-compliance with BSA requirements. Specifically, while OTS examiners identified substantive BSA violations at 180 of the 986 thrifts examined during the audited period, OTS issued written enforcement actions against only 11.

In our review, we sampled 68 of the remaining 169 thrifts with substantive BSA violations where written enforcement actions were not taken by OTS. We found that for those thrifts, OTS primarily exercised moral suasion and relied on thrift management

assurances to comply with the BSA. This approach failed for 21, or more than 30 percent of the thrifts sampled. That is, the 21 institutions did not correct the violations, which in some cases went back more than 5 years. In some instances, subsequent examinations found that BSA compliance actually worsened from the time the violations were first identified. OTS should have clearly taken more forceful and timely enforcement actions against these thrifts.

Our audit also reviewed, in detail, 9 of the 11 cases where OTS did issue written enforcement actions. In 5 cases, we found that OTS either did not take timely enforcement actions or did not address all the substantive violations it identified. Moreover, for 2 of these 5 cases, the enforcement actions taken by OTS were not effective in correcting the violations identified.

In its response to our report, OTS, among other things, agreed to issue additional guidance to its examiners. We have not followed up on this work. It should be noted that OTS also stated in its response that our report demonstrated that the thrift industry and OTS supervision on the whole had achieved a record of sound BSA compliance. Our audit reached no such conclusion.

BSA Compliance Oversight of Private Banking Practices and Trust Accounts

With regard to oversight of BSA compliance over private banking and trust account services offered by national banks, we completed an audit of OCC's BSA examination program relative to these services in November 2001 (the work was performed prior to 9/11). Overall, in that audit we found that OCC needed to focus greater attention on its BSA compliance exams in the high risk areas of private banking and trust account services.

Among other things, OCC's BSA compliance exams at national banks did not always include the banks' private banking and trust account services. In a sample of 20 BSA compliance exams performed at banks offering private banking services, we found that

12 – 60 percent of the exams in our sample – did not cover the banks' private banking services. Similarly, in a sample of 34 BSA compliance exams at banks with trust account services, we found that 6 – 18 percent of the exams in our sample – did not show evidence of BSA compliance examination coverage. While trust account services may pose a lower risk than private banking services for possible terrorist financing and/or money laundering, these 6 banks alone had trust assets exceeding $67 billion.

We also found that in 28 BSA compliance exams sampled where there was evidence that OCC examiners reviewed BSA compliance over private banking or trust account services as part of their exam, 9 – or more than 30 percent of the exams sampled – did not fully comply with OCC's own BSA examination guidelines. We identified examinations where either the wrong examination handbook was used or examiners did not perform mandatory examination procedures.

That audit also found that BSA compliance exams lacked sufficient testing of high-risk transactions commonly associated with money laundering or lacked review and evaluation of critical BSA reports that banks are required to file. Specifically, examiners tested wire transfers in only half the examinations, and even fewer examinations included testing of transactions with foreign correspondent banks, currency transaction reports, or SARs. Transaction testing in high-risk areas is necessary to reliably assess BSA program compliance and to provide some assurance that bank-wide internal controls are working as intended.

In our report, we recommended that OCC (1) require coverage of private banking and trust account services in all BSA compliance exams, (2) ensure examiners complete all mandatory examination procedures, and (3) ensure examiners perform testing in all high risk areas. OCC responded that it would take steps to address these recommendations. We have not followed up on this work.

FinCEN's Database

With regard to FinCEN's database, we have completed two audits on the accuracy of FinCEN's BSA database for SARs, and we have a follow-up audit in progress. Overall, we have consistently found that the SAR database lacked critical information or included inaccurate data. SAR data is considered critical to law enforcement agencies (LEA) in identifying money laundering and other financial crimes. The events of September 11th only increase the importance of SARs for use in tracing financial crimes and transactions used to finance terrorist activities.

FinCEN established the SAR database in 1996 as a single collection point for all SARs to provide LEAs with critical information to enable comprehensive analyses of trends and patterns in financial crime activity. FinCEN operates and maintains the SAR database through IRS' Detroit Computer Center (DCC). Financial institutions and other required SAR filers can file SARs via paper or electronically.

In December 2002, we reported that regulatory and LEA officials (Federal Bureau of Investigation, United States Secret Service, and IRS) we interviewed believed the SAR database was very useful in identifying suspected bank-insider abuse and BSA violations. However, they indicated that the usefulness of the SAR database would be enhanced if it included more complete and accurate SAR data. At that time, we found that the SAR database sometimes lacked critical information or included inaccurate data because SAR filers disregarded SAR form instructions, did not always understand the violations listed on the SAR form, or were concerned with personal liability. Some illustrative examples follow:

- One LEA provided 6-month statistics documenting about 2,400 SARs involving $178 million in losses where the suspected violation was not indicated. SAR filers often filed under "other" instead of a specific violation even when the filer was reporting a known violation, such as money laundering.

- One LEA's database of downloaded SARs included 500 that did not identify the regulator. SAR filers did not always indicate their regulator on the SAR.

- A critical field on the SAR form is the filer's narrative description of the suspicious activity; some SARs did not include this narrative. Instead the filer included a "see attached" – the attachment was not captured in the database.

- SARs did not always accurately indicate the location where the suspicious activity occurred. Instead, the SAR database included the office location from where the SAR was filed rather than the branch or office where the reported violation occurred.

- At the time, there were also about 3,300 duplicate SARs in the database.

We also reported that IRS DCC contractor personnel sometimes made keypunch errors and omissions while inputting data from paper SARs. These errors and omissions were not always corrected.[1]

Although FinCEN personnel told us during the audit that they believed progress had been made in improving SAR accuracy, officials from both FinCEN and IRS DCC agreed there was still an on-going problem with SARs having missing and incomplete data and were working to identify and correct these problems. FinCEN officials believed the SAR database contained missing and incomplete data because SAR filers make human errors. FinCEN personnel also stated they were working to improve the data in the SAR database by proposing additional manual and system edits and data perfection routines, communicating with filers regarding invalid and missing data, and enhancing outreach efforts. The major objective of the enhanced outreach program would be to focus on the accuracy of the SARs filed.

[1]These deficiencies were similar to those found and reported on in our previous January 1999 audit.

We recommended in our report that FinCEN, in coordination with IRS DCC and the Federal regulators: (1) implement procedures to increase editing, mandatory data, and feedback with financial institutions and regulators, (2) revise the SAR form or find other means to address the problems with narrative write-ups and identifying violations, and (3) eliminate duplicate SARs in the system. Due to the importance of reliable SAR data to FinCEN's core mission and these repeated deficiencies, we also recommended that FinCEN consider designating SAR accuracy as a material weakness under the Federal Manager's Financial Integrity Act (FMFIA). In its response to our report, FinCEN concurred with the reported findings and indicated that it would complete a series of actions to improve its SAR database by June 2003. However, FinCEN did not agree that the inaccuracies in the SAR database identified in our report warranted reporting as an FMFIA material weakness.

In its response to our report, FinCEN also provided its view that the responsibility for the accuracy of SAR data is shared with the 5 Federal regulators (OCC, OTS, Federal Reserve, FDIC, and National Credit Union Administration). In this regard, FinCEN asserted that the Federal regulators are also owners of the SARs with equal responsibility for the issues raised in our audit, and that FinCEN was bound by agreements with the regulators, which required their concurrence on SAR issues. In our view, this statement highlights a fundamental problem in the existing regulatory regime for BSA. That is, responsibility, and therefore accountability, for the administration of the BSA has been dispersed both within and outside the Treasury Department. We are unaware of any legislative requirement that FinCEN is required to obtain concurrence by the Federal regulators on SAR issues.

We considered the accuracy of SAR information so important to law enforcement that we began a follow up audit in July 2003 to assess FinCEN's progress in implementing its planned corrective actions to our December 2002 report. The scope of that work entails assessing the accuracy of a sample of SARs filed between November 2002 and October 2003. We interviewed LEAs to identify those fields on the SAR form they consider critical to (1) develop an investigative case or (2) conduct trend analyses for

intelligence or policy assessment purposes. These are the fields we are testing in our sample.

While that audit is in progress, we are once again finding problems with accuracy of the SAR database. The problems include: (1) missing information – data fields left blank; (2) incomplete information – data fields partially completed; (3) inappropriate information – clearly erroneous data; and (4) inconsistent information – conflicting data. We are currently discussing our sample results and other findings with FinCEN management and expect to complete this audit later this fiscal year.

Before I discuss my concerns with OFAC's foreign sanctions program, I want to briefly comment on some work we have done on referrals by regulators to FinCEN and FinCEN's enforcement actions on those referrals. Our work in this area is limited. Having said that, in October 2002 we completed an audit of FinCEN's efforts to deter and detect money laundering in casinos and its related enforcement actions. It should be noted that the IRS is responsible for performing BSA compliance exams of casinos.[2] Overall, we found that FinCEN was inconsistent and untimely in its enforcement actions against casinos for BSA violations referred by the IRS.

In that audit we looked at 28 BSA violation referrals to FinCEN. For 7 of the referrals – 25 percent of those in our sample, FinCEN either issued warning letters or took no enforcement action. The potential civil monetary penalties that could have been assessed for these 7 referrals exceeded $8 million. At that time, FinCEN was embarking on a new enforcement philosophy focused on fostering casino compliance through education and industry outreach, with civil penalties imposed in the more egregious cases. FinCEN urged IRS to develop procedures to support its new philosophy. We found that IRS officials did not agree with several aspects of this new enforcement philosophy but their concerns were not resolved. As a result, we reported that the IRS might be reluctant to refer future casino BSA violations to FinCEN. Our

[2]There is one exception to IRS's BSA compliance exam authority -- Nevada casinos are examined by the State of Nevada pursuant to a May 1985 memorandum of agreement with Treasury.

concern was reiterated by TIGTA in its March 2004 report on IRS' BSA compliance program covering both money services businesses and casinos. In that report, TIGTA noted that of approximately 3,400 IRS compliance exams during fiscal year 2002, only 2 BSA violations were referred to FinCEN for civil penalty consideration. Based on discussions with IRS personnel, TIGTA concluded that there was a perception among examiners that there was no need to refer cases to FinCEN because FinCEN did not assess penalties. FinCEN officials, on the other hand, told TIGTA that, because of poor case documentation and inadequate evidence, the referred cases did not provide the information necessary for assessing penalties. If such a perception exists between FinCEN and the regulators on the matter of referrals, it could impair the quality and timeliness of enforcement actions necessary to carry out an effective BSA program. We have not followed up on this work.

OFAC Foreign Sanctions Program

The last area you asked me to address is our concerns with OFAC's foreign sanctions program. We completed an audit of OFAC in April 2002. Overall, we found that OFAC was limited in its ability to directly monitor financial institution compliance with foreign sanction requirements. While OFAC devoted considerable effort to compliance outreach in the financial community to enhance the awareness of foreign sanction requirements, it, like FinCEN, is dependent on the financial institutions regulators to examine compliance. Our testing has found gaps in OFAC examination coverage by the regulators.

Specifically, OFAC primarily relies on authority established under the Trading With the Enemy Act (TWEA) and the International Emergency Economic Powers Act (IEEPA). Neither TWEA nor IEEPA provide OFAC with the authority to test a financial institution's compliance with foreign sanction requirements. Unless OFAC is made aware that a prohibited transaction was allowed/occurred, or that there is a blockable interest, OFAC cannot examine the transactions of a financial institution. Also, the Right to Financial Privacy Act (RFPA), with some exceptions, does not allow financial institution regulators

to share the financial records of the institutions they supervise with OFAC because OFAC is not a bank supervisory agency.

As a result, OFAC must rely on the financial institution regulators' examination process to monitor financial institution compliance with foreign sanctions. This process may not provide adequate assurance that financial institutions are complying with the requirements of the various foreign sanctions. While we have not comprehensively audited OCC and OTS' OFAC compliance examination programs, as part of this audit we looked at 15 OCC compliance exams and 4 OTS compliance exams to assess the procedures used by examiners in determining foreign sanction compliance. Of the 15 OCC examinations, 2 exams did not address OFAC processes and controls at all. Furthermore, only 2 of the other 13 exams included any transaction testing even though examiners identified OFAC deficiencies at 4 other banks where transaction testing was not done. None of the 4 OTS compliance examinations included any transaction testing for OFAC programs although examiners noted OFAC deficiencies at 1 thrift. Transaction testing -- testing individual financial transactions for compliance with foreign sanctions -- is necessary to determine whether a prohibited transaction had been allowed/occurred.

Also, because OFAC is not a bank supervisory agency it cannot dictate the requirements for financial institution compliance programs. We found that, based on a survey of financial institutions, the extent of foreign sanction compliance efforts varied. Of the 102 financial institutions that responded to our survey:

- 26 financial institutions, including 17 large institutions (institutions exceeding $1 billion in assets) reported that they did not use interdict software (a useful automated electronic application) to detect prohibited transactions.

- 16 financial institutions, including 13 large institutions, reported that they had not specifically designated a compliance officer to handle sanction issues.

- 8 financial institutions reported that their compliance programs did not include written procedures and guidelines for examining financial transactions for prohibited countries, entities, and individuals.

In addition, we found that OFAC had limited assurance that statistical reports on sanction activities captured complete, reliable, and timely information. Specifically, we found instances where procedures were not established, databases were not updated, and guidance was not followed in (1) processing blocked and rejected financial transactions, (2) reporting on blocked assets, (3) reviewing license applications, and (4) assessing civil penalties.

We recommended in our report that Treasury inform the Congress that OFAC lacked sufficient legislative authority to ensure financial institution compliance with foreign sanctions. Also, we recommended that Treasury inform the Congress that OFAC's ability to ensure financial institution compliance with sanctions would be enhanced by providing for the bank regulators to share pertinent information that comes to their attention with OFAC. This could be accomplished by amending the RFPA to include OFAC in its definition of a "bank regulator" for the purpose of sharing information with OFAC. We also provided a number of recommendations to improve reporting of blocked and/or rejected financial transactions.

In its response to our report, OFAC management took exception to our finding that legislative constraints hampered its ability to monitor financial institution compliance. However, OFAC did not provide any additional information to support its position. OFAC did agree that current legislative authority could be improved with regard to Federal bank regulators sharing information and that increased oversight and detailed account reviews by regulators could be beneficial. We have not followed up on this work.

In concluding my testimony, I would like to make a few observations. The intent of BSA, expanded by the USA PATRIOT Act, is to provide law enforcement with information on

currency transactions and suspicious financial activity to help it identify and combat terrorist financing, money laundering, and other financial crimes. For that information to be of maximum benefit, it must be complete and accurate, and made available to law enforcement as soon as possible. In the current structure, FinCEN is dependent on many Federal and non-Federal regulators to monitor BSA compliance. Ultimately, however, it is Treasury's responsibility, through FinCEN to ensure that law enforcement is getting the information it needs and that it is timely and useful. In this regard, we believe the Department can do a better job.

Our work, and that of other OIGs, has shown gaps in compliance monitoring by the regulators. As I discussed earlier, OCC did not always do a thorough job of determining whether financial institutions had adequate BSA programs, and OTS did not always effect compliance when it found BSA violations. The FDIC OIG and TIGTA have identified problems with BSA compliance monitoring at their agencies as well. We also found that information contained in the BSA reports coming into FinCEN were oftentimes less than the law *requires*, yet these reports were accepted with little consequence to the filer. The universe of required BSA filers is expanding as more opportunities are identified for moving money through our financial markets. This will result in dispersing BSA compliance monitoring among even more regulatory bodies.

One of FinCEN's challenges has been ensuring that the regulators of these various industries provide adequate and effective BSA compliance monitoring. To this end, FinCEN's approach to BSA administration has been focused on consensus building rather than leading, an approach that has met with limited success. I believe that for the current regulatory structure to work, it must be effectively managed through a cohesive effort that transcends the stovepipes of the individual regulators. FinCEN needs to take a more aggressive leadership role in that effort and require from all those involved in the regulatory structure an approach that, while risk-based, is thorough and intolerant of noncompliance. FinCEN also needs to be more engaged in analyzing the results produced by the various regulators so that it can be more proactive in addressing gaps

in compliance monitoring. Finally, FinCEN needs to be more assertive in using its authority to levy monetary penalties for noncompliance with BSA requirements.

This type of approach would also apply to programs for which OFAC is responsible since it also relies on other regulators to administer its programs. The newly created Treasury Office of Terrorism and Financial Intelligence (TFI), to which FinCEN and OFAC will report, can be the vehicle to pull this all together and establish a regulatory structure for BSA and the OFAC sanction programs that is strong, effective, and accountable.

This concludes my testimony; I would be pleased to answer any questions the Subcommittee may have.

APPENDIX

Department of the Treasury Office of Inspector General
Recent Reports Related to Compliance Monitoring and Enforcement of
The Bank Secrecy Act and Office of Foreign Assets Control Sanction Programs

Compliance Monitoring and Enforcement of the BSA

Office of the Comptroller of the Currency (OCC) Bank Secrecy Act Examinations Did Not Always Meet Requirements; OIG-00-027, issued January 3, 2000

BANK SECRECY ACT: OCC Examination Coverage of Trust And Private Banking Services; OIG-02-016, issued November 29, 2001

MONEY LAUNDERING/BANK SECRECY ACT: FinCEN Needs To Strengthen Its Efforts To Deter And Detect Money Laundering In Casinos; OIG-03-001, issued October 1, 2002

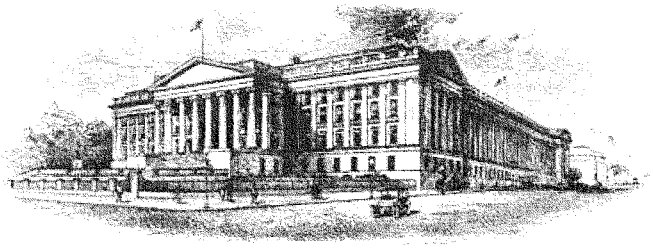
FinCEN: Reliability of Suspicious Activity Reports; OIG-03-035, issued December 18, 2002

OTS: Enforcement Actions Taken for Bank Secrecy Act Violations; OIG-03-095, issued September 23, 2003

Compliance Monitoring and Enforcement of OFAC Foreign Sanction Programs

FOREIGN ASSETS CONTROL: OFAC's Ability To Monitor Financial Institution Compliance Is Limited Due To Legislative Impairments; OIG-02-082, issued April 26, 2002

Compendium Report



SAFETY, SOUNDNESS, AND ACCESSIBILITY OF FINANCIAL SERVICES: Summary of Treasury OIG's Material Loss Reviews of Failed National Banks and Thrift Institutions Between 1993 and 2002

OIG-CA-04-004

May 28, 2004

Office of
Inspector General

Department of the Treasury

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Abbreviations

ALLL	Allowance for Loan and Lease Losses
BIF	Bank Insurance Fund
CEBA	Competitive Equality Banking Act
C&D	Cease and Desist
DIDMCA	Depository Institutions Deregulation and Monetary Control Act
DRR	Division of Resolutions and Receiverships

Contents

EV	Examiner View
FDI Act	Federal Deposit Insurance Act
FDIC	Federal Deposit Insurance Corporation
FDICIA	Federal Deposit Insurance Corporation Improvement Act
FFIEC	Federal Financial Institutions Examination Council
FHLBB	Federal Home Loan Bank Board
FIRREA	Financial Institutions Reform, Recovery, and Enforcement Act
FRB	Federal Reserve Board
FSLIC	Federal Savings and Loan Insurance Corporation
MLR	Material Loss Review
OCC	Office of the Comptroller of the Currency
OIG	Office of Inspector General
OTS	Office of Thrift Supervision
PCA	Prompt Corrective Action
SAIF	Savings Association Insurance Fund
SBA	Small Business Administration
Treasury	Department of the Treasury

OIG

Compendium Report

The Department of the Treasury
Office of Inspector General

May 28, 2004

Wayne A. Abernathy
Assistant Secretary for Financial Institutions

John D. Hawke, Jr.
Comptroller of the Currency

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Director, Office of Thrift Supervision

In this report, we summarize the results of the 7 Material Loss Reviews (MLRs) of failed financial institutions that our office performed between 1993 and 2002 pursuant to the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA). Collectively, the current estimated amount of losses to the deposit insurance funds for these 7 failed institutions totals approximately $1.7 billion. This report was prepared to provide bank regulators, Treasury officials, congressional oversight committees, and other interested parties a historical perspective on: (1) the circumstances that led to the 7 failures resulting in material losses, (2) our observations on the supervision exercised over these institutions, and (3) our recommendations to improve supervisory policies and practices. *It is important that this report be read with the understanding that the supervisory weaknesses noted relate only to the 7 failed institutions reviewed, and may not reflect the supervisory practices in place today at the Office of the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS).*

We are also providing as appendices: (1) our general audit approach and methodology for conducting an MLR (Appendix 1), (2) background on significant legislation during the 1980s and early 1990s impacting regulation of the financial industry (Appendix 2), (3) a summary of recommendations to the Treasury regulators

resulting from the 7 MLRs (Appendix 3), and (4) a list of our MLR reports (Appendix 4).

Background

The thrift industry crisis of the 1980s resulted in losses of approximately $153 billion.[1] During that time, or shortly thereafter, commercial banks were also failing in record numbers. Many of the circumstances surrounding the earlier thrift failures were also being manifested in the bank failures. In response, FDICIA was enacted to provide measures to sustain the bank insurance fund (BIF) as well as provide for regulatory changes to strengthen the banking industry. Included in Section 131 of FDICIA was a requirement for the Office of the Inspector General (OIG) of the primary federal banking regulator to conduct a review of the failed financial institution when the deposit insurance funds incur a material loss. Currently under FDICIA, a loss is considered material when it is the greater of $25 million or 2 percent of the institution's assets.

For an MLR, FDICIA requires that the respective OIG: (1) ascertain why the institution's problems resulted in a material loss to the deposit insurance fund; (2) review the primary regulator's supervision of the institution, including the requirements of Prompt Corrective Action (PCA); and (3) make recommendations for preventing any such loss in the future.

To date, the Treasury OIG has conducted 7 MLRs at 5 national banks and 2 thrift institutions. The first 2 MLRs were considered "pilots" since the losses occurred before such reviews were required by law. Table 1 on the next page lists the 7 MLRs we conducted along with the dates of failure, initial estimated losses, and the most current, or in some cases the final loss amounts incurred by the BIF or the Savings Association Insurance Fund (SAIF) as a result of the failure.

[1] As of December 31, 1999, the cost to taxpayers was approximately $124 billion and the cost to the thrift industry was another $29 billion (*FDIC Banking Review 2000*).

Table 1: MLRs by Treasury OIG (Dollars in Millions)

Institution/Location	Date of Failure	Initial Loss Estimate	Loss Estimate (as of February 28, 2004)
County Bank, Federal Savings Bank (FSB) Santa Barbara, CA (Pilot MLR)	3/27/91	$176	$103 (Final Loss Amount)
Mission Viejo National Bank, Mission Viejo, CA (Pilot MLR)	2/28/92	$47	$31 (Final Loss Amount)
Mechanics National Bank Paramount, CA	4/1/94	$36	$48 (Final Loss Amount)
First National Bank of Keystone (Keystone) Keystone, WV	9/1/99	A range of $750 to $850	$651
Superior Bank (Superior), FSB Oakbrook Terrace, IL	7/27/01	A range of $426 to $526	$436
Hamilton Bank, N.A. Miami, FL	1/11/02	A range of $350 to $500[a]	$149
NextBank, N.A. Phoenix, AZ	2/7/02	A range of $300 to $400[b]	$259
Totals		**A range of $2,085 to $2,535**	**$1,677**

Source: Treasury OIG MLRs, Federal Deposit Insurance Corporation (FDIC) Division of Finance.

(a) By June of 2002, the initial loss estimate for Hamilton Bank was reduced to a range of $175 million to $225 million.
(b) In November 2002, the initial loss estimate for NextBank was revised to a range of $300 million to $350 million.

Circumstances Leading to the Material Losses

Analysis of our MLRs indicate that deficient management at the institutions was often identified as a factor in the failures. However, the Keystone failure had an added dimension. Although management deficiencies were also evident at Keystone, fraudulent acts committed by the institution's management contributed to the institution's failure.

For the 6 other failed institutions, management developed either new high-risk products/services or high-risk variations for existing business strategies and implemented them without appropriate safety and soundness standards. These business strategies were then aggressively pursued with little or no regard to the necessary managerial expertise, adequate oversight by the institutions' boards

of directors,[2] or adequate risk management strategies. When problems arose, management was unable to restore the institution to profitability and avert further capital depletion. This strategy of investing heavily in high-risk activities without appropriate safeguards ultimately proved costly to the institutions and the deposit insurance funds.

Despite regulatory efforts at these institutions, a reversal of the trends proved impossible due to a heavy concentration[3] in inferior quality assets. In order to effectively manage high-risk activities, institutions must address the increased risks with increased controls. In each case, management did not develop or implement adequate policies, procedures, or managerial expertise prior to engaging in higher-risk activities and, in some instances, were non-responsive to regulators' efforts to correct these unsafe and unsound practices. The broad categories of deficiencies associated with the failed institutions are shown in Table 2.

[2] Since the term "management" covers the board of directors as well as the executive managers of financial institutions, we will collectively refer to both of them as "management" throughout this report.

[3] A concentration is a significantly large volume of economically-related assets that an institution has advanced or committed to one person, entity, or affiliated group. These assets in the aggregate may present a substantial risk to the safety and soundness of an institution.

Table 2: Failed Institutions – Common Deficiencies

Deficiency	Institution/Treasury Regulator						
	County Bank, FSB (OTS)	Mission Viejo National Bank (OCC)	Mechanics National Bank (OCC)	First National Bank of Keystone (OCC)	Superior Bank, FSB (OTS)	Hamilton Bank, N.A. (OCC)	NextBank, N.A. (OCC)
Deficient Management and Management Practices	X	X	X	X		X	X
Inferior Asset Quality	X	X	X	X	X	X	X
Accounting Weaknesses	X			X	X (1)	X	X
Over Reliance on Continued Growth in the Economy	X	X	X				
Fraud			(2)	X		(2)	

Source: OIG MLR Reports.

(1) Improper application of accounting principles for the valuation of asset securitizations and residual interests directly related to the failure of Superior Bank.

(2) The Small Business Administration (SBA) recently indicted several former officials at Mechanics National Bank. Charges were also recently handed down by the Securities and Exchange Commission in connection with the Hamilton Bank failure.

The broad categories of deficiencies identified in Table 2 are described below:

Deficient Management and Management Practices. At 6 of 7 institutions, some form of managerial deficiency was evident. We found that many of the institutions were headed by a passive board of directors, such as County Bank and Mission Viejo National Bank, and 5 of the institutions (County Bank, Mission Viejo National Bank, Mechanics National Bank, Keystone,[4] and Hamilton Bank) were dominated by one individual. Although each of the institutions had its own set of business practices, the absence of established prudent banking practices led to the decline of the asset structures. Examples of the lack of prudent banking practices included, but were not limited to, adopting speculative growth strategies, failing to implement adequate policies and procedures, engaging in poor loan underwriting, neglecting to establish limits on concentrations, and failing to implement an

[4] Although not specifically cited in our MLR report, OCC documents we reviewed during the MLR indicated that the institution was dominated by one individual until his death in 1997, and by another individual afterwards.

adequate system of internal controls. Management of the institutions generally embarked in areas where they possessed little or no experience or expertise, such as asset securitization.[5] Furthermore, management did not implement appropriate internal controls to mitigate the risks associated with the high-risk asset structures.

Inferior Quality Assets. Management engaged in aggressive growth, high-risk activities such as subprime lending and securitization. However, management did not implement safeguards to mitigate the risks associated with these activities, which resulted in, among other things, excessive concentration of high-risk assets. As a result, when problems developed, management was unable to stem the deterioration of the asset structure or curb the ensuing losses.

Accounting Weaknesses. Management at several of the institutions misapplied various accounting standards. The misapplication of the standards resulted in overstated earnings, which, in turn, inflated the institutions' capital accounts. For example, Superior Bank misapplied the provisions of Financial Accounting Standards No. 125, *Transfers of Financial Assets and Extinguishment of Liabilities*, which overstated its earnings and capital. When adjustments to income were required at this and other institutions to apply the standards correctly, the capital accounts were significantly affected by the reduction in income. In some cases, such as Superior Bank, the institution was unable to recover from the required capital reduction for the overvaluation of its assets. Other examples of accounting weaknesses included the failure to provide adequate funds for the Allowance for Loan and Lease Losses (ALLL), which occurred at Superior Bank, Hamilton Bank, and NextBank; and improperly recording expenses as assets, which occurred at NextBank.

Over Reliance on Continued Growth in the Economy. Although economic factors may have appeared to have adversely affected several of the institutions, the changes did not cause the

[5] Securitization is the process where interests in loans, generally mortgages and other receivables including credit cards and automobile loans, are packaged, underwritten, and sold in the form of asset-backed securities. A benefit of the securitization process is that it converts relatively illiquid assets (loans) into readily marketable securities with reasonably predictable cash flows.

institutions' failures. The economic downturns merely exacerbated the over reliance by management on a strong economy to support the institutions' high-risk activities. For example, County Bank relied on the robust real estate market to generate high-risk, high-yield loans. As long as the economy was flourishing, management continued to engage in speculative initiatives without implementing adequate safeguards. However, once the economy deteriorated, the inferior nature of the assets surfaced. Similarly, Mission Viejo Bank amassed profits as long as the real estate market was strong. However, once the economy declined, the effects of poor management surfaced. In cases like these, during cycles of economic decline, the already tentative abilities of some borrowers to repay further hamper management's efforts to restore profitability and maintain capital at regulatory minimums.

Fraud. Although fraud was only responsible for contributing to the failure of one institution, Keystone, it was also evident in two other institutions, Mechanics National Bank and Hamilton Bank. The existence of the frauds and related consequences at these 2 institutions were not known at the time we conducted the MLRs. Although the fraudulent activities at Keystone were known at the time of the MLR, the full extent of the activities was not known until after the MLR was completed. However, as we reported in our MLR of Keystone, examiners declared the institution insolvent after they were unable to verify $515 million in recorded loans. Another aspect of the frauds that came to light after our MLRs had been completed was that in all cases, the sources of the frauds were internal as opposed to external parties defrauding the institutions. This post-MLR discovery of a material contributing cause of an institution's failure does point to one limitation of an MLR. That is, the statutory requirement that a MLR be completed in 6 months upon determination of a material loss. In most cases, it was several years later that law enforcement and regulators surfaced the facts surrounding the fraud that resulted in losses.

Supervision Exercised Over the Failed Institutions

As part of an MLR, we assessed the regulators' supervision of the failed institution, including the implementation of the PCA requirements of Section 38 of the Federal Deposit Insurance Act (FDI Act). In this section, we discuss recurring supervisory

weaknesses noted in our MLRs. These weaknesses are summarized in Table 3 and described in more detail in Appendix 3. It is important to note, however, that these supervisory weaknesses relate only to the 7 failed institutions reviewed, and may not reflect the supervisory practices in place today at OCC or OTS.

Table 3: Supervisory Weaknesses

Regulator Weaknesses/ Difficulties Encountered	County Bank, FSB (1)	Mission Viejo National Bank	Mechanics National Bank	First National Bank of Keystone	Superior Bank, FSB	Hamilton Bank, N.A.	NextBank, N.A.
Non-identification or attribution of banks' problems	X	X (2)	X	X	X	X	X
Failure to review "red flags"		X	X	X	X	X	X
Failure to determine banks' true condition		X	X	X		X	X
Delayed supervisory response due to institution's apparent profitability		X	X	X		(3)	
Failure to expand scope of examination		X	X	X			X
Failure to implement enforcement action above the examiner level.		X	X	X		X	
Failure to recommend enforcement actions			X	X	X	X	
Failure to implement or pursue more stringent enforcement actions	X		X	X	X		X
Lack of examiners and/or experience	X				X	X	X
Failure to follow-up on past examination criticisms					X	X	X
Failure to verify information				X	X		X

Source: OIG MLR Reports-1993 through 2002.

(1) The Federal Home Loan Bank Board (FHLBB) regulated thrifts until the creation of OTS in 1990. Our MLR found that the FHLBB needed to be more proactive in its examinations of County Bank. Also, we noted that FHLBB examination conclusions did not match its underlying examination workpapers and other information. OTS did not regulate County Bank until the final year of its operations. In this regard, our only observed weakness of OTS' supervision was that it did not follow-up on certain actions taken against parties affiliated with the institution.
(2) Examiners did not identify management as the source of the institution's problems.
(3) The institution's capital level rather than profitability delayed actions.

By the regulators not identifying and/or acting on the early warning signs and the underlying causes of the problems, management at these institutions, in the absence of mitigating controls, continued to engage in activities that resulted in uncontrolled risk taking and the accumulation of high-risk assets. These activities resulted in a rapid deterioration in the financial condition at many of these institutions. Accordingly, it was not uncommon for the institutions to have satisfactory composite CAMELS[6] ratings at one examination and be on the verge of insolvency at the next examination.

Use of Enforcement Tools and Prompt Corrective Action

The enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and FDICIA provided additional regulatory tools to address the problems experienced in the banking and thrift industries, including tools to deal with recalcitrant bank management. For example, FIRREA expanded and increased the dollar limits on civil money penalties. FDICIA expanded the authority of regulatory agencies by enacting PCA, requiring annual regulatory examinations, developing and implementing safety and soundness standards, and applying capital standards to restrict the use of brokered deposits.[7]

For the 7 MLRs, we found that OCC or OTS did not always use these tools in a timely and effective manner. Instead, examiners attempted to first persuade management to cease unsafe and unsound practices through less formal measures. When stricter actions were eventually imposed, the institutions were too

[6] Financial institution regulators use the Uniform Financial Institutions Rating System to evaluate an institution's performance. CAMELS is an acronym for the performance rating components: Capital adequacy, Asset quality, Management administration, Earnings, Liquidity, and Sensitivity to market risk. The Sensitivity component was added effective January 1997. Numerical values range from 1 to 5, with 1 being the highest rating and 5 representing the worst rated banks.

[7] Brokered deposits are funds, which a bank obtains, either directly or indirectly, by or through a broker, for deposit into a deposit account. Brokered deposits include funds in which a single depositor holds the entire beneficial interest and funds in which the deposit broker sells participations to one or more investors. Under 12 CFR § 337.6, only "well capitalized" banks may accept brokered deposits without FDIC approval.

weakened from deteriorating asset quality, deficient capital, nonexistent earnings, and other factors to affect a recovery.

Section 38 of the FDI Act, *Prompt Corrective Action*, established regulatory capital minimums to assist in the regulation of financial institutions. PCA was intended to resolve problem institutions by providing more timely intervention by regulators to achieve the least possible long-term loss to the deposit insurance funds. Section 38 stratifies institutions into 5 capital categories ranging from the highest category referred to as "well capitalized" to the lowest category known as "critically undercapitalized." There are 3 other intermediate categories between these 2 extremes ("adequately capitalized," "undercapitalized," and "significantly undercapitalized"). The PCA categories are looked upon as rungs on a ladder. With this in mind, the way PCA is intended to work is that as an institution ventures down the "PCA capital ladder" from the top rung of "well capitalized" to a lower category, Section 38 provides for the application of more operating restrictions on the institution, and the federal banking regulators are required to take increasingly severe actions to attempt to halt further deterioration of the institution. These actions range from restricting certain activities, such as asset growth or dividend payments, to closing institutions that remain in a "critically undercapitalized" state.

PCA was used at 5 of the failed institutions.[8] However, PCA was unsuccessful in rehabilitating these institutions, as discussed below:

- At Mechanics National Bank, OCC initiated PCA the year prior to its failure. In this regard, OCC reclassified the institution's capital category from "adequately capitalized" to "undercapitalized" based on its unsafe and unsound condition. By doing this, OCC was able to dismiss two key individuals and effect the resignation of another individual who was responsible for the deteriorating condition of the bank. However, the bank's condition continued to deteriorate and once it became "critically undercapitalized," the bank was closed by OCC within 90 days as provided by PCA.

[8] County Bank and Mission Viejo National Bank failed prior to the effective date of PCA.

- The overstatement of Keystone's assets due to fraud precluded an accurate determination of its actual capital ratios in time for PCA to take effect. Once Keystone's capital was adjusted downward for the unsubstantiated loans, its PCA category fell from "adequately capitalized" to "critically undercapitalized" and the bank was closed.

- Although OTS used PCA in response to Superior Bank's problems, its usefulness was impacted by OTS' delayed supervisory response in detecting deficiencies at the thrift. It also appeared that OTS exercised regulatory forbearance by delaying the recognition of Superior Bank's true capital position in early 2001.

- OCC used PCA to reclassify Hamilton Bank's capital category from "adequately capitalized" to "undercapitalized," which restricted certain of its activities, after OCC concluded the institution had engaged in unsafe and unsound practices. However, due to the institution's weakened condition, it failed less than a year after OCC instituted PCA.

- Because of its operational deficiencies NextBank suffered an immediate drop in its capital category from "well capitalized" to "significantly undercapitalized" in October 2001. This immediately subjected NextBank to PCA restrictions, and OCC implemented additional restrictions. By December 2001, NextBank was unable to address its capital deficiency and the institution closed in February 2002.

In addition to PCA, regulators can effect changes in problem institutions through the use of informal and formal enforcement actions. Informal actions are (1) less severe than formal actions, (2) not legally enforceable, (3) not public information, and (4) generally entered into by consent. Examples of informal actions are Board Resolutions, Commitment Letters, and Memoranda of Understanding. Conversely, formal actions are severe remedies designed to address significant problems, violations, and non-compliance with prior enforcement actions. They are issued either by consent or following an administrative hearing and are generally public information. Examples of formal enforcement actions

include Formal Agreements, Cease and Desist (C&D) Orders, and Temporary C&D Orders.[9]

All 7 institutions were under some type of informal action, formal action, or both, prior to failure. Analysis of our MLRs pertaining to the recommendation, implementation, and follow-up of enforcement actions noted that: (1) the actions, whether formal or informal, were generally not stringent enough to address the institutions' deficiencies, (2) bank management was unresponsive to the provisions contained in the corrective measures, (3) progressively more forceful action was not always taken when management did not address and comply with the enforcement actions, (4) verification of compliance with the provisions of the various actions was not always performed, and (5) many of the actions were implemented too late to effect correction.

MLR Recommendations to Improve Supervisory Policies and Practices

We made a number of recommendations, detailed in Appendix 3, to address supervisory weaknesses noted in our MLRs. In each case, OCC and OTS management concurred with the recommendations, and instituted policies and procedures, expanded examination guidance, and took other corrective action that generally met the intent of our recommendations. For example, although both OCC and OTS use a risk-based approach to examine financial institutions, OCC expanded its risk-based approach to include a 9-point risk assessment process to facilitate the best use for examination resources. There is also a management review section in OCC's Examiner View (EV) system[10] that incorporates varying levels of supervisory review depending on the risks associated with the management factor. The regulators also actively monitor institutions that engage in high-risk activities. For example, OCC performs quarterly supervisory reviews on its community and mid-sized banks to determine if the institutions' ratings or risk profile

[9] Temporary C&D Orders are not public information.

[10] EV is OCC's automated examination system that contains modules addressing specific topics and varying levels of supervisory review. The level of supervisory review depends on problems noted at previous examinations and any additional potential areas at the institution that could affect the management component rating.

have changed. OCC revises EV as needed. Furthermore, both OCC and OTS update examination guidelines and issue memorandums and directives to examiners concerning various regulatory issues as they arise.

Additionally, following any national bank failure, OCC conducts a "lessons learned review." OCC initiated these reviews after the Keystone failure to determine if its supervisory efforts were adequate or if extra measures should have been instituted. OTS also conducted a "lessons learned review" after the failure of Superior Bank. Furthermore, the Federal Financial Institutions Examination Council (FFIEC)[11] publishes Financial Institution Letters to keep the financial industry appraised of agreements among the regulatory agencies regarding requirements or examination treatments for new or unusual items, or potential changes in, or the initiation of, outstanding or proposed regulations.

Office of Financial Institutions, OCC, and OTS Comments

We provided a draft of this Compendium Report to the Assistant Secretary for Financial Institutions, OCC, and OTS. The Office of Financial Institutions did not offer any comments on the draft. OCC staff provided several technical comments, which were incorporated in our final report as appropriate. OTS provided a written response, which is included in Appendix 5. In its response, OTS suggested that certain references on page 13 regarding the use of PCA at Superior Bank be deleted. The first reference relates to the appearance that OTS exercised regulatory forbearance by delaying the recognition of the thrift's capital position in early 2001. In this regard, OTS noted that it immediately placed Superior into receivership when it became clear that credible and repeated representations by Superior's ownership interests to infuse capital were not going to be honored. As discussed in more depth in our MLR report, and as indicated in the response, OTS provided Superior additional time to obtain capital even after it was

[11] FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the examination of banks by federal regulators (OCC, OTS, FDIC, the Board of Governors of the Federal Reserve System, and the National Credit Union Administration) established under Title X of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.

apparent the thrift was near insolvency. Accordingly, we did not make the suggested change to this report. The second reference relates to OTS failing to enforce PCA restrictions on senior executive bonuses. We revised our report and deleted the reference. OTS made several technical comments in its response which we addressed as appropriate.

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If you have any questions about this report, please contact me at (202) 927-5400. Major contributors to the report are listed in Appendix 6.

Marla A. Freedman
Assistant Inspector General for Audit

The objectives of an MLR are mandated by law. Section 38(k) of the FDI Act, 12 USC § 1831o(k), as amended by FDICIA, provides that if a deposit insurance fund incurs a material loss with respect to an insured depository institution on or after July 1, 1993, the Inspector General for the appropriate federal banking agency shall prepare a report to the agency, which shall:

- Ascertain why the institution's problems resulted in a material loss to the insurance fund;
- Review the agency's supervision of the institution, including the requirements of PCA; and
- Make recommendations for preventing any such loss in the future.

We initiate an MLR once our office receives written notification from the FDIC OIG that a material loss has been recorded on FDIC's books (i.e., loss is greater of $25 million or 2 percent of the institution's total assets). Our report is required to be completed within 6 months of the notification of a material loss. By law, we provide a copy of our MLR report to (1) the Comptroller General of the United States, (2) the FDIC, and (3) any Member of Congress upon request.

In performing an MLR, we:

- Interview OCC or OTS examiners, analysts, attorneys, and other personnel to obtain their perspectives on the institution's condition and the scope of the examinations performed at the institution.
- Interview personnel of FDIC's Division of Resolutions and Receiverships (DRR) and Division of Finance personnel who were involved in the receivership process conducted before and after the institution's closure and appointment of receiver. We also review the records of the failed institution in the possession of the FDIC DRR.

- Review OTS and OCC's supervisory actions to gain an understanding of (1) if or when deficiencies leading to the institution's failure were identified, (2) the approach used by the regulators to assess the extent of the deficiencies and the institution's condition, and (3) the regulatory actions instituted to compel management to address identified deficiencies.

- Review examination workpapers, files, and examination reports to determine the nature, scope, and conclusions regarding the regulatory review of the institution. A chronology of significant events is then developed.

- Assess the adequacy of regulatory actions taken based on internal guidance and legislative mandates.

- Inquire of appropriate law enforcement agencies about the existence and nature of any criminal investigations being conducted into the activities of the failed institution. These inquiries are made throughout the duration of the MLR.

If the institution was owned by a holding company, we also review relevant records of the Board of Governors of the Federal Reserve Board (FRB), and interview FRB staff. If the institution is owned by a thrift holding company, we also review relevant OTS supervisory records for the holding company. Our reviews of FDIC and FRB records and interviews with agency personnel are coordinated through the OIGs of these agencies.

Before we issue our report on an MLR, we provide a draft to OCC or OTS management for official comment. We also circulate the draft to FDIC and, as appropriate, to the FRB and law enforcement agencies, and consider any comments they may have when finalizing the MLR report.

We conduct the MLR in accordance with the generally accepted government auditing standards.

The 1980s and early 1990s ushered in numerous regulatory changes for the banking and thrift industries, the most notable transformation in regulation among these entities since the Great Depression. There were five major laws enacted between 1980 and 1991 that significantly affected the financial industry, and they are listed below:

- Depository Institutions Deregulation and Monetary Control Act of 1980;
- Garn-St Germain Depository Act of 1982;
- Competitive Equality Banking Act of 1987;
- Financial Institutions Reform, Recovery, and Enforcement Act of 1989; and
- Federal Deposit Insurance Corporation Improvement Act of 1991.

By 1980, problems in the thrift industry were beginning to surface. In an attempt to remedy the troubles, Congress enacted the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA), which contained provisions that were intended to reduce and/or eliminate the problems. DIDMCA was also an attempt to deregulate a heavily regulated industry and create a level playing field for all financial institutions by removing several of the barriers that existed between banks and thrifts.[12]

When it became apparent that DIDMCA was not resolving the problems in the thrifts, the Garn-St Germain Depository Act of 1982 (Garn-St Germain Act) was enacted in an attempt to rescue the thrift industry. Broad areas affected by Garn-St Germain Act included the following:

[12] Areas affected by DIDMCA included establishing uniform reserve requirements, availing Federal Reserve services to all depository institutions, removing interest rate ceilings on maximum allowable deposit rates, authorizing the issuance of checking and negotiable order of withdrawal (NOW) accounts or their equivalents for all institutions, and increasing the deposit insurance level to $100,000. This is not an all-inclusive list; additional powers were also granted by DIDMCA. However, these noted areas contributed to significant changes in the industry.

1) Sources of funds were expanded and included the creation of money market deposit accounts, the ability of federal, state, and local governments to acquire NOW accounts, and the abolishment of any residual interest rate differentials on deposit accounts between banks and thrifts.
2) Thrifts were granted additional powers.[13]
3) Rules on lending and borrowing by national banks were revised.
4) Statutory restrictions on real estate lending by national banks were removed.
5) FDIC and the Federal Savings and Loan Insurance Corporation (FSLIC) were empowered to provide assistance to troubled institutions.

Despite the expansion of powers granted through the enactment of DIDMCA and the Garn-St Germain Act, by 1987 the thrift industry was in crisis. The Competitive Equality Banking Act (CEBA) was passed in 1987 with the primary purpose of assisting the FSLIC[14] and eliminating the problems in the ailing thrift industry. Some of CEBA's major provisions included providing funds to recapitalize the FSLIC fund, creating a forbearance program for qualifying well-managed thrifts, and providing for stricter appraisal, accounting, reserve, and capital standards for the industry. Other provisions in CEBA were focused on efforts to encourage the acquisition of failing or failed institutions, whose numbers were increasing and reaching epidemic proportions - a total of 204 institutions failed during 1986 alone.

Attempts at regulatory intervention, in an effort to abate the thrift crisis, were not succeeding. Therefore, in 1989, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), which significantly restructured the regulation of the thrift industry. The statute abolished the FSLIC and established the

[13] Thrifts were permitted to invest a maximum of 5 percent of their assets in commercial loans and a maximum of 30 percent of their assets in consumer loans. The Act enabled them to also invest in local and State government revenue bonds.

[14] Prior to the establishment of the OTS and SAIF, the FHLBB was the primary federal regulatory agency and FSLIC was the insurer for the savings and loan industry.

SAIF, which is maintained by FDIC.[15] FIRREA also established the FSLIC Resolution Fund and the Resolution Trust Corporation to handle insolvent institutions that were formerly insured by FSLIC. The FHLBB, the regulator of the thrifts, was abolished and OTS was created as a Treasury bureau to regulate this industry. Stricter accounting, capital, and lending standards were also established for the industry.

In addition to the provisions directed at the thrifts, there were provisions of FIRREA that were applicable to commercial banks. The enforcement authority of primary federal regulators was greatly enhanced. Deposit insurance protection could be revoked more quickly and insurance coverage could be suspended on institutions with no tangible capital. C&D[16] authority was expanded to address specific activities. Temporary C&Ds could be issued for various actions including restrictions on the institution's growth. If a regulator determined that certain activities posed risks that could result in significant damage to the institution or if the institution's books and records were too incomplete to enable regulators to assess the true condition of the bank, a temporary C&D could also be levied. Civil money penalties that regulators could impose upon institutions were greatly increased. Additionally, banks that did not meet certain capital adequacy standards were prohibited from accepting brokered deposits without prior approval from the FDIC. Each federal financial regulatory agency was required to establish real estate appraisal standards. An Appraisal Subcommittee under the FFIEC was created under FIRREA to establish the standards.

As Congress continued to address the thrift crisis, the banking crisis continued to escalate and the number of bank failures began to erode the BIF. By 1990, the BIF required replenishment, and congressional efforts were concentrated on stabilizing the banking industry. The Federal Deposit Insurance Corporation Improvement

[15] FIRREA also established the BIF, which is also maintained by the FDIC. The BIF covers banks, and the SAIF covers thrifts.

[16] A C&D is a formal enforcement action that regulators can recommend for institutions or affiliated parties to stop an unsafe or unsound practice or violation. A C&D may be terminated when the bank's condition has significantly improved and the action is no longer needed or the bank has materially complied with the provisions in the C&D.

Act (FDICIA) was passed in 1991 and resulted in significant regulatory changes. To address the deficient insurance fund, the law increased FDIC's borrowing authority from the Treasury to cover insurance losses[17] with repayment to be derived from deposit insurance assessments. FDICIA also enabled FDIC to borrow on a short-term basis for working capital needs with repayment from asset sales from failed institutions. The recapitalization of the BIF was to occur within 15 years and the recapitalization of the SAIF within a "reasonable" time. Regulatory reforms were also included in FDICIA. One of the most prominent features was PCA. PCA required regulators to develop a laddering of five capital categories ranging from "well capitalized" to "critically undercapitalized."[18] The purpose of this laddering was so that as an institution's capital level dropped from one category to a lower category, regulators were empowered to enforce greater restrictions on its activities. Annual examinations[19] were also required. Although FDICIA contained numerous mandates that affected the financial industry, the most relevant provisions included requirements that:

1) Institutions with assets exceeding $150 million provide annual audited financial statements to their primary federal regulator.
2) Federal regulators develop safety and soundness standards relating to operations and management; asset quality, earnings, and stock valuation; and employee compensation.
3) Federal regulators revise risk-based capital standards to include interest rate risk.
4) Institutions adopt uniform standards for real estate lending.
5) Federal regulators apply capital standards to restrict the use of brokered deposits by financial institutions.

Additionally, FDICIA enacted provisions for deposit insurance reform, which required the implementation of risk-based premiums

[17] The limit was increased from $5 billion to $30 billion.

[18] The intervening capital categories were "adequately capitalized", "undercapitalized", and "significantly undercapitalized."

[19] The annual cycle was subsequently expanded to an 18-month interval for healthy banks with assets of less than $100 million.

by 1994. FDICIA also requires FDIC to use the "least cost" alternative in failed bank resolutions.[20]

[20] Least cost resolution is required unless there is a determination that this approach would result in a systemic risk of serious adverse effects on economic conditions or financial stability. Such a determination can only be made by the Secretary of the Treasury upon recommendation (by a vote of at least two-thirds of the members) of the FDIC Board of Directors and the Board of Governors of the Federal Reserve. In this event, the FDIC can take other action and or provide assistance to avoid or mitigate such adverse effects.

The following table summarizes (1) the causes of failure for the seven failed institutions reviewed by Treasury OIG, (2) the supervisory weaknesses noted with these institutions, and (3) our recommendations directed to OCC or OTS management to prevent future losses.

Table 4: OIG MLR Recommendations to OCC and OTS Management

Institution Name, Failure Date, and Principal Causes of Failure	Supervisory Weaknesses	OIG Recommendations
County Bank, FSB March 27, 1991 Decisions and practices by the Board of Directors and senior management resulted in: (1) speculative growth strategy; and (2) poor lending policies and procedures	FHLBB should have been more proactive by identifying County Bank's poor lending policies and practices in 1984 versus 1986. Also, FHLBB should have conducted more in-depth loan sampling during full-scope examinations between 1984 and 1989 to identify the extent of the asset quality problems.	We reflected in the report that legislative actions (FIRREA and FDICIA) addressed deficient areas by instituting measures such as (1) limitations on brokered deposits and (2) improved capital standards that require risk- based capital standards to consider concentrations of credit risk. We recommended that OTS: (1) determine if there was any merit in pursuing prohibition orders against any of the parties involved in the institution's failure and if so, a plan be developed to pursue the action before the statute of limitations expired; (2) determine if the likelihood of overlooking levying prohibition orders for thrift officials after thrift closures is a systemic OTS-wide problem and if so, a plan of action to address the problem be developed; and (3) continue to develop working arrangements to improve coordination and information sharing with other regulatory agencies, such as the FDIC or Resolution Trust Corporation.
Mission Viejo National Bank February 28, 1992 Poor management by the Board of Directors resulted in (1) deficient underwriting and loan administration and (2) reliance on volatile funding.	OCC failed to attribute the bank's problems to the institution's management. This was due to OCC's examination approach that devoted efforts to previously identified problems and potential risks. By the time OCC identified and reported the inadequate board supervision, the bank had too many loans that it could not sell and was unable to attract depositors to meet its daily liquidity needs.	There were no formal recommendations in the report. However, the report contained suggestions that OCC (1) require examiners to conduct management appraisals when problems remain uncorrected and (2) issue enforcement actions based on industry-wide standards as outlined in the Standards on Safety and Soundness as promulgated under FDICIA.

Table 4: OIG MLR Recommendations to OCC and OTS Management

Institution Name, Failure Date, and Principal Causes of Failure	Supervisory Weaknesses	OIG Recommendations
Mechanics National Bank April 1, 1994 Decisions and practices by the Board of Directors and senior management resulted in: (1) uncontrolled, rapid growth; (2) lack of expertise, systems, policies and procedures; (3) loans centered in speculative construction and development activities; (4) poor underwriting and loan administration; and (5) an adversarial relationship with regulators.	OCC's examination efforts could have been more proactive. OCC did not fully identify or address the managerial weaknesses or unsafe lending practices until a base of problem loans was established. If the management and lending problems were identified earlier, OCC may have initiated enforcement actions earlier.	The report did not contain any formal recommendations. The report did state that various changes including legislative actions, FIRREA and FDICIA, and changes in examination policies and procedures would address regulatory shortcomings by instituting measures such as: (1) enhancing enforcement actions including increased civil monetary penalties; (2) requiring annual full scope examinations; (3) enacting of PCA requirements restricting asset growth; (4) enacting of stricter controls over real estate lending; (5) incorporating Safety and Soundness Standards which requires regulators to prescribe guidelines relating to loan standards, growth, internal controls and auditing, and compensation; and (6) revising risk-based capital standards by incorporating the effect of concentrations of credit risk. Additionally, an Interagency Policy Statement was issued requiring banks to maintain an ALLL that considers both on and off balance sheet risks.
The First National Bank of Keystone (Keystone) September 1, 1999 Unsafe and unsound banking practice of including nonexistent loans on institution's balance sheet led to its insolvency. The overstated asset values were attributed to alleged fraudulent activities. The inadequate accounting systems and controls as well as uncooperative management masked the alleged fraud.	Despite finding significant problems, OCC generally did not perform more extensive examination procedures that may have revealed the true condition of the bank. OCC focused on the credit risk associated with the subprime mortgage loan securitizations rather the inaccurate financial records. The timeliness and types of enforcement actions may have been contributing factors.	We recommended that OCC: (1) issue guidance requiring risk assessment of bank's financial accounting, reporting, and controls to determine overall risk; (2) develop examination guidelines to determine when reliance upon external auditors' reports is not acceptable; (3) establish testing procedures for instances when the external audit reports are not acceptable; (4) enhance existing review procedures for enforcement actions that establish clear guidance on areas concerning what constitutes full compliance of a provision before an action is terminated, extended, or replaced, and the maximum time allotted to achieve full compliance with enforcement action provisions; (5) reassess current practices that permit use of concurrent informal actions for repeat violations; (6) reassess use of PCA reclassification as a vehicle to curb growth without adequate controls in place; (7) perform an assessment as to whether Keystone's failure necessitates a different supervisory response to mitigate ultimate risk exposure to the BIF. With respect to this last recommendation, the assessment should focus on high-risk growth, while addressing known unsafe and unsound practices; adequacy of existing regulations for brokered deposits; and certain interest rate restrictions.

Table 4: OIG MLR Recommendations to OCC and OTS Management

Institution Name, Failure Date, and Principal Causes of Failure	Supervisory Weaknesses	OIG Recommendations
Superior Bank, FSB July 27, 2001 Insolvency was due to extensive asset write-downs to correct improper accounting and valuation practices. OTS records trace these causes to thrift practices from possibly as early as 1993. The MLR details the problems that the OTS regulators experienced with management.	In the early years, OTS' supervision appeared incongruous with the institution's increasing risk profile since 1993. It was not until 2000 that OTS expanded examination coverage of residual assets and began meaningful enforcement action. OTS examinations lacked supervisory skepticism and assumed that the ownership interests would not allow Superior Bank to fail and would always provide any needed capital. OTS assumed that thrift management was experienced in and had implemented sufficient controls to safely manage the complexities and high-risks of asset securitizations. OTS also unduly relied on the external auditors to attest to Superior Bank's residual asset valuation.	We recommended that OTS: (1) ensure examination coverage of third party servicers by expanding guidance to include assessing management adequacy and controls to monitor and manage risks associated with third party servicers, evaluate risk factors and conditions to determine examination coverage, determine expected documentation for an assessment of nature and extent of third party relationships; (2) ensure adequate examination coverage is afforded to geographically dispersed operating units; (3) ensure adherence to OTS policies, require quality assurance reviews covering examinations when expanded assessments of external auditor's workpapers would be warranted; (4) reassess guidance to ensure adequate examination coverage of proper application of new accounting pronouncements and standards; (5) establish minimum testing procedures to ensure sufficient coverage of thrifts' valuation policies and procedures; (6) ensure that quality assurance reviews cover adequacy of examiner follow-up on previously reported problems; (7) assess whether appropriate enforcement sanctions should be pursued with respect to senior executive bonuses that were paid in possible violation of PCA restrictions; (8) assess the adequacy of existing supervisory controls to ensure thrifts' compliance with PCA restrictions; and (9) discuss with the FFIEC the need to assess if revisions to PCA are warranted with respect to brokered deposit restrictions.
Hamilton Bank, N.A. January 11, 2002 Failure attributed to rapid growth coupled with unsafe and unsound banking practices including aggressive growth, weak underwriting practices, and inadequate risk management systems and controls. The board was ineffective and management was non-responsive.	OCC's on-site examinations and enforcement actions could have been more forceful between 1992 and 1997. OCC did not fully identify or address management's weakness or unsafe lending practices until the institution established a base of problem loans. The OCC did not follow up on identified accounting deficiencies until 10 months later. OCC also did not follow-up to determine compliance with a Safety and Soundness Notice.	We recommended that OCC: (1) ensure the recommendations in from its "lessons learned" review of the Hamilton Bank failure are implemented as planned; (2) reassess the "lessons learned" review process to ensure coverage of all pertinent areas and provide support for recommendations and conclusions, (3) develop or revise policies to include examiner review procedures for institutions experiencing significant capital infusions, (4) reassess examination guidance regarding actions to be taken when examiners encounter unusual accounting transactions that warrant further investigation, and (5) establish controls to ensure timely examiner follow-up on bank compliance with enforcement actions.

Table 4: OIG MLR Recommendations to OCC and OTS Management

Institution Name, Failure Date, and Principal Causes of Failure	Supervisory Weaknesses	OIG Recommendations
NextBank, N.A. February 7, 2002 Failure is attributed to improperly managed rapid growth. NextBank's exorbitant growth was exacerbated by expansion in subprime lending activities	The first OCC examination was supposed to be a full-scope examination. However, the actual examination only included the lack of documented controls, the risk management systems, and whether or not the bank adhered to its business plan. Little, if any, portfolio analysis was completed, the actual impact of the absence of controls and management systems was not assessed, and the bank's true condition as a result of its rapid growth into subprime lending was not determined. OCC lacked examiners who were experienced in this area and did not provide adequate time to conduct the examination. The next examination revealed the deteriorating financial condition and quantified the understated losses associated with deficient accounting practices.	We recommended that OCC: (1) establish a process to allocate specialized examiners to institutions with a high or increasing risk profile. The process should be centralized to permit specialized requests and assigning resources and the pool of specialized examiners should be expanded based on emerging trends and industry developments; (2) reassess OCC's audit handbook for clarity and determining if procedures need to be expanded to incorporate reviewing external auditor's workpapers to determine compliance with generally accepted accounting principles; (3) reassess OCC guidance relating to a third party servicer, (4) assess the actual amount of brokered deposits for the fourth quarter 2001 to determine if further sanctions are needed, (5) seek clarification regarding OCC's authority to condition a change-in-control application, and (6) reassess the adequacy of OCC's guidance on how examiners evaluate the effects and risks presented by the parent entity to the bank.

Source: OIG Summary of MLRs from 1993 through 2002.

Appendix 4
List of Treasury OIG MLR Reports

Following is a list of Treasury OIG MLR Reports issued from 1993 through 2002 that were the basis of this Compendium Report:

- *Pilot Audit of a Failed National Bank Under the Federal Deposit Insurance Corporation Improvement Act of 1991* [Mission Viejo National Bank], OIG-93-131, September 24, 1993.

- *Pilot Material Loss Review Under FDICIA: County Bank, A Federal Savings Bank, Santa Barbara, California*, OIG-94-059, March 22, 1994.

- *Material Loss Review Under FDIA: Mechanics National Bank, Paramount, California*, OIG-95-134, September 29, 1995.

- *Material Loss Review of the First National Bank of Keystone*, OIG-00-067, March 10, 2000. (See Report at http://www.ustreas.gov/offices/inspector-general/audit-reports/2000/oig00067.pdf)

- *Material Loss Review of Superior Bank, FSB*, OIG-02-040, February 6, 2002. (See Report at http://www.ustreas.gov/offices/inspector-general/audit-reports/2002/oig02040.pdf)

- *Material Loss Review of NextBank, NA*, OIG-03-024, November 26, 2002. (See Report at http://www.ustreas.gov/offices/inspector-general/audit-reports/2003/oig03024.pdf)

- *Material Loss Review of Hamilton Bank, NA*, OIG-03-032, December 17, 2002. (See Report at http://www.ustreas.gov/offices/inspector-general/audit-reports/2003/oig03032.pdf)

Office of Thrift Supervision
Department of the Treasury *Managing Director, Examinations, Supervision, and Consumer Protection*
1700 G Street, N.W., Washington, DC 20552 • (202) 906-7984

May 25, 2004

Marla A. Freedman
Assistant Inspector General for Audit
Department of the Treasury
740 15th Street, NW, Suite 600
Washington, D.C. 20220

Dear Ms. Freedman:

Thank you for the opportunity to comment on the draft compendium report entitled "Summary of Treasury OIG's Material Loss Reviews of Failed National Banks and Thrift Institutions Between 1993 and 2002." Director Gilleran asked that I reply on behalf of the Agency. In the main, we have focused our review on the discussion of failed thrift institutions and offer no comment on the discussion of failed national banks.

We have a few comments regarding the discussion on the failed thrifts. We offer the following suggested changes to clarify the draft.

Page 6, footnote 1 to Table 2. Delete "Changes in accounting pronouncements" and substitute "Improper application of accounting principles". This change properly presents the situation and it aligns footnote 1 with the text in the middle of the first full paragraph on page 8.

Page 13, first bullet point. We recommend deleting the following two sentences: "It also appeared that OTS exercised regulatory forbearance by delaying the recognition of Superior Bank's true capital position in early 2001. OTS may also have failed to enforce one of the PCA restrictions over senior executives' bonuses." [1] Regarding the first sentence, the ownership interests of Superior made credible and repeated representations to OTS executive management that they would implement the capital plan and promptly infuse the necessary capital into the institution. When it became clear that this representation was not going to be honored, OTS immediately placed Superior into receivership. Regarding the second sentence concerning alleged bonuses, it appears that the payments at issue were deferred compensation payments, not bonuses. Despite extensive reviews by other federal offices, the payments in question have never been proven to be bonuses.

Page 18 of Appendix 1. In addition to the sentence regarding the Federal Reserve Board's holding company authorities, a parallel sentence regarding OTS's authority over thrift holding

[1] If the sentence regarding senior executives' bonuses is deleted, Recommendation 7 in Table 4 of Appendix 3 should also be deleted.

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companies should be added: "If the institution is owned by a thrift holding company, we also review relevant records of the OTS and interview OTS staff."

Please contact me or Randy Thomas (202-906-7945) if you would like further discussion of these issues.

Sincerely,

Scott M. Albinson

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Appendix 6
Major Contributors To This Report

Donald R. Kassel, Director, Banking and Fiscal Service Audits
Benny W. Lee, Director, Western Field Audit Office
Delores V. Dabney, Audit Manager
Leslye K. Burgess, Auditor-in-Charge
Cedric E. Hammond, Sr., Referencer

The Department of the Treasury

Under Secretary for Domestic Finance
Assistant Secretary, Financial Institutions
Director, Office of Strategic Planning and Evaluations
Director, Office of Accounting and Internal Control

Office of the Comptroller of the Currency

Comptroller of the Currency
First Senior Deputy Comptroller and Chief Counsel
Chief National Bank Examiner
Senior Deputy Comptroller- Large Bank Supervision
Senior Deputy Comptroller – Mid Size/Community Banks
Senior Advisor – OIG/GAO Liaison

Office of Thrift Supervision

Director
Audit Liaison

Office of Management and Budget

OIG Budget Examiner

United States Congress

Senate Committees (Chairman and Ranking Member)
- Appropriations
- Banking, Housing and Urban Affairs
- Finance
- Governmental Affairs

House Committees (Chairman and Ranking Member)
- Appropriations
- Financial Services
- Government Reform
- Ways and Means

Questions for the Record
June 16, 2004 Testimony
House Financial Services Committee
Subcommittee on Oversight & Investigations

Question 1

At the recent G-8 summit in Sea Island Georgia, and at the Summit of the Americas earlier this year, the Bush Administration made a commitment to reduce by half the costs of remittances to consumers by the year 2008. The communiqués referred to efforts to promote competition, use financial literacy efforts, and help people join the financial mainstream. Can you please outline for the Subcommittee the specific policies the Administration will adopt to promote competition in the remittances industry, and any other specific efforts that will lead to lower costs?

Answer 1

The Administration places great importance on market competition as a guiding principal in all industries, including financial services. Creating a level playing field is critically important to ensuring broad-based competition at all levels and that consumers have access to low cost, efficient financial services, including for remittances.

The key elements of the Administration's remittance strategy include – promoting competition, strengthening the financial infrastructure, promoting/providing financial literacy, and minimizing regulatory barriers. Several multilateral and bilateral initiatives on remittances are underway, including through APEC, the U.S-Mexico Partnership for Prosperity, the Summit of Americas and the G8 Sea Island process. All of these efforts focus on these key elements, through the following manner:

- **To support competition**: raising awareness among financial institutions of the size and potential of the remittance market in the United States and Mexico stimulated a flood of new remittance products servicing the US-Mexican market. A number of remittance products have been introduced that use a variety of electronic payment technologies, including stored value cards, ATM cards, bank-to-bank account transfers, etc. While some of these new products have proven more successful than others, it has illustrated that financial institutions are interested in this market opportunity.

  - Treasury held a private-sector outreach with top financial services providers in May 2004 in New York City as part of the G8 Sea Island summit's efforts to understand industry's challenges and opportunities of offering remittance services. I personally chaired a roundtable on remittances with private and public sector participation at the Partnership for Prosperity meeting in Guadalajara, Mexico last month. The United States also co-chairs an APEC committee that held a remittance symposium in Japan in early June on the role of the private sector in offering remittance services. Similar events will be held as part of our regional outreach through the Summit of Americas (SOA) work.

- **Strengthening financial infrastructure** is an important step to transferring funds, even in small sums, easily from one country to another. More efficient payments systems would make a significant contribution to expanding access to, and lowering the cost of, remittance services. However, in order to modernize infrastructure, financial institutions must have access to advanced technology and access to sound, reliable payment systems.

    - Within the context of the SOA, USAID and Treasury will be identifying and addressing weaknesses and barriers to financial infrastructure in pilot countries. To this end, outreach will be conducted with private-sector, academic and government organizations to understand and overcome barriers to creating more efficient channels to send remittances.

    - To strengthen bilateral cross-border payment infrastructure, the Federal Reserve is working with a number of countries, including Mexico, to develop a bilateral Automated Clearinghouse (ACH) connection to allow for direct payments. The Treasury and the Federal Reserve are using such an arrangement to deliver some Federal benefit payments to individuals in Mexico, and a similar arrangement will be in place with Panama before the end of the year. In addition, the Federal Reserve Bank of Atlanta will hold a conference in October 2004 on establishing regionally compatible electronic payment systems in the Latin American region as part of the SOA commitment. The conference will bring together financial sector leaders and payment system experts to discuss ways to reduce the cost of transfers, including sharing experiences with automated clearinghouses (ACH) and other electronic payment systems, and exploring ways to harmonize payment systems in the region and build regional electronic payments interchanges. More uniform domestic ACH systems would both strengthen the development of efficient systems in all countries and pave the way toward for direct electronic linkage of the domestic payment systems, facilitating remittance flows in the Western Hemisphere.

    - For a number of years now, Treasury has offered an Electronic Transfer Account (ETA)--a low-cost account through participating financial institutions--to individuals receiving federal benefit payments such as Social Security and veterans' benefits. The purpose of the ETA is to encourage direct deposit and to bring people without bank accounts or with past financial problems into the financial mainstream. Nearly 500 financial institutions participate in this program by offering the ETA at more than 17,000 branch locations across the nation. More than 74,000 ETA accounts are currently open.

- **Encouraging physical access to financial services:** One of the key barriers to competition in remittance services is a lack of physical access to financial institutions in rural communities. To overcome this, facilitating the involvement of non-bank financial institutions (e.g., credit unions and micro-finance institutions) can extend access to financial services to serve very small, poor, and/or isolated communities. Adopting innovative approaches, such as creating partnership between banks and wires transfer companies, using convenience store outlets as a remittance distribution center, or expanding ATM networks, may also help.

- USAID has provided assistance for financial-sector development to such institutions, as credit unions and microfinance institutions, to strengthen and enable them to provide remittance services. As part of the SOA commitment, USAID will be expanding these efforts in the pilot countries.

- **Expanding Financial Literacy:** Removing perceived and/or actual barriers to the use of formal financial institutions is a sorely needed step in both sending and receiving countries. In the United States, as well as in many of the other G7 countries, the proportion of the immigrant population that is unbanked, e.g., has no account with any financial institution, is significantly higher than amongst the population in general. One contributing factor is a lack of familiarity with, and/or trust in, formal financial institutions in this segment of the population.

  - The U.S. financial agencies - the Federal Reserve, FDIC and Treasury - will continue to offer financial literacy training in the United States to encourage wider use of financial services. As part of the SOA commitment, USAID will also be providing more than $3 million in assistance over the next two years to expand access to financial services in Latin America and the Caribbean. Target countries will include Jamaica, Guatemala, Nicaragua, Haiti, Mexico, Bolivia, and Colombia.

- **Minimizing regulatory barriers**: regulatory barriers can unnecessarily prevent competition among existing and potential remittance service providers. First, in some countries, allowing direct access to the payment system can facilitate competition. Second, in many countries, institutions allowed to distribute remittances are limited to banks or other narrow groups of institutions – expanding the classes of institutions allowed to participate in this market can facilitate greater market entry and more competition. Third, some countries have burdensome anti-money laundering or counter-terrorist financing regulations that can make remittance services substantially more expensive. Bilateral and multilateral assistance and policy dialogues are concrete ways to work with governments to overcome these regulatory impediments. We are working to specifically identify, in consultation with our domestic financial services providers, regulatory barriers that may exist abroad that limit their ability to provide remittances through policy discussions.

  - Treasury offers technical assistance throughout the world to assist reform-minded authorities to strengthen financial regulatory and supervisory practices and to ensure a level playing field for all institutions. One goal is to help ensure that the flow of remittances is handled in a trustworthy and transparent manner, and thereby help boost the confidence in the banking system and help protect against fraud, money-laundering and terrorist financing. Such transparency efforts should have a positive effect on encouraging a more competitive environment for financial institutions in these countries.

Question 2

Ranking Member Frank, myself, and two other Members of this Committee, Mssrs. Hinojosa and Baca, recently asked the banking regulators whether it is permissible under current regulations to provide CRA credit to regulated financial institutions for the offering of low cost remittances services. The regulators agree that this is possible. Do you support this effort? What will the Treasury Department do to encourage financial institutions to enter the remittances market so that they can offer lower cost alternatives to consumers?

Answer 2

As you know, the Community Reinvestment Act (CRA) directs the banking regulators to use their appropriate authority to encourage banks "to help meet the credit needs of the local communities in which they are chartered" consistent with safety and soundness concerns. The banking regulators, which are independent agencies, are in the best position to interpret their CRA rules and decide how they apply to remittances within the context of the statute.

At the Treasury, we encourage remittances through several means, including the following:

- We work to identify unnecessary regulatory barriers, whether at home or abroad, that limit or inhibit remittance services, and then work to remove those barriers.
- We actively encourage competition in the remittances arena, which has been a powerful factor in recent days in lowering remittance costs and increasing access to remittances here and abroad.
- We encourage financial services providers to explore the business potential of remittances. Several financial institutions recently have come to the conclusion that providing low-cost remittance services is an effective means of developing customer loyalty.

Question 3

I understand that Treasury has proposed that GSEs have a tough "OCC" like regulator. Do you really think that the OCC is the type of shining example of a tough regulator you should be holding up as an ideal?

Answer 3

The Administration has proposed that a new regulatory structure for the housing government sponsored enterprises (GSEs) be created that has a strong, credible, and well-resourced regulator with all of the powers, authority, and stature needed to do its job. In that regard, the new regulator's powers should be comparable in scope and force to those possessed by our nation's other financial regulators, including the Office of the Comptroller of the Currency (OCC), the Federal Reserve Board, the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS), and the National Credit Union Administration (NCUA). These financial supervisors have the necessary regulatory authority to carry out their mission, and those are the types of authorities that we have proposed for the new regulator of the housing GSEs.

Question 4

In your testimony to the Senate Banking Committee, you indicated that you are the accountable person in the Federal government for using the financial information that comes to you, specifically through FinCEN, to identify, and disrupt the financing of terrorist operations, and to seize the assets of terrorists. Do you agree with this characterization of your role?

Answer 4

As the Deputy Secretary of the Department of the Treasury, I am accountable for all matters that pertain to this Department. This includes not only the use of financial information gathered by the Financial Crimes Enforcement Network (FinCEN), but all aspects of the fight against terrorist financing as it pertains to Treasury's most fundamental responsibility - safeguarding the soundness and integrity of the U.S. and international financial systems.

Of the Treasury Department's many statutory mandates, several implicate terrorist financing. FinCEN's administration of the Bank Secrecy Act (BSA) is but one. In addition Treasury's other terrorist financing responsibilities include maximizing the financial expertise of IRS-CI, utilizing Treasury's economic sanction authorities combined with our unique ability to implement orders that freeze the assets of terrorists under Executive Order 13224 as administered by the Office of Foreign Assets Control (OFAC), and employing the unique authority granted to the Treasury Department in Section 311 of the USA PATRIOT Act ("Patriot Act")..

The newly created Office of Terrorism and Financial Intelligence (TFI) brings together all of Treasury's intelligence, regulatory, law enforcement, sanctions, and policy components in this area. TFI will increase Treasury's ability and efforts to identify, and disrupt the financing of terrorist operations, and to seize the assets of terrorists in several ways.

- The combined use of intelligence and financial data is the best way to detect how terrorists are exploiting the financial system and to design methods to stop them. By coordinating Treasury's intelligence functions and capabilities, TFI will benefit from enhanced analytical capabilities, as well as additional expertise and technology.
- The Patriot Act gave the Treasury Department important new tools to detect and prevent the abuse of our financial system by terrorists and other criminals. TFI will coordinate Treasury's aggressive effort to enforce these regulations.
- We have forged a strong international coalition to combat terrorist financing. The ongoing, cooperative efforts between the U.S. and our international partners are at unprecedented levels. The unified structure will promote a robust international engagement and allow us to intensify outreach to our counterparts in other countries.
- Having a single office is the best way to ensure accountability and achieve results for this essential mission.

Question 5

If so, do other Federal agencies in the Federal government, such as the Homeland Security Department, and the Justice Department, share information on terrorist financing matters with Treasury?

Answer 5

Yes, other agencies share information on terrorist financing matters with Treasury.

The primary focal point for using terrorist financing information is the Terrorist Financing Policy Coordinating Committee (PCC). The PCC participants bring together all the terrorist financing principals in the U.S. Government to develop policy through information sharing and collaboration. The NSC currently chairs the PCC. This reflects the high-level of importance that the White House places on the issue and its continued integration into the overall effort against terrorism. Treasury plays an important role on the PCC. We – along with the other PCC members – are a key figure in the decision-making process that determines which individuals and entities to target and what steps should be taken.

Numerous other interagency mechanisms exist as well for information sharing related to terrorism and terrorist financing. The Terrorist Financing Operations Section (TFOS) of the FBI is the central focal point for terrorist financing law enforcement operations, and Treasury participates in TFOS through the IRS-CI, OFAC, and FinCEN. Other relevant mechanisms include the Terrorist Threat Integration Center (TTIC) and the Foreign Terrorist Asset Tracking Group (FTAT-G). In addition, Treasury forms an integral part of the NSC-led Counter-Terrorism Security Group (CSG), where information is shared on a daily basis.

Question 6

It is my understanding that the Treasury Department is not a party to a memorandum of understanding between the Homeland Security and Justice departments on money laundering-related issues. Given that you are the lead agency on money laundering and terrorist financing issues, and that you are ultimately accountable, based on your testimony to the Senate Banking Committee, can you please explain how and why Treasury was excluded from this important coordinating mechanism in the Federal government?

Answer 6

The memorandum of understanding between the Departments of Justice and Homeland Security was intended to clarify the roles of the FBI and the Bureau of Immigration and Customs Enforcement (ICE) in investigating domestic criminal cases with potential terrorist financing links. As we have said, the FBI is the lead agency for terrorist financing law enforcement investigations. The Treasury Department's law enforcement and law enforcement support entities (i.e., IRS-CI, FinCEN, and OFAC) support the FBI on terrorist financing investigations through participation in TFOS and the various Joint Terrorism Task Forces (JTTFs) around the

country. There was no need for the Treasury Department or any of its components to have been or to be a part of any such MOUs because there was no confusion or need for clarification about Treasury's law enforcement role.

Question 7

Your written testimony indicates that Office of Terrorism Financing and Intelligence (TFI) will complement the work of other Federal agencies and will be "fully integrated into established task forces and processes." One of those established "processes" is the MoU on terrorist financing investigations between Justice and Homeland Security. Will you get Treasury integrated into this MoU, as your testimony suggests?

Answer 7

The memorandum of understanding, discussed above in the answer to question 6, does not establish a task force or a process. As noted above, there was no need for the Treasury to be a party to this MOU, nor is there a suggestion in the testimony that we should be a part of this MOU.

Question 8

On June 15, the Council on Foreign Relations (CFR) released a report critical of Saudi efforts to curb terrorist financing. Though the Saudi government has enacted laws and regulations against terrorist financing, no public arrests, trials, or incarcerations have occurred, nor does it appear, according to the Council on Foreign Relations, that anyone has been held accountable for terrorist financing activities. In fact, the report notes that some key financiers roam freely in the kingdom. Can you please comment on these findings, especially given that on June 2nd, Deputy Assistant Secretary Juan Zarate participated in a press event with the Saudis to discuss joint efforts to crack down on financing of terrorist activities?

Answer 8

The CFR Report articulates substantial progress that Saudi Arabia has made in the area of terrorist financing, but notes that more work needs to be done. We agree with both parts of this conclusion. We certainly also agree that it is important for terrorist financiers in Saudi Arabia and throughout the world to be held accountable for their actions. We do think, however, that the Report is flawed in a number of important respects that call into question several of its more detailed conclusions. In addition, the conclusions are limited in their value since the Report relied only on open source information to form the basis of its conclusions.

One concern with the Report is that it fails to place its criticism of the apparent lack of terrorist financing prosecutions within Saudi Arabia in the appropriate global context. Though we agree that prosecutions are vitally important, it should be noted that a lack of terrorist financing prosecutions is a worldwide problem and not one limited to Saudi Arabia. If the number of

successful terrorist financing prosecutions is the litmus test for cooperation in the fight against terrorist financing, then very few jurisdictions would be receiving high marks.

More significantly, the Report combines the concepts of arrests and prosecutions with the designation process under United Nations Security Council Resolution (UNSCR) 1267. In so doing, the Report seems to imply that persons designated under UNSCR 1267 should be arrested and prosecuted. It is important to understand, however, that one of the most valuable aspects of the designation process is its flexibility, its reduced evidentiary standards, and its ability to rely on classified information that would not be available in criminal prosecutions. To suggest that designations should be delayed until criminal cases can be brought would inappropriately hamper the designation process.

Finally, it is simply incorrect to imply that Saudi Arabia has not taken action against terrorist financing. In fact, Saudi Arabia has taken significant steps to designate, capture and in many instances kill operatives, facilitators and financiers for al Qaida. The Saudi government has taken steps to isolate and freeze the assets of individuals and entities designated as terrorist supporters – including the freezing of over five million dollars and seizure of terrorist-related assets. Additionally, Saudi Arabian law enforcement entities partner closely with the FBI and IRS-CI on the ground in Saudi Arabia through the U.S.-Saudi Joint Terrorist Financing Task Force.

One recent example of joint U.S.-Saudi action was the June 2nd joint designation of five branches of the Saudi-based Al Haramain Islamic Foundations, which is referenced in the question. This joint designation follows on the heels of an earlier joint designation of four AHF branches located in Indonesia, Kenya, Tanzania and Pakistan. All branches had provided financial, material and logistical support to the al Qaida network and other terrorist organizations. This announcement was also augmented by the Saudi government's announcement that they are collapsing their charitable institutions and sector into a singular charity to provide transparency and oversight to funds flowing out of the Kingdom. The June 2nd announcement was a significant event in terms of charitable reform and action in Saudi Arabia.

Question 9

The CFR report notes that the Saudi government has made some progress in this area but that some outstanding questions about Saudi political will remain. Can you comment on this finding?

Answer 9

See answer to question 8.

Question 10

The Council on Foreign Relations testified on June 15 before the Senate Governmental Affairs Committee and recommended the adoption of a certification system that would "name and shame" countries on the basis of their cooperation with the U. S. and international efforts to cut off terrorist funding. Does the Bush Administration support this idea?

Answer 10

A certification program for terrorist financing cooperation is an interesting idea. One major difficulty with such an approach, however, is that terrorist financing is just one piece of the puzzle, and separating that effort from the overarching war on terror may not be an effective way to judge or set a standard for cooperation. Thus, certification in this area without reference to cooperation on the terrorism front more broadly may be of limited value.

Question 11

If so, does the Bush Administration support the idea that countries failing to comply with a certification regime should be subject to sanctions, such as denial of foreign assistance?

Answer 11

See answer to question 10.

Question 12

As you know, Section 311 of the Patriot Act authorizes the Treasury Secretary to impose special measures in an area of primary money laundering concern, be it a country, a financial institution, a type of transaction, or a type of account. This legislation originated in the Clinton Administration's Treasury Department and from the bipartisan leadership in this Committee (Leach-LaFalce). It is our understanding that Section 311 has been invoked in some discrete instances, most recently in the case of Burma. Why has Treasury not used Section 311 to designate areas, countries or financial institutions known to be used by al-Qaeda in the Middle East and in other areas of the world where al-Qaeda is known to operate?

Answer 12

Section 311 is an important tool in the fight against terrorist financing. Until recently, however, the inability to protect classified information when presented with challenges to the imposition of special measures limited Section 311's utility.

Congress recently addressed this problem, and since that time, the Treasury Department has utilized Section 311 in several instances. One such recent use of the authority is the designation

of the Commercial Bank of Syria (CBS) and its subsidiary Syrian Lebanese Commercial Bank, which was based upon, among other reasons, terrorist financing concerns.

Of course, as the question notes, Treasury has not limited its application of the authorities in Section 311 to terrorist financing concerns. Last November, Treasury designated two Burmese banks -- Myanmar Mayflower Bank and Asia Wealth Bank -- due to their connection with notorious Southeast Asian drug trafficking organizations. These designations have already borne fruit, resulting in an announcement by Burmese authorities of investigations into the two banks and enhanced law enforcement cooperation in ways previously resisted by the Burmese authorities. Other uses of Section 311 have included designations of Ukraine and Nauru, each of which resulted in legislative reform within those jurisdictions.

Our developing experience is demonstrating that Section 311 is among the most effective tools that we have in the fight against money laundering and terrorist financing. In some instances, the greatest use of Section 311 is simply in its threatened use.

With this experience in mind, we are continuing to identify and develop cases against appropriate targets. Treasury is committed to using Section 311 appropriately and aggressively, including further designations based on terrorist financing concerns, in addition to concerns related to other financial crimes. .

Question 13

Last year, we gave Treasury authority in the Intelligence Authorization Act to rely on classified information that could be reviewed by a court in camera and ex parte to designate an area of primary laundering concern under Section 311. Have you used this authority and has it helped you go after the finances of al-Qaeda and/or other terrorist organizations?

Answer 13

See answer to question 12.

Question 14

As you know, the President's budget includes a proposal to study a merger of the Mint and the Bureau of Engraving and Printing. In testimony before Congress in 1997, the GAO indicated that neither of the studies done to date on merging the operations of the U.S. Mint and the BEP, nor any of the Treasury officials that GAO interviewed for its testimony, provided information on the savings that would accrue from a merger of the two entities. In addition, a 1987 Treasury study also did not provide support for cost savings from a Mint-BEP merger. Does the Treasury Department or OMB have new cost savings information since both of these studies were conducted that would now justify a merger of the two entities?

Answer 14

As part of the Administration's ongoing effort to improve government operations, and consistent with the language in the Fiscal Year 2005 President's Budget, the Department studied options to achieve savings and improve efficiencies at the BEP and the Mint. While similar studies have been conducted in the past, the environment (impact of E-Commerce on demand/customer expectations and the 9/11 impact on security) has changed since the prior studies. The study did incorporate and consider information and analysis from prior study efforts while focusing on potential efficiencies within this new environment. The Department recently received the final version of the study and issued it to the Congress. While we have no plans to pursue a consolidation of the BEP and the Mint, the study did provide valuable information and insights, as well as a number of options to achieve savings. The BEP and the Mint will use the study to continue to find ways to collaborate, building on their successful partnering efforts over the past few years.

Question 15

Why did OMB and Treasury resort to the use of a private contractor instead of a government agency, such as the Treasury Inspector General, to determine whether any cost savings would accrue from a merger of the Mint and the BEP?

Answer 15

The Department's approach to determine efficiency options was to develop a data-driven business assessment for BEP/Mint efficiencies. Given the desire to complete the study by July 1, 2004 and the availability of several contractors with expertise in government management and efficiencies, the Department determined that contract support could best supply the needed expertise within the necessary timeframe. An open competition was held - using GSA schedule - between IBM, Logistic Management Institute (LMI), and Booz Allen Hamilton. The Department ultimately chose LMI, a contractor with over 40 years of experience, to conduct this analysis.

Question 16

Regarding the information security problems at Treasury that you discussed at the hearing, what are the projected cost estimates for fixing the problems? What is the time estimate for when the vulnerabilities will be eliminated? Is it true that classified materials are currently readily available to hackers through Treasury's intranet?

Answer 16

Based on the information at this time, the immediate remediation costs are estimated at several million dollars. This estimate includes cleaning the data spill and building a secure storage area for backup tapes which we are required to retain for litigation purposes.

Cleanup and remediation of the system is ongoing. The estimated time to clean the system is between three and six months. The most reliable process that we can use to delete these files requires manually reviewing an extremely large amount of data.

The Treasury Intranet does not contain classified data. It is not physically connected to the areas of the system identified as having classified data spills. Treasury employs a multilayered defense against hackers, which has multiple intrusion detection breakpoints where malicious activity is detected and stopped.

Question 17

Have hacking incidents increased recently at Treasury? Are there documents or attachments on the unsecure LANN system at Treasury that should not be there? If so, how many documents? Are any top secret or above? What specific actions are being taken and at what cost to remove these? What actions are being taken to insure that Treasury does more to insure the security of government information? How did the secure documents get on the unsecure system? What actions have been taken to mitigate the problem? Has the intelligence community audited the Treasury system? Will you have the CIA certify the security of the system or will you rely on an outside contractor who you pay and you control?

Answer 17

We closely monitor efforts to hack into the Treasury system, which go up and down. The unclassified LAN is not un-secure, it is protected with multiple levels of intrusion detection to prevent unauthorized access. At this point in time, we have found approximately 140 documents, including some documents that should have been classified as top secret, which were inadvertently placed on the unclassified LAN.

As mentioned in the above response, the immediate cleanup costs associated with correcting the problem are estimated at several million dollars. We have established a project team, comprised of the Deputy Assistant Secretary of Security and the Chief Information Officer to oversee all aspects of the cleanup. A dedicated technical team has also been formed to handle the day-to-day removal of the documents from the network. In addition, an independent third-party has been brought in to assess the Department's methodology for this cleanup. Classified documents were put on the unclassified system because they were not properly marked. The Department has mandated security training for all DO employees, and we have created, funded, and filled a career position of Deputy Assistant Secretary for Security to develop a comprehensive security training program and institutionalize security awareness.

The Intelligence Community has not audited the Treasury system. The CIA has been apprised of the information spill and is aware of Treasury's clean up efforts. The CIA will be provided Treasury's Mitigation Plan which will detail actions taken to clean up the spill and hardware, software, procedural and training enhancements to prevent the likelihood of another spill.

Question 18

Please provide detailed breakouts of Treasury's budget and current spending to date in FY'04. How much was requested in FY'05 to fund the TFI and bolster information security weaknesses? Since these were not requested in the FY'04 budget, how are you paying for these expenses? What activities are suffering and what departments' budgets are being raided? Please provide specific details. If certain activities are not being undertaken that were funded in last year's legislation, are they being requested in this year's? Are these activities we are lacking causing harm to the functions of Treasury and its mission or did Treasury have an excess appropriation in the past?

Answer 18

The following table reflects DO's initial FY 2004 Budget, actual spending through June 30, 2004, and the projected spending through the end of the fiscal year.

Office	FY 2004 Budget	Spending thru 06/30/04	Projected thru 9/30/04
Economic Policy	$4,145,000	$2,934,721	$3,963,000
International Affairs	$27,881,000	$17,420,980	$27,363,000
Tax Policy	$13,955,000	$10,372,196	$13,685,000
Domestic Finance	$9,448,000	$6,740,046	$9,336,000
Terrorism and Financial Intelligence (TFI)	$0	$10,611	$1,914,000
Terrorist Financing and Financial Crimes (TFFC)	$5,186,000[1]	$1,124,659	$5,186,000
Foreign Asset Control	$21,855,000	$16,447,505	$21,726,000
Management and CFO Programs	$14,275,000	$10,384,979	$13,926,000
Executive Direction	$17,168,000	$10,358,072	$16,844,000
Treasury-Wide Financial Audits	$3,393,000	$3,393,980	$3,372,981
Administration	$61,704,000	$52,760,371	$57,753,976
0.59% Rescission	($1,037,043)		
Total	**$175,069,957**	**$131,948,120**	**$175,069,957**

TFI had not been created when Treasury submitted its FY 2005 President's Budget and therefore there was no specific line item for this new office in the budget. The Department has, however, submitted a request for reprogramming to both the House and Senate Appropriations Committees that asks for a redistribution of the FY 2005 budget to fund this high priority mission. The redistributed dollars were based on anticipated salary savings that will be generated through careful management of vacancies. Vacancies will be reviewed and prioritized in order to make resource decisions based on the Department's highest priorities.

[1] This amount includes $2.9 million for money laundering grants, which is expected to be distributed by the end of the fiscal year.

The FY 2005 funding request of $1 million provides for the implementation of a cohesive and comprehensive Information Security program for Treasury's Headquarters offices, including the Office of the Secretary and Policy Offices. The IT security program for Treasury's Headquarters offices has been inadequate for a number of years. This has been described by the Treasury Inspector General as a continuing material weakness and must be addressed.

Efforts to address security training and awareness are a priority. The request of $1 million will provide for the following:

- Issuance of policy and procedures ($100,000)
- Certification and Accreditation of applicable systems (19 Systems - $300,000)
- Project management ($100,000)
- Compliance monitoring ($150,000)
- Security Engineering and Network Services support ($350,000)

In FY 2004, $1.9 million will be funded through the use of salary savings that have been generated during this fiscal year.

Since October 2003, many offices have experienced attrition and the dollars saved during the process of filling those positions will be used to start up this new office. Offices with the employee turnover that generated the funds are:

Office	Salary Savings Generated from Turnover
Executive Direction Offices	$324,000
Tax Policy	$270,000
Domestic Finance	$112,000
Economic Policy	$182,000
International Affairs	$518,000
Treasury-Wide Management and Administration	$575,000
Total	$1,981,000

Offices have an opportunity to request any significant shortfalls during the FY 2006 budget process, which we are now undergoing. During this process, offices are examining their use of resources, identifying savings, and reinvesting those savings in higher priority areas.

The Secretary is committed to ensuring that Treasury's mission is not jeopardized and is careful in properly allocating resources to ensure functions do not suffer. Treasury's appropriation is far from excessive, particularly after divestiture to the Department of Homeland Security. On the other hand, he is cognizant of the fact that the availability of appropriations is extremely tight and is managing Treasury's resources in a manner that is fiscally responsible without being harmful to Treasury's mission.

Question 19

Treasury was originally the head of the Presidential Coordinating Committee on Terrorist Financing. What is Treasury's role now that it is no longer leading this effort? Why is Treasury no longer the Chair and how did this shift come about?

Answer 19

The decision to place the NSC at the chair of the Policy Coordinating Committee (PCC) reflects the high-level of importance that the White House places on the fight against terrorist financing and its continued integration into the overall effort against terrorism. The purpose of the PCC has always been to coordinate the policy direction and actions of the U.S. government related to terrorist financing. Treasury continues to play an important role on the PCC that, outside of the administrative responsibilities of the chair, is not very different from our previous role. Through our readiness to bring our authorities to bear, Treasury can drive the process and force a discussion on all relevant options, thereby ensuring that the interagency community considers fully all potential actions that can be taken with respect to each identified target.

Question 20

The House has passed and sent to the Senate H.R. 3786, sponsored by Representatives King and Maloney and introduced at the request of the Administration. Given the importance to national security of having strong economies in the countries of all of our allies, and given the important safeguards contained in the legislation, it seems self-evident that this is good, no cost legislation that should already have been enacted. Also, according to news accounts, the lack of authority for the Bureau of Engraving to print new currency for Iraq caused the Administration to authorize the spending of some $80 million to print the currency overseas at a time when every single American manufacturing job is important. However, senior Senators key to this legislation's passage have never received more than letters from the Administration supporting the bill, leading them to conclude that it is not an Administration priority and can thus be ignored. Can you assure me that you, or Secretary Snow, will either call or personally visit with both Senator Sarbanes and Senator Shelby and work to ensure its passage before the end of this Congress?

Answer 20

The Department of the Treasury strongly supports Senate passage and final enactment of legislation to authorize the Secretary of the Treasury to produce currency and other security documents for friendly foreign governments on a reimbursable basis. Enactment of this legislation is vital to ensure that the U.S. government is able to produce secure currency to support allies and fledgling democracies, such as Iraq, in the future.

The Department looks forward to continuing our work with Chairman Shelby and Senator Sarbanes on this issue.

Question 21

Enclosed is a letter received by my office from an OCC employee expressing concerns about the way the agency is funded and the dependence the agency has on its regulated institutions. Given these concerns as well as the clear evidence of sparse resources at the OCC as exemplified in the IG's May 28 report as well as the OCC's recent work on the Riggs matter, wouldn't it make more sense for the OCC to be an appropriated agency? Can you suggest additional funding alternatives?

Answer 21

The issue of funding for the OCC has been raised over the years both in the context of national banks remaining competitive with state chartered banks that generally have lower costs of supervision and in terms of the OCC having adequate resources. As a general principle, all of the federal and state bank supervisory agencies should have the resources necessary to accomplish their missions, and the distribution of supervision funding among financial institutions that perform similar activities is an important question that should be further evaluated. In that regard, however, it is important to remember that Congress long ago determined, and in recent legislation reaffirmed, that a funding source separate from the annual appropriations process is an important element in preserving the independence required for the federal banking regulators to do their job effectively and professionally, in a truly unbiased manner. That is why, for example, we have urged for several years that the funding for the Office of Federal Housing Enterprise Oversight (OFHEO) be removed from the annual appropriations process.

Questions for the Record
from
Congressman Gutierrez
Subcommittee on Oversight and Investigations
House Committee on Financial Services
June 16, 2004

QUESTION:
It is my understanding that the OCC was initially informed by the FBI and the press regarding the problems with shoddy BSA compliance by Riggs Bank as early as 1997, if not before. It is also our understanding, based on your Senate testimony, that FinCEN did not become aware of BSA-related problems at Riggs until 2003. Can you please clarify for the Subcommittee when your agency was made aware of problems at Riggs and why would you not have known about them concurrently with the OCC?

RESPONSE:
The Office of the Comptroller of Currency referred the Riggs matter to FinCEN on June 20, 2003. At that point, FinCEN began to independently evaluate the materials referred to it by the Office of the Comptroller of the Currency to determine whether there were sufficient grounds to conclude that Riggs had committed a willful violation of the Bank Secrecy Act warranting a civil enforcement action. During the fall of 2003 and January of 2004, additional examinations by the Office of the Comptroller of Currency resulted in new findings coming to light that were shared by the Office of the Comptroller of Currency with FinCEN, and this material became part of the evaluation process aimed at determining an appropriate remedy. On March 2, 2004, FinCEN and the Office of Comptroller of Currency simultaneously issued letters to Riggs outlining the alleged Bank Secrecy Act deficiencies and requesting a response. After reviewing responses from Riggs, and all other relevant information, FinCEN and the Office of the Comptroller of Currency assessed a concurrent civil money penalty against Riggs, in the amount of $25 million, on May 13, 2004.

Generally, FinCEN identifies potential Bank Secrecy Act enforcement cases through: (1) referrals from federal supervisory and other agencies examining for compliance with the Bank Secrecy Act; (2) self-disclosures by financial institutions; or, (3) FinCEN's own inquiry to the extent it becomes aware of possible violations. These referrals and self-disclosures are conducted at the discretion of the federal supervisory agency or financial institution.

An issue that FinCEN is presently addressing – the difficulty in obtaining information about institutions with potentially significant Bank Secrecy Act violations at an earlier stage – is the focus of the second part of your question. The reality is that without access to examination reports or other information discovered by examiners, FinCEN is limited in its ability to proactively identify such violations within institutions, even those that appear in press reports. Given FinCEN's role as the administrator of the Bank Secrecy Act and the need for FinCEN and all regulators to work together to better ensure Bank Secrecy Act compliance, the Department of the Treasury and FinCEN are working toward an enhanced oversight role for FinCEN. Part of that plan involves the production to FinCEN by the agencies examining for Bank Secrecy Act compliance of more information related to Bank Secrecy Act deficiencies within the institutions

they regulate. This will help FinCEN develop a more accurate picture of compliance in the industry and address these issues within specific institutions earlier.

QUESTION:
Your agency collects an enormous amount of currency transaction data that are used for law enforcement case support. However, it seems as though these data might be useful to also construct a broad picture of whether we have a serious money laundering, or terrorist financing problem either within the U.S. financial institutions system, or in money services businesses, or in certain regions of the world. Section 361 of the Patriot Act requires you to analyze the information you receive to determine whether any financial crimes are occurring. Can you, as the head of the world's leading financial intelligence unit, give this Subcommittee an assessment of the specific threats, and where they are, regarding terrorist financing and money laundering?

RESPONSE:
Section 361 of the USA PATRIOT Act lists the full spectrum of FinCEN's duties. Those duties include: maintaining a government-wide data access service; coordinating with financial intelligence units in other countries on anti-terrorism and anti-money laundering initiatives; assisting our clients in combating the use of informal, non-bank networks and payment and barter system mechanisms; and furnishing research, analytical, and informational services to financial institutions and appropriate Federal regulatory agencies. As pointed out in your question, FinCEN is also responsible for analyzing and disseminating available data for the purpose of identifying possible criminal activity, supporting ongoing criminal financial investigations and prosecutions, and determining emerging trends and methods in money laundering and other financial crimes. FinCEN takes all aspects of its mission seriously and is aligning its resources to meet these important duties.

In the terrorism context, the movement of funds on the front end is in many cases a reverse form of money laundering – taking clean money (charitable contributions) and converting it to criminal use. On the back end, the financing of terrorist acts typically involves amounts well below reporting requirements and/or thresholds which generally trigger scrutiny; a distinct absence of traditional indicators of suspicious behavior; and an understanding of the types of financial service products and providers that are least susceptible to existing financial industry controls and monitoring.

The financing of terrorism poses a threat with domestic implications that can only be addressed on the international level. Terrorist organizations are known to engage in a variety of criminal activities to generate operational funds, but they also depend on funding that comes from what can be considered as legitimate sources. Intelligence agencies believe that charitable donations figure prominently in this mix. Diversion of charitable contributions from the intended use to terrorism typically takes place downstream in a chain of transactions far removed from any U.S. involvement. As a result, absent the identification of specific charities engaging in this conduct, financial institutions that handle transactions tied to charities cannot screen for potential suspicious activity and either do not report suspicious activity, or report all transactions associated with charities whether suspicious or not. This threat is international in scope, but

logically predominates in nations with large immigrant populations that adhere to religious mandates for charitable giving.

Considerable work has been done by law enforcement to reconstruct the financing of 9/11 and build a profile of the hijackers' financial activities in the United States; FinCEN has participated in this work. From their actions, one could conclude that the 9/11 terrorists were fully aware of transaction reporting requirements under the Bank Secrecy Act, and were careful to avoid activity or behavior that could be construed as suspicious. Some transactions were less than $5,000, and for those that exceeded $10,000 there was no indication of attempts to structure such into amounts below the $10,000 Currency Transaction Report threshold. No suspicious activity reports were generated—the hijackers did not try to disguise the nature or source of funds, they used their true identities, they presented acceptable forms of identification, and their account activity did not appear to be incongruous with stated professions or livelihood. Although they opened bank accounts, they relied heavily on debit cards that use automated teller machine (ATM) networks to access accounts, and used travelers' checks and money transmitters to move funds—almost always in small amounts.

To fund on-the-ground acts, we believe that terrorists will continue to use what has worked in the past, adjusted for the government's response subsequent to 9/11 and coupled with an increased understanding of where regulatory control starts to break down. Our assessment is that a threat will continue to be posed by financial services and products that afford the greatest flexibility and anonymity. These include, for example, ATM debit cards, stored value cards, travelers' checks and non-bank money transmissions. With respect to non-bank activity, considering the whole of this industry, we believe that the threat is focused within those segments of the money service business industry that provide these products and services, but are either inexperienced in understanding regulatory requirements and instructions or are disinclined to interact with the government because of cultural barriers or fears that this regulation is a pretext for the pursuit of other policy goals, such as enforcement of the immigration laws, or both. There are large numbers of small providers who at best speak English as a second language and who service immigrant populations with ties to problematic countries. They can not easily understand regulatory requirements and instructions written in complex English to correctly assess the applicability of requirements to specific lines of business, or apply risk-based business models to any given set of financial services. These are all factors inherent to the Bank Secrecy Act regulatory regime in the form that it has been applied to them.

Money laundering and terrorist financing are very different challenges. The tools and analytical approaches traditionally used to identify money laundering have limited utility with regard to identifying and disrupting terrorist financing. Moreover, whereas investigating financial crime has been largely a reactive effort, identifying and disrupting terrorist financing must be proactive and indeed predictive if it is to succeed. FinCEN recognizes this and is making necessary adjustments to our tools, organizational structure and analytical approaches so that we may produce more proactive and predictive analyses. To that end, a pilot is underway to look at the top-known foreign terrorist organizations through a financial lens. A team of FinCEN analysts is conducting extensive research to study the business models of these organizations. The objective of each analyst is to become familiar with the mechanisms each group uses to eventually be able

to identify inherent vulnerabilities in the organization's business structure. This team is reaching out to the law enforcement and intelligence communities in an effort to gather all possible sources of information and to ensure that this effort remains responsive to the needs of the end users of our analysis.

In the meantime, FinCEN is continuing its efforts to reach out to the segments of the non-bank financial services providers most at risk for abuse. For example, we have developed educational material concerning the regulatory regime printed in a variety of languages and are working with industry groups to help get our message out to these providers. We are also working with the IRS, the entity charged with responsibility for examining these institutions for compliance, to better identify and target such businesses for compliance examinations. FinCEN expects to enhance its ability to provide support to the IRS in this regard going forward. Additionally, FinCEN has been, and will continue to study the vulnerabilities associated with stored value products, automated teller machines, and internet-based payment systems for the purpose of educating the industry and formulating an appropriate regulatory response. Finally, FinCEN issued a report on informal value transfer systems, as well as an advisory for financial institutions in an effort to educate the industry about the operation of such systems.

One mechanism FinCEN uses to report on trends and patterns in money laundering and financial crime is its *Suspicious Activity Review.*[1] The next issue will focus on the continued abuse by money launderers of third party checks, the use of foreign shell corporations to disguise illicit money movements, and the potential for abuse in the ATM system as mentioned earlier in this response. It will also highlight consumer loan, tax refund anticipation loan, and food stamp fraud.

QUESTION:
In section 361 of the Patriot Act, Congress elevated FinCEN's status from an office within Treasury to a full-blown statutory bureau. The Patriot Act outlined the specific duties of FinCEN, which included analyzing available data to identify possible criminal activity; determining emerging trends and methods in money laundering and other financial crimes; and among other things, identifying possible instances of failure to comply with various money laundering laws. Can you point to specific instances in which FinCEN has fulfilled these congressional responsibilities?

RESPONSE:

Under Section 361 of the USA PATRIOT Act, FinCEN was elevated to a bureau within the Department of the Treasury and was given a broad range of responsibilities. These responsibilities include:

- Providing advice on matters relating to financial intelligence to Treasury;
- Maintaining a government-wide data access system;
- Analyzing and disseminating data in accordance with legal requirements;

[1] The SAR Activity Review's companion analysis, "By the Numbers Issue 2" was released in May of 2004.

- Providing tactical support to law enforcement and regulators;
- Furnishing analytical products to government and the financial sector;
- Supporting government efforts against illegal informal value transfer networks;
- Supporting Treasury's efforts in the tracking of foreign assets;
- Coordinating with financial intelligence units in other countries; and
- Administering the Bank Secrecy Act to the extent delegated such authority by the Secretary.

Since FinCEN was already performing many of these tasks, the formalization of these duties, in its organic statute, led FinCEN to review its operations to ensure it was in full compliance with the statutory mandate. FinCEN identified the following areas in which additional action was required and has taken the following steps:

Data Access - Consistent with the mandate of Section 358 of the USA Patriot Act, FinCEN expanded the universe of entities to which it disseminates data collected under the Bank Secrecy Act. We have also begun the development of the BSA Direct data project, through which we will improve the means by which authorized agencies can access and analyze the Bank Secrecy Act data. FinCEN concurrently reviewed the safeguards needed to protect the confidentiality of this sensitive information and issued new guidelines governing its use and dissemination.

Informal Value Transfer Networks - FinCEN established a new analytical group to study informal value transfer networks. This group ultimately produced a report to the Congress, mandated by Section 359 of the USA PATRIOT Act, as well as producing an advisory (FinCEN Advisory, Issue 33, dated March 2003) to financial institutions on how to identify such entities within the financial system, and created a detailed power point for training. The study of these networks is on going.

Analytic Products - FinCEN produced a bulletin (FinCEN Bulletin, Issue 4, dated January 2002) on terrorist financing for the financial community, created reference guides for law enforcement on aspects of the financial services industry (e.g., money transmission) and enhanced the content of the biannual SAR Activity Review.

Support Efforts to Track Foreign Assets - FinCEN has extended Platform access to its data to Treasury's Office of Foreign Assets Control to ensure that its targeting efforts are fully supported, and continues to support a wide range of money laundering and terrorist financing investigations, integrating Bank Secrecy Act data with commercial and other data available to it.

Financial Intelligence Units - FinCEN has continued to play a leading rule in expanding the membership of the Egmont Group, which recently grew to include financial intelligence units from 94 nations. Through information exchanges within the Egmont Group, FinCEN has supported investigations and prosecutions within the United States and internationally.

Bank Secrecy Act Administration – Following the enactment of the USA PATRIOT Act, Treasury revised the Order delegating authority from the Secretary to the Director of FinCEN to administer the Bank Secrecy Act. Pursuant to that authority, FinCEN has issued regulations,

regulatory rulings, interpretive guidance, and has pursued enforcement actions against a variety of financial institutions. This regulatory activity has spanned the financial services industry, from casinos to broker-dealers, to banks, and to money services businesses. Particular emphasis has been given to the money services industry. FinCEN created a website devoted solely to money services businesses and provided compliance materials for them in a nation-wide outreach program. FinCEN will also shortly expand the anti-money laundering regimes further to include such businesses as insurance companies and dealers in precious metals, stones, and jewels. Beyond that, FinCEN is currently in the process of developing a plan for the enhanced oversight of those agencies examining financial institutions for compliance with the Bank Secrecy Act. This plan will involve the creation of a new Office of Compliance, within FinCEN, to coordinate such functions.

QUESTION:
The Money Laundering Suppression Act of 1994 eliminated cumbersome and not-always-useful and targeted currency reporting requirements. The 1994 Act streamlined the currency transaction reporting process by creating a two-tiered reporting system: (1) a mandatory exemption from reporting requirements for transactions by banks with other banks, and state and Federal entities; and (2) a discretionary provision allowing banks to exempt their best known customers on the basis of criteria set by the Treasury. It is my understanding that financial institutions have not taken full advantage of the exemptions available to them under the law. Please provide an explanation for this.

RESPONSE:
We share your concern that the exemptions relating to currency transaction reporting are not resulting in a reduction of unnecessary filing. We believe there are a variety of reasons for this; however, one reason appears most significant – cost. It is cheaper for financial institutions to file currency transaction reports than not to file them through the use of an exemption.

In 2002, FinCEN commissioned a study of the efficacy of the currency transaction reporting exemption process as part of the process of preparing a report to the Congress pursuant to Section 366 of the USA PATRIOT Act. A representative sample of the banking community was surveyed, and results showed that banks were hesitant to file Designation of Exempt Person forms – a form that must be filed biennially on each business the financial institution seeks to exempt under the second-tier exemption – because of the compliance costs of conducting due diligence, the difficulty determining whether a customer is eligible for exemption, and the ease with which currency transaction reports could be electronically filed. The survey also noted that the exemption process was being scrutinized by regulators, which led to fear of regulatory action if an exemption was determined to be incorrect, even though the exemption system included a safe harbor for banks from Bank Secrecy Act civil penalty liability for exemption determinations made in good faith. FinCEN submitted the report to the Congress in October of 2002 discussing the results of the industry survey, identifying the challenges associated with this problem, and discussing next steps.[2]

[2] Report to the Congress: Use of Currency Transaction Reports, FinCEN, U.S. Department of the Treasury, October 2002.

In December 2003, FinCEN formed a subcommittee of the Bank Secrecy Act Advisory Group to review the CTR filing requirements, evaluate usage of currency transaction reports by law enforcement and the regulators, and propose ways to reduce the number of currency transaction reports filed that have little or no value to law enforcement in a way that reduces the burden on financial institutions and enhances the utility of the currency transaction reporting system. The subcommittee is comprised of approximately 30 participants from law enforcement, banking regulators, trade associations, and FinCEN staff. FinCEN's Director, who is also the chair of the Bank Secrecy Act Advisory Group, has tasked this subcommittee with making recommendations by the end of the year.

QUESTION:
Section 362 of the Patriot Act mandated that FinCEN establish a secure network that would allow financial institutions to file suspicious activity reports (SARs) and provide such institutions with information regarding suspicious activities warranting special scrutiny. It is my understanding that financial institutions have not taken full advantage of the opportunity to file SARs electronically, and that the industry has been slow in moving towards filing these reports electronically. Please provide an explanation as to why financial institutions have not taken advantage of this provision and what you are doing to encourage financial institutions to file electronically.

RESPONSE:
FinCEN shares your concerns that the E-filing initiative succeed. During April and May of this year, we conducted a top-to-bottom review of the project to determine whether it provides and will continue to provide the right E-filing platform, whether there are inherent technical or other constraints that create roadblocks to maximum effective use, and whether the marketing and usage goals built into the system's business model are appropriate.

The review indicated that the system is indeed a viable and productive one that many financial institutions have found saves them time and money. Early successes notwithstanding, the study also found that many financial institutions were unaware that the system is available for immediate use, that the technical infrastructure of the system needed to be strengthened and that certain technical approaches needed to be streamlined.

The filing of Bank Secrecy Act reports is a highly concentrated activity with less than 1500 entities accounting for more than 90% of all reports filed in a given year. The business model applied to the Patriot Act Communications System takes this concentration into account and guides us in our outreach and marketing. Two hundred and thirty of those top filers are already using the system. Our outreach and marketing pays particular attention to the remaining high-volume filers. Although we believe that the conversion of 90 percent of all Bank Secrecy Act reports to E-filing is an appropriate goal based on economies of scale, we have not limited our marketing to the 1,500 top filers. To date there are more than 1,400 individual users of the system representing more than 530 financial institutions. We recognize that we must greatly accelerate our marketing to make all financial institutions aware of the many benefits of the

system. We have already begun to do so with a realignment of FinCEN's resources. Going forward, we will use the resources of our newly created Division of Client Liaison and Services to market the system broadly.

The review of the Patriot Act Communications System also showed us that the system's infrastructure needed to be strengthened in order to achieve the level of use envisioned by the system's business model. These enhancements will enable the highest volume filers, those that operate in mainframe computing environments, to use the system for the first time. We have already begun this work and will continue to work with the industry to ensure that any technical enhancements made make the system easier for filers to use.

QUESTION:
Please explain your progress in implementing the BSA Direct system. Will the CTR reports that now come to the IRS through the Detroit Computing Center be incorporated into BSA Direct? Why does FinCEN not take over management and control of the BSA data that it is responsible, by statute, for analyzing and safekeeping? Please provide figures for the cost of implementing the BSA system, and estimates of cost savings of incorporating the CTR database into the BSA Direct system.

RESPONSE:
The BSA Direct project is on schedule to be fully operational by October of 2005. Once complete, BSA Direct will enable FinCEN to assume management and control over the data collected under the Bank Secrecy Act. On June 30, 2004, FinCEN awarded a contract to EDS for the design, development, implementation, web hosting and support services of the BSA Direct system. Based on the contract, we expect that the cost will be approximately $9 million to build and deploy BSA Direct, and it is estimated $2.5 million will be needed per year thereafter for operations and maintenance. FinCEN plans to provide access to all the data collected under the Bank Secrecy Act, including currency transaction reports, through BSA Direct. Because BSA Direct will so radically improve maintenance and access to data collected under the Bank Secrecy Act, it is difficult to fully measure the cost savings involved.

BSA Direct will encompass systems and processes that significantly will alter business practices as to the way Bank Secrecy Act information is provided to law enforcement and the regulators that access the information. It will provide those entities, including FinCEN, with state-of-the-art data search tools in a robust, user-friendly environment. Users will be able to search Bank Secrecy Act information faster and better, and will be able to do more with the data than currently possible. Eventually, sophisticated data mining, geographic and other analytic tools will be added to the environment, which will further enhance the analytic possibilities of Bank Secrecy Act information. BSA Direct will help free FinCEN analytic resources to focus on more complex and strategic analysis of the financing of terror, money laundering, and other illicit finance.

QUESTION:

It is my understanding that data from some CTRs are manually logged in by individuals in a location in the Midwest. Do the individuals inputting CTR data into the IRS-managed system have appropriate security clearances and security checks? What safeguards are in place to protect the integrity of these data?

RESPONSE:
We have been advised by the Internal Revenue Service's Detroit Computing Center that contract employees who input currency transaction reports are required as a condition of employment to go through the same background investigation as Internal Revenue Service employees. In addition, these individuals are required to complete a "Questionnaire for Public Trust Positions" and background investigations are conducted using responses on the form and on the Declaration for Federal Employment (OF 306) to develop information to show "they are reliable, trustworthy, of good conduct and character, and loyal to the United States."

We respectfully suggest that you contact the Internal Revenue Service for additional information.

Questions for the Record - Ranking Member Gutierrez
U.S. House of Representatives
Committee on Financial Services
Subcommittee on Oversight and Investigations

Question:

Mr. Schindel, your testimony reveals some disturbing aspects about the OCC's conduct of BSA examinations. For example, in more than 45 percent of the exams you reviewed in your sample, OCC examiners did not perform a complete BSA compliance examination. In one instance, the OCC even failed to cite a bank, as it is required to do, for having an incomplete BSA policy. Can you please explain to the Subcommittee what the implications of these lax regulatory practices are for the safety of our national banking system?

Answer:

The implications of the lax regulatory practices that are contemplated by your question impact the banking system on two fronts. The first is the implication to law enforcement. That is, lax regulatory practices have resulted in financial institutions failing to implement rigorous Bank Secrecy Act (BSA) compliance programs. As a result, these institutions are unduly exposed to financial schemes that may ultimately put our National interests at risk. In short, lax regulatory practices that allow for something less than a comprehensive BSA compliance program create situations where law enforcement may be denied timely information critical to the detection and investigation of criminal financial activity.

The second implication of lax regulatory practices goes to the on-going business of the institution itself and the safety and soundness of our national banking system. This implication may be less apparent than the implication on law enforcement, but nevertheless exists. For example, once regulators do respond to an institution's BSA violations, there may be significant monetary fines imposed as well as substantial media coverage of the situation. These sorts of events can have an effect on the institution's earnings because of both the financial penalty involved and the potential damage to the institution's

reputation. The effects on reputation can be severe, especially if current or potential customers decide not to do business with an entity that is viewed as not doing its part to combat terrorist financing and other financial crimes. One might even draw some of these conclusions in light of the recent events at Riggs -- the oldest Washington-based bank, which was fined in May for repeated violations of laws designed to prevent money laundering and the subject of intense media coverage and Congressional attention. It was recently sold to PNC (subject to regulatory approval). Preceding the sale, Riggs had informed investors that it confronted potentially substantial civil fines for its alleged regulatory infractions that could significantly reduce earnings. Once the sale was announced, PNC said that under its plan, Riggs would exit the business of embassy and international banking that were the subject of regulatory enforcement actions.

With regard to the Office of the Comptroller of the Currency's (OCC) BSA compliance examination program specifically, our work is somewhat dated and we have not been able to follow-up to determine if the deficiencies we identified were corrected. The events at Riggs, however, do raise questions as to whether OCC adequately addressed our concerns. To the extent that the Riggs situation is isolated, we do not see significant impact to our national banking system. If, however, the situation is more wide-spread, the implications would obviously be greater such as a potential loss of public confidence that our national banking system is adequately guarding against criminal financial activity.

Question:

Do you believe that the OCC is currently excelling in its Congressionally mandated responsibilities to such an extent that it should actually be taking on additional tasks from the states which are currently doing an excellent job? What kind of accountability does the OCC have to ordinary consumers compared to, for example, an Attorney General, who is elected directly by the people?

Answer:

We have issued a number of reports over the years pointing out areas where the Office of the Comptroller of the Currency (OCC)

needed to improve its supervisory responsibilities. While in these instances OCC agreed to take corrective action, we have not been able to follow up due to resources. We have also not undertaken a sufficient body of work that would enable us to provide an informed position on OCC's supervision as compared to that of state supervisory agencies. As for OCC accountability, we are unaware of any additional accountability beyond that to the Secretary of the Treasury and the Congress as provided by law.

Question:

When will you be conducting an investigation into the OCC's conduct regarding Riggs bank? Will this encompass the OCC's failure to disclose to this Subcommittee, in response to a direct question from its Chairwoman, a material fact, namely that the examiner in charge of Riggs at the OCC had gone to work for Riggs? What do you think the procedure should be when an examiner goes to work for an examined entity? What accountability do you think the OCC should have to Congress for its actions?

Answer:

On June 4, 2004, we initiated an investigation concerning post employment issues of the OCC examiner with Riggs Bank. Upon conclusion of the investigation, we will be pleased to provide the Subcommittee with any information we can share consistent with law and regulation.

The post employment activities of an examiner are subject to the Government-wide ethics and standards contained in 18 U.S.C. and 5 C.F.R. In fact, we stated that in our two reports on this matter: (1) *The Office of The Comptroller of the Currency Needs to Strengthen Conflict of Interest Controls Over Examiners Resigning for Employments with Banks* (OIG-97-068; issued April 8, 1997); and (2) *Follow-Up Audit of the Office of the Comptroller of the Currency's Controls Over Post-Employee Conflicts of Interest,* (OIG-01-031, January 9, 2001). OCC did revise its internal procedures in response to our 1997 reported control weaknesses over examiners who left for employment with a financial institution. OCC also instituted periodic compliance reviews over the pre-clearance processing of departing employees and included supervisory reviews of the departing employee's

work products. These supervisory reviews were aimed at determining whether the employee's negotiations may have affected the quality of their work or the outcome of examination or supervision activities. However, as discussed in the 2001 report, we found that these post employment reviews were not always completed. We have not had resources available to perform follow-up on this matter since then.

Question:

What is the current status of the investigation into Secretary Snow's investments in more than $10 million of debt issued by Fannie Mae and Freddie Mac?

Are you aware that Secretary Snow also holds an investment in a venture capital fund valued between $250,000 and $500,000 in DLJ Venture Partners II, which has indirect investments in a company offering accounting services from India and in a cable company scarred by scandal?

The DLJ fund invests in five separate funds, which in turn have equity stakes in individual companies. After attempts to sell the share failed, Snow sought and received in October 2003 a waiver from White House counsel Alberto Gonzales that said the investment posed no conflict of interest. One of the fund's holdings is Outsource Partners International Inc., a New York and Los Angeles-based company that provides finance and accounting services for firms through centers in Dallas and Bangalore, India, according to its Web site. There is also a stake in cable company Adelphia Communications which filed for bankruptcy in 2002 after the chief executive and chief financial officer, resigned amid allegations of wrongdoing (they were subsequently indicted). Another holding in the DLJ fund is Montpelier Re Holdings, a Bermuda-based reinsurer that could be affected by Treasury's ruling, on whether to extend the requirement that insurance companies cover terror risk. One of Montpelier's largest shareholders, White Mountains Insurance Group Ltd., is a New Hampshire company that in 1999 moved its headquarters to Bermuda - on paper only - to cut its U.S. corporate tax bill. Obviously, the investments in outsourcing and offshore tax scofflaws are not particularly desirable. Do you believe that these holdings pose a potential conflict of interest, as the Secretary's actions could have a direct and predictable effect on these companies' bottom line, particularly

the reinsurance company? What standards should govern investments of Treasury Secretaries and related Agency heads?

Answer:

On May 27, 2004, we initiated an investigation concerning Secretary Snow's disclosure of certain investments. We appreciate the additional detailed information provided in your question. We will take this information into consideration as we determine how the scope of this investigation should unfold. Upon conclusion of the investigation, we will be pleased to provide the Subcommittee with any information we can share consistent with law and regulation.

Question:

What is the status of the inquiry into the propriety of having Treasury civil servants spend their time analyzing the tax proposals of Democratic presidential candidate John Kerry?

Answer:

On April 2, 2004, we initiated an investigation concerning the allegation that Treasury employees analyzed the tax proposal of presidential candidate John Kerry. We have also reported this matter to the Office of Special Counsel (OSC), as required by our policy. The OSC in conducting a joint investigation into this matter and is the lead agency at this time. Upon conclusion of the investigation, we will be pleased to provide the Subcommittee with any information we can share consistent with law and regulation.

Question:

In the case of Universal Savings, a failed thrift in my district, the FDIC indicated to this Subcommittee that a criminal investigation was still pending regarding the circumstances leading to the institution's failure, which stemmed from paying out a check which did not clear. I have a few concerns here. My primary concern was for the depositors, and that they be made whole, which was done quickly, for the most part. However, it was a mutual thrift, which means that the depositors were, in fact, the owners. If this was an issue of managerial malfeasance, should this have been covered by

bond? Since the managers were not the owners, are there additional protections for the owners when closing an institution of this type that would preserve the ownership rights of the depositor/owners? Is there precedent for closing an institution under assumption of management wrongdoing when ownership is not also management? How do you evaluate the conflict of protecting the interests of depositors and owners when they are, in fact, the same individuals?

Answer:

Although Treasury OIG does not normally audit areas dealing with the disposition of failed bank assets, we can provide some observations.

As to your question regarding bonding, Section 18(e) of the Federal Deposit Insurance Act provides that the Federal Deposit Insurance Corporation (FDIC) may require fidelity insurance protection be obtained by an insured depository. As we understand industry practice, the amount and extent of, and exclusions to, actual bond coverage varies depending on factors such as availability, risks to be covered, actuarial derived risk assessments, and costs. In a case such as Universal Federal Savings, if there had been bankers blanket bond coverage, the FDIC would have likely sought available coverage shortly after the institution was closed.

As for any precedent for closing an institution due to management wrongdoing when ownership is also not management, we are not aware of any such precedent nor are we aware that this was the basis for closing Universal Federal Savings. As a general observation however, it is our understanding that the closure of any federally insured depository institution would be based on the institution's inability to meet federal capital requirements, and not on the institution's organizational structure. Consequently, closure is normally premised on an institution's inability to either cover current or eminent financial losses with existing bank capital. This would be irrespective of the cause(s) of those losses.

As to your question regarding protecting the interests of depositors and owners under a mutual savings organizational structure, it is our understanding that depositors are insured by FDIC up to the regulatory limit of $100,000 per insured

account. Similarly, deposits in excess of the $100,000 insured amount are subject to the same claims processing and disposition as any other Federally insured institution.

Having said all this, we would also suggest that you consider asking these questions of FDIC given its responsibility for the disposition of failed bank assets and insured deposits, including insured mutual savings associations.

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