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DOMESTIC MONEY LAUNDERING: BANK SECRECY ACT COMPLIANCE AND ENFORCEMENT

REPORT

MADE BY THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

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The members of the Committee on Governmental Affairs, except those who are members of the Senate Permanent Subcommittee on Investigations, did not participate in the hearings on which this report was prepared. Under these circumstances, they have taken no part in the preparation and submission of the report, except to authorize its filing as a report by the subcommittee.

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DOMESTIC MONEY LAUNDERING: BANK SECRECY ACT COMPLIANCE AND ENFORCEMENT

I. INTRODUCTION

The Permanent Subcommittee on Investigations (PSI) has a long-standing interest in the problem of money laundering.[1] In 1981, the Subcommittee began an investigation of offshore banks, corporations, and other entities used to facilitate criminal activities in the United States. A staff report was issued in February, 1983;[2] and hearings were held in March and May of 1983.[3] Following these hearings, a Subcommittee Report [4] recommended, *inter alia,* that the U.S. government ensure that its own house was in order by stepping up enforcement of the requirements set forth in the Bank Secrecy Act for the reporting of large cash transactions. The Subcommittee's Report concluded that "the laundering of the illicit proceeds of major criminal cartels, is, in effect, the glue that holds these cartels together. It is a major element without which these organizations would literally fall apart." [5]

In light of these recognized links between money laundering, organized crime, and drug trafficking, the Subcommittee, during 1985 and 1986, turned its attention specifically to the issues of compliance by financial institutions with the reporting requirements of the Bank Secrecy Act and the enforcement of these requirements by the responsible federal agencies, the Department of the Treasury's oversight of the Act, and the use by law enforcement authorities of data generated by the Act.

The Bank Secrecy Act[6] and its implementing regulations[7] require, with certain exceptions, that banks and other financial institutions file a Currency Transaction Report (CTR) with the Internal Revenue Service for each deposit or exchange of currency in excess of $10,000 and that any person transporting monetary instruments of more than $5,000 into or out of the United States must file a Currency or Monetary Instrument Report (CMIR) with the U.S. Customs Service. The federal agencies that oversee the operations

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[1] Money laundering is the process by which one conceals the existence of illegal sources of funds and income. According to Charles Blau, Associate Deputy Attorney General, Department of Justice, money laundering "has become a very large business," and "(t)he figures range anywhere from on the small side in narcotics along from $40 billion to $150 billion annually in the country." Money Laundering in Puerto Rico, S. Hrg. 99-271 (hereinafter "Puerto Rico Hearing") p. 9.

[2] Crime and Secrecy: The Use of Offshore Banks and Companies, S. Prt. 98-21.

[3] Crime and Secrecy: The Use of Offshore Banks and Companies, S. Hrg. 98-151.

[4] Crime and Secrecy: The Use of Offshore Banks and Companies, Senate Report 99-130.

[5] *Ibid.,* p. 141.

[6] 31 U.S.C. §§ 5311-5323.

[7] 31 U.S.C. §§ 103.11-128.37.

of financial institutions have responsibility for monitoring compliance with the Act and its regulations.[8]

The reporting requirements of the Bank Secrecy Act were intended to disrupt the laundering schemes of drug traffickers and other criminals as they guide their illicit cash through legitimate banks and businesses, by leaving a paper trail for law enforcement officials to follow. However, the Act's effectiveness depends on proper administration and enforcement by both bank officials and bank regulatory agencies.

In pursuit of its investigation of domestic money laundering, PSI held a series of hearings during 1985 and 1986. On March 12, 1985, following a guilty plea on February 7, 1985 by the First National Bank of Boston for failing to report over $1.2 billion in international cash transfers, the Subcommittee heard testimony regarding enforcement of the Bank Secrecy Act in Massachusetts. Persons testifying included officials of the First National Bank of Boston; the Shawmut Bank of Boston, N.A.; the Department of the Treasury; the Comptroller of the Currency; and the Massachusetts U.S. Attorney. The Subcommittee's investigation and hearing brought to light the lack of attention that the reporting laws were being given by both banks and the bank regulatory agencies. The evidence showed that examiners from the Office of the Comptroller of the Currency failed to cite several Boston banks for massive reporting violations.

A Subcommittee hearing on July 25, 1985 concentrated on allegations of money laundering by financial institutions in Puerto Rico and the enforcement efforts of the Federal Home Loan Bank Board. The Subcommittee heard testimony regarding an undercover investigation of financial institutions in Puerto Rico that led to the arrest of 17 persons, most of whom were bank officials. This investigation uncovered widespread non-compliance with the Bank Secrecy Act and allegations of collusion among bank officials and drug traffickers to effect large currency transactions without filing the required Currency Transaction Reports. Again, there was evidence that bank examiners, this time from the Federal Home Loan Bank Board, failed to properly identify or report incidents of non-compliance.

In response to concerns about non-compliance with the Bank Secrecy Act uncovered by PSI's investigations, Subcommittee Chairman William V. Roth, Jr., requested the General Accounting Office to examine Bank Secrecy Act enforcement efforts and the use by law enforcement agencies of the information generated by the Act. On October 29, 1985, General Accounting Office officials testified regarding their preliminary findings on the enforcement of the

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[8] The Department of the Treasury has overall responsibility for implementing the Bank Secrecy Act. Treasury has delegated responsibility for assuring compliance with the reporting and recordkeeping requirements of the Act and its supporting regulations as follows (*see* 31 C.F.R. § 103.46): Office of the Comptroller of the Currency, for all National Banks; Federal Reserve System, for all state-chartered Federal Reserve member banks; Federal Deposit Insurance Corporation, for all other federally insured banks and branches of foreign banks operating in the United States; Federal Home Loan Bank Board, for all federally insured savings and loan associations; National Credit Union Administration, for all federal credit unions; Securities and Exchange Commission, for securities dealers and brokers; Internal Revenue Service, for all other financial institutions; and U.S. Customs Service, for transportation of currency into or out of the country.

Bank Secrecy Act by the regulatory agencies. On June 12, 1986, General Accounting Office officials testified concerning the Treasury Department's overall management of the Act, and law enforcement's use of Act data.

PSI's investigation demonstrated that, at least until recently, compliance with the Bank Secrecy Act by financial institutions was dismal, and enforcement of the Act by bank regulatory agencies was virtually non-existent. As Chairman Roth stated:

> (W)e are very concerned about this problem of money laundering, both domestically and internationally. It is a matter of real concern to this Subcommittee, because we firmly believe that it is the glue that holds criminal activity together.
>
> Frankly, I don't think we will have any success in the war against crime until we are successful in striking at the heart of those money-laundering operations.
>
> There are some bright stories, and I want to compliment many of our law enforcement agents in the areas, but at the same time, I have to say that I deeply regret that the evidence is such that it seems neither the private institutions nor the regulatory agencies fully understand the importance of this matter. . . .
>
> (T)here is no question in our minds that the Bank Secrecy Act is an indispensable link in the prosecution chain of major crimes, particularly those involving organized crime, drug traffickers, and major frauds. . . . Therefore, we don't take the Bank Secrecy Act lightly, nor do we consider it a technical regulation to be enforced in an agency's spare time.[9]

II. BANK SECRECY ACT COMPLIANCE AND ENFORCEMENT: MASSACHUSETTS

The Bank of Boston

INTERNATIONAL CURRENCY TRANSACTIONS

The Subcommittee's investigation of the First National Bank of Boston (the Bank of Boston) followed the Bank's guilty plea to failing to file Currency Transaction Reports for approximately $1.2 billion in currency transfers with foreign banks.[10]

Based upon the Subcommittee's investigation and hearing, it appears that the Bank of Boston's failure to report large international currency transactions primarily was caused by the lack of importance the Bank attached to revised currency reporting requirements of the Bank Secrecy Act. In short, a first-line manager misinterpreted the Comptroller's notice of change, and his supervisors, all the way to senior management, neglected to ensure that the

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[9] Domestic Money Laundering: The First National Bank of Boston, S. Hrg. 99-62 (hereinafter "Bank of Boston Hearing"), pp. 1-3.

[10] *See ibid.*, pp. 149-153 (Hearing Exhibit No. 2—Felony Information: *United States of America* v. *The First National Bank of Boston*). At the hearing, Massachusetts U.S. Attorney William Weld testified that prosecutors had not yet traced where the $1.2 billion came from and went to, and that "any statement that that $1.2 billion is associated with any specified illegal activity would be premature. . . ." *Ibid.*, p. 15.

new regulations were being implemented. The situtation was aggravated by the disregard the Office of the Comptroller of the Currency's bank examiners and managers gave to compliance verification of the currency reporting requirements of the Bank Secrecy Act.

The Bank of Boston received Banking Issuance 80–18 on June 21, 1980 from the Comptroller of the Currency.[11] This notice was issued to explain the Treasury Department's final rule amending certain sections of the Bank Secrecy Act regulations. The one-page issuance stated in part that: "(t)he major amendments in the revised final rule require . . . (3) the filing of a report of transactions with or originated by foreign banks. . . ." In the upper left-hand corner of the Bank of Boston's copy of Banking Issuance 80–18 were eight sets of initials.

William L. Brown, Chairman of the Bank of Boston, confirmed at the hearing that the sets of initials represented eight senior officers of the Bank of Boston.[12] However, Mr. Brown testified that the bank officials apparently had not focused on the rule changes or their importance to the bank.[13]

Despite his institution's past shortcomings, Mr. Brown acknowledged the primary role banks must play in effectuating the requirements of the Bank Secrecy Act. He stated:

> W(e) cannot rely solely on the regulatory process to monitor our compliance with those requirements. We are ready to work closely with the government to develop new procedures to prevent the misuse of the banking system, but we understand that the principal responsibility to ensure that such misuse does not occur is ours. I and the dedicated, hard-working employees of the Bank of Boston are committed to achieving that goal.[14]

The Subcommittee's investigation and hearing probed the events that led to the Bank of Boston's non-compliance and subsequent prosecution. The currency shipments later involved in the criminal charges were handled by the Bank's Coin and Currency department. From March 1980 to at least the time of our hearing, that department was under the supervision of Daniel Dormer, Vice President, Deposit Operations.

Mr. Dormer testified that he was using a Customs form for shipments of foreign currency instead of the Currency Transaction Report required by the regulation. He stated that he misunderstood the bulletin and regulations and believed that the Customs form was the required form.

> Chairman ROTH. Mr. Dormer, I guess I would best characterize the compliance with regulations in your bank as casual. Is it typical when you get a new bulletin or new

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[11] *Ibid.*, p. 172 (Hearing Exhibit No. 7).

[12] *Ibid.*, pp. 24–25.

[13] At the hearing, the following exchange took place:

Senator RUDMAN. So essentially what we have here is eight very high-level people essentially asleep at the switch.

Mr. BROWN. Well, either that or doing something else when they should have been perhaps reading the rules and regulations. *Ibid.*, p. 25.

[14] *Ibid.*, p. 112 (Prepared Statement of William L. Brown).

regulation to ask your secretary as to whether you are in compliance therewith, or do you ever refer such matters, for example, to counsel?

Mr. DORMER. What do I do now, or what did I do at that point, sir?

Chairman ROTH. At that point.

Mr. DORMER. At that point, I questioned my secretary for some specific procedures——[15]

He did not, however, ask counsel at that time for an interpretation.[16]

Mr. Dormer, when questioned by Senator Rudman, explained his contact with his supervisor, Mr. Tangney, Executive Vice President, Automated Corporate Services.

> Senator RUDMAN. So I think we have a clear understanding now what happened at your level, what happened at your level was that there was a question of mistaken reference. When you said to your superior, yes, I have the notice; I am complying; we are filing the form, he said, fine, great, pleased to hear it, he was thinking about the form that is the subject of this hearing and the form you were talking about is the form you had been filing with U.S. Customs?
>
> Mr. DORMER. Unfortunately, yes, sir.[17]

Mr. Dormer's next brush with the currency reporting requirements and the 1980 changes came in early 1982, when he received the Bank of Boston's operation procedure number 64, revision 2.[18] This document purported to bring the Bank's operating procedures in line with the 1980 revisions to the regulations. The change regarding international currency transactions appeared in a sentence in the beginning paragraph of the document: "(t)he Bank need not file the IRS Form—4789 for transactions with Federal Reserve Banks, Federal Home Loan Banks or other domestic banks."

Mr. Dormer's final contact with the currency reporting provisions, prior to the federal government entering into an investigation of the Bank, occurred in July 1982. When questioned by Subcommittee Majority Chief Counsel Daniel Rinzel at the hearing, Mr. Dormer testified that he did not recall being told, during a telephone conversation with Robert Stankey of the Treasury Department, that CTRs were required to be filed on currency transactions with foreign banks.

> Mr. DORMER. I do not recall that, sir.
>
> Mr. RINZEL. Well, your copy of the June 1982 Treasury letter sent to you by Mr. Stankey has a handwritten notation which you have reviewed previously with us, as I recall, which says, and that is exhibit 10 of the exhibit list, "Form 4789, IRS for International Shipment and 4790." Did you make those notes during the course of your conversation with Mr. Stankey?

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[15] *Ibid.*, p. 32.
[16] *Ibid.*
[17] *Ibid.*, p. 34.
[18] *Ibid.*, pp. 176–179 (Hearing Exhibit No. 8).

Mr. DORMER. Yes, I did, sir.

Mr. RINZEL. And doesn't that indicate to you those are the form numbers for international shipments, the CTR numbers and the CMIR numbers; isn't that correct?

Mr. DORMER. Those are the forms, sir. It was my understanding at that point that that was referring to individuals as opposed to banks.[19]

During further questioning by Mr. Rinzel, Mr. Dormer stated that he first became aware that CTRs were required to be filed on international shipments of currency in excess of $10,000 during the summer of 1984.[20]

Mr. Dormer's telephone conversation with Treasury was later addressed by Mr. Robert Stankey, Jr., then advisor to the Assistant Secretary for Enforcement and Operations of the Department of the Treasury. Mr. Stankey said that during his conversation with Mr. Dormer:

> He (Dormer) asked some questions about reporting currency transactions, and I think that during that conversation we covered the international shipments to banks as well as shipments to domestic banks. He apparently was under the impression that they could be put on the exempt list or didn't have to be reported. . . . My best recollection is I told him they definitely had to be reported.[21]

Mr. Dormer's apparent misunderstanding of the revised reporting requirements should quickly have been discovered if federal regulators were doing their job. However, the Subcommittee's investigation into the Bank of Boston's non-compliance with the Bank Secrecy Act revealed glaring deficiencies in the performance of the Office of the Comptroller of the Currency's Bank Secrecy Act compliance examinations. Not only did the Comptroller's examiners fail to follow standard procedures, they also missed the significance of specific Treasury Department requests to examine certain banks for suspected non-compliance. In fact, in the case of the Bank of Boston, Treasury asked the Comptroller to verify currency transactions in the Coin and Currency department because of indications that the Coin and Currency department, and specifically, Mr. Dormer, lacked familiarity with the reporting requirements.

In the summer of 1982, the Treasury Department requested assistance from the Office of the Comptroller of the Currency in tabulating currency receipts at the Federal Reserve Bank in Boston in conjunction with its analysis of Massachusetts bank compliance with the Bank Secrecy Act. The Boston regional office of the Comptroller assigned two Assistant National Bank Examiners to the task.

On September 7, 1982, Comptroller examiners commenced a regularly scheduled examination of the Bank of Boston. Subcommittee staff's review of the final work papers and its interviews with examiners indicated that the compliance verification consisted solely

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[19] *Ibid.*, p. 31.
[20] Ibid., p. 32.
[21] *Ibid.*, p. 85. *See also ibid.*, p. 184 (Hearing Exhibit No. 11—*Memorandum of Robert Stankey of his July 12, 1982 conversation with Dan Dormer).*

of inquiries of internal audit staffs and a manager of the metropolitan division who had responsibility for assuring branch compliance with the Bank Secrecy Act, and did not involve examination of documents. This compliance check of the Bank of Boston resulted in no findings of non-compliance on the part of the Bank.

However, on September 21, 1982, Robert Powis, then Treasury's Deputy Assistant Secretary (Enforcement), sent a memorandum to the Office of the Comptroller reporting the results of the earlier review of Massachusetts banks' currency shipments to and from the Federal Reserve Bank of Boston, their exempt lists, and their Currency Transaction Report filings.[22] The memorandum states that the review indicated that "compliance with the reporting requirements of the Bank Secrecy Act by banks in Massachusetts (was) very low," there appeared to be a "(n)oteable (sic) lack of understanding of the exemption provisions in the (Bank Secrecy Act) regulations," and that "(t)he number and dollar amount of Currency Transaction Reports filed by banks in Massachusetts" during the review period was "not consistent with the large volume of currency involved in the transactions between member banks and the Federal Reserve Bank during the same period."

The Powis memorandum attached a list of nine national banks that had conducted substantial currency transactions but had not filed a correspondent number of CTRs. The memorandum also noted that Treasury's review of the Bank of Boston indicated that it was the largest purchaser of currency from the Federal Reserve Bank of Boston, yet had a very "low level of compliance with the Bank Secrecy Act." The memorandum specifically pointed out to the Comptroller's Office that "(t)he officer in charge of currency operations at that bank, in contacts with my office regarding exemption lists, has informed us that he is not completely familiar with the provisions of the Bank Secrecy Act regulations." Finally, the memorandum requested "a special feedback report on the 31 CFR Part 103 compliance examination of the First National Bank of Boston" and noted that "(w)e are especially interested in the trans-shipments of currency by the bank to correspondent banks and internationally."

This memorandum was forwarded from the regional Comptroller's office to the Examiner in Charge of the Bank of Boston compliance examination, who then took an Assistant National Bank Examiner back to the bank to respond to Treasury's concerns.[23] The Assistant reconciled the January through April 1982 transshipments of currency from the Federal Reserve, through the Bank, and on to its customers with the number of CTRs filed, and concluded that the Bank of Boston was a wholesale operation sell-

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[22] *Ibid.*, pp. 193–194 (Hearing Exhibit No. 13). For a description of the events leading to the September 21, 1982 Powis memorandum, *see ibid.*, pp. 72–73 (Testimony of John M. Walker, Jr., then Assistant Secretary for Enforcement and Operations, Department of the Treasury).

[23] Stephen Connors, former Senior National Bank Examiner (Examiner in Charge) and Thomas Rollo, Assistant National Bank Examiner, Comptroller of the Currency, testified at the Subcommittee's March 12, 1985 hearing, *see ibid.*, pp. 58–69. Mr. Connors and Mr. Rollo had been involved in the regularly scheduled examination of the Bank of Boston that commenced on September 7, 1982. By the time the Powis memorandum was received, Assistant Rollo had already completed his examination of the bank's cash program compliance, thus necessitating his return to the bank to respond to Treasury's concerns. *See ibid.*, pp. 142, 143 (Appendix to Statement of C.T. Conover, Comptroller of the Currency).

ing large amounts of currency to various banks through New England. As these types of transactions are not reportable on CTRs, this explained some of the discrepancy between the low number of CTRs filed and currency transactions with the Federal Reserve Bank. However, the Bank had failed to comply with the Bank Secrecy Act requirement to include the names of the domestic banks with which it had engaged in these currency transactions on its exempt list.

The Examiner in Charge and the Assistant, in a memorandum dated October 8, 1982, reported these findings to their supervisors.[24] In that memorandum they also stated that "Dan Dormer, Officer in Charge of Coin and Currency . . . determined he was unaware of the regulations concerning International Transactions, and as such had not reported them." The examiners, however, failed to cite the bank for this non-compliance—the very violation for which the bank was later criminally charged. The examiners took no further actions with respect to the international currency transactions.

When Subcommittee staff interviewed the Assistant Examiner prior to the March 1985 hearing, he stated that at the time he reviewed the Bank of Boston's currency department operations, he was unaware that currency transactions with foreign banks were required to be reported on CTRs. However, during testimony before the Subcommittee, the Assistant Examiner and the Examiner in Charge both deduced that the Assistant must have known of the new regulations since their October 8, 1982 memorandum noted that Mr. Dormer "was unaware of the regulations concerning International Transactions."[25] The Examiner in Charge, when asked why he did not cite the Bank for failing to file CTRs for international transactions in his final Report of Examination, stated that he had simply made a mistake and should have reported the violation. Further, he understood from the Assistant Examiner that the Bank of Boston had been in contact with Treasury on this matter and would be filing the required reports.[26] The Assistant Examiner testified, however, that he did not recall advising Mr. Dormer that he was required to file CTRs for foreign currency transactions.[27]

Deputy Assistant Secretary Powis sent another memorandum, dated December 8, 1982, to the Office of the Comptroller stating that he would like to obtain information concerning the other eight national banks about which Treasury has asked for special feedback.[28] In early March 1983, a National Bank Examiner from the Office of the Comptroller in Washington, D.C. who had been assigned the responsibility of preparing a response to the Treasury request, discussed the matter with a Treasury official who identified six banks as presenting particular concerns, and then contacted the Boston Deputy Regional Administrator to obtain an update on the status of the compliance examinations at these banks. The

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[24] *See ibid.*, pp. 195–196 (Hearing Exhibit No. 14).
[25] *Ibid.*, pp. 60, 64–65.
[26] *Ibid.*, p. 61. *See ibid.*, p. 198 (Hearing Exhibit No. 16—Excerpt from Comptroller's Office's report of its 1982 examination of the Bank of Boston).
[27] *Ibid.*, p. 64.
[28] *Ibid.*, p. 197 (Hearing Exhibit No. 15).

regional office provided information concerning the scope and timing of the examinations for the six banks. The Washington examiner understood that particular "verification procedures"—those involving a special intensive set of auditing procedures—had been or would be used in performing the compliance examinations. Thus, the Office of the Comptroller notified Treasury in an April 5, 1983 letter that the expanded examination procedures were being used.[29]

However, in his testimony before the Subcommittee, C. T. Conover, then Comptroller of the Currency, stated that he subsequently learned that the examiners performing the Bank Secrecy Act compliance checks at the Bank of Boston had not, in fact, used the enhanced auditing procedures and that the examiners for many of the other eight banks had exhibited a "similar lack of knowledge regarding the current procedures" for verifying compliance with the Bank Secrecy Act. Mr. Conover also testified that the examiners "did not give the priority to the Treasury Department information that we would have liked." He stated that, "(w)e view this as an institutional, rather than an individual, failure."[30] According to Mr. Conover, the Comptroller's Office planned to take a series of steps to improve its future discharge of its responsibilities under the Bank Secrecy Act.[31]

The Comptroller's Office's inadequate performance in Massachusetts was compounded by the inability of the Treasury Department to perform any meaningful oversight of the compliance checks. According to John M. Walker, Jr., then Treasury's Assistant Secretary for Enforcement and Operations, Treasury did not have the administrative tools to audit the Comptroller's examination procedures or the way in which they were implemented. He stated that at the time, he had no reason to disbelieve the Comptroller's Office's assurances that its examiners were using the special, intensive examination procedures in Massachusetts. However, in light of the recent investigations, Mr. Walker testified that he presently had no reason to believe that the Comptroller or other regulatory agencies were performing adequately in supervising compliance with the Bank Secrecy Act.[32]

The Subcommittee's own attempt to verify the adequacy of compliance examinations met substantial roadblocks. The Subcommittee staff's review of the Comptroller's work papers during the investigation failed to indicate the scope and detail of the review performed by the examiners. Thus, it was difficult to determine how extensive the review of the Bank Secrecy Act's requirements had been on any given examination.

In sum, the Subcommittee's investigation clearly revealed that, in the case of the Bank of Boston, the Comptroller's bank examin-

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[29] *Ibid.*, pp. 200–201 (Hearing Exhibit No. 18).

[30] *Ibid.*, p. 45. At the Subcommittee's July 25, 1985 hearings, DOJ's Associate Deputy Attorney General Blau stated that most of the bank regulatory agency examiners have traditionally focused on the financial soundness of the banks, and that Bank Secrecy Act compliance has not been given a high priority. Puerto Rico Hearing, p. 17.

[31] Bank of Boston Hearing, pp. 45–46. These steps included ensuring effective compliance examinations in Massachusetts, improving internal and interagency communications and cooperation, intensifying examiner training, and strengthening management controls over implementation of the Comptroller's Bank Secrecy Act responsibilities. *Ibid.*

[32] *Ibid.*, p. 77.

ers generally were not sensitive to significant provisions of the Bank Secrecy Act or aware of required procedures for verifying compliance with the Act. Moreover, numerous violations were overlooked as a result of the low priority assigned to Bank Secrecy Act compliance. Even when Treasury specifically requested the Comptroller's Office to conduct an examination of specific problem areas in a particular bank, the Comptroller failed to report violations and ensure that proper corrective action ensued.

EXEMPT LISTS

Another Bank Secrecy Act non-compliance situation existed at the Bank of Boston's North End branch, involving the Bank's non-compliance with the Act's exempt list requirements.

For a period of years, members of the Angiulo family in Boston's North End conducted numerous and large currency transactions with the Bank of Boston for which no Currency Transaction Reports were filed.[33] The Angiulo's companies, Federal Investments, Inc. and Huntington Realty Company, were placed on the Bank's exempt list prior to 1980. The then existing regulations governing exempt lists were somewhat vague.[34] However, changes in the regulations in 1980 made it very clear that neither company could be eligible for exemption without prior written permission from the Department of the Treasury because neither was a retail business nor dealing in goods provided to ultimate consumers.[35] In a March 9, 1985 affidavit provided to the Subcommittee,[36] Hubert W. Cox, Manager of Banking Offices Administration at the Bank of Boston described how the two Angiulo companies came to remain on the Bank's exempt list after the 1980 changes. His affidavit states in part:

> 7. Shortly after the Comptroller promulgated the amendments to 31 C.F.R. 103 in the summer of 1980, I was asked by Mr. Colbert (a Bank official) to prepare for his signature a memorandum to all the branches summarizing the requirements of the new regulation. . . .
>
> 8. Among the responses to the memorandum was a letter dated July 29, 1980 from Gloria C. Cushing, Manager of the Bank's North End office. Mrs. Cushing requested that eleven customers, including Huntington Realty Company and Federal Investments, Inc., be placed on the exempt list.

Mr. Cox's affidavit also relates that upon Treasury's request, he sent the Bank's exempt list to Treasury in the spring of 1982 and that Treasury official Robert Stankey shortly thereafter returned the list, indicating problems with the list's inclusion of both Hun-

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[33] Several members of the Angiulo family subsequently were convicted of racketeering and/or gambling offenses in the United States District Court for Massachusetts and sentenced to substantial prison terms.

[34] Prior to 1980, exceptions to the Bank Secrecy Act reporting requirements included "transactions with an established customer maintaining a deposit relationship with the bank in amounts which the bank may reasonably conclude do not exceed amounts commensurate with the customary conduct of the business, industry or profession of the customer concerned." 31 C.F.R. 103.22, 37 Fed. Reg. 6912, 6913.

[35] 31 C.F.R. 103.22(b)(2)(i).

[36] Bank of Boston Hearing, pp. 154–160 (Hearing Exhibit No. 3).

tington Realty and Federal Investments.[37] Mr. Cox continues in his affidavit as follows:

> 16. I also recall having a telephone conversation at some point in time with Mrs. Cushing (the North End Branch Manager) about whether Huntington Realty and Federal Investments qualified as retail businesses that could be maintained on the exempt list.
>
> 17. Unfortunately, I do not remember whether this conversation with Mrs. Cushing took place in 1980 after the change in the Comptroller's regulations or whether it occurred in 1982 after the receipt of the Treasury Department's inquiry.
>
> 18. Although I am not certain of the date of my conversation with Mrs. Cushing, I do recall its general substance. To the best of my recollection, Mrs. Cushing stated in response to my questions that Huntington Realty owned various rental properties and that the large quantities of cash were the result of rental payments that were made weekly or monthly.
>
> 19. Similarly, Mrs. Cushing informed me that Federal Investments was a mortgage company that typically had large cash transactions as a result of mortgage payments that were made in cash.
>
> 20. To the best of my recollection, Mrs. Cushing also stated that both companies had been on the exempt list for some time and that it was customary in the North End for people to use cash to pay rent or to make mortgage payments.
>
> 21. For all these reasons, Mrs. Cushing told me that she believed that it was appropriate for both Huntington Realty and Federal Investments to remain on the exempt list.
>
> 22. At the time of this conversation, I do not recall being totally convinced that Huntington Realty and Federal Investments met the requirements of the Comptroller's regulations but I nevertheless accepted Mrs. Cushing's position on the theory that both entities were in a sense dealing with ultimate consumers and therefore could perhaps be considered retail operations.
>
> 23. In retrospect, I realize that neither Huntington Realty nor Federal Investments in fact meets the criteria established by the Comptroller and that I could have exercised better judgment at the time of my conversation with Mrs. Cushing about whether these two companies should remain on the exempt list.

William Brown, Chairman of the Bank of Boston, testified that:

> Clearly, our officer used poor judgment in retaining these customers on the exempt list, but the fact that they had been retained did not come to the attention of higher

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[37] Treasury's request for a list reporting those customers whose currency transactions were exempt from reporting requirements was transmitted in an April 28, 1982 letter from Robert E. Powis, Deputy Assistant Secretary (Enforcement). *See ibid.*, pp. 180–181 (Hearing Exhibit No. 9). Mr. Stankey returned the bank's exempt list with a letter to Mr. Cox dated June 8, 1982. The letter notes that checkmarks had been placed next to items that were incorrect or required additional information, and that X's appeared next to depositors who did not appear eligible for exemption without prior approval of the Treasury Department. *Ibid.*, pp. 182–183 (Hearing Exhibit No. 10). According to Mr. Cox's affidavit, "(t)here were both check marks and Xs placed next to Huntington Realty and Federal Investments." *Ibid.*, p. 157.

management until the Justice Department began its investigation.[38]

Thus, this situation is another example of a first-line officer making a decision not reviewed by senior management at the Bank of Boston and the Bank later discovering that it had not complied with the Bank Secrecy Act.

NEW BANK SECRECY ACT COMPLIANCE PROGRAM

The Bank of Boston instituted some procedural changes during 1985 to prevent recurrence of the types of problems related above. These procedures include establishment of an overall corporate compliance program that is built on a network of compliance officers with responsibility for specific operating areas; management review procedures for Currency Transaction Reports for both domestic and foreign cash transactions; a formal process for placing customers on the exempt list and regular reviews of the list; improved training of officers and employees at every level on compliance with the Bank Secrecy Act, including the development of training materials which employees use for both self-teaching and training purposes; and the implementation of a manual log system requiring tellers and other relevant employees to record information about large cash transactions, which information is then reviewed daily to ensure that Currency Transaction Reports have been properly filed. The Bank also began to implement an automated system allowing the logs to be kept automatically, and to track, under certain circumstances, multiple transactions by a single customer, each of which is for less than $10,000 but all of which in the aggregate total over $10,000.[39]

Shawmut Bank

During its investigation of the Bank of Boston, the Subcommittee decided to review at least one other Boston area bank's compliance with the Bank Secrecy Act and chose the Shawmut Bank of Boston, N.A. (Shawmut) for this purpose.

At the hearing, John P. Hamill, President, Shawmut Corp. and Executive Vice President of Shawmut, testified that following the Bank of Boston's guilty plea to criminal charges, Shawmut commenced an immediate internal review. The Bank concluded from this review that it had erroneously continued to treat certain customers as exempt from Bank Secrecy Act reporting requirements which, after the 1980 regulatory amendments, it was not authorized to exempt without Treasury approval. These customers included seven foreign banks and 20 institutions and firms in the Boston area.[40]

On February 19, 1985, according to Mr. Hamill, Shawmut officials advised the Office of the Comptroller and the Treasury Department of the conclusions of their review and submitted CTRs for the foreign bank transactions going back to 1980.[41]

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[38] *Ibid.*, p. 20.
[39] *See ibid.*, pp. 21–22 and 109–111 (Testimony and Prepared Statement of William L. Brown).
[40] *Ibid.*, p. 36.
[41] *Ibid.*

The foreign banks, for which CTRs had not been filed, included one bank in Spain, two in Portugal, one in Ireland and four in Canada. All were long-term customers of the bank, none for less than 20 years. Between 1980 and 1985, deposits of currency from these foreign banks totaled $157.2 million, and withdrawals totaled $33.9 million. In addition, there was a single currency transaction with a Swiss bank in 1983, for the amount of $5 million.[42]

The domestic customers that Shawmut had erroneously treated as exempt customers included nine educational, religious and health organizations, scheduled airlines, and 11 commercial firms located in eastern Massachusetts. Shawmut has since applied for permission to exempt these customers because their currency transactions are considered normal for the conduct of the customers' business activities.[43]

Mr. Hamill attributed the Bank's compliance deficiencies to "human error."[44] He testified that the 1980 regulatory amendments were routed to the Bank's branch division which had dealt with the Bank Secrecy Act for the previous eight years. "The currency department," however, "never received a copy of the change in regulations, and it continued to treat customers it had been dealing with as it had for the prior 8 years."[45]

Thus, as in the case of the Bank of Boston, bank management at Shawmut paid inadequate attention to Bank Secrecy Act requirements, and federal regulators failed to detect the problems during their compliance examinations.

Following Shawmut's internal review of its compliance procedures, the Bank took a number of specific steps to improve the level of its compliance with the Bank Secrecy Act, including issuing a memorandum from its legal department to branch managers and the currency department setting forth current detailed procedures for compliance with the Act. In addition, Shawmut enhanced its training programs to ensure it was managing the process of complying with the Act's requirements.[46]

Chairman Roth commended Shawmut for voluntarily undertaking an internal review and corrective action and said ". . . I think it is important that institutions have the courage where errors are made to correct them. I would hope any other institution that finds itself in the same set of circumstances would have the courage to correct it."[47]

Despite the less than acceptable performance by certain banks and federal regulators in Massachusetts in the area of Bank Secrecy Act compliance and oversight, then Massachusetts U.S. Attor-

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[42] *Ibid.*, pp. 38, 117 (Testimony and Prepared Statement of John P. Hamill). Mr. Hamill also stated that Shawmut had determined that another area where reports should have been filed involved the bank's purchases and sales of foreign currency. *Ibid.*, p. 117.

[43] *Ibid.*, p. 116 (Prepared Statement of John P. Hamill).

[44] *Ibid.*, p. 114.

[45] *Ibid.*, p. 37.

[46] *Ibid.*, pp. 38, 113 (Testimony and Prepared Statement of John P. Hamill). *See also ibid.*, pp. 118–128 (February 25, 1985 Memorandum to Shawmut Branch Managers and Manager, Currency Department).

[47] *Ibid.*, p. 39. Massachusetts U.S. Attorney William Weld testified that following the Bank of Boston's guilty plea, a number of banks had come forward and acknowledged that internal investigations had indicated problems; Mr. Weld stated that these banks were actively cooperating with his office. *Ibid.*, p. 13.

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ney William F. Weld confirmed the valuable role the Act plays in law enforcement. He testified:

> That statute is used every time one of the forms which is filed in compliance with the law is introduced in evidence in a Federal criminal trial, and that happens everyday in our Federal courts in Massachusetts; and if it happens every day in one district, I daresay it happens all over the country.
>
> If you have a historical narcotics conspiracy prosecution and you have to prove that the smugglers had a lot of cash at some time in 1980 or 1981, frequently the only way you can prove that, and yet a conclusive way of proving that, is to go back and get from the local bank . . . a copy of the CTR showing on those days Mr. Big came in with $400,000 in $20 bills.
>
> So the evidence which is available to prosecutors as a result of this statute is frequently not only available from no other source, but it is frequently decisive in the prosecution for narcotics conspiracy.[48]

III. BANK SECRECY ACT COMPLIANCE AND ENFORCEMENT: PUERTO RICO

Introduction

On June 6, 1985, over 200 federal agents raided 10 financial institutions in Puerto Rico and arrested 17 persons, most of whom were bank officials, as a result of one of the largest money laundering investigations in U.S. history.[49] The Subcommittee immediately commenced an investigation in Puerto Rico as part of its on-going interest in money laundering. The Subcommittee sought to determine what circumstances led to violations of the Bank Secrecy Act by bank employees and what measures could prevent this type of non-compliance in the future—in Puerto Rico and elsewhere. Chairman Roth emphasized, however, that the Subcommittee's investigation in no way addressed the financial soundness of banking institutions in Puerto Rico.[50]

The Government's Puerto Rican investigations originated in an analysis done by the Treasury Department of currency flows between financial institutions and the Federal Reserve Bank. At the Subcommittee's July 25, 1985 hearing, Charles Blau, Associate Deputy Attorney General for the Department of Justice, testified:

> The Federal Reserve Bank in New York, through its correspondent bank, Banco de Ponce, reported a tremendous

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[48] *Ibid.* pp. 9–10.

[49] The defendants were charged, in most instances, with conspiracy to defraud and to commit other offenses against the United States, and with failure to file and causing the failure to file currency transaction reports on transactions exceeding $10,000 in cash or its equivalent, as part of a pattern of illegal activity involving transactions exceeding $100,000 within a 12-month period. Puerto Rico Hearing, p. 29 (Prepared Statement of Charles W. Blau). For a listing of the case dispositions as of September 4, 1986 *see* Appendix (Prepared by Department of Justice, Narcotic and Dangerous Drug Section).

[50] Chairman Roth cautioned that no one should draw any conclusions one way or the other that the Subcommittee's investigation of particular financial institutions in any way involved their solvency. Puerto Rico Hearing, pp. 7–8.

> increase in the currency flow into Puerto Rico from 1980 through 1982. Puerto Rico at the time had 16 commercial banks which had increased their assets from approximately $1.6 billion to $11.74 billion for the year ending in 1981.[51]

Mr. Blau stated that an analysis of certain banks indicated that almost none had complied with the Bank Secrecy Act, and that a disproportionately small number of CTRs had been filed. In addition, the Internal Revenue Service reviewed reports submitted by correspondent banks to the Federal Reserve for 1980–1982, and these showed that a majority of Puerto Rican banks sent more currency to the Federal Reserve than they received, and this currency was not reported on CTRs. Based upon this information, the Departments of Justice and Treasury joined efforts in Operation Greenback-Puerto Rico and began to funnel resources to Puerto Rico to ascertain the source of this currency.[52]

According to Mr. Blau, undercover operations primarily began through a cooperating individual who had been a Drug Enforcement Administration source of information relating to the heroin distribution ring between Puerto Rico and Chicago. The source made introductions for government agents with bankers and currency dealers, and a series of financial undercover operations developed. As a result, Operation Tracer, the designated name for the Florida-Caribbean Organized Crime Drug Enforcement Task Force, was formed.[53]

The Subcommittee, concerned over the apparent widespread noncompliance with the Act in one locality, conducted a broad inquiry in Puerto Rico. The investigation included interviews with 42 officials representing 10 financial institutions in Puerto Rico and interviews with managers and examiners of the Federal Home Loan Bank Board and the Federal Deposit Insurance Corporation. Investigators also met with the Puerto Rican Secretary of Treasury, the U.S. Attorney for Puerto Rico, and representatives of Operation Tracer.

In seven of the 10 financial institutions, Subcommittee investigators examined policy and procedural manuals, internal audit manuals and training documents. They also reviewed procedures used by tellers and branch officers to process and record large cash transactions, the banks' exempt lists, and Currency Transaction Reports retained by the institutions. With the assistance of two

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[51] *Ibid.*, p. 9. In addition, Mr. Blau stated:

> The Federal Reserve cash analysis for 12 of those banks showed that currency movements into Puerto Rico had increased significantly in 1980–1982. Specifically, the annual net surplus currency flowing into the national reserve from Puerto Rico had grown from approximately $3.04 million from January of 1980 through the end of July 1980 (to) $528 million from January 1, 1982 through the end of October 1982, as reflected by a summary prepared by the Banco de Ponce for the Federal Reserve in New York.

Ibid.

[52] *Ibid.*, p. 10.

[53] *Ibid.* President Reagan directed the formulation of the task force program in 1982. The Florida-Carribean Task Force, which commenced on October 1, 1984, focuses on criminal organizations involving national and international drug trade. Operation Greenback, however, from which Operation Tracer stems, has focused on the laundering of narcotics proceeds by and through financial institutions in Puerto Rico since 1983. *Ibid.*, p. 26 (Prepared Statement of Charles W. Blau).

bank examiners from the Federal Deposit Insurance Corporation, a detailed examination of cash transactions of three of the seven institutions was conducted.[54]

Charles Morley, then chief investigator for the Subcommittee, testified that while many of the financial institutions in Puerto Rico have detailed policies and an awareness of the Bank Secrecy Act, "officers and employees were nonetheless able to launder money with little effort."

Mr. Morley stated that the major factors leading to this breakdown were "the use of bearer certificates of deposit and poor recordkeeping practices." Moreover, he noted a "seemingly pervasive attitude that tax evasion is harmless; therefore, a banker who assists in tax evasion is not really corrupt. Inadequate supervision by bank managers and bank regulators further compounds the problem and allows its perpetuation." [55]

Chairman Roth criticized the attitude problem referenced by Mr. Morley:

> Chairman ROTH. Now the suggestion has been raised that all this dirty money in Puerto Rico is merely tax evasion money; that tax evasion is a kind of sport wherein hundreds of rich players buy bearer certificates of deposit under a phony name with the help of understanding bankers. We are told that nothing serious is going on and that we can rest assured that no one would accept drug money.
>
> I would like to clear up that misconception right now. Bank employees who knowingly help people evade taxes are committing a crime. They are corrupt. The fact is that widespread corruption of employees in the banking industry is an open invitation to narcotics money laundering. And in the case of Puerto Rico, as is all too common elsewhere in the United States, the narcotics money launderers have arrived. It is up to all of us to run them out, and I just want to reemphasize that it is money laundering that enables the illicit drug industry to exist, and we are not going to be satisfied in this Subcommittee until we end this kind of money laundering, for whatever reason.[56]

In his testimony, Associate Deputy Attorney General Blau confirmed that corrupt banking employees and narcotics money laundering go hand-in-hand. He described a particular money laundering operation uncovered by Operation Greenback, in which a loosely associated network of local financial institutions acted in concert with certain lottery ticket dealers. Those dealers, in violation of Puerto Rican law, would purchase winning tickets from their owners, and resell the tickets to clients who wished to legitimize illicit income. According to Mr. Blau, dealers are aware that certain bank officials at local financial institutions will conduct cur-

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[54] *Ibid.*, p. 39 (Testimony of Charles Morley). Mr. Morley testified that four out of the ten institutions reviewed accounted for the great majority of the excess currency returned by Puerto Rican banks to the Federal Reserve Bank; virtually all the excess appeared to be due to transactions with exempt customers. *Ibid.*, p. 39 and p. 40 (Hearing Exhibit No. 3—"Large Currency Flows through Puerto Rican Banks").

[55] *Ibid.*, p. 41.

[56] *Ibid.*, p. 2.

rency transactions without complying with the reporting requirements of the Bank Secrecy Act. Undercover agents posing as narcotics traffickers received introductions from lottery ticket dealers to local banking officers who engaged in currency transactions, many of which were unreported or falsely reported in violation of the law.[57] Mr. Blau testified that this lottery ticket money laundering scheme has also been utilized by narcotics organizations in New York, Chicago, Miami and elsewhere.[58]

Bearer Certificates of Deposit

The Subcommittee's investigators identified bearer certificates of deposit in Puerto Rican financial institutions as the most troublesome item in their examination. Bearer certificates are owned by the person who has them in their physical possession and in Puerto Rico, the interest earned by these certificates is supposed to be reported to the Puerto Rican Treasury. Bank Secrecy Act regulations require detailed records to be kept on all certificates of deposit, bearer or registered.[59]

Mr. Morley testified that this regulation was often ignored:

> We found case after case of certificates that were issued by financial institutions without any name or other identifying information appearing in the banks' so-called confidential customer file. We now know—through the undercover operations of Operation Tracer, that in some of these cases, the names appeared in so-called black books that were kept by certain officers in their locked desk drawers or file drawers. In several cases, the internal audit functions of the institutions discovered these omissions and the banks took steps to correct them, in some cases after dismissing the offending officers.
>
> Another common practice we discovered consists of entering phony names in the bearer certificate register. I might reiterate that this is not only non-compliance with the Bank Secrecy Act, but under certain circumstances would constitute a criminal violation. . . . As an illustration, we looked at one bearer certificate register that had notations throughout such as "fat woman," "one hand," "bug-eyed," "glasses," "real name is" and then they would have some other name, "real address is" and they would have some other address.[60]

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[57] *Ibid.*, pp. 10–11. Mr. Blau also stated that:

> DEA intelligence indicates that approximately half a dozen suspected major narcotics traffickers have at one time or another claimed to have won the lottery in Puerto Rico for amounts in excess of $100,000. . . .
>
> I should also point out that the undercover agents we utilized in this operation were not posing as the Good Humor man. They were there acting as narcotics dealers, and they had little trouble dealing with the financial institutions under this setup.
>
> As a result, the Department has returned approximately 12 indictments, has charged 16 persons, and the investigation is ongoing.

Ibid., p. 11.

[58] *Ibid.*, p. 15.

[59] 31 C.F.R. 103.34(b)(11).

[60] Puerto Rico Hearing, pp. 41–42. Mr. Morley described the system staff investigators found was employed at several financial institutions:

Continued

The Subcommittee's investigation revealed that several institutions permitted certain customers to purchase hundreds of thousands of dollars in bearer certificates without their names appearing anywhere on the banks' records. In one case, two of these individuals appeared to be among the banks' largest purchasers of certificates of deposit. Yet, they were unknown to anyone but the officer they dealt with; this officer subsequently was charged with criminal violations of the Bank Secrecy Act.

Mr. Morley noted that Operation Tracer had uncovered a number of cases in which bank officers had apparent authority to act alone in issuing bearer certificates. He suggested that problems might be alleviated if two responsible officers were required to be involved with the issuance of these instruments. Moreover, he noted that several banks only issued certificates of deposit to established customers and required full identification for certificates over specified amounts. "This is an extension of the 'know your customer policy'," Mr. Morley testified, and "seems to be good insurance at little cost."[61]

Testimony before the Subcommittee indicates that bearer certificates should not facilitate money laundering if the recordkeeping requirements of the Bank Secrecy Act are followed.[62] Thus, the problem is not the instrument itself, but the improper treatment of the instrument by some financial institutions.

Inadequate Records

In addition to incomplete records of the identities of persons holding bearer certificates, the investigation in Puerto Rico uncovered other inadequate recordkeeping practices. For example, several of the institutions examined did not record distinctions between currency transactions and transactions negotiated by check or otherwise. Thus, currency transactions cannot be traced through tellers' records at these institutions. During the Subcommittee's investigation, this situation surfaced at several savings and loans in Puerto Rico. The Subcommittee has since found that this "non specific" recordkeeping practice is also fairly common in smaller financial institutions throughout the United States.

Inadequate recordkeeping seriously hampers the ability of internal auditors and bank regulators to verify compliance with the Bank Secrecy Act, because their work depends on detailed, initial records. As Mr. Morley testified, when a teller at one bank was asked to assist Subcommittee investigators in reading another tell-

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> A customer wishing to buy a bearer certificate . . . would be taken by an officer, generally a branch manager, to a private room. The only records that normally emerged from that room were the minimum necessary to prepare the certificate and to make an entry into the register. The cash received, or the check, frequently never went through a teller. . . . Of course, only the officer involved knows whether or not the name entered into the register is accurate. . . .
>
> It is interesting to note that after the June raids, we found numerous cases of name changes on the bearer certificate records of several institutions. This indicates to us that the initial names were false, and the institutions took steps to rectify their records following the raids.

Ibid.

[61] *Ibid.*, p. 55.

[62] *Ibid.*, p. 115 (Testimony of Antonio J. Munoz, Chairman and Chief Executive Officer, Banco Financiero de Puerto Rico) and p. 137 (Testimony of Hector Ledesma, President, Puerto Rico Bankers Association and Chief Executive Officer, Banco Popular de Puerto Rico).

er's records, "(w)e discovered that she couldn't explain many of the entries. Needless to say, if another teller couldn't understand the tape, there is little reason to believe that an internal auditor or a bank examiner could." [63]

Mr. Morley explained the importance of adequate recordkeeping and described how recorded currency transactions can alert banks to possible Bank Secrecy Act violations:

> It is virtually impossible for an internal auditor to audit large currency transactions in an institution that does not specifically record currency transactions on the teller's tape. On the other hand, institutions we reviewed which had on-line computer systems or which manually prepared cash-in, cash-out tickets, left very easy trails for internal audit to follow. Bank managers may wish to ensure that their systems leave a clear audit trail for currency transactions in order to further protect themselves from being victimized by money launderers and their accomplices. . . .
>
> Several banks in Puerto Rico require daily currency analyses to be conducted by their operations officers at the branch level. This immediately identifies any unusual currency flows and alerts senior management to the possibility that these may be unreported. These banks view this additional step as sound cash management which goes hand in glove in determining the branches daily cash needs, a process all banks must go through regardless.[64]

Federal Home Loan Bank Board Examinations

As in Boston, a very disturbing aspect of the Puerto Rico investigation concerned the inadequate oversight by the federal bank regulators. Chairman Roth characterized their performance as "oblivious to situations you would have to be blind to miss." [65] He stated:

> Bearer certificates of deposit are an excellent case in point. This may come as a surprise to the Federal Home Loan Bank Board, but failure to keep detailed identifying records with respect to certificates of deposit is a violation of the Bank Secrecy Act. Knowingly failing to do so is a crime. It took our investigators only a matter of minutes in several banks to find case after case of such violations. Some have had all the earmarks of criminal violations. Now the Federal Home Loan Bank Board regulators didn't catch these incredible violations because in most cases they apparently simply gave the Bank Secrecy Act check sheet to their appropriate bank officials to complete. The results were predictable.
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> It is instructive to note that in 1983, the Federal Home Loan Bank Board examined 2,185 savings and loans nationwide, including Puerto Rico, and found only two Bank Secrecy Act violations, whereas in the same year, the

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[63] *Ibid.*, p. 43.
[64] *Ibid.*, p. 55.
[65] *Ibid.*, p. 2.

FDIC found 10 of the 11 Puerto Rican banks examined to be in some form of noncompliance with the Act. . . .

Let me say, apparently the Board and its examiners have no idea of the significance of the Act's value in attacking organized criminal groups. They must not read the newspapers. Unfortunately, their negligence has allowed a totally intolerable situation to perpetuate itself for years to the great detriment of the financial institutions and the citizens of Puerto Rico.[66]

One situation reviewed by the Subcommittee involved the Federal Home Loan Bank Board's oversight of Bank Secrecy Act compliance at Caribbean Federal Savings and Loan (Caribbean). That Bank's former president, Raul Penagaricano, and other bank officers were charged with criminal violations as a result of Operation Tracer.[67]

During a 1985 examination at Caribbean, a Federal Home Loan Bank Board examiner requested copies of all CTRs filed during the preceding 30 months. In response, Caribbean produced only one CTR. Upon further review, the examiner found a large number of apparent cash purchases of certificates of deposit over $10,000 for which no CTRs were filed. He noted these findings in his draft report. Thereafter, a Federal Home Loan Bank Board field manager revised the examiner's comments, and stated that Mr. Penagaricano would ensure corrections of any compliance deficiencies, even though the manager had not spoken to the Bank's president. Later, the Acting Regional Director deleted the examiner's comments from the final report, based on information supplied by Mr. Penagaricano—in part, for the wrong time period—claiming that the deposits did not require reporting.[68]

At the Subcommittee's hearing, Frank Nelson, the field manager involved in these events, acknowledged that "this was not a good performance" by the Federal Home Loan Bank Board.[69] William J. Schilling, Director, Office of Examinations and Supervision, Federal Home Loan Bank Board, testified:

> These alterations in the examination reports have been referred to our Inspector General for investigation and recommendation. The original comments and responses are being reinserted. . . . Our new policies will require that before a change can be made, we have to go back to the examiner in question before any substantive change can be made.[70]

Mr. Schilling also testified that the Federal Home Loan Bank Board is taking steps to improve the Board's program of examination and supervision under the Bank Secrecy Act.[71] Among other

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[66] *Ibid.*, pp. 2–3, 7.

[67] At the time of his arrest, Raul Penagaricano also was serving as Vice Chairman of the Federal Home Loan Bank of New York, the agency responsible for enforcing Bank Secrecy Act compliance among savings and loans in Puerto Rico. He later resigned both positions.

[68] Puerto Rico Hearings, pp. 42–53 (Testimony of Charles Morley and Hearing Exhibit 4), pp. 68, 71 (Testimony of William Schilling), pp. 71–75, 79–80 (Testimony of Frank Nelson and Vincent Cerreta).

[69] *Ibid.*, p. 80.

[70] *Ibid.*, pp. 68, 71.

[71] *Ibid.*, pp. 68–69.

things, Chairman Gray requested the Board's Office of Inspector General to investigate the Board's examination and supervisory apparatus in connection with the federal investigation of money laundering in Puerto Rico. The Inspector General retained Price Waterhouse to conduct this evaluation.

Senator Rudman, in his questioning of Mr. Schilling, referred to the preliminary findings of Price Waterhouse: [72]

> Senator RUDMAN. . . . based on Price Waterhouse—let me read you the significant parts of what they say.
>
> "The nature of the examination procedures generally carried out with respect to currency transactions could not reasonably be expected to provide assurance of compliance with the Act and efforts significantly greater than those currently taken would be necessary to achieve such assurance."
>
> Then they say in the next paragraph—I am not taking these out of context; I am reading the concluding sentence of each of these paragraphs.
>
> "The examination procedures are not sufficient, however, to establish that an association is in substantial compliance with the reporting provisions of the Act nor to detect intentional violations."
>
> Then they go on to say,
>
> "Examination files frequently contain insufficient documentation of work performed and related findings to support conclusions regarding the nature and adequacy of procedures which control the reporting of currency transactions."
>
> And they go on to say something we all agree with, "Compliance with the Act has been a low priority issue to most examinations." And then after those five declarations, they write this, and if you can explain it to me, after a lot of talk about how preliminary the work is and it is going to take some time to gain assurance everybody is in compliance, they say this:
>
> "Consequently, at this stage in our investigation, we tend to believe that the level of effort expended in reviewing compliance with the Act was generally appropriate under the circumstances."
>
> Now that concluding sentence, and I am sure you have read this report more closely that I have—I read it this morning—totally baffles me because they make five findings that you weren't doing your job and then they say what you were doing was appropriate under the circumstances. . . .[73]

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[72] *Ibid.*, pp. 103–107 (Price Waterhouse Interim Report, "Evaluation of Regulatory Actions and Procedures in Connection With Possible Violations of the Currency and Foreign Transaction Reporting Act by Four Savings Institutions in Puerto Rico").

[73] *Ibid.*, pp. 76–77. The concluding sentence of the report was preceded by the following: "However, we question whether any realistic level of effort could be relied upon to detect instances of intentional non-reporting where the participation of association management is involved." *Ibid.*, p. 107.

In the final Price Waterhouse report submitted to the Federal Home Loan Bank Board, Price Waterhouse was less critical of the Board's procedures and more critical of the efforts expended in applying those procedures.[74] Among other things, the report concludes that at the financial institutions under review,

> examination efforts were reduced somewhat beyond the level required to achieve a reliable basis for satisfaction that procedures adequate to foster compliance were in place. This results not from any inadequacy of Bank Board procedures, but from generally insufficient effort expended in carrying them out.[75]

According to the report, more thorough effort and better work paper documentation "might have been instrumental in bringing potential noncompliance conditions to light. . . .[76] The report includes recommendations for improving compliance with the Act.[77]

It is apparent that the level of effort expended by the Federal Home Loan Bank Board in reviewing compliance with the Act was generally inappropriate under the circumstances, especially in view of the fact that it took staff investigators a matter of minutes to find significant evidence of non-compliance in more than one institution. While the Subcommittee's investigators may have known exactly what to look for, they were also burdened by heavy time constraints and other pressures, similar to bank examiners. Nonetheless, violations were quickly spotted.

Efforts by the Puerto Rican Financial Community

It is important to point out that findings of wrongdoing involved a small number of individual bank employees acting somewhat unilaterally within their own institutions. In most cases, they acted in direct opposition to their institution's written policies.[78] In fact, several of the bankers involved had been discharged by the institutions months before the raids took place. Furthermore, several institutions in Puerto Rico reviewed by Subcommittee staff investigators were far more conscientious in sensitizing their employees to compliance with the Bank Secrecy Act than similar institutions on the United States mainland. As Chairman Roth made clear, "much of the banking industry in Puerto Rico is complying and trying to live within the law." [79]

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[74] The final Price Waterhouse report is entitled "Federal Home Loan Bank Board—Evaluation of the Effectiveness of Regulatory Actions and Procedures in Determining Compliance with the Currency and Foreign Transaction Reporting Act by Four Savings Institutions in Puerto Rico" (August 16, 1985). A copy of this report is contained in the Subcommittee's files.

[75] *Ibid.*, p. 12.

[76] *Ibid.*, p. 2.

[77] *Ibid.*, pp. 18–22. *See also* Price Waterhouse's assessment of the Board's actions at the Caribbean Federal Savings Bank discussed previously in this Report. *Ibid.*, pp. 12–13.

[78] For example, in another situation reviewed by Subcommittee staff, a courier daily delivered to Banco Financiero numerous $9,500 checks drawn by Rodal Magazine Distributors on another bank. The courier, assisted by a bank officer, would buy numerous managers' checks, payable to third parties. The next day, these checks would be redeposited back into Rodal's account from which the funds were removed in the first place, thus covering otherwise bad checks. These transactions apparently had the blanket approval of a board member with Banco Financiero. According to Charles Morley, "these transactions violated Banco Financiero's policies and were apparently conducted unbeknownst to the president of the bank. . . ." Puerto Pico Hearing, pp. 53–55.

[79] *Ibid.*, p. 130.

The Puerto Rico Bankers Association and the Puerto Rico Savings and Loan Association have both taken very active leadership roles in working with their member institutions regarding compliance with the Bank Secrecy Act provisions. These associations are to be commended for their current efforts.[80]

IV. BANK SECRECY ACT MANAGEMENT AND ENFORCEMENT: THE GENERAL ACCOUNTING OFFICE'S FINDINGS

Introduction

Concerned by the lack of compliance with and enforcement of the Bank Secrecy Act uncovered by the Subcommittee's investigations, Chairman Roth requested the General Accounting Office (GAO) to examine how effectively the regulatory agencies were doing their jobs of overseeing Bank Secrecy Act compliance, how well the Treasury Department was managing its responsibilities under the Act, and the use law enforcement agencies were making of the data generated by the Act.

Bank Secrecy Act Oversight by the Regulatory Agencies

At the Subcommittee's October 29, 1985 hearing, GAO representatives presented their preliminary findings of the performance by regulatory agencies, in enforcing the Act.[81] With respect to the three principal bank regulatory agencies, the Federal Reserve System, the Comptroller of the Currency, and the Federal Deposit Insurance Corporation, GAO found that of the 18 offices of those agencies reviewed, only four, all Federal Reserve offices, adequately were performing and documenting the various review steps incorporated in the relevant guidelines.[82]

At the Federal Home Loan Bank Board, GAO found that many of the necessary steps in examining compliance with the Bank Secrecy Act were not conducted by Bank Board examiners.[83] The Na-

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[80] The Subcommittee suggests that other financial institutions consider the testimony of the presidents of these associations. *Ibid.,* pp. 126–190 (Testimony and Prepared Statements of Hector Ledesma, President, Puerto Rico Bankers Association and Chief Executive Officer, Banco Popular de Puerto Rico, and Mariano J. Mier, President, Puerto Rico Savings and Loan Association and President, First Federal Savings Bank).

[81] *See* footnote 8. GAO randomly and scientifically sampled 1,254 examinations conducted in six geographical regions of the United States. Broken down, GAO looked at 187 examinations conducted by Federal Reserve personnel, 261 by personnel of the Comptroller of the Currency, 254 by Federal Deposit Insurance Corporation personnel, 300 by the National Credit Union Administration personnel, 183 by Securities and Exchange Commission personnel, and 252 by Federal Home Loan Bank Board personnel. GAO also looked at a sample of 48 of 420 examinations conducted by the Internal Revenue Service in Manhattan, Brooklyn, Illinois and Dallas. Bank Secrecy Act Hearings, Part I, S. Hrg. 99–472, pp. 5–6 (Testimony of William J. Anderson, Director, General Government Division, GAO). For an update on GAO's preliminary results as provided before the Subcommittee on October 29, 1985 and GAO's final conclusions and recommendations, *see* GAO's Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate, "Bank Secrecy Act, Financial Institution Regulators' Compliance Examinations" (GAO/GGD–86–94 August 1986).

[82] These agencies all used a set of model procedures developed by the Federal Financial Institutions Examination Council, a group conisting of representatives from all the bank regulatory agencies ("FFIEC guidelines"). The FFIEC guidelines provide for two separate modules. Module 1 requires examiners to obtain certain information such as the institution's procedures, currency flows, and internal audits; if this information is deemed acceptable, examiners need not proceed to module 2, which includes more intensive procedures, such as testing of teller transactions. GAO found that at these three regulatory agencies, in eight percent of the examinations reviewed, examiners concluded module 1 with an analysis of why they were not going to do module 2. *Ibid.,* pp. 6–7 (Testimony of William J. Anderson).

[83] *Ibid,* p. 7. Mr. Anderson noted that a shortage of Federal Home Loan Bank examiners and an emphasis on safety and soundness resulted in less emphasis on Bank Secrecy Act work. *Ibid.*

tional Credit Union Administration allows its examiners to do work in the Bank Secrecy Act area at their option; out of 300 NCUA examinations reviewed by GAO, there were only three instances of work done in the area of Bank Secrecy Act compliance.[84]

At the Securities and Exchange Commission, examiners used a six-point checklist developed by the agency. In most instances, GAO found that examiners filled out the checklists, but there was no supporting documentation. In addition, GAO believed that the checklist lacked sufficient detail and could result in inconsistent examinations.[85]

GAO found that the the Internal Revenue Service, the last agency it examined, was technically doing a good job in its examinations. That agency's problem, according to GAO, was in trying to identify the firms it should examine because of the vagueness of the applicable statutory language governing its responsibilities.[86]

William J. Anderson, Director, General Government Division, GAO, summarized GAO's preliminary findings as follows:

> Although the regulatory agencies undertake examinations of their constituent financial institutions to assure compliance with the Act . . . these agencies, as a group,
>
> —place greater emphasis on mission-related objectives, and lesser emphasis on Bank Secrecy Act compliance when allocating examination resources because they believe these resources are limited;
>
> —do not have detailed Bank Secrecy examination procedures and apply those they do have inconsistently;
>
> —do not sufficiently document the examination work performed, which makes it difficult to accurately assess how well examiners are performing compliance examinations; and
>
> —tend, in some instances, to use examiners with lesser levels of experience and training to assess compliance with the Act.[87]

In addition, GAO found that examination procedures could be strengthened, and that Treasury and the agencies could better communicate and coordinate their Bank Secrecy Act-related activities.[88]

According to Mr. Anderson:

> The bottom line summary is that I feel we're putting a lot of effort out there, but I wonder how well focused it is.
>
> The effort that we're putting in does not appear to be well managed by the heads of the various regulatory agen-

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[84] *Ibid.*
[85] *Ibid.*
[86] *Ibid.* Treasury has delegated to the Internal Revenue Service responsibility for those miscellaneous "financial institutions" not assigned to other agencies. *See* footnote 8. The statute identifies some of these "financial institutions" as including "a pawn broker," "a travel agency," or "another business or agency carrying out a similar, related or substitute duty or power the Secretary of the Treasury prescribes." 31 U.S.C. § 5312(a)(2). According to GAO, the Internal Revenue Service does not have a definitive list of firms to examine, and must resort to the telephone book yellow pages to identify specific firms. Bank Secrecy Act Hearings, Part I, p. 7.
[87] Bank Secrecy Act Hearings, Part I, pp. 17–18 (Prepared Statement of William J. Anderson).
[88] *Ibid.*, p. 18.

cies that are responsible for it. You almost sense that there's a need to rethink what institutions we look at in depth and what an indepth look should consist of from the standpoint of the procedures that apply.[89]

Treasury Department Management

At the Subcommittee's June 12, 1986 hearing, GAO and Treasury Department representatives addressed Treasury's role and performance under the Bank Secrecy Act.

Although Treasury has delegated most of the Act's day-to-day operations to the Internal Revenue Service, the U.S. Customs Service and a number of federal financial regulatory agencies, the Secretary of the Treasury retains overall responsibility for implementing the Act.[90] Treasury's Assistant Secretary for Enforcement performs this role on behalf of the Treasury Department.

According to William Anderson, GAO found that Treasury began more actively implementing the Bank Secrecy Act following the Bank of Boston's February 1985 conviction for criminal violations of the Act, and has taken some actions to improve compliance with and enforcement of the Act. GAO concluded, however, that opportunities exist for further improvements by Treasury.[91]

In particular, GAO found that Treasury headquarters needs to obtain more information about how the internal Revenue Service, the U.S. Customs Service and the financial regulatory agencies are administering the Act [92] and how law enforcement authorities are using Act-generated data.[93]

GAO also found Treasury should more actively be involved in the Act data collection [94] and analysis processes,[95] and should revise the guidelines for dissemination of Act data to facilitate access by the law enforcement community.[96] These activities are critical. As Chairman Roth stated.

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[89] *Ibid.*, p. 9.

[90] *See* footnote 8.

[91] General Accounting Office Findings on the Enforcement of the Bank Secrecy Act, S. Hrg. 99–781 (hereinafter Bank Secrecy Act Hearings, Part II), p. 26 (Prepared Statement of William J. Anderson). GAO's detailed findings on Treasury's implementation of the Act, and law enforcement's use of the Bank Secrecy Act and the data generated thereunder are set forth in detail in GAO's Report to the Chairman, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, United States Senate, "Bank Secrecy Act, Treasury Can Improve Implementation of the Act" (GAO/GGD–86–95, June 1986) (hereinafter GAO's June 1986 Bank Secrecy Act Report).

[92] Bank Secrecy Act Hearings, Part II, p. 9. Although the Act's regulations require the regulatory agencies and the Internal Revenue Service to periodically report to Treasury on their efforts to assure compliance, GAO found that not all these agencies submit these reports, and those that are submitted are not timely or consistent. *Ibid.*, p. 29 (Prepared Statement of William J. Anderson).

[93] *Ibid.*, p. 120.

[94] *Ibid.*, p. 31 (Prepared Statement of William J. Anderson). Treasury has delegated to the Internal Revenue Service and the U.S. Customs Service the day-to-day operating authority for collecting data generated by the Bank Secrecy Act. *Ibid.*

[95] *Ibid.*, p. 32 (Prepared Statement of William J. Anderson). Treasury has delegated to the U.S. Customs Service the responsibility for analyzing data for use by law enforcement authorities. GAO found that law enforcement personnel thought some of the reports were useful, but some characterized them as helpful mainly as background information and not for tactical use. *Ibid.*, p. 8.

[96] *Ibid.*, pp. 32–33 (Prepared Statement of William J. Anderson). Treasury has delegated to the U.S. Customs Service the task of disseminating Act data to federal, state, local and foreign law enforcement agencies. Customs proposed revisions to the current dissemination guidelines in 1982 and 1986; as of the date of the hearing, they were still under review by Treasury. *Ibid.*

Continued

> The primary purpose of the (Bank Secrecy) Act is to aid law enforcement agencies in prosecuting criminal activities. If the . . . Act is to assist law enforcement agencies in the battle against crime, information that is generated must be effectively collected and processed.[97]

Acknowledging "the substantial contribution that (the Subcommittee) has made to our progress in improving the administration and enforcement of the (Bank Secrecy) Act," [98] Francis A. Keating, II, Assistant Secretary of the Treasury (Enforcement) described to the Subcommittee Treasury's recent efforts to improve Bank Secrecy Act implementation.

Mr. Keating testified that in July 1985, Treasury established the Office of Financial Enforcement as the unit primarily responsible for administering the Bank Secrecy Act, and increased the commitment of staff resources to that office.[99] In addition, Treasury has convened a permanent Treasury Bank Secrecy Act Enforcement Advisory Group, chaired by the Deputy Assistant Secretary (Enforcement), and consisting of supervisory level representatives of Treasury, Customs, IRS, the SEC and the bank regulatory agencies, that will address mutual enforcement problems and discuss Treasury policy initiatives. The Advisory Group has established a Bank Secrecy Act Working Group to work on specific tasks assigned by the Advisory Group.[100]

In April 1986, according to Mr. Keating, Treasury issued final improved examination procedures to the bank supervisory agencies.[101] In addition, Treasury strengthened Bank Secrecy Act regulations in several aspects, and, at the time of the hearing, was circulating a major regulatory revision package among bureaus within Treasury with Bank Secrecy Act responsibilities and to the Justice Department. These proposed new reporting and recordkeeping requirements were subsequently published in the *Federal Register* on August 25, 1986.[102] Among other things, the proposed regulatory revisions require financial institutions to report cash purchases exceeding $3,000 of monetary instruments such as cashier's checks, traveler's checks or money orders where the aggregate value of all such same-day purchases totals more than $10,000. In addition, financial institutions would have to report any kind of

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David Queen, Deputy Assistant Secretary of the Treasury (Enforcement) testified that Customs is disseminating access to the data base to field offices, and the Internal Revenue Service is adding 38 terminals in the field office that will have access to the data. *Ibid.*, p. 200.

[97] *Ibid.*, p. 3.

[98] *Ibid.*, p. 18.

[99] *Ibid.*, p. 16. According to Mr. Keating, that "office has broad responsibilities for the compliance activities of all agencies that have been delegated responsibility under that Act." Three of the four positions authorized for that office had been filled, and as of the date of the hearing, Treasury was in the process of selecting a new Director for that office. *Ibid.*

[100] *Ibid.*, p. 15 and pp. 40–41 (Prepared Statement of Francis A. Keating, II). The Working Group is revising the standard procedures for referral of penalty cases to Treasury and working with the Office of Financial Enforcement to develop a pamphlet for distribution to financial institutions on procedures for exempting customers from the Bank Secrecy Act's reporting requirements. In the future, according to Mr. Keating, the Working Group will be developing guidelines for more comprehensive periodic reports to Treasury by the regulatory agencies on their Bank Secrecy Act enforcement." *Ibid.*, p. 15.

[101] *Ibid.*, p. 14.

[102] *See* 51 Fed. Reg. 30233 *et seq.* (August 25, 1986). Comments on the proposed rule must be received by Treasury on or before November 24, 1986.

multiple currency transactions by a single customer of which they are aware that exceed $10,000 in one day.[103]

In the wake of the *Bank of Boston* case, the number of filed Currency Transaction Reports has dramatically increased. According to Mr. Keating, there will be an estimated three million CTRs filed this year, as compared to approximately 1.8 million filed in 1985 and 700,000 in 1984.[104] Although this upsurge initially created a processing backlog, that backlog has now been eliminated.[105]

Mr. Keating also testified that as a result of the publicity surrounding the *Bank of Boston* case, and in response to Congressional hearings, over 60 financial institutions have approached Treasury to report past violations of the Bank Secrecy Act.[106] As of June 1986, 18 civil penalties had been assessed under the Act, ranging from $75,000 to $4.75 million, and other cases were under review.[107]

Addressing legislative initiatives, Mr. Keating endorsed the Administration's bill, S. 1335, the "Money Laundering and Related Crimes Act," that makes money laundering a substantive criminal offense, and would provide the Secretary of the Treasury with summons authority for financial institution witnesses and documents in connection with Bank Secrecy Act violations.[108]

Mr. Keating testified that Treasury also urges "early and favorable action" on S. 2306 (H.R. 4573), introduced by Senator D'Amato and Congressmen Pickle and Schulze. That bill prohibits structuring of currency transactions to avoid the $10,000 currency transaction reporting requirement,[109] and provides seizure and forfeiture authority for currency related to a domestic (CTR) reporting violation or interest in property traceable to the currency. Subsequent to Mr. Keating's testimony, Congress passed the Anti-Drug Abuse Act of 1986, which included extensive provisions dealing with money laundering (Subtitle H of Title I, the "Money Laundering Control Act of 1986").

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[103] These proposed reporting requirements address the problem of "smurfing," whereby individuals seek to avoid the reporting requirements of the Act by taking illicit cash to a number of banks in amounts less than 10,000, buying a number of cashier's checks, and then depositing the checks to an account, and often wiring them abroad. Bank Secrecy Act Hearings, Part II, p. 44 (Prepared Statement of Francis A. Keating, II). *See* footnote 109.

[104] *Ibid.*, p 18.

[105] *Ibid.*, p 17.

[106] *Ibid.* According to Mr. Keating, some came forward on their own initiative, and others have done so as a result of bank regulatory examinations. *Ibid.* According to GAO, of the 76 cases Treasury has under review, only one resulted from an audit finding. *Ibid.*, p. 10.

[107] *Ibid.*, p. 17. Mr. Keating testified that Treasury is continuing to encourage financial institutions to voluntarily disclose past Bank Secrecy Act violations, and that non-volunteer institutions will be dealt with more severely. *Ibid.*

[108] *Ibid.*, p. 16.

[109] *Ibid.* In the past, the U.S. Courts of Appeal have not been in accord on whether alleged money launderers could successfully be prosecuted for causing financial institutions not to file reports on multiple currency transactions, each of which is less than $10,000, but when aggregated, exceed $10,000, or for causing financial institutions to file inaccurate reports. *Contrast United States v. Tobon-Builes,* 706 F.2d 1092 (11th Cir. 1983) (conviction upheld) with *United States v. Varbel,* 780 F.2d 758 *(9th Cir. 1986) and United States v. Anzalone,* 766 F.2d 676 (1st Cir. 1985) (unsuccessful prosecutions).

The latter courts viewed the law as not imposing a duty on bank customers to inform financial institutions of the structured nature of their currency transactions. This conclusion stemmed from the ambiguity regarding coverage of the Bank Secrecy Act and its regulations; while the former extended reporting requirements to financial institutions *and* any other participants in the transaction the Secretary may prescribe (31 U.S.C. S5312(a)), the latter limited the reporting requirements to financial institutions *only* (31 C.F.R. § 103.22).

While acknowledging that there is still room for improvement, the Assistant Secretary testified that Treasury had made progress and emphasized that "this is a time of activity and innovation in the Treasury's Bank Secrecy Act program."[110]

Use by Law Enforcement of the Act and Act-Generated Data

At the Subcommittee's June 12, 1986 hearing, William Anderson also described the use of Bank Secrecy Act data by law enforcement agencies in Florida and California; GAO had selected those locations for review because of substantial drug trafficking and money laundering activities known to be conducted in those states.

GAO found that law enforcement agencies in Florida and California are using the Bank Secrecy Act and the data generated thereunder to disrupt money laundering and drug trafficking activities, as well as to enforce criminal and civil tax laws. Multi-agency task forces, such as BANCO, led by DEA, and GREENBACK, led by Treasury have been particulary active in these efforts.[111]

According to GAO, the Bank Secrecy Act itself provides a deterrent to money laundering, provides a mechanism for enlisting the support of financial institutions in identifying possible currency violations, and furnishes authority for seizing unreported currency being transported in and out of the United States.[112] The data generated by the reporting requirements of the Act is used by law enforcement personnel to identify investigatory targets, to provide corroborating evidence against individuals identified through other sources, such as informants, and to establish knowledge of the Act's reporting requirements by persons who have previously filed reports.[113]

V. CONCLUSIONS AND RECOMMENDATIONS

This Subcommittee has been investigating money laundering and its connection to crime for several years, and we have concluded that the Bank Secrecy Act is potentially one of the most effective tools available to law enforcement in the war against crime.

There is ample evidence, however, that the problem of money laundering is not going away. The scope of the cocaine problem alone indicates that billions of dollars will be generated each year that criminals will attempt to conceal through the laundering process. Therefore, money launderers will continue to search out institutions unfamiliar with the Bank Secrecy Act or those that can otherwise be penetrated and used to hide the source and true ownership of proceeds from illegal activity.

Unfortunately, the record of Bank Secrecy Act compliance and enforcement has been poor. Recent improvements in these areas

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[110] Bank Secrecy Hearing, Part II, pp. 14, 17.

[111] *Ibid.*, p. 12. *See also* GAO's June 1986 Bank Secrecy Act Report (cited in footnote 91), Appendix I, "Selected Examples of Use of the Bank Secrecy Act And/Or the Data Generated By the Act," pp. 30–38.

According to Assistant Secretary Keating, investigations by the Department of Justice and Treasury under the President's Organized Crime Drug Enforcement Task Force Program have relied upon Bank Secrecy Act data and Treasury analyses of these data. In approximately three years of full operation, these task forces have initiated 1,350 cases, resulting in the indictments of 8,649 persons, 3,678 of whom have been convicted. Bank Secrecy Act Hearings, Part II, p. 16.

[112] *See* GAO's June 1986 Bank Secrecy Act Report, Appendix I, p. 31.

[113] *Ibid.*

have been encouraging, but we believe that additional steps must be taken by all concerned in an effort to make money laundering more difficult. The Subcommittee offers the following recommendations:

A. Bank Regulators

1. It is obvious that regulators have not adequately stressed the important role Bank Secrecy Act provisions play in preventing money laundering.

We recommend that regulators of financial institutions ensure that their staffs, particularly examiners, are fully familiar with the techniques used to launder money and with the provisions of the Bank Secrecy Act through intensive training programs that alert employees to the characteristics of money launderers and that review Bank Secrecy Act requirements. This training should include both classroom and on-the-job training components. Examiners should be able to demonstrate a thorough understanding of Bank Secrecy Act requirements before conducting bank examinations. Periodic refresher courses should be required on a regular basis.

2. The Subcommittee found that bank regulators were often unaware of their responsibilities and of the procedures for testing compliance with the Bank Secrecy Act.

In April 1986, the Department of the Treasury issued revised examination procedures to the bank supervisory agencies. These improved procedures should be vigorously implemented, and after an appropriate testing period, reviewed in order to evaluate their effectiveness.

3. The investigations revealed many instances where violations of the Act were not cited and reported, or in the case of the Bank of Boston, were noted in work papers but not reported to the Department of the Treasury.

We recommend regulators apply strict criteria to violations uncovered in financial institutions and report all such violations to Treasury in detail sufficient for Treasury to make adequate decisions as to further investigations. Written criteria should specify the procedures governing the reporting process.

4. Regulators' work papers were found to be woefully inadequate, at times only checklists, for determining what efforts were made to test for compliance of the Act during examinations.

We recommend regulators provide more detailed work papers that allow supervisors to review the work of subordinates and determine if they are taking all appropriate examination steps.

B. Financial Institutions

Financial institutions may want to consider the following suggestions as aids to improving their compliance with the Bank Secrecy Act.

1. Many financial institutions do not have a designated bank officer who is responsible for Bank Secrecy Act compliance. The resulting confusion and lack of awareness often leads to lack of compliance with the Act. Therefore, financial institutions might find it

helpful to appoint a compliance officer who has ultimate responsibility for compliance with the Bank Secrecy Act.

2. Many financial institutions do not have currency controls and therefore, large currency transactions can move in and out of the bank without detection. Adoption of strict currency controls might help these institutions to identify and isolate large currency transactions. In addition, implementation of systems that will isolate all currency transactions over $10,000 in the aggregate for any given account might facilitate Bank Secrecy Act compliance.

3. The Subcommittee's investigation revealed a lack of familiarity with the Bank Secrecy Act and money laundering schemes in almost every situation where a financial institution has been charged with violations. Therefore, financial institutions may benefit by instituting training in Bank Secrecy Act requirements and money laundering ploys for all bank employees and members of management involved in customer currency transactions. Periodic internal audits of Bank Secrecy Act compliance procedures within the institution would help monitor the effectiveness of these training programs.

C. Other Recommendations

1. We recommend that Treasury and the other bank regulatory agencies develop a procedure for yearly subjecting a random sampling of institutions to intensive compliance examinations, similar to the way the IRS performs random audits of tax returns. This procedure might provide a significant deterrent effect for other financial institutions, particularly if sufficient penalties are assessed for those violations that are detected.

2. We recommend that Treasury expand its analyses of CTRs, CMIRs, and Federal Reserve cash figures, to quickly isolate other potential pockets of non-compliance with the Bank Secrecy Act throughout the country. This would allow the possibility of more intense examinations at targeted institutions and more effective use of bank regulators' resources.

3. We believe the Administration should examine the resource needs of the financial investigative task forces and consider shifting resources accordingly or approaching Congress to request additional resources.

4. We recommend that Treasury take a more active role in monitoring the Bank Secrecy Act compliance performance of the bank regulatory agencies, and in managing the collection, processing and dissemination of data generated by the Act. This oversight should be ongoing and implemented at the highest level feasible. We suggest that Treasury evaluate, and to the extent possible, implement, the recommendations of the General Accounting Office contained in its June 1986 report "Bank Secrecy Act: Treasury Can Improve Implementation of the Act."

5. In the final days of the 99th Congress, Congress passed the Anti-Drug Abuse Act of 1986, which included extensive provisions dealing with money laundering (Subtitle H of Title I, the "Money Laundering Control Act of 1986"). We recommend vigorous enforcement of the new legislation, with Congressional review of these enforcement efforts at the earliest appropriate time.

APPENDIX

Department of Justice, Narcotic and Dangerous Drug Section

DISTRICT OF PUERTO RICO, OPERATION TRACER (CASE DISPOSITION)

Defendant	Criminal number	Disposition	Sentence
1. Alejandro Melendez-Carmona (Bank Manager).	85–208 and 85–210	August 16, 1985—Defendant entered a plea of guilty to Count II of Cr. 85–208 during first year of probation. November 25, 1985—Defendant entered a plea of guilty to Count I of N. 85–210. Dismissed.	November 25, 1985—Defendant was sentenced in Cr. 85–208 to 3 years imprisonment with all but 6 months suspended. Placed on probation for 2 years and ordered to perform community service for 16 hours a month during first year of probation. December 9, 1985—Defendant was sentenced in Cr. 85–210 to same sentence as above with 3 years probation to run concurrent. All other charges dismissed.
2. Efrain Tosado-Miranda (Computer Specialist).	85–198; 85–203; and 85–241	Case dismissed on December 16, 1985, due to death of defendant.	
3. Juan J. Elias-Arroyo (Acaparador).[1]	85–207	September 17, 1985—Defendant pleaded guilty to 1 count.	November 8, 1986—Defendant was sentenced to 1 year in prison and $1,000 fine. Sentence suspended and placed on probation for 3 years with 12 hours of community service per month during first year of probation. Fine to be paid during first month of probation and jury cost to be paid during first year of probation. All other charges dismissed.
4. Reinaldo Ramos-Ramos (Bank Manager).	85–201 and 85–230	November 8, 1985—Defendant pleaded guilty to Counts I–II and VI of 85–201.	December 10, 1985—Defendant was placed on probation for 2 years. All other charges dismissed.
5. Hector Rey-Balaguer (Acaparador).	85–201 and 85–202	October 29, 1985—Defendant entered plea of guilty to Counts II and III of Indictment 85–201. October 30, 1985—Defendant entered plea of guilty to Count I of Cr. 85–202.	December 5, 1985—In Count II of Cr. 85–201 defendant was sentenced to serve 3 months in jail and to pay a fine of $10,000. On Count III he received a 3-year suspended sentence; probation for 4 years and a fine of $10,000. Fine in Count II to be paid while in jail; fine in Count III be paid while on probation. December 18, 1985—Defendant was sentenced to 3 months in jail in Cr. 85–202 to run concurrently with sentence in 85–201. All other charges dismissed.
6. Daniel Calderon Flores (Bank Vice-President).	85–208 and 85–210	August 16, 1985—Defendant entered plea of guilty to 1 count in 85–208. September 12, 1985—Defendant entered plea of guilty to 1 count in 85–210.	October 25, 1985—3 years in prison with all but 6 months suspended in Cr. 85–208; 2 years probation with 16 hours per month of community service during first year of probation. October 26, 1985—Same sentence as above in Cr. 85–210 to run concurrent. All other charges dismissed.
7. Maria Lloret de Cancel (Bank Manager).	85–202	August 23, 1986—Defendant entered plea of guilty to Counts I and II of indictment.	September 27, 1985—3 years imprisonment, suspended and placed on probation for 3 years. Defendant must perform 16 hours per month of community service during first year of probation.
8. Javier Juarbe-Perez (Bank Manager).	85–198	September 6, 1985—Defendant entered plea of guilty to Counts I and II of Indictment.	October 31, 1985—Defendant sentenced to 3 years imprisonment with all but 6 months suspended and fined $5,000 in Counts I and II to run concurrently. All other charges dismissed.

DISTRICT OF PUERTO RICO, OPERATION TRACER (CASE DISPOSITION) —Continued

Defendant	Criminal number	Disposition	Sentence
9. Guillermo Rivera-Guerrero (Bank Manager).	85–200 and 85–210	August 15, 1985—Defendant entered plea of guilty to 1 count in Cr. 85–200. August 29, 1985—Defendant entered a plea of guilty to 1 count in Cr. 85–210.	September 27, 1985—Sentence suspended and defendant is placed on probation for a period of 3 years and to pay a fine of $5,000 in Cr. 85–200. Same sentence imposed in Cr. 85–210 to run concurrently with 85–200. All other charges dismissed.
10. Carlos A. Vazquez-Alvarez (Bank Manager).	85–198	November 18, 1985—Defendant entered a plea of guilty to Count I.	December 18, 1985—Sentence suspended and defendant placed on probation for 2 years. All charges dismissed.
11. Wanda I. Munoz-Correa (Bank Officer, Assistant to Vice-President).	85–203	February 3, 1985—Defendant went to trial and was acquitted on all charges.	
12. Andres Bernal-Cardona (Bank Vice-President).	85–203	January 27, 1986—Government dismissed indictment. Defendant agreed to plead guilty in a related case, presently under investigation.	
13. Santos Carrasquillo-Cora (Acaparador).	85–201 and 85–207	September 17, 1985—Defendant entered plea of guilty to 1 count in 85–201. October 29, 1985—Defendant entered plea of guilty to 1 count in Cr. 85–207.	December 4, 1985—Cr. 85–201 and Cr. 85–207—Suspended and 3 years probation on each case to run concurrent and sentenced to pay cost of jury (approx. $1,500).
14. Galo Rodriguez-Mejias (Bank Manager).	85–230	July 23, 1985—Defendant entered a plea of guilty to the 1 count he is charged with.	August 30, 1985—3 years imprisonment with all but 6 months suspended. Placed on probation for 5 years with 16 hours of community service per month for the first 3 years of probation.
15. Julio R. Hernandez-Abril (Bank Manager).	85–241	January 8, 1986—Defendant entered a plea of guilty to Counts I and II of indictment.	February 19, 1986—Defendant placed on probation for 3 years on both counts. He is to perform community service for 1 year. All other charges dismissed.
16. Victor Colon-Aleman (Bank Manager).	85–178	July 29, 1986—Defendant entered a plea of guilty to 1 count of the indictment.	September 6, 1985—3 years imprisonment; suspended and defendant placed on probation for a period of 3 years. He is to pay a fine of $3,000 within first 2 years of probation. He will perform 16 hours of community service a month for the first year of probation. Other charges dismissed.
17. Raul Rodriguez-Alicea (Bank Manager).	85–497	December 9, 1985—Defendant entered plea of guilty to an information after waiver of indictment.	January 23, 1986—Sentence suspended; probation for 3 years with 16 hours of community service.
18. Caribbean Federal Savings Bank (Savings & Loan Institution).	85–498	December 10, 1985—Defendant entered a plea through its president Jose Durmont to a 3 count information after waiver of indictment.	March 14, 1986—$150,000 on each of 3 counts. $100,000 to be paid immediately and rest to be paid during course of 5 years probation. As part of probation 1 yearly audit will be performed by the Federal Home Loan Bank Board and copy of audit sent to probation service.
19. Raul E. Penagaricano-Soler (Executive Vice-President of Caribbean Federal Savings Bank).	85–209 and 85–210	August 20, 1986—Defendant's motion to suppress post-arrest statements denied by Magistrate Pre-trial hearing set for September 9, 1986 at 9:30 before Judge Carmen Cerezo. Trial set for September 23, 1986.	

[1] Acaparador—A person who buys winning lottery tickets to sell them for a premium to people who want to launder money.

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