

Jerome H Powell: Anti-money laundering and the Bank Secrecy Act

Testimony by Mr Jerome H Powell, Member of the Board of Governors of the Federal Reserve System, before the Committee on Banking, Housing, and Urban Affairs, US Senate, Washington DC, 7 March 2013.

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Chairman Johnson, Ranking Member Crapo, and other members of the committee, thank you for inviting me to discuss the important role the Federal Reserve plays in the U.S. government's effort to combat money laundering and terrorist financing. I will begin by describing our efforts to ensure banking industry compliance with the requirements of the Bank Secrecy Act (BSA) and the economic sanctions authorized by the President and Congress. I will also highlight some of the important actions we have taken to enforce the law and to promote safe and sound practices in this area.

Background

Congress enacted the BSA in 1970 to help safeguard the U.S. financial system and our financial institutions from the abuses of financial crime, and has revised and strengthened the act many times since. The Federal Reserve has issued regulations to implement the BSA, including regulations that require the institutions we supervise to establish a BSA compliance program, and has integrated BSA examinations into our supervisory program. The Federal Reserve also works closely with Treasury's Financial Crimes Enforcement Network (FinCEN) to ensure that the institutions we supervise provide law enforcement with the reports prosecutors need to investigate suspicious activity.

The particular steps a banking organization must take to develop a BSA compliance program have been documented extensively. The foundation for such a program begins with a well-developed and documented risk assessment that identifies and limits the risk exposures of the banking organization's products, services, customers, and geographic locations. Monitoring systems should be in place to identify and report suspicious activity, in particular any account or transaction activity that is not consistent with the bank's expectations. These systems should be accompanied by a strong training program to ensure that personnel, including those in offshore offices, are familiar with U.S. regulatory requirements and bank policies. The BSA compliance program should be reviewed by management, subjected to periodic independent tests that measure whether the program is functioning properly, and improved as needed. Finally, a qualified bank officer should be given sufficient authority to ensure that regulatory requirements and bank policies are being followed on a day-to-day basis.

Banking organizations are also expected to maintain a program for ensuring compliance with U.S. economic sanctions administered by the Treasury's Office of Foreign Assets Control (OFAC). The OFAC program should identify higher-risk areas within a bank's operations, and implement appropriate internal controls for screening and reporting prohibited transactions. Banks are expected to perform independent testing for compliance, designate a bank employee or employees that are specifically responsible for OFAC compliance, and create training programs for appropriate personnel in all relevant areas of the bank. A bank's OFAC compliance program should be commensurate with its activities and its risk profile.

The supervisory process

The Federal Reserve conducts a BSA and OFAC compliance program review as part of its regular safety-and-soundness examination program for the approximately 1,060 state-member banks; state chartered branches and agencies of foreign banking organizations; and Edge Act and agreement corporations we supervise. The frequency of the on-site

examination is normally every 12 to 18 months, depending upon the banking organization's condition, asset size, and rating. On average, we conduct approximately 960 BSA and OFAC reviews each year.

The Federal Reserve's BSA and OFAC reviews are risk-focused. In other words, supervisors have the flexibility to apply the appropriate level of scrutiny to higher-risk business lines. To ensure consistency in the design and execution of our BSA and OFAC examinations, we use procedures developed jointly with the member agencies of the Federal Financial Institutions Examination Council (FFIEC),¹ FinCEN, and OFAC. The findings of our BSA and OFAC reviews are taken into account in determining the institution's examination ratings, either as part of the management component rating for domestic institutions, or as part of the risk management and compliance component ratings used to evaluate the U.S. operations of foreign bank branches and agencies we supervise.

The Federal Reserve reinforces its supervisory program by conducting targeted examinations of financial institutions that show signs of being vulnerable to illicit financing. Banks are selected for such examinations based on, among other things, our analysis of the institution's payments activity, suspicious activity reports, currency transaction reports, and law enforcement leads.

The Federal Reserve devotes substantial resources to BSA compliance. Each Federal Reserve Bank has a BSA specialist and coordinator on staff, and, since the late 1980s, the Board's Division of Banking Supervision and Regulation has included an anti-money laundering section, overseen by a senior official, to help coordinate these efforts.

Coordination efforts

Effective implementation and enforcement of the BSA and U.S. economic sanctions requires the participation of, and coordination among, several agencies and international groups. Let me be specific about the steps we are taking to coordinate.

First, to ensure that the banking industry has clear understanding of regulatory expectations, the Federal Reserve has actively participated in supervisory forums, such as the FFIEC, which has an expansive BSA working group that promotes high standards for bank examinations and compliance. In addition, we participate in the Bank Secrecy Act Advisory Group, a public-private partnership established for the purpose of soliciting advice on the administration of the BSA. The Federal Reserve also joined the U.S. Treasury's Interagency Task Force on Strengthening and Clarifying the BSA/AML Framework (Task Force), which includes representatives from the Department of Justice, OFAC, FinCEN, the federal banking agencies, the Securities and Exchange Commission, and the Commodity Futures Trading Commission. The primary focus of the Task Force is to review the BSA, its implementation, and its enforcement with respect to U.S. financial institutions that are subject to these requirements, and to develop recommendations for ensuring the continued effectiveness of the BSA and efficiency in agency efforts to monitor compliance.

Second, to make the supervision of internationally active banking organizations more effective, we are engaged as a member of the U.S. delegation to the Financial Action Task Force, an international policymaking and standard-setting body dedicated to combating money laundering and terrorist financing globally. Further, as a member of the Basel Committee on Banking Supervision (BCBS), we have been involved in various efforts to prevent criminal use of the international banking system. For example, in 2009, as a complement to BCBS efforts to promote transparency in cross-border payments, the Federal

¹ The FFIEC member agencies include the Federal Deposit Insurance Corporation (FDIC), National Credit Union Administration (NCUA), Office of the Comptroller of the Currency (OCC), and the Consumer Financial Protection Bureau (CFPB), as well as the Board of Governors of the Federal Reserve System.

Reserve issued guidance with other federal banking agencies that clarifies U.S. regulatory expectations for U.S. banks engaged in correspondent banking activities.

Finally, we are working cooperatively with other federal banking agencies, state regulators, the Department of Justice, the Department of Treasury, and foreign regulators to ensure comprehensive enforcement of the law. We have participated in many of the largest, most complex enforcement cases in the BSA and U.S. sanctions area. Collectively, these cases have focused attention on potential misuse of the financial system for financial crimes, strengthened compliance programs at banking organizations (both in the U.S. and abroad), and generated billions of dollars in fines paid to the U.S. Treasury.

Our coordination efforts begin at an early stage in the supervisory process. For example, the Federal Reserve brings every instance of an anti-money laundering deficiency or violation to the attention of FinCEN so that FinCEN may consider assessing a penalty for violations of the BSA. We also notify OFAC of any apparent, unreported sanctions violations discovered in the course of an examination, and direct the banking organization we supervise to provide information directly to OFAC as required by regulation. In addition, we share information and coordinate with the Department of Justice, state law enforcement, the federal banking agencies, and state regulators, as appropriate, as part of our enforcement program.

The enforcement process

It has been our experience that the majority of institutions supervised by the Federal Reserve have well-administered and effective BSA and OFAC compliance programs. Nevertheless, there have been instances where concerns have been raised by our examiners. Importantly, the Federal Reserve does not have authority from Congress to conduct criminal investigations or to prosecute criminal cases. The decision to prosecute a financial institution for money laundering offenses and criminal violations of the BSA and U.S. sanctions laws is made by the Department of Justice.

Most of these problems are resolved promptly after they are brought to the attention of a bank's management and directors. In some instances, problems are of more serious concern and use of the Federal Reserve's enforcement authority is deemed appropriate. In these cases, an informal supervisory action may be taken, such as requiring an institution's board of directors to adopt an appropriate resolution or executing a memorandum of understanding between an institution and a Reserve Bank.

In the most serious cases, the Federal Reserve may take a formal enforcement action against an institution. These actions may include a written agreement, a cease and desist order, or a civil money penalty. Congress has also given the Federal Reserve the authority to terminate the operations of certain entities operating in the U.S. upon the conviction of a money laundering offense by the Department of Justice, and to prohibit insiders who intentionally commit such offenses from participating in the banking industry. The type of enforcement action pursued by the Federal Reserve against an institution is directly related to the severity of the offense, the type of failure that led to the offense, and management's willingness and ability to implement corrective action.

In the last five years, the Federal Reserve has issued 113 enforcement actions relating to BSA and OFAC compliance, including 25 public cease and desist orders and written agreements. Together with these recent actions, the Federal Reserve has assessed hundreds of millions of dollars in penalties. The institutions that have been subject to these actions are large and small, domestic and foreign. In each case, the Federal Reserve has required the institution to take corrective measures to ensure their programs are brought into compliance.

Enforcement of U.S. economic sanctions

Many of the recent U.S. sanctions cases the Federal Reserve has pursued involve foreign banks with operations that extend across many different countries around the world. These cases have attracted significant attention and involve a particular type of activity worthy of special attention.

The misconduct in these cases relates primarily to the manner in which these firms handle cross-border payments. Cross-border payments can be broadly defined as transactions between banking entities that are located in different countries, but there are many different permutations of cross-border payments. For example, cross-border payments can be carried out as a wire transfer where the originator and beneficiary are located in different countries; a wire transfer where the originator and beneficiary are in the same country, but where one or more correspondents in a second country are used; or as a chain of wire transfers that has at least one international element. Cross-border payments typically occur when the originator and beneficiary, or their banks, are located in different countries or where the currency used for the payments is not the currency of the country where the transaction originates. For example, U.S. dollars may be used to make a payment between parties each located in a different foreign country.

Structurally, there are usually two components to these cross-border payments: (1) the instructions, which contain information about the originator and beneficiary of the funds, and (2) the actual funds transfer. The payment instructions for cross-border payments typically are sent to an intermediary bank using industry financial telecommunications systems, such as the Society for Worldwide Interbank Financial Telecommunication (SWIFT). The actual funds transfer occurs separately, typically through the domestic funds transfer system of the originator, via a book transfer of an intermediary with a presence on both sides of the border, and through the domestic funds transfer system of the beneficiary.

Foreign banks often operate in jurisdictions that do not impose the same economic sanctions on foreign customers as the United States. Transactions involving these sanctioned customers are nonetheless subject to U.S. law if the transaction is routed through the U.S., as is typical for transactions conducted in U.S. dollars. Foreign banks that operate in countries without sanctions similar to those imposed by the United States have not always had in place the mechanisms to ensure transactions routed through the U.S. comply with U.S. law. Many of the Federal Reserve's enforcement activities are directed at remedying these situations.

One of the Federal Reserve's most important sanctions enforcement cases involved ABN AMRO. In response to corrective measures the Federal Reserve imposed on the firm's New York branch in 2004,² which required the bank to review certain historical transactions, ABN AMRO discovered numerous payment messages that were sent through its U.S. branch or a U.S. correspondent in a manner designed to circumvent the filters used by the U.S. institution to detect transactions involving sanctioned parties. In particular, the information that identified a U.S. sanctioned party was omitted from the SWIFT payment sent through the U.S., while a complementary payment instruction with sanctioned party information was deliberately routed outside the United States. The Federal Reserve responded by escalating our enforcement action to a cease and desist order and imposing a substantial penalty on ABN AMRO.³ The Federal Reserve's order required ABN AMRO to implement a global compliance program and take specific steps to prevent circumvention of the required U.S.

² Board of Governors of the Federal Reserve System (2004), "[Written agreement with ABN AMRO Bank](#)," press release, July 26.

³ Board of Governors of the Federal Reserve System (2005), "[Agencies release bank supervisory and penalty actions against ABN AMRO Bank, N.V.](#)," press release, December 19.

sanctions filters. We coordinated this action with other U.S. and foreign regulators, including the home country supervisor for ABN AMRO.

The Federal Reserve's enforcement action against ABN AMRO triggered important changes in cross-border payment practices. The Federal Reserve played a key role in this debate and in developing the standards that have since been adopted to improve transparency in cross-border payment messages – including the standards adopted by the Basel Committee on Banking Supervision and SWIFT. These standards require the expanded disclosure of the originator and beneficiary on payment instructions sent as part of cover payments.

In the years since the ABN AMRO case, the Federal Reserve and other U.S. authorities have taken action against international banks that had been engaged in similar evasive misconduct. Most recently, the Federal Reserve has imposed cease and desist orders on Credit Suisse, Barclays, Standard Chartered, and HSBC.⁴ In each case, the bank's home country supervisor has agreed to help monitor compliance with the Federal Reserve's order. These enforcement cases reflect our continued view that international banks have an obligation to ensure that they do not interfere with the ability of U.S. financial institutions to comply with the sanctions laws.

Enforcement of the Bank Secrecy Act

The Federal Reserve has also taken a number of recent enforcement actions to require depository institutions to improve their BSA programs and comply with other anti-money laundering obligations, including the reporting requirements that exist under the BSA. While bank holding companies are not statutorily mandated to have the same program requirements as depository institutions, we have also taken action against bank holding companies to require them to improve their oversight of the subsidiary bank's BSA programs and compliance. For example, in 2010, we issued a cease and desist order against HSBC requiring the U.S. holding company to improve its oversight of the compliance program at HSBC's national bank subsidiary.⁵ HSBC's failure to address our concerns in a timely manner was part of the reason for imposing a substantial penalty on HSBC and its U.S. holding company last year.⁶

The Federal Reserve takes seriously its responsibility to pursue formal, public action in cases of BSA non-compliance. For example, in January, the Federal Reserve issued a cease and desist order requiring JPMorgan Chase to take corrective action to enhance its program for compliance with the BSA and other anti-money laundering requirements at the firm's various

⁴ Board of Governors of the Federal Reserve System (2009), "[Consent order to cease and desist against Credit Suisse](#)," press release, December 16; Board of Governors of the Federal Reserve System (2010), "[Cease and desist order against Barclays Bank and Barclays Bank New York Branch](#)," press release, August 18; Board of Governors of the Federal Reserve System (2012), "[Federal Reserve Board issues consent cease and desist order, and assesses civil money penalty against Standard Chartered](#)," press release, December 10; and Board of Governors of the Federal Reserve System (2012), "[Federal Reserve Board issues consent cease and desist order, and assesses civil money penalty against HSBC Holdings PLC and HSBC North America Holdings, Inc.](#)," press release, December 11.

⁵ Board of Governors of the Federal Reserve System (2010), "[Cease and desist order against HSBC North America Holdings](#)," press release, October 7.

⁶ Board of Governors of the Federal Reserve System (2012), "[Federal Reserve Board issues consent cease and desist order, and assesses civil money penalty against HSBC Holdings PLC and HSBC North America Holdings, Inc.](#)," press release, December 11.

subsidiaries.⁷ In June 2012, we issued a public enforcement action against Commerzbank AG and its U.S. branch for its failure to comply with certain BSA reporting obligations.⁸

Conclusion

The Federal Reserve places great importance on ensuring that the institutions we supervise comply with the BSA and U.S. economic sanctions. When we find problems at a supervised institution, we demand specific corrective measures, by specific dates, and we take strong enforcement actions when necessary. We will continue these efforts and work cooperatively with law enforcement and other financial regulators to ensure a coordinated response to the threat posed by illicit financing to the U.S. financial system.

Thank you very much for your attention. I would be pleased to answer any questions you may have.

⁷ Board of Governors of the Federal Reserve System (2013), "[Federal Reserve Board issues two consent cease and desist orders against JPMorgan Chase & Co.](#)," press release, January 14.

⁸ Board of Governors of the Federal Reserve System (2012), "[Federal Reserve Board issues enforcement actions with Calvert Financial Corporation and Mainstreet Bank, Commerzbank AG, First Security Bank of Malta, Grant Park Bancshares, Inc., and Robertson Holding Company, L.P.](#)," press release, June 14.