United States General Accounting Office

GAO

Report to the Honorable Carl Levin, Ranking Member, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

March 2001

MONEY LAUNDERING

Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers

GAO-01-474

Contents

Abbreviations

BSA	Bank Secrecy Act
CTR	Currency Transaction Report
FinCEN	Financial Crimes Enforcement Network
GLBA	Gramm-Leach-Bliley Act
OCC	Office of the Comptroller of the Currency
OTS	Office of Thrift Supervision
SAR	suspicious activity report
SEC	Securities Exchange Commission
SRO	self-regulatory organization

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

March 22, 2001

The Honorable Carl Levin
Ranking Member
Permanent Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate

Dear Senator Levin:

This letter addresses one of several matters raised in your December 1999 request that we review money laundering[1] issues in the securities industry; remaining matters related to your overall request will be addressed in a subsequent report. In this interim report, we address your concern that the Gramm-Leach-Bliley Act[2] (GLBA) might affect oversight to ensure the securities industry's compliance with U.S. anti-money laundering requirements. Although the extent to which the securities industry is used for money laundering is unknown, trillions of dollars flow through the industry each year. However, unlike banks that are depositories for cash, securities firms do not usually receive funds from investors in cash form and, as such, may be faced with different types of anti-money laundering issues. The Bank Secrecy Act (BSA)[3] enables the Department of the Treasury (Treasury) to impose requirements on all financial institutions as a means of detecting and preventing money laundering. Among these requirements are those requiring financial institutions to report suspicious activities to Treasury. Currently, banks, thrifts, and bank holding companies are required to file suspicious activity reports (SAR). In addition, their subsidiaries, including any broker-dealer subsidiaries of these firms, are required to file SARs under banking law. However, the

[1]Money laundering, in general, is the disguising or concealing of illicit income to make it appear legitimate.

[2]The Gramm-Leach-Bliley Act, P.L. 106-102, 113 Stat. 1338 (1999), permits eligible bank holding companies to form affiliations that engage in securities and insurance activities through a financial holding company structure. Under GLBA, banks' securities activities, formerly subject to oversight by both banking and securities regulators are now, subject to limited exceptions, only under the Securities and Exchange Commission's oversight.

[3]Currency and Foreign Transactions Reporting Act of 1970 (commonly referred to as the Bank Secrecy Act), 12 U.S.C. § 1829b, 12 U.S.C. § 1951-1959, and 31 U.S.C. § 5311-5330.

remainder of the securities industry is not yet required to file SARs because regulations specifically applicable to the securities industry are not yet in place.

GLBA has changed the structure of financial regulation in the United States by, among other things, providing for functional regulation of financial conglomerates and making the Securities and Exchange Commission (SEC) the functional regulator of all securities activities, including broker-dealer subsidiaries of depository institutions and their holding companies.[4] Our objectives for this interim report were to determine (1) how federal bank regulators[5] were overseeing SAR compliance for broker-dealers under their jurisdiction before and after GLBA and (2) what actions SEC was taking to oversee SAR compliance of broker-dealers previously monitored by bank regulators.

Results in Brief

Since the passage of GLBA, the broker-dealer subsidiaries of depository institutions and their holding companies are no longer being examined to assess their compliance with SAR requirements, although they are being examined for compliance with reporting currency transactions and other requirements Treasury has specifically placed on broker-dealers. Before GLBA, federal bank regulators were responsible for examining broker-dealer firms affiliated with depository institutions for compliance with the banking SAR rules and related requirements they adopted. According to bank regulatory officials, the functional regulation provisions of GLBA have led them to curtail examinations, including coverage of SAR compliance, of the broker-dealer subsidiaries of depository institutions and their holding companies under their purview. Although information on the total number of broker-dealer subsidiaries of depository institutions that were no longer being examined for SAR compliance since GLBA was not available, such examinations ceased for at least 52 broker-dealer subsidiaries of bank holding companies. As of December 1999, according to the Federal Reserve, these 52 firms' total assets accounted for 44 percent of the assets represented by New York Stock Exchange members doing business with the public. Although bank regulators have generally ceased

[4]15 U.S.C. § 78c(a)(4)(A)(2000).

[5]For purposes of this report, "federal bank regulators" refers to the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision.

examining these broker-dealer subsidiaries for SAR compliance, the bank regulators' SAR rules still apply to these subsidiaries.

SEC officials stated that they have not assumed examination responsibility for the area because they do not have specific authority to examine for compliance with the banking SAR rules. SEC officials explained that their agency only has specific authority to enforce the rules and regulations promulgated under the various securities laws and for certain other laws for which authority has been specifically delegated to SEC. They stated that SEC has not examined for SAR compliance because it cannot enforce the bank regulators' SAR rules, and a Treasury SAR rule applicable to the securities industry has not yet been promulgated. SEC officials indicated that they have worked with Treasury to develop a SAR rule that is tailored to the securities industry and noted that once such a rule is issued, SEC will begin examining broker-dealers for compliance with these requirements. Treasury had expected to issue an industry-specific SAR rule for comment by the end of 2000. As of March 1, 2001, the rule had not been issued and Treasury officials had not officially set a new date for its issuance.

This report makes no recommendations. We asked Treasury, the Board of Governors of the Federal Reserve System (Federal Reserve), the Office of the Comptroller of the Currency (OCC), the Office of Thrift Supervision (OTS), and SEC to comment on this report. In general, these agencies agreed with the information presented and we incorporated their technical comments as appropriate.

Background

SEC has primary responsibility for overseeing the U.S. securities markets and its broker-dealer participants, including those owned by or affiliated with banks. Prior to GLBA, federal bank regulators also assumed certain oversight responsibilities, including examining for SAR compliance, for broker-dealers owned by or affiliated with banks. For example, the Federal Reserve, which has primary supervisory responsibility for state-chartered banks that are members of the Federal Reserve System and bank holding companies, also assumed some oversight responsibility for various bank holding company subsidiaries, including any broker-dealer subsidiaries. OCC, the primary regulator for nationally chartered banks (national banks), assumed some oversight responsibility for the subsidiaries of these banks. OTS, the primary regulator of all federal and many state-chartered thrift institutions, including savings banks, savings and loan associations, and thrift holding companies, assumed some oversight responsibility for the subsidiaries of these institutions.

The anti-money laundering responsibilities of financial institutions arise primarily under the BSA. In 1970, this act authorized the Secretary of the Treasury[6] to issue regulations requiring financial institutions to keep records and file reports that regulators and law enforcement agencies have determined have a high degree of usefulness in criminal, tax, and regulatory matters. Specifically, BSA authorizes the Secretary of the Treasury (1) to issue regulations on the reporting of certain currency transactions and (2) as amended in 1992, to issue regulations on suspicious transactions that may involve criminal activities. Under the BSA, Treasury issued a reporting rule requiring all financial institutions to file a Currency Transaction Report (CTR) with the Internal Revenue Service to report transactions over $10,000 in currency.[7] The BSA regulations also impose other reporting and recordkeeping obligations on financial institutions, including broker-dealers. For example, these regulations require reports of the transportation of currency or monetary instruments, and reports of a financial interest in or signature authority over a bank, securities, or other financial account in a foreign country. The regulations also require records of certain funds transmittals.

Beginning in 1985, the bank regulators also required depository institutions and other banking organizations that they supervised, including bank holding companies, nonbank subsidiaries of depository institutions and U.S. branches and agencies of foreign banking organizations, to report to law enforcement, as well as to the regulating agencies themselves, any suspicious or suspected criminal activity occurring at or through the organizations.[8] In 1996, Treasury issued a specific rule to require depository institutions to report suspicious activities relating to possible money laundering using a simplified SAR form and establishing a new suspicious activity reporting system.[9] During the same year, bank regulators issued regulations requiring all depository institutions to report money laundering

[6]Within the Department of the Treasury, authority to administer the BSA has been delegated to the Director of the Financial Crimes Enforcement Network (FinCEN). FinCEN was established in 1990 to support law enforcement agencies by analyzing and coordinating financial intelligence information to combat money laundering.

[7]31 C.F.R. § 103.22.

[8]This criminal referral process was used by the banking regulators to assist with their supervisory oversight responsibilities as well as for law enforcement referral purposes.

[9]Treasury issued this rule pursuant to authority it obtained through the Annunzio-Wylie Anti-Money Laundering Act enacted in 1992.

as well as other suspicious activities using this form.[10] The bank regulators also placed these SAR requirements on the subsidiaries, including broker-dealer firms, of the depository institutions and their holding companies under their jurisdiction. However, the rest of the securities industry, including the majority of broker-dealers, is not currently subject to SAR requirements or related oversight because a specific rule has not yet been promulgated.

Objectives, Scope, and Methodology

We focused our work for this report primarily on that part of the broker-dealer industry whose status was affected by GLBA.[11] We discussed the BSA and SAR oversight of broker-dealers, particularly those affiliated with depository institutions, with officials of SEC, Federal Reserve, OTS, and OCC. We also reviewed BSA examination manuals and other agency documents pertaining to BSA oversight of broker-dealers and to guidance on the implementation of GLBA. We did not attempt to determine the adequacy of the examinations covering SAR compliance that bank regulators conducted for the broker-dealer subsidiaries and affiliates of depository institutions. Our work also did not cover broker-dealer subsidiaries of state-chartered, federally insured banks that were not members of the Federal Reserve and were overseen by the Federal Deposit Insurance Corporation. We also interviewed Treasury officials regarding the rules they have issued for the banking industry and their efforts to issue a similar rule for the securities industry. We conducted our work primarily in San Francisco, California, and Washington, D.C., between April 2000 and February 2001 in accordance with generally accepted government auditing standards.

[10]Although Treasury's SAR rule requires reporting suspicious activities related to the BSA and other anti-money laundering statutes, the bank regulators' SAR rules require reporting suspicious activities that go beyond anti-money laundering statutes, such as insider criminal misconduct.

[11]In the summer of 2001, we expect to report on money laundering issues affecting the securities industry as a whole.

Federal Bank Regulators Ceased Examinations of Broker-Dealers Subject to Banking SAR Rules

Since the passage of GLBA, the broker-dealer subsidiaries of depository institutions and their holding companies, which are still subject to the banking SAR rules, are not being examined for compliance with the banking SAR rules. Officials of the Federal Reserve, which conducted oversight of 52 broker-dealer subsidiaries of bank holding companies and foreign banking organizations, said that before GLBA their staff examined these broker-dealers for SAR compliance as part of a risk-based approach to overseeing the activities of the parent companies. OCC and OTS officials indicated that their staff also examined for SAR compliance at the broker-dealer subsidiaries of the banks and thrifts they oversee as part of a risk-based examination approach, although neither agency was able to readily determine the number of broker-dealer subsidiaries it oversaw.[12] GLBA established specific conditions under which the Federal Reserve and other bank regulators can examine functionally regulated entities. According to bank regulators, these GLBA provisions affect SAR oversight of broker-dealer subsidiaries and have caused them to cease examining these functionally regulated entities.

Before GLBA, Federal Reserve Monitored Broker-Dealers Subject to SAR for Compliance

Before GLBA, Federal Reserve officials told us that their examiners reviewed broker-dealer subsidiaries of bank holding companies and foreign banking organizations for compliance with BSA regulations and the banking SAR rule during annual or biannual inspections of the parent companies. BSA and SAR compliance was covered because of the potential effects of the subsidiaries' operations on the parents' safety and soundness. The Federal Reserve's 1999 annual report noted that 45 bank holding companies and foreign banking organizations owned a total of 52 former section 20 securities subsidiaries. As of December 31, 1999, the asset size of these securities subsidiaries ranged widely from $1 million to almost $160 billion, with an average asset size of approximately $17 billion. The total assets of the former section 20 subsidiaries, according to information provided by the Federal Reserve, accounted for 44 percent of the total assets represented by New York Stock Exchange members doing business with the public.

[12]No current, comprehensive data exist on the number of broker-dealers that are owned or are affiliates of banks or thrifts. In our report *Banks' Securities Activities: Oversight Differs Depending on Activity and Regulator* (GAO/GGD-95-214, Sept. 21, 1995), we projected, based on survey results, that 2,400 banks or 22 percent of all banks, offered retail brokerage services as of 1994.

Federal Reserve officials explained that the frequency of bank holding company inspections was determined as part of an overall assessment of the risks posed by the activities of the banking organization, such as its asset size and the operational risk inherent in the activities being conducted. They told us that examiners generally used the same BSA examination procedures to review both the parent holding company and the broker-dealer subsidiary. However, because the BSA examination was designed to review banking activities, examiners used only the segments of the examination manual that were applicable to the lines of business of the broker-dealer subsidiary.[13]

Federal Reserve officials could not, however, readily identify the extent to which the broker-dealers subsidiaries were actually reviewed for SAR compliance and other BSA requirements during these inspections for various reasons. For example, they said that examiners may not necessarily note in the examination reports that SAR compliance was reviewed if no problems were found in the area.

In general, Federal Reserve officials said that they did not identify significant problems related to BSA compliance at broker-dealer subsidiaries of bank holding companies. Federal Reserve officials provided us examinations from six inspections of bank holding company broker-dealer subsidiaries conducted during 1999. Based on our review of these examinations, the examiners cited three of the broker-dealer subsidiaries for failing to have complete procedures relating to SAR requirements and for other minor deficiencies.

OTS and OCC Previously Examined Broker-Dealer Subsidiaries for SAR Compliance but the Number of Subsidiaries Is Unknown

OTS and OCC officials stated that, before GLBA, broker-dealer subsidiaries were generally reviewed for SAR compliance. Information on the number and size of securities subsidiaries of national banks and federal thrifts, however, was not readily available. OCC officials estimated that hundreds of national banks were involved in securities activities either by conducting

[13]For example, if the broker-dealer subsidiary did not deal in cash transactions, the examiner did not use the segment of the BSA examination manual that deals with currency transactions. Similarly, if the broker-dealer subsidiary only acquired new customers from referrals of its affiliated bank (already subject to BSA oversight), the examiner did not use the examination segment dealing with vetting new customers.

them in subsidiaries, within the bank itself, or using third-party broker-dealers that conduct operations on bank premises.[14] OCC and OTS officials told us that the SAR compliance examinations of the broker-dealer subsidiaries of the institutions they oversee were conducted as part of a BSA or compliance examination conducted of the supervised bank or thrift. They explained that, based on an overall risk analysis of the supervised entity, decisions were made as to whether the subsidiaries, including broker-dealers, would be reviewed or tested for SAR compliance. Nevertheless, OTS and OCC could not identify which or how many broker-dealer subsidiaries were subject to SAR reviews before GLBA.

Both OTS and OCC have initiated actions to improve their ability to identify broker-dealer activities by the entities they oversee. OTS' information system did not distinguish between broker-dealer subsidiaries and broker-dealer service providers prior to the passage of GLBA. OTS has since developed a new information gathering methodology with more precise coding for supervised entities to use when completing required financial reports. According to OTS officials, the new instructions will be effective with financial reports submitted for the quarter ending in March 2001. OCC officials have indicated that their agency has also implemented a new system for capturing examination information that will provide data on supervised banks' profiles and operations, including the extent to which they are involved in securities activities. They anticipated that much of the data would be incorporated into this system by March 31, 2001.

GLBA Affects Ability of Bank Regulators to Conduct Examinations of Functionally Regulated Entities

The functional regulation provisions of GLBA affected the authority of bank regulators to examine the broker-dealer subsidiaries of depository institutions and their holding companies. After GLBA, the banking regulators may examine functionally regulated subsidiaries under certain prescribed circumstances. Specifically, they must have reasonable cause to believe that (1) the subsidiary is engaged in an activity that poses a material risk to its affiliated depository institution; (2) after reviewing relevant reports, the examination is necessary for the banking regulator to be adequately informed about the subsidiaries' systems for monitoring and controlling the financial and operational risks that may affect the safety and soundness of the subsidiary; or (3) based on reports and other

[14]Although securities activities conducted by bank subsidiaries or by the bank itself are subject to the banking SAR rule, third-party broker-dealers that conduct operations on bank premises are not.

available information, the subsidiary is not in compliance with any federal law that the banking regulator has specific jurisdiction to enforce and if the regulator cannot make that determination through examinations of the parent company.

Since GLBA, Federal Reserve, OCC, and OTS staffs said that they have curtailed their examinations of the broker-dealer subsidiaries of banks, bank holding companies and foreign banking organizations, and thrifts that they oversee. For example, in early 2000, after GLBA was passed, the Federal Reserve instructed responsible staff at each of the Federal Reserve District Banks to discontinue their examinations of broker-dealer subsidiaries. Federal Reserve officials estimated that examinations of broker-dealer subsidiaries actually ceased in March 2000. OCC did not directly instruct its examiners to cease examinations of national bank subsidiaries, but it did advise them that GLBA has sharply restricted OCC's authority to conduct such examinations. OCC officials anticipated that such restrictions would, in effect, largely curtail the agency's examinations of broker-dealer subsidiaries. In August 2000, OTS issued guidance detailing how GLBA restricts the examinations of functionally regulated entities, including broker-dealers affiliates.

SEC States It Lacks Authority to Examine for Compliance With Banking SAR Rules

Although SEC conducts examinations for those BSA requirements for which it has been delegated authority, SEC officials said they cannot examine the broker-dealers subsidiaries of depository institutions or their holding companies for compliance with the banking SAR rules because SEC lacks specifically assigned authority to enforce the rules and related requirements. They indicated that such examinations would begin after Treasury issues a rule specific to the securities industry.

SEC Conducts Examinations for Applicable BSA Requirements but States It Cannot Enforce the Bank Regulators' SAR Rules

Under the BSA rules, Treasury delegated to SEC responsibility to determine broker-dealer compliance with BSA regulations that apply to broker-dealers. These regulations require financial institutions to file certain transaction reports and create and retain various records. These include, for example, currency transactions required to be reported on CTRs as well as requirements relating to the transport of currency and monetary instruments into or out of the United States and those relating to foreign bank accounts. After Treasury assigned authority to SEC to

examine broker-dealers for compliance with requirements,[15] SEC adopted rule 17a-8 under the Securities Exchange Act of 1934 (the Exchange Act) that incorporates these reporting, recordkeeping, and record retention provisions into its own regulations. As such, SEC and the self-regulatory organizations (SRO) can enforce broker-dealer compliance with these requirements just as they do for any other requirements that broker-dealers are subject to under the securities laws.

SEC officials advised us that for more than 20 years, its examination staff has conducted on-site examinations of broker-dealers for those BSA requirements for which it has been granted specific authority. These examinations include reviews of written policies, procedures, and memorandums regarding the BSA regulations, use of Treasury's automated systems, and other file reviews. SEC staff also told us that the New York Stock Exchange and the National Association of Securities Dealers Regulation, which are self-regulatory organizations with compliance and enforcement responsibilities under the Exchange Act, also examine broker-dealers for BSA provisions for which Treasury has delegated authority to SEC.[16]

Unlike the currency and foreign bank account related BSA requirements, Treasury has not yet extended the BSA SAR requirements to the securities industry. Therefore, only those broker-dealers that are subsidiaries of depository institutions, bank or financial holding companies,[17] or are themselves bank or financial holding companies are currently subject to the SAR requirements promulgated by the bank regulators. However, SEC officials explained that SEC does not have the authority to enforce these banking requirements. Under its general authority, SEC is empowered to ask a broker-dealer to present any documentation for review. However, SEC officials explained that they do not use this authority to examine for rules for which they lack specific enforcement authority.

[15]SEC has the authority to examine broker-dealers for recordkeeping and reporting requirements pursuant to 31 CFR § 103.56(b) adopted under the BSA.

[16]The SROs have also issued a number of written advisories to their members about anti-money laundering issues.

[17]A financial holding company is a qualified bank holding company that may engage in any statutorily enumerated activity and also may engage in additional activities that are determined to be financial in nature or incidental or complementary to such financial activities.

Although some broker-dealers are currently subject to the banking SAR rules, SEC officials told us they believed the specific requirements of these rules are generally not appropriate for securities firms. For example, they noted that the low reporting threshold of $5,000 for depository institutions applies to too many otherwise routine securities transactions.[18]

SEC Examinations of Broker-Dealers to Begin After Securities Industry SAR Rule Is Issued by Treasury

SEC officials told us that when Treasury adopts an SAR rule for the securities industry, all broker-dealers, including those owned by or affiliated with depository institutions, would be required to file SARs and subject to compliance examinations. Once Treasury issues an SAR rule specifically applicable to the securities industry, SEC officials said that these provisions would be incorporated into SEC's rules automatically through rule 17a-8, which by its terms refers to all of the reporting, recordkeeping and record retention requirements under the BSA. At that point, both SEC and the SROs would have authority to examine for and enforce compliance with SAR requirements similar to the authority under the CTR rule. However, the timing of when an SAR rule specifically for the securities industry will be in place is not clear. The Treasury and Justice Departments' National Money Laundering Strategy for 2000 set out the goal of issuing a proposed securities SAR rule for public comment by the end of 2000. This milestone was not met and, as of February 1, 2001, a new expected issuance date had not yet been established. Moreover, a public comment period as well as the time needed to process such input would precede the final issuance of such a rule.

Conclusions

Since the passage of GLBA, banking regulators ceased examinations of certain broker-dealers for compliance with the banking SAR rule and related requirements, although these requirements continue to apply to them. SEC, the functional regulator, states it lacks authority to examine these broker-dealers for compliance with the banking SAR rules. Regulatory oversight of SAR requirements applicable to broker-dealers, including subsidiaries of depository institutions and their holding companies, is not expected to resume until Treasury adopts an SAR rule tailored and applicable to the securities industry as a whole. Issuing such a rule is also important to ensure consistent regulation and oversight in the

[18]The reporting threshold of $5,000 applies when suspicious activities involve a known subject, and a $25,000 threshold applies when the subject is not known. There is no minimum reporting threshold for suspicious activities involving an insider.

area. However, when a securities SAR rule will be proposed and become final is not clear.

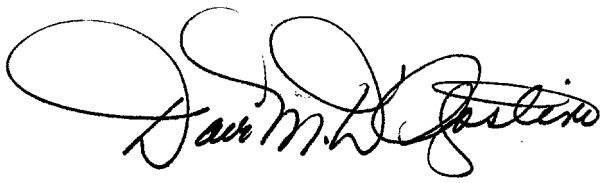
Agency Comments

We received comments on a draft of this report from Treasury's Financial Crimes Enforcement Network (FinCEN), the Federal Reserve Board, OCC, OTS, and SEC. Officials from the Federal Reserve Board, OCC, and OTS, generally agreed with the information presented in the draft report and they provided oral technical comments, which we incorporated in this report as appropriate. Treasury's FinCEN, whose written comments appear in appendix I, agreed with the draft report and the conclusion that issuance of a Treasury SAR rule applicable to all broker-dealers could resolve the oversight issues highlighted in our report. FinCEN also noted that an important goal in devising its rule is determining if it can address the examination and supervisory objectives of both SEC and the federal banking agencies. Finally, FinCEN commented that consistent application of suspicious transaction reporting rules to similarly situated institutions raises unique legal and practical issues that must be resolved before a final rule is issued. OCC provided written comments that appear in appendix II. OCC concurred with our conclusions. SEC, whose written comments appear in appendix III, shared the concern that effective and appropriate regulatory systems be in place for U.S. financial institutions to address money laundering. They reiterated that SEC has no statutory authority to determine broker-dealer compliance with the rules for depository institution affiliates. However, they also noted that this issue should be resolved once Treasury adopts an SAR rule applicable to all broker-dealers. SEC also pointed out that a number of broker-dealers already have programs to file SARs on a voluntary basis. We are examining this and other matters in our broader review of money laundering issues and the securities industry.

As agreed with your office, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days from its issuance date. At that time, we will send copies of this report to Senator Susan Collins and other congressional committees. We will also send copies to the Honorable Paul H. O'Neill, Secretary of the Treasury; the Honorable Alan Greenspan, Chairman of the Federal Reserve Board of Governors; the Honorable John D. Hawke, Jr., Comptroller of the Currency; the Honorable Ellen S. Seidman, Director, OTS; and the Honorable Laura S. Unger, Acting Chairman, SEC. Copies will also be made available to others upon request.

Key contributors to this report are listed in appendix IV. If you have any questions, please call me at (202) 512-5431 or Cody Goebel, Assistant Director, at (202) 512-7329.

Sincerely yours,



Davi M. D'Agostino
Director, Financial Markets
and Community Investment

Comments From the Financial Crimes Enforcement Network

DEPARTMENT OF THE TREASURY
FINANCIAL CRIMES ENFORCEMENT NETWORK

MAR 8 2001

Ms. Davi M. D'Agostino
Director
Financial Markets and Community Investment
United States General Accounting Office
Washington, DC 20548

Dear Ms. Agostino:

The draft GAO report entitled Money Laundering: Oversight of Suspicious Activity Reporting at Bank-Affiliated Broker-Dealers Ceased After Gramm-Leach-Bliley has been referred for comment. In general, the report provides an informative and accurate account of how broker-dealers affiliated with banks or bank holding companies are subject to anti-money laundering requirements issued by the Securities and Exchange Commission (SEC), the bank or holding company's federal regulator, and the U.S. Department of the Treasury.

We are most interested in your finding that since the enactment of Gramm-Leach-Bliley (GLB), P.L. 106-102, neither federal bank regulators nor the SEC are currently authorized to examine bank-affiliated broker-dealers for their compliance with suspicious activity reporting rules. This highlights the complexity in the post-GLB environment of implementing a suspicious activity regulatory regime for broker-dealers, and coordinating that regime with the reporting regime for depository institutions.

Nonetheless, we agree with the conclusion expressed in the draft report and by the SEC that this issue could be resolved if the U.S. Department of the Treasury issued rules expressly subjecting broker-dealers, including those broker-dealers owned by bank holding companies, to suspicious activity reporting requirements under the Bank Secrecy Act. We are currently working with all interested parties, including the SEC, to develop a draft proposal that would apply suspicious activity reporting requirements to both affiliated and non-affiliated broker-dealers. An important goal in this effort is to determine if we can devise regulatory requirements which address the examination and supervisory objectives of both the SEC and the federal banking agencies. Consistent application of suspicious transaction reporting rules to similarly situated institutions is a crucial objective, and as your report suggests, this endeavor raises unique legal and practical issues that must be resolved before a final rule is issued.

Sincerely,

William F. Baity
Deputy Director

Comments From the Office of the Comptroller of the Currency

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

March 7, 2001

Ms. Davi M. D'Agostino
Director, Financial Markets and Community Investment
United States General Accounting Office
Washington, DC 20548

Dear Ms. D'Agostino:

We have received and reviewed your draft report entitled Money Laundering: Suspicious Activity Reporting Oversight at Certain Broker-Dealers Ceased. The interim report addresses Senator Levin's concern that the Gramm-Leach-Bliley Act (GLBA) might affect oversight of the securities industry's compliance with U.S. anti-money laundering requirements. Your objectives were to determine 1) how federal bank regulators were overseeing suspicious activity report (SAR) compliance for broker-dealers under their jurisdiction before and after GLBA; and 2) what actions the Securities and Exchange Commission (SEC) was taking to oversee SAR compliance for broker-dealers previously monitored by bank regulators.

You report that, since the passage of GLBA, federal bank regulators ceased and SEC has not begun examinations of broker-dealers subject to the banking SAR rules.

We concur with your conclusions. Separately, we provided some editorial suggestions to the evaluators for the purpose of clarifying statements made about the OCC's systems and guidance to examiners.

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

Sincerely,

John D. Hawke, Jr.
Comptroller of the Currency

Comments From the Securities and Exchange Commission

DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

March 6, 2001

Davi M. D'Agostino
Director, Financial Markets
and Community Investment
United States General Accounting Office
Washington, DC 20548

Dear Ms. D'Agostino:

Thank you for the opportunity to comment on the General Accounting Office's (GAO) draft report titled Money Laundering: Oversight of Suspicious Activity Reporting at Bank Affiliated Broker-Dealers Ceased After the Gramm-Leach-Bliley Act. The Securities and Exchange Commission (SEC) shares the concern that an effective and appropriate regulatory system to address money laundering risks be in place for U.S. financial institutions which led the Permanent Subcommittee on Investigations to request GAO's report.

As our staffs have discussed in conjunction with this report, the SEC has had in place for more than twenty years an examination and enforcement program to oversee broker-dealer compliance with the provisions of the Bank Secrecy Act (BSA) applicable to broker-dealers. The SEC also participates actively in all of the interagency working groups on money laundering, as well as in the U.S. delegation to the Financial Action Task Force on Money Laundering. As your report has also clarified, the SEC's authority to act on money laundering issues is directly linked to the BSA. The SEC may examine broker-dealers to determine compliance with rules adopted by the Department of the Treasury under the BSA. It has no such authority with respect to rules adopted by bank regulators applicable to bank affiliates under the banking statutes. Moreover, the Commission itself has no rule-writing authority under the BSA.[1]

[1] The Commission has consistently reported to Congress in the past that the Commission's responsibilities concerning suspicious activity reporting by broker-dealers would be triggered by rulemaking under the Bank Secrecy Act. See, e.g., U.S. Securities and Exchange Commission Staff Report on Anti-Money Laundering Compliance and Broker-Dealers, attached to letter dated December 21, 1999 from Arthur Levitt, Chairman, Securities and Exchange Commission, to the Honorable John D. Dingell, Ranking Member, Committee on Commerce, U.S. House of Representatives, ("[w]hile it does not have rulemaking authority under the BSA, it does have responsibility for examining broker-dealers to determine their compliance with the BSA. . . . The BSA enables Treasury to require financial institutions to report suspicious transactions relating to possible money laundering. Treasury's Financial Crimes Enforcement Network (FinCEN), which administers the BSA, imposed requirements to file suspicious activity reports (SARs) on depository institutions in 1996. Since that time, FinCEN has been working on extending SAR reporting to a wide variety of other financial institutions. The Commission staff has been actively working with FinCEN's staff to develop a rule for the securities industry. FinCEN has identified other industry groups, however, as a priority on its rulemaking agenda."); Securities and Exchange Commission Staff Report Regarding Money Laundering attached to letters dated December 20, 1993 from Brandon Becker, Director of the Division of Market Regulation, Securities and Exchange Commission, to the Honorable John D. Dingell, Chairman, United States House of Representatives Committee on Energy and Commerce, and to the Honorable Alfonse M. D'Amato, United States Senate, Committee on Banking, Housing, and

GAO's report addresses an area in which there is a clear difference in the regulatory scheme for broker-dealers and depository institutions – suspicious activity reporting (SAR). The National Money Laundering Strategy for 2000 (Strategy) [2] recognizes the need for a separate SAR rule for broker-dealers that takes into account existing examination and enforcement programs of securities regulators and recognizes the fact that the securities industry is generally not utilized in the money laundering "placement" stage. The Strategy also establishes priorities for Treasury's SAR rulemaking. Under the Strategy's priorities, Treasury has addressed SAR rules for other non-bank financial institutions – money services businesses and casinos – before proceeding with rulemaking for broker-dealers because of the greater use of cash in those businesses.

The draft report notes that bank regulators adopted parallel SAR rules for depository institutions, and extended them to affiliates, including broker-dealers. As GAO is aware, the bank regulators' rules stemmed in part from their prior use of criminal referral forms as part of their regulatory program that were replaced by the single SAR form filed with Treasury. The SEC has no statutory authority to determine compliance with the rules for depository institution affiliates, such as broker-dealers, adopted by depository regulators.

The SEC is committed to continuing its active participation in the fight against money laundering. The staff is prepared to work closely with broker-dealers and the self-regulatory organizations to develop effective programs to file SARs, and to examine for the effectiveness of those programs. Moreover, as the GAO is aware, a number of broker-dealers already have such programs in place on a voluntary basis. The staff believes that the regulatory issue addressed by the draft will be resolved once Treasury adopts one SAR rule applicable to all broker-dealers. We remain committed to working with Treasury to assure that an appropriate rule is proposed and adopted.

Sincerely,

Annette L. Nazareth
Director

Urban Affairs, ("[Annunzio-Wylie] also authorizes Treasury to require registered-broker-dealers to report suspicious transactions, and the staff understands that Treasury is drafting rules that will require registered brokers and dealers to report suspicious transactions. The Commission staff understands that Treasury staff will soon consult with it regarding a draft of these regulations. Once the rules related to [SARs] are adopted, the Commission will have the responsibility under the Bank Secrecy Act to examine broker-dealers for compliance with them."); and Response of the Securities and Exchange Commission Staff to February 8, 1993 Inquiry from the House Committee on Banking, Finance and Urban Affairs Regarding Money Laundering, attached to letter dated April 7, 1993 from Richard C. Breeden, Chairman, Securities and Exchange Commission, to The Honorable Henry B. Gonzalez, Chairman, Committee on Banking, Finance and Urban Affairs, ("Annunzio-Wylie . . . authorizes the Treasury Department to write rules requiring non-bank financial institutions, such as broker-dealers registered with the Commission, to . . . report suspicious transactions . . . . The Commission staff expects to work closely with Treasury to develop effective regulations."

[2] The National Money Laundering Strategy for 2000 was issued by the Department of the Treasury and the Justice Department in March 2000. The Strategy addresses government-wide efforts to fight money laundering.

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Related GAO Products

Suspicious Banking Activities: Possible Money Laundering by U.S. Corporations Formed for Russian Entities (GAO-01-120), Oct. 31, 2000.

Money Laundering: Observations on Private Banking and Related Oversight of Selected Offshore Jurisdictions (GAO/T-GGD-00-32), Nov. 9, 1999.

Private Banking: Raul Salinas, Citibank, and Alleged Money Laundering (GAO/T-OSI-00-3), Nov. 9, 1999.

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