

**STATEMENT OF WILLIAM J. FOX, DIRECTOR
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UNITED STATES DEPARTMENT OF THE TREASURY**

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

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Chairman Shelby, Senator Sarbanes, and distinguished Members of the Committee, I appreciate the opportunity to appear before you to discuss the issues and challenges before us as we attempt to establish an effective and comprehensive anti-money laundering regulatory regime for two diverse and important sectors in the financial industry – money services businesses and casinos. Again, we applaud your leadership Mr. Chairman and the leadership of Senator Sarbanes and the other members of this Committee on these issues. These issues are critically important to the health of our nation's financial system and, indeed, our national security.

It is a pleasure for me to be here today with Superintendent Diana Taylor of the New York Banking Department and Commissioner Kevin Brown of the Internal Revenue Service's Small Business/Self-Employed Division. Superintendent Taylor and I have begun what I believe to be a very good dialogue between our two agencies. We have high hopes that this dialogue will lead to a closer and deeper relationship with the New York Banking Department that will prove to be mutually beneficial.

As you know, the Secretary of the Treasury has delegated Bank Secrecy Act examination authority to the Internal Revenue Service for a variety of non-bank financial institutions including money services businesses and casinos. Commissioner Brown's division is responsible for this program. In the short time I have worked with him, I can state unequivocally that he and the people he has dedicated to this effort are taking their responsibilities under the Bank Secrecy Act quite seriously. We are all fortunate to have Commissioner Brown and his team in place.

When I appeared before you last June, I outlined a plan for establishing more aggressive and coordinated administration of the regulatory implementation of the Bank Secrecy Act. Since that time, we have made progress.

- We have created, within the Financial Crimes Enforcement Network's Regulatory Division, a new Office of Compliance devoted solely to overseeing the implementation of the Bank Secrecy Act regulatory regime by those agencies with delegated examination authority.
- We have created a new Office of Regulatory Support in our Analytics Division, thereby devoting, for the first time in the history of the Financial Crimes

Enforcement Network, a significant part of our analytic muscle to our regulatory programs. These analysts will be used to identify regulatory weak points and common compliance deficiencies. The analysts will assist our Office of Compliance and the other delegated examiners to be smarter about their programs for Bank Secrecy Act compliance.

- We are very close to finalizing a Memorandum of Understanding with the five federal bank regulators to provide information to us, in both specific and aggregate fashion, to prevent another situation such as the Riggs matter earlier this year and to give us a better understanding of the overall health of the Bank Secrecy Act regulatory regime. In those agreements, we have committed our direct involvement and support to those regulators in helping them discharge their regulatory plans.
- Finally, we are working to obtain similar agreements with the Internal Revenue Service, the Securities and Exchange Commission and the Commodities Futures Trading Commission, which will enhance our collective ability to oversee Bank Secrecy Act compliance in the non-bank financial sectors.

Mr. Chairman, the importance of the personal and direct support that you and your colleagues on the Committee have provided to these efforts cannot be understated. That support will enable us to implement this plan in a much faster and more efficient manner. We believe that is critical and important, and we wish to thank you for that support.

I would do this Committee and my Agency a disservice if I did not tell you that we believe that the challenges associated with establishing and implementing an effective and comprehensive regulatory regime for non-bank financial institutions have been and continue to be extraordinary. In the money services business industry alone, we continue to face innumerable challenges. Beyond that, the USA PATRIOT Act directed FinCEN to extend the regulatory landscape to an even broader range of financial institutions, including such varied entities as unregistered investment companies, operators of credit cards systems, insurance companies and dealers in precious metals, stones and jewels. While we are firmly committed to expanding the Bank Secrecy Act regulatory regime to those financial service providers posing risks for abuse by money launders and terrorists, it is essential that everyone understand the challenges we are facing when it comes to ensuring compliance with those regimes.

That said, it is our view that the non-bank financial services industry generally, and money services businesses and casinos in particular, understand the important link between the Bank Secrecy Act and our national security, and seek to comply with our regulations. There will always be outliers who seek to avoid regulation for the purpose of carrying out illegal acts. There will also always be those industries, such as the money services business industry, where we find a significant number of persons who do not understand their compliance obligations. Our task is to maximize compliance from all by

utilizing the skills, resources and expertise of our federal and state based regulatory partners.

I. Money Services Businesses

A. Overview of the Money Services Business Industry

The term “money services business” refers to five distinct types of financial services providers: currency dealers or exchangers; check cashers; issuers of traveler’s checks, money orders, or stored value; sellers or redeemers of traveler’s checks, money orders, or stored value; and money transmitters. The five types of financial services are complementary and are often provided together at a common location. Money services businesses have grown to provide a set of financial products that one would traditionally look to banks to provide. For example, a money services business customer who receives a paycheck can take the check to a check casher to have it converted to cash. The customer can then purchase money orders to pay bills. Finally, the customer may choose to send funds to relatives abroad, using the services of a money transmitter. All of these services are available without the customer needing to establish an account relationship with a bank or credit union. These businesses perform valuable services to a wide array of individuals.

In 1997, FinCEN commissioned Coopers & Lybrand to conduct a study of the industry prior to its rulemaking process. Based on this study, we had estimated the number of money services businesses nationwide to be in excess of 200,000.¹ Of these, approximately 40,000 were outlets of the U.S. Postal Service, which sells money orders. The study estimated that eight business enterprises accounted for the bulk of money services business financial products (that is, money transmissions, money orders, traveler’s checks, and check cashing and currency exchange availability) sold within the United States, and accounted, through systems of agents, for the bulk of locations at which these financial products were sold. Members of this first group include large firms, with significant capitalization, that are publicly traded on major securities exchanges. We are commissioning another survey to and update the information in the Coopers & Lybrand Study to get a better sense of the current size, composition, and nature of the industry, as well as of the potential for growth in the industry’s component segments.

¹ See Coopers & Lybrand L.L.P., “Non-Bank Financial Institutions: A Study of Five Sectors for the Financial Crimes Enforcement Network” (Feb. 28, 1997). This study estimated that there were approximately 158,000 money services business outlets or selling locations (not including Post Offices, which sell money orders and other money services business financial products, participants in stored value products trials, or sellers of various stored value or smart cards in use in *e.g.*, public transportation systems); and provided financial services involving approximately \$200 billion annually. This study estimated that, given trends current at the time, each money services business sector would grow at the following rates:

Check cashers:	11 % per year
Money Transmitters:	15 % per year
Money Orders and Traveler’s Checks:	5 % or less per year

A larger group of (on average) far smaller enterprises competes with the largest firms in a highly bifurcated market for money services. In some cases, these small enterprises are based in one location with two to four employees. Moreover, the members of this second group may provide both financial services and unrelated products or services to the same sets of customers.² Far less is known about this second tier of firms than about the major providers of money services products.³

B. The Growth of the Legal and Regulatory Framework

Money services businesses have been subject to currency transaction reporting rules since the inception of the Bank Secrecy Act, and additional regulatory obligations have been added subsequently. In 1988, Congress enacted Section 5324 of the Bank Secrecy Act, requiring sellers of monetary instruments for \$3,000 or more in currency to verify the identity of the purchasers. The Money Laundering Suppression Act of 1994 mandated a system of registration for money services businesses. This was considered to be a necessary first step towards identifying a universe of financial service providers that was largely unregulated at the federal level, extremely diverse both culturally and in size, and generally unknown to federal regulators beyond the handful of large corporate entities such as Western Union and American Express. FinCEN proposed implementing registration regulations in 1997 along with a proposal to require the filing of suspicious activity reports. FinCEN finalized the rules in 1999, with a phased-in implementation period so that all initial registrations for existing money services businesses were required to be filed by December 31, 2001. In addition, money services businesses were required to begin filing suspicious activity reports in January 2002. In April 2002, in response to the mandate of Section 352 of the USA PATRIOT Act that financial institutions institute anti-money laundering programs, FinCEN issued a final rule requiring money services businesses to establish anti-money laundering programs reasonably designed to prevent such businesses from being used to facilitate money laundering and the financing of terrorism.

² Members of the second group may include, for example, a travel agency, courier service, convenience store, grocery or liquor store.

³ For example, at the time of the study, two money transmitters and two traveler's check issuers made up approximately 97 percent of their respective known markets for non-bank money services. Three enterprises made up approximately 88 percent of the \$100 billion in money orders sold annually (through approximately 146,000 locations). The retail foreign currency exchange sector was found by Coopers & Lybrand to be somewhat less concentrated, with the top two non-bank market participants accounting for 40 percent of a known market that accounts for \$10 billion. Check cashing is the least concentrated of the business sectors; the two largest non-bank, check cashing businesses make up approximately 20 percent of the market, with a large number of competitors.

C. Addressing the Challenges

The challenges we face in regulating the whole of the money services business industry are significant. We believe that that a multi-faceted approach – a combination of aggressive outreach and education to domestic industry, targeted examinations, fostering and development of similar international standards and approaches, and appropriate civil and criminal enforcement – with close coordination among FinCEN, the Internal Revenue Service, state regulatory authorities, and law enforcement, is the only way that we can maximize industry compliance.

1. Identifying the Universe of Money Services Businesses

Identifying the universe of businesses subject to our money services businesses anti-money laundering regulatory regime is a basic yet challenging initial step. Many of these businesses are small, one- or two-person operations. Additionally, the proprietors may not speak English as a first or even a second language. The challenge of merely identifying these businesses cannot be understated.

Our regulations require most money services businesses to register with the Department of the Treasury every two years. Certain money services businesses are exempt from that registration requirement, including:

- U.S. Postal Service outlets;
- Businesses that are considered money services businesses solely as issuers, sellers or redeemers of stored value; and
- Branch offices and agents of a money services business.⁴

As of September 27, 2004, there are 21,058 money services businesses registered with FinCEN. Although, this number does not take into account the margin of error for filing mistakes, duplications, etc. While not all money services businesses are required to register, we believe there are a significant number of money services businesses required to register that have failed to do so.

Finding ways to enhance compliance with the registration requirement has been a focus of FinCEN since the inception of the registration concept. Initially, we hired a public relations contractor to engage in a multi-year outreach campaign (2000- 2003) designed to educate money services businesses about the new registration and reporting requirements. The campaign employed a variety of techniques. The constituency

⁴Businesses that are considered money services businesses solely because they serve as agents of another money services business are not required to register under current regulations; instead, the principal money services business must register and maintain a current list of its agents, which it must provide to the Financial Crimes Enforcement Network or the Internal Revenue Service upon request.

relations portion of the campaign informed key third-party organizations and corporate entities, and their members and employees, respectively, about the new regulations. Media outreach consisted of issuing press releases, placement of stories and advertisements in targeted media, and arranging interviews with select reporters. Also, four ethnic subcontractors were engaged to conduct ethnic media outreach to the African-American, Arab-American, Asian American, and Latino/Hispanic American communities. In addition, we created a website (www.msb.gov) dedicated to money services business regulations and guidance.

As part of FinCEN's outreach campaign, we developed free, easy-to-understand educational materials to help inform money services businesses about their obligations under the Bank Secrecy Act. These materials can be ordered or downloaded directly from the www.msb.gov website. These materials include a "Quick Reference Guide to Bank Secrecy Act Requirements for Money Services Businesses;" a more detailed guide to money laundering prevention; Posters and "Take One" cards, available in multiple languages and bi-lingual versions, to inform money services business customers about Bank Secrecy Act requirements and help customers understand why the business must ask for personal information; and videos and CD-ROMs, in English and Spanish, with case studies designed to educate money services business employees about the Bank Secrecy Act requirements.

This year we posted the list of registered money services businesses on our website. By identifying registered money services businesses, we are assisting banks and other financial services providers in their own due diligence and publicizing further those businesses that comply with the registration requirement. We updated the list in July of this year, and intend to do such updates at regular intervals going forward.

Most recently we solicited bids from contractors to update the money services businesses industry study originally conducted in 1997. This information, when coupled with the evolving information being obtained by the Internal Revenue Service as it conducts its examination activities, will further guide us in our outreach efforts and help us to target our examination and enforcement resources.

2. Unearthing the Underground Businesses

Perhaps the greatest challenge to regulating effectively the whole of the money services business industry lies in identifying and compelling the compliance of underground money transmitters or other informal value transfer systems. Steeped in history and clouded by secrecy, informal value transfer systems have existed for centuries and they continue to thrive in countries throughout the world, including here United States. Legitimate informal value transfer systems are utilized by a variety of individuals, businesses, and even governments to remit funds domestically and abroad in circumstances where a formal banking system does not exist. However, because such systems provide security, anonymity, and versatility to the user, the systems can be very attractive for misuse by terrorists and criminals. The vulnerability of informal value transfer systems in moving money on behalf of criminal organizations, and their potential

misuse by terrorist organizations, poses a substantial investigative challenge to the U.S. law enforcement community, and certainly to us as regulators. These challenges include: (1) non-standardized or non-existent recordkeeping and customer due diligence practices; (2) frequent commingling of informal systems with other business activities, including commodity trading or smuggling; (3) language and cultural barriers; and, (4) inconsistent laws and regulations at the international and domestic levels.

The challenge is further complicated by the recognition that informal value transfer systems often provide invaluable financial services to categories of individuals historically underserved or left out of the formal banking system. Our goal must be clear – to enhance the transparency of such systems through compliance with our regulatory requirements, without eliminating the ability of the unbanked to move legitimate funds to family members in other countries.

From a regulatory perspective, there are few things more challenging than identifying businesses that are deliberately seeking to avoid detection for unlawful purposes. However, in some instances, informal value transfer systems may be ignorant of the regulatory requirements, or they may be avoiding regulation because of a misperception of why we insist on transparency. While persuasion and outreach will never be effective in reaching the former, we are targeting our efforts toward the latter, both domestically and internationally.

In addition to the outreach efforts described above to educate these businesses about the requirements, FinCEN is working with the Department, the Internal Revenue Service and, increasingly, state regulators and law enforcement to better identify money services businesses operating underground, whether intentionally or ignorantly. For example, we are working with the Internal Revenue Service and law enforcement to develop “red flags” for legitimate financial institutions to help us identify money services businesses that choose to operate outside the regulatory regime. This builds on the prior work of FinCEN to educate the financial community about informal value transfer systems in Advisory 33, issued in March of 2003. While it is theoretically possible for informal value transfer systems to operate wholly outside of the banking system, it is not the most likely scenario. Instead, most such systems will utilize an account to clear and settle transactions internationally. By providing our banks and other financial institutions with red flags and other indicia of such clearing accounts, they will be better able to assist us in identifying systems operating outside of our regulations. In our *SAR Activity Review* (Vol. 6) in November 2003, we highlighted informal value transfer systems and gave examples of the types of activities reported on suspicious activity reports by financial institutions that referenced such operations.

We are continuing our work with the Department of the Treasury on a variety of international initiatives not only to educate other jurisdictions about the need for a comprehensive regulatory regime, but also to learn from the experience of other jurisdictions as they attempt to address the problem of underground value transfer.

We also look forward to working even more closely with law enforcement as they target unlicensed and unregistered money transmitters. It is vital that we strike the appropriate balance between aggressive criminal enforcement and less invasive forms of education and outreach to those operating underground systems. As when we try to bring a school of fish to the surface, the splash spearing the one at the top may cause the others to scatter to the depths of the pond and actually make our job more difficult.

Finally, we will continue to analyze Bank Secrecy Act data, particularly to review suspicious activity reports filed by depository institutions to identify unregistered and/or unlicensed money transmitter businesses, and to perform independent research to unearth underground financial services providers.

3. Achieving better Compliance within the Money Services Sector

Since January 2002, money services businesses have filed more than 450,000 suspicious activity reports. These reports are providing useful information to law enforcement, but we are also seeing common deficiencies that need to be addressed through examination and guidance. This is to be expected from an industry with less experience in filing suspicious activity reports, especially given the wide diversity of businesses with varying levels of sophistication. That said, we are taking steps now to enhance the quality of data received. We have issued guidance to financial institutions on filing complete and accurate suspicious activity reports. Added emphasis is being placed on the quality of suspicious activity report data in all of our training seminars and presentations to the money services business industry. Finally, we will be monitoring reports filed to identify and ultimately minimize the occurrence of blank data fields.

We are seeing positive results. For example, we recently used suspicious activity reports filed by money services businesses to develop a case involving the remittance of U.S. Dollars by U.S. citizens in circumstances indicating the potential for the funds to be diverted for terrorist funding purposes. This case has been referred to law enforcement.

II. Casinos

A. Overview of the Industry

Casinos in the United States are subject to a decentralized regulatory structure and are primarily regulated by the states and by tribal regulatory authorities. All casinos, including tribal casinos, with gross annual gaming revenue in excess of \$1,000,000 also are subject to the Bank Secrecy Act. There are approximately 800 casinos and card clubs operating in at least 30 jurisdictions in the U.S. (including Puerto Rico, the U.S. Virgin Islands, and Tinian) that are subject to the requirements of the Bank Secrecy Act. In particular, there has been a rapid growth in riverboat and tribal casino gaming as well as card room gaming over the last ten years. More than \$800 billion was wagered at casinos and card clubs in the United States in 2003, accounting for approximately 85 percent of the total amount of money wagered for all legal gaming activities throughout the United States.

B. The Growth of the Legal and Regulatory Framework

State licensed gambling casinos were generally made subject to the recordkeeping and currency reporting requirements of the Bank Secrecy Act by regulation in 1985. Casinos were also, by regulations adopted in their current form in 1993 and amended in 1995 (there was a version in 1993), the first non-bank financial institutions required to develop anti-money laundering programs, prior to enactment of the USA PATRIOT Act. Gambling casinos authorized to do business under the Indian Gaming Regulatory Act similarly were made subject to the Bank Secrecy Act by regulation in 1996. The Department of Treasury adopted Bank Secrecy Act regulations for casinos because it determined that:

- Casinos, as high cash volume businesses, are vulnerable to manipulation by money launderers, tax evaders, and other financial criminals; and
- In addition to gaming, casinos offer their customers a broad array of financial services, such as deposit or credit accounts, funds transfers, check cashing and currency exchange services, that are similar to those offered by other financial institutions and other financial firms.

In recognition of the importance of the application of the Bank Secrecy Act to the gaming industry, the Money Laundering Suppression Act of 1994 added casinos and other gaming establishments to the list of financial institutions specified in the Bank Secrecy Act. Specifically, the definition of casino includes a casino, gambling casino or gaming establishment that is duly licensed or authorized to do business as such, and has gross annual gaming revenue in excess of \$1 million, or that is an Indian gaming operations conducted under or pursuant to the Indian Gaming Regulatory Act other than a class I gaming operation.⁵

In 2002, FinCEN adopted rules requiring casinos, effective April 1, 2003, to file suspicious activity reports.

C. Current Challenges

Historically, casinos are no strangers to comprehensive regulation, and, as a result, simply do not pose the same types of risks as do money services businesses. Casinos have remained important partners in the fight against money laundering and financial crime. The challenge for FinCEN and the Internal Revenue Service is to determine how best to target casino examinations to deal with new issues, new products, and, importantly, new entrants to the industry. Providing outreach and guidance to the

⁵ The Indian Gaming Regulatory Act, 25 U.S.C. 2701, establishes the jurisdictional framework that governs Indian gaming. The Act establishes three classes of games with a different regulatory scheme for each. Class I gaming is defined as traditional Indian gaming and social gaming for minimal prizes. Regulatory authority over class I gaming is vested exclusively in tribal governments.

industry also will continue to be critical in assuring quality reporting and consistent compliance.

One facet of our efforts to coordinate with other federal regulators and law enforcement to identify issues and target our examination efforts is FinCEN's participation on the Indian Gaming Working Group. The Federal Bureau of Investigation's Indian Country Unit established the Indian Gaming Working Group in February 2003 in an effort to identify and direct resources to Indian gaming matters and to focus on "national impact" cases. Indian Gaming Working Group's members include, in addition to FinCEN, representatives from the FBI, the Department of Interior-Office of Inspector General, the National Indian Gaming Commission, the Internal Revenue Service Tribal Government Section, the U.S. Department of Justice, and the Bureau of Indian Affairs. The purpose of the Group is to identify, through a monthly review of Indian gaming cases deemed to have a significant impact on the Indian gaming industry, resources to address the most pressing criminal violations in the area of Indian gaming. FinCEN provides regulatory guidance pertaining to the Bank Secrecy Act and case support to law enforcement as appropriate.

In an effort to help casinos understand the importance of reporting requirements under the Bank Secrecy Act, we are stepping up our outreach programs. Last year we published Suspicious Activity Reporting Guidance for Casinos. We are now instituting programs at FinCEN to better monitor reporting under the Bank Secrecy Act to detect anomalies. Our new Office of Compliance will also be focusing on the casino industry as part of our efforts to enhance Bank Secrecy Act compliance. We are developing technological tools both in-house and in conjunction with the Internal Revenue Service that will enable us to develop sophisticated profiles of all financial institutions subject to regulation under the Bank Secrecy Act, not just casinos. This is our BSA Direct project about which I have spoken with you previously.

While BSA Direct is being developed, FinCEN has worked with the Detroit Computing Center to develop a monthly query to identify casinos with significant variances in their Bank Secrecy Act filings. The query compares the volume of casino currency transaction reports filed for the current month with the volume of currency transaction reports filed during the same month in the prior year. Based on the query, a report is produced which lists casinos whose currency transaction report filing volume has decreased by 30 percent or more. FinCEN has received and is analyzing the first report from the Detroit Computing Center, which compares data from January through August 2004 with data from January through August 2003. While this tool is not able to conduct the sophisticated monitoring that will be available through BSA Direct, this interim step should provide a rudimentary "early warning system" in the event of a catastrophic failure to file forms, as was experienced in the Mirage case. We believe such tools will enhance our capabilities to identify and address potential compliance programs.

Finally, we will continue to work closely with the industry and industry leaders such as the American Gaming Association, who you will hear from shortly.

III. Further Examination and Regulatory Implementation

Today our focus has been on money services businesses and casinos, yet the challenge of regulating all non-bank financial institutions is much larger. We will shortly issue final regulations requiring certain insurance companies and dealers in precious stones, metals, and jewels to establish anti-money laundering programs. There will be more industries that follow. Each new industry poses unique difficulties not only to FinCEN as the administrator of the Bank Secrecy Act, but also to the Internal Revenue Service as the examiner. We believe we are both doing all we can with present resource levels to attempt to achieve proper implementation of this regulatory regime, but the challenges are significant.

I would like to emphasize how we are working closely with the Internal Revenue Service on the issues associated with Bank Secrecy Act compliance in the non-bank financial sector. We believe that we are in this together and that we can only succeed if we work in close consultation. We meet monthly with the Internal Revenue Service to discuss examination issues, share information, and set priorities in a collaborative environment. FinCEN and the Internal Revenue Service also work together to train examiners, prepare education and outreach materials, participate in conferences and seminars, and prioritize and target examinations. FinCEN has conducted a comprehensive review of the Internal Revenue Service's Bank Secrecy Act examination manual and offered our suggestions for improving processes based on our experience in the other financial services sectors. FinCEN also provides analytical, regulatory and interpretive support for Internal Revenue Service examiners. Recently, FinCEN has supported and facilitated the development of a Memorandum of Understanding that would permit sharing of Bank Secrecy Act examination information between the Internal Revenue Service and state regulators.

Finally, our discussion of Bank Secrecy Act examination and enforcement, especially in the non-bank context, would be incomplete without acknowledging the vital role played by the state-based regulatory authorities. While we do not delegate federal Bank Secrecy Act examination duties to the states, through their own authority and through similar regulatory regimes, the states apply their resources to these important duties. We have enjoyed a strong working relationship with our state regulatory partners and intend to enhance and supplement that relationship going forward to maximize the utility of scarce resources and to ensure the uniform application of our regulations.

IV. Conclusion

In conclusion, Mr. Chairman, I hope my testimony today conveys the sense of urgency, energy, and commitment with which all of us at the Financial Crimes Enforcement Network are trying to tackle these challenging issues. Notwithstanding all of that good work, a robust and properly resourced examination function is the keystone to the success of our effort. We must avoid at all costs the cynicism created by a regulatory paper tiger. We are keenly aware of the importance of this task – we know

that it is critical to our national security. We are committed to all we can with the resources we have been give to implement this regulatory regime in the best way possible. Again, we appreciate your leadership, support and willingness to address these issues. Thank you.