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**TESTIMONY OF**

**THE OFFICE OF THE COMPTROLLER OF THE CURRENCY**

**Before the**

**PERMANENT SUBCOMMITTEE ON INVESTIGATIONS**

**of the**

**COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS**

**of the**

**U.S. SENATE**

**July 17, 2012**

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.

## **I. Introduction**

Chairman Levin, Ranking Member Coburn, and members of the Subcommittee, the Office of the Comptroller of the Currency (OCC) appreciates the opportunity to appear before you today to discuss the importance of effective Bank Secrecy Act (BSA) compliance programs at U.S. financial institutions and the role the OCC – and the other financial institution regulators – play in examining financial institutions for compliance in this area. As well, this testimony focuses on the OCC's supervision of HSBC Bank USA, N.A. (HBUS or Bank) with respect to BSA compliance, our enforcement action against the Bank, and other matters in which the Subcommittee has expressed an interest.

The OCC is committed to ensuring that the institutions under its supervision have effective controls in place to safeguard them from being used as vehicles to launder money for drug traffickers and transnational and other criminal organizations, or facilitate the financing of terrorist acts. Together with the other Federal banking agencies, the banking industry, and the law enforcement community, the OCC shares the Subcommittee's goal of deterring money laundering, terrorist financing, and other criminal acts and preventing the misuse of our nation's financial institutions.

National banks and thrifts have been required to have a BSA compliance program since 1987, and to monitor, detect and report suspicious activity since the 1970s. However, regulatory requirements and supervisory expectations under the BSA have increased significantly since that time, with the result that most institutions have had to make substantial improvements in their BSA compliance programs. In response, many of the largest institutions have implemented highly sophisticated programs and systems that screen transactions to identify and report suspicious activity to law enforcement, and to ensure that such transactions do not involve entities subject to Office of Foreign Assets Control (OFAC) sanctions. The suspicious activity reports (SARs) that are filed have provided law enforcement with access to critical information needed to initiate and conduct successful investigations and prosecutions. There are now approximately 5.6 million SARs in the centralized database that is maintained by the Financial Crimes Enforcement Network (FinCEN). The majority of these SARs have been filed by national banks and thrifts.

However, as our financial institutions' BSA compliance programs have evolved and changed over time, so has the sophistication and determination of money launderers, terrorist financiers and other criminals in finding other ways to gain access to our financial institutions. The technology, products and services offered by our institutions to give customers better and quicker access to financial services also are being used by criminals to instantaneously and anonymously move money throughout the world, sometimes through the simple click of a keypad. Consequently, banks, thrifts, and other financial institutions have had to devote increasingly larger amounts of resources to maintain effective programs.

Comptroller Curry recently spoke on the operational risks that are challenging financial institutions. One of the areas he spotlighted was BSA compliance. He noted that BSA compliance is inherently difficult, combining the challenges of sifting through large volumes of transactions to identify features that are suspicious, with the presence of criminal and possibly

terrorist elements dedicated to, and experts in, concealing the true nature of the transactions they undertake. Rendering BSA compliance more challenging is the fact that such risks are constantly mutating, as criminal and terrorist elements alter their tactics to avoid detection. They move quickly from one base of operations to another, finding sanctuary in places where law enforcement, or sympathy for U.S. policy objectives, is weakest. Furthermore, money laundering and terrorist financing schemes are becoming more complex, involving entities and individuals located in numerous jurisdictions worldwide.

Comptroller Curry emphasized, and we reaffirm today, that notwithstanding these challenges, the OCC expects the institutions we supervise to have effective programs in place to comply fully with the requirements of the BSA. Primary responsibility for compliance with the BSA rests with the nation's financial institutions themselves. The OCC and the other Federal banking agencies are charged with ensuring that these institutions have effective systems and controls to detect and monitor for suspicious activity related to money laundering and terrorist financing, provide the necessary reports to law enforcement, and compile and maintain records that are useful to regulatory and criminal investigations. This is not a static area of compliance as new money laundering and terrorist financing risks emerge and as existing risks change. Therefore, the OCC remains committed to continually improving our supervisory processes to help ensure the ongoing effectiveness of national banks' and federal savings associations' (hereafter referred to as "banks") BSA compliance programs.

The Subcommittee's Report (Report) contains three recommendations focused on the OCC's BSA/AML supervision. We agree with the concerns reflected in each of the recommendations and will take actions in response. We have already identified a new approach that we will implement to assure that BSA/AML deficiencies are fully considered in a safety and soundness context and are taken into account as part of the "Management" component of a bank's CAMELS rating. We are revising and clarifying the operation of our cross-functional Large Bank BSA Review Team (LB Review Team) to enhance our ability to bring different perspectives to bear and react on a more timely basis to circumstances where a bank has multiple instances of Matters Requiring Attention, or apparent violations of the required components of its BSA/AML program. We will also explore how we track and review relevant information in this regard and whether new initiatives are appropriate in that area as well. We will also revisit our current approach to citing BSA/AML violations in order to provide more flexibility for individual "pillar" violations to be cited, and we will identify what steps we can take in our examinations to more promptly obtain a holistic view of a bank's BSA/AML compliance. Finally, we will review other areas, such as training, staffing, recruitment, policies, and interagency coordination, to make improvements in our BSA/AML supervision program.

## **II. OCC BSA/AML Supervisory Policies and Practice**

Recognizing the increasing and evolving challenges of BSA/AML compliance, the OCC has continually sought ways to enhance and improve our supervision. In 2005, we undertook a set of comprehensive initiatives to improve our BSA/AML supervision. These initiatives were designed to strengthen OCC BSA/AML examinations; enhance OCC resources and expertise devoted to BSA/AML supervision; and provide clear and consistent communications about our BSA/AML supervisory expectations to the industry. Some of the key changes in our BSA/AML

supervision included the development and implementation of enhanced risk identification and analysis tools, such as the OCC's Money Laundering Risk Assessment system (MLR), which enables the OCC to identify potentially high-risk banks and activities that warrant increased scrutiny and supervisory resources. With the other Federal banking agencies, we finalized and issued the Federal Financial Institutions Examination Council's (FFIEC) Interagency BSA/AML Examination Manual (Manual) that provides consistent and comprehensive examination procedures for BSA/AML and OFAC. We also worked with the other Federal banking agencies to develop and issue a uniform policy on citing BSA compliance program violations and taking enforcement actions. And we created and filled a new Director-level position for the OCC's BSA/AML Compliance Policy Department and augmented staff reporting to this new Director.

In addition to the development and annual maintenance of the MLR information collection system, the OCC implemented a number of quality assurance processes to ensure that we are consistent in identifying and communicating BSA issues. These initiatives include enhanced MRA tracking and the LB Review Team process. The LB Review Team was formed in 2004 to ensure consistency in the area of BSA/AML compliance for the largest banks under our supervision. The LB Review Team is comprised of the Director of the Enforcement and Compliance Division, the Director for BSA/AML Compliance Policy, and the Senior Counsel for BSA/AML.

The BSA/AML Compliance Policy Department provides comprehensive BSA training to our examiners and organizes a BSA compliance conference every three years to inform our examiners of emerging money laundering and terrorist financing threats and vulnerabilities. Representatives of the law enforcement community are regular participants in these conferences and training sessions, establishing an on-going dialogue with our examiners concerning criminal typologies, schemes and arrangements. Such exchanges allow our examiners to be continually aware of the risks facing the banks, including those risks discussed here today, to scope examinations accordingly, and to provide timely guidance to the industry in addressing those risks.

The BSA/AML Compliance Policy Department also leads the OCC's National Anti-Money Laundering Group (NAMLG), which is an internal task force that serves as the focal point for BSA/AML issues within the agency. The NAMLG facilitates intra-agency communication; promotes cooperation and information sharing with national and district office AML groups; identifies emerging risks, best practices and possible changes in anti-money laundering policies and procedures; discusses legislative proposals; and serves as a clearing house for ideas developed throughout the OCC. The NAMLG's resource sharing program initiative provides BSA policy expert resources to complex banks, higher risk banks, or examinations in need of specialized expertise. The resource sharing program promotes BSA/AML knowledge transfer, examiner development, and improves the allocation of BSA resources.

Globalization is a critical feature of the business activities of the large internationally-active banks. It provides them with access to new markets, customers and opportunities. However, it also increases their exposure to potential money laundering and terrorist financing risks. The OCC recognizes this challenge and the BSA/AML Compliance Policy Department works closely with the U.S. Treasury's Office of Terrorism and Financial Intelligence (TFI), FinCEN, and

OFAC to promote the implementation of sound international anti-money laundering and counter terrorist financing (AML/CFT) standards. The OCC also annually hosts two AML schools to train our foreign counterparts, and we are active participants in the U.S. delegation to the Financial Action Task (FATF) that is led by TFI.

The OCC also works with the other FFIEC agencies, FinCEN and OFAC to review and develop BSA examination and enforcement policies and procedures. The publication of the Manual in 2005 was an outstanding example of cooperation and coordination within the government, and between the government and the banking industry. The Manual reinforces the agencies' position that sound BSA/AML risk management enables a banking organization to identify BSA/AML risks and better direct its resources, with the ultimate goal of helping safeguard its operations from money laundering, terrorist financing, and other illicit activities. The Manual has been revised three times since its initial publication so that it remains current with the latest technological and payment system innovations and emerging threats and vulnerabilities.

In fact, at the initiative of the OCC, the latest version of the Manual in 2010 contained a new section on bulk cash repatriation that provides detailed guidance and examination procedures relating to this high risk product. Based upon our experience and expertise in the bulk cash and remote deposit capture (RDC) area, the OCC took the lead in drafting the bulk cash section of the Manual and the related examination procedures, and updating the section on RDC. The next round of revisions to the Manual, which will be chaired by the OCC, is currently in the planning stages and should be completed during the next year. We expect that the revised Manual will include expanded sections on new payment systems such as prepaid access, mobile banking, and emerging risks associated with new products, services and customers that the agencies have identified through our collective supervisory processes.

The OCC monitors compliance with the BSA and its implementing regulations by applying the examination procedures set forth in the Manual. These procedures are typically completed within each bank's examination cycle. Community banks are on either 12 or 18 month examination cycles, and large banks and midsize banks are on an annual examination cycle. These procedures are risk-based and direct examiners to focus examination resources on high-risk areas within banks and high-risk banks. During an examination, examiners use the procedures to assess the implementation and effectiveness of the bank's policies, procedures, systems, and controls. Every BSA/AML examination includes, at a minimum, a review of the bank's risk assessment and its BSA/AML compliance program (focusing on internal controls, training programs, independent testing and BSA officer independence and qualifications). We also assess the effectiveness of the bank's OFAC compliance program.

OCC examiners perform ongoing supervision and conduct targeted testing in areas that may present higher money laundering and terrorist financing risks. The Manual also includes supplemental procedures that cover specific BSA requirements (*e.g.*, currency transaction reporting, suspicious activity reporting, foreign correspondent bank, private banking, funds transfer recordkeeping) and specific examination procedures covering risks from products and services and persons and entities (*e.g.*, correspondent banking, private banking, trade finance, electronic banking, third-party payment processors, bulk shipments of currency, pouch activities, politically exposed persons, business entities). The OCC routinely downloads and analyzes BSA

data, currency transaction reports and suspicious activity reports to identify unique risks and augment our risk-based examination processes. This information permits examiners to scope and plan examinations appropriately to ensure that the bank's higher risk activities are evaluated. Such activities may be reflected in accounts associated with repetitive SAR filings, significant cash activity, or activity that is inconsistent with the type of business of the customer, and are examples of the types of accounts that would be selected for transaction testing and further examiner investigation. In cases where examiners identify areas of concern, deficiencies or violations, they typically expand the examination scope and perform transaction testing in targeted areas to ensure they identify and evaluate all pertinent issues. This combination of our ongoing supervision and targeted examinations allows us to conclude on the adequacy of a bank's BSA/AML compliance program.

Currently, the OCC takes the findings from its BSA/AML and OFAC compliance examinations into account in determining the bank's regulatory ratings in two ways: (i) compliance risk management (including BSA/AML) is a part of the Management component of the Uniform Financial Institutions Rating System (UFIRS), more commonly referred to as CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk); and (ii) BSA/AML is taken into account as part of the compliance rating under the Uniform Interagency Consumer Compliance Rating System. The OCC's approach of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating differs from the approach of the other Federal banking agencies, which incorporates consideration of a bank's BSA/AML and OFAC compliance only in the Management component of a bank's CAMELS rating.<sup>1</sup>

We appreciate the concerns raised in the Subcommittee's Report about this approach and the need to ensure that deficiencies in BSA/AML compliance are considered in the context of safety and soundness and are taken into account in determining the Management component of the CAMELS rating. To address this concern, we are developing directions to our examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's Management component rating. We will also

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<sup>1</sup> In assigning this compliance rating, OCC examiners consider major BSA/AML and OFAC examination findings including, but not limited to:

- The current and historical adequacy of the bank's BSA/AML/OFAC compliance program;
- The significance, volume, and history of program deficiencies and violations and whether they were accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for money laundering, potential terrorist financing, and a pattern of structuring to evade reporting requirements;
- Money laundering and terrorist financing risks posed by the bank's customers, products and activities;
- The adequacy of monitoring systems to detect and report suspicious activity;
- The adequacy of systems to detect and report monetary transactions that require the filing of Currency Transaction Reports;
- The adequacy of systems to comply with BSA recordkeeping requirements;
- Evidence of insider complicity; and
- The board of directors' and management's willingness and ability to administer an effective BSA/AML and OFAC compliance program.

The Office of Thrift Supervision, prior to its merger with the OCC, used the same approach as the OCC by factoring BSA/AML and OFAC compliance into the Consumer Compliance rating and incorporating them within the Management rating, as appropriate.

provide guidance on how to document application of this approach in determining the Management component rating.

### **III. OCC's BSA/AML Supervisory and Enforcement Process**

The OCC uses a variety of methods to communicate problems or weaknesses in a bank's systems and controls, including BSA deficiencies, and to obtain corrective action. In most cases, problems in the BSA/AML area, as well as in other areas, are corrected by bringing the problem to the attention of bank management and obtaining management's commitment to take corrective action promptly. The Report of Examination or, in the case of large or midsize banks, the Supervisory Letter, documents the OCC's findings and conclusions with respect to its supervisory review of a bank.

Problems or weaknesses are communicated to the bank's senior management and board of directors in the "Matters Requiring Attention" (MRA) section of the Report of Examination or Supervisory Letter. MRAs are conditions or issues that management is required to change or correct. MRAs are a serious consequence of the examination and they include practices that: (i) deviate from sound governance, internal control and risk management principles which may adversely impact the bank's earnings or capital, risk profile, or reputation if not addressed; or (ii) result in substantive noncompliance with laws and regulations, internal policies, controls or processes, OCC supervisory guidance, or supervisory conditions imposed in an interpretive letter or licensing approval. Once MRAs are identified and communicated to the bank, the bank's senior management and board of directors are required to promptly correct them within the agreed upon time frame. OCC examiner guidance specifically provides that supervisory strategies for banks with MRAs must include plans to follow up on the concerns. The plans need to be consistent with the seriousness of the MRA and include activities to monitor progress and verify the effectiveness of the corrective actions. The OCC does not deem an MRA corrected until the supervisory office has verified that the bank has adopted and implemented an effective corrective action.

MRAs involving banks in our Large Bank supervision program are tracked by the OCC in a Large Bank data system that is continually updated by the examiners. On a quarterly basis, Large Bank supervision reports on the outstanding MRAs by bank and core function to ensure that corrective actions remain on track.

When deficiencies in the BSA/AML area rise to the level of a BSA compliance program violation (12 C.F.R. § 21.21), or when a bank fails to correct problems with the program that had been previously reported to the bank (including through MRAs), a statutory mandate (12 U.S.C. 1818(s)) requires the banking agency to use its cease and desist (C&D) authority to correct the problem. Section 1818(s) specifically provides that if an insured depository institution has failed to establish and maintain a BSA compliance program or has failed to correct any problem with the BSA compliance program previously reported to the institution by the appropriate Federal banking agency, the agency shall issue a C&D order against the institution.

To ensure that the OCC's process for taking administrative enforcement actions based on BSA violations is measured, fair, and fully informed, in 2005, the OCC adopted a process for taking

administrative enforcement actions against banks based on BSA violations, including situations where a bank fails to correct a problem that was previously brought to its attention. This process includes the following stages:

- (i) Preliminary assessment of the facts and discussion with bank management.
- (ii) Additional reviews by cross functional review groups, including the OCC's LB Review Team.
- (iii) Written findings provided to the bank and an opportunity for the bank to respond.
- (iv) Washington Supervision Review Committee (WSRC) review. The WSRC reviews significant enforcement actions proposed to be taken by the OCC, including all cases involving BSA enforcement, all cases that are unique or highly visible, and those cases involving referrals to other agencies.
- (v) Final decision by the appropriate Senior Deputy Comptroller.

As previously noted, the OCC also worked within the FFIEC to develop and issue an interagency policy on citing BSA compliance program violations and taking enforcement actions, and our enforcement decisions are framed by that policy. The Interagency Statement on Enforcement of BSA/AML Requirements (Interagency Statement) was issued in 2007 and it sets forth the Federal banking agencies' policy on the circumstances in which an agency will issue a C&D order to address noncompliance with certain BSA/AML requirements, particularly in light of the statutory mandate in Section 1818(s). The Interagency Statement provides that a compliance program violation occurs where either of the following conditions exists:

The bank fails to adopt or implement a written BSA compliance program that adequately covers the required program elements: (1) internal controls (including customer due diligence, procedures for monitoring suspicious activity or appropriate risk assessment); (2) independent testing; (3) designated compliance personnel; and (4) training; or

The bank has defects in its BSA compliance program in one or more program elements indicating that either the written program or its implementation is not effective. For example, program deficiencies indicate ineffectiveness where the deficiencies are coupled with other aggravating factors such as evidence of: (i) highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing; (ii) patterns of structuring to evade reporting requirements; (iii) significant insider complicity; or (iv) systemic failures to file currency transaction reports, suspicious activity reports, or other required BSA reports.

A program violation may occur where customer due diligence, monitoring of suspicious activity, risk assessment, or other internal controls fails with respect to a "high risk area," or to "multiple lines of business that significantly impact the institution's overall BSA compliance." An agency

will also consider the application of the institution's program across its business lines and activities. In the case of institutions with multiple lines of business, deficiencies affecting only some lines of business or activities would need to be evaluated to determine if the deficiencies are so severe or significant in scope as to result in a conclusion that the institution has not implemented an effective overall program.

The Interagency Statement also specifically addresses repeat problems for purposes of the statutory mandate for a C&D order in 12 U.S.C. § 1818(s). It provides that in order to be considered a "problem" within the meaning of section 1818(s), the deficiency reported to the institution would ordinarily involve a serious defect in one or more of the required components of the institution's BSA compliance program or implementation thereof. In addition, it sometimes takes a considerable period of time to correct BSA/AML deficiencies especially when large institutions merge system platforms and information technology changes are required. As a result, with regard to repeat problems, the Interagency Statement provides that a C&D is not required if the agency determines that the institution has made "acceptable substantial progress" toward correcting the problem at the time of the examination immediately following the examination where the problem was first identified and reported to the institution.

The Report highlights and calls for change in the OCC's current practice of not citing violations of the individual required components of an effective BSA program (*i.e.*, internal controls, independent testing, designated compliance personnel, and training) where the deficiencies fall short of a program violation. We understand the concerns reflected in the Report that the OCC's approach seems to limit examiners to using only MRAs to remedy identified problems, and we will revisit our current approach in order to provide more flexibility for individual "pillar" violations to be cited. One of the reasons for the current OCC approach is that it requires the OCC to focus on determining whether the deficiencies in a bank's program amount to a BSA compliance program violation. Therefore, in implementing changes on this point, it will be important not to create disincentives to making the tough calls when there are BSA compliance program violations mandating the issuance of a C&D order.

While our practice in this regard has differed from that of the other Federal banking agencies, the OCC's public enforcement record is nonetheless strong. As shown in Section IV below, between 2005 and 2011, the OCC issued BSA/AML focused C&Ds against banks at nearly twice the rate of the Federal Deposit Insurance Corporation (FDIC), the nearest other agency (per number of banks supervised), and issued CMPS at nearly four times the rate of the FDIC. The OCC also brought over 60 percent of the total dollar value of BSA penalty actions issued by the OCC, the Board of Governors of the Federal Reserve System (Federal Reserve) and the FDIC.<sup>2</sup> Thus, the component violations being cited by these other agencies are not resulting in as many C&D orders or CMP actions (which are the most stringent types of actions taken), as compared to the approach taken by the OCC.

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<sup>2</sup> As set forth in the charts on the following page, between 2005 and 2011, the OCC brought 43 BSA/AML focused C&Ds against banks as compared to 58 for the FDIC and 9 for the Federal Reserve. In addition, the OCC issued CMPs against 14 banks totaling \$124 million, as compared to six CMPs issued by the FDIC totaling \$24.675 million, and two CMPs issued by the Federal Reserve totaling \$50 million. In 2011, the OCC supervised 1,973 banks, the FDIC supervised 4,647 banks, and the Federal Reserve supervised 826 banks and bank holding companies.

#### **IV. OCC BSA/AML Enforcement Actions and Industry Trends**

In recent years, the OCC has taken numerous formal actions against national banks to bring them into compliance with the BSA. These actions are typically C&D orders. The OCC has also taken formal actions against institution-affiliated parties who participated in BSA violations. Since September 11, 2001, the OCC has issued over 180 public formal enforcement actions based in whole, or in part, on BSA/AML violations (including formal agreements, C&D orders and civil money penalty (CMP) actions). As set forth in the following charts, between 2005 and 2011, the OCC brought BSA focused C&D orders and CMP actions against banks at a higher rate than the FDIC and the Federal Reserve (per number of banks supervised):

Number of Bank BSA Focused C&D Orders by Agency

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	16	10	2	4	0	9	2	43
FDIC	1	7	20	11	7	5	7	58
Federal Reserve	2	1	1	1	1	2	1	9

Number of Depository Institutions Regulated by Agency

	2005	2006	2007	2008	2009	2010	2011	
OCC	1984	1762	1662	1559	1495	1418	1973	
FDIC	-	5243	5200	5140	4987	4785	4647	
Federal Reserve	-	896	877	875	846	826	826	

Number of Bank BSA CMP Actions by Agency

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	3	1	3	2	1	2	2	14
FDIC	0	3	0	0	0	1	2	6
Federal Reserve	1	0	1	0	0	0	0	2

Dollar Amounts of Bank BSA CMP Actions by Agency (In Millions)

	2005	2006	2007	2008	2009	2010	2011	Totals
OCC	\$27.75	\$0.15	\$10.75	\$15.2	\$5.0	\$50.2	\$15.0	\$124.05
FDIC	0	\$13.4	0	0	0	\$.025	\$11.25	\$24.675
Federal Reserve	\$30.0	0	\$20.0	0	0	0	0	\$50.00

Some of the more significant recent cases were actions against Wachovia Bank, N.A., Zions First National Bank, and Citibank, N.A. There are also many other examples where the OCC identified BSA non-compliance or, in some cases, actual money laundering, took effective action to stop the activity, and ensured that accurate and timely referrals were made to law enforcement. The Wachovia, Zions, and Citibank actions are discussed below:

Wachovia Bank, N.A., Charlotte, North Carolina (Wachovia) - On March 17, 2010, the OCC assessed a \$50 million penalty and issued a C&D order against this bank for violations of the BSA as part of a coordinated action with the Department of Justice, FinCEN, and other federal agencies. Wachovia also entered into a deferred prosecution agreement with the U.S. Attorney's Office in the Southern District of Florida and the Department of Justice (DOJ) Asset Forfeiture and Money Laundering Section (AFMLS) and agreed to forfeit \$110 million to the U.S. Additionally, FinCEN assessed a \$110 million civil money penalty that was deemed satisfied by the forfeiture to the U.S. Government.

The OCC found that Wachovia: (a) failed to implement adequate policies, procedures, or monitoring controls governing the repatriation of nearly \$14 billion of U.S. dollar (USD) bulk cash for high risk casa de cambio (CDC) and other foreign correspondent customers; (b) failed to conduct monitoring of high volumes of monetary instruments flowing through the CDCs and other foreign correspondent accounts in the form of RDC products, consisting of nearly six million checks worth approximately \$41 billion; (c) failed to conduct adequate levels of due diligence of high risk CDC and foreign correspondent customers; (d) failed to appropriately monitor traveler's checks in a manner that was consistent with the bank's policy limits over sequentially numbered traveler's checks for high risk CDC customers; (e) failed to appropriately institute risk-based monitoring of the bank's foreign correspondent customers, primarily as a result of placing too much emphasis on staffing considerations when setting alert parameters; (f) failed to file timely SARs involving suspicious transactions conducted through certain foreign correspondent accounts at the bank; and (g) failed to adequately report cash structuring activity from review of alerts generated in the bank's Financial Intelligence Unit. After conducting a voluntary look back, the bank filed over 4,300 SARs involving suspicious transactions conducted through the bank by CDCs and high risk foreign correspondent customers.

The OCC's enforcement action focused attention on the bulk cash repatriation money laundering scheme. The OCC played a lead role in this case and linked remote cash letter instrument processing to the bulk cash scheme. As a result of the Wachovia investigation and findings, the OCC took the lead in integrating bulk cash processing and the RDC implications into the Manual and commenced horizontal reviews of bulk cash activity and RDC at all national banks in the OCC's Large Bank supervision program, including HSBC's banknote activity.

Shortly after the Wachovia case, the government of Mexico implemented significant restrictions on U.S. dollar transactions at Mexican financial institutions and made significant changes to its AML laws and regulatory processes. In response, the drug cartels have adjusted their money laundering schemes and techniques to adapt to this change, and the OCC continues to work with law enforcement to identify new areas of vulnerability.

Zions First National Bank, Salt Lake City, Utah (Zions) - On February 11, 2011, the OCC assessed an \$8 million penalty against Zions for failures involving correspondent banking and RDC. Concurrent with the OCC's penalty, FinCEN assessed an \$8 million penalty against Zions. Both penalties were satisfied by a single \$8 million payment to the U.S. Department of the Treasury. The OCC had commenced an investigation into the bank's former foreign correspondent business and identified deficiencies in its BSA/AML controls, which resulted in

violations of law. In particular, the bank pioneered the development of a RDC product that enabled customers to deposit imaged items electronically from remote locations and marketed this product to high risk customers with insufficient regard for BSA/AML compliance implications. The bank exited the foreign correspondent line of business in early 2008, promptly conducted a voluntary look back, and reported suspicious activity. The significance of this case is that it presents a good example of how banks need to ensure that compliance issues are at the forefront of technological developments and are not secondary issues to be considered after the product is launched and the volumes become unmanageable.

*Citibank, N.A., Sioux Falls, South Dakota (Citibank)* - On April 4, 2012, the OCC entered into a consent order with Citibank, N.A., to address BSA deficiencies involving internal controls, customer due diligence, audit, monitoring of its RDC and international cash letter instrument processing in connection with foreign correspondent banking, and suspicious activity reporting relating to that monitoring. These findings resulted in violations by the bank of statutory and regulatory requirements to maintain an adequate BSA compliance program, file SARs, and conduct appropriate due diligence on foreign correspondent accounts. Among its requirements, the consent order directs the bank to: (i) ensure the independence of the bank's compliance staff, (ii) require new products and services be subject to high level compliance review, (iii) ensure that all customer due diligence processes are automated and accessible; and (iv) conduct a look back of the RDC cash letter activity.

Each of these cases has been discussed extensively at public forums and they underscore the OCC's commitment to ensuring that all national banks and federal savings associations have a strong BSA/AML function that keeps pace with changing technologies and threats.

Our examination and enforcement activities have identified a number of trends and concerns in the BSA/AML area that warrant continued attention by supervisors and banks:

- Compliance Resources – Some cases have identified the lack of sufficient staffing, high turnover rates, or the impact of compliance cuts on the program. In some cases, banks cut staffing and resources in the BSA area during the financial crisis. In other cases, banks' compliance department staff and expertise have failed to keep pace with the growth of the institution. For example, a mid-size bank should not have the same compliance program and staff levels that it had when it was a smaller community bank.
- International Focus or Component – Foreign correspondent banking, cross border funds transfers, bulk cash repatriation, remote deposit capture, and embassy banking have all been high risk areas that some banks have not managed effectively.
- New Technologies – Some banks have introduced new technologies and products without appreciating or understanding the compliance risks. In addition, some products have evolved through technology and need to be periodically re-evaluated (*e.g.*, prepaid access money transfers, payroll cards).
- Third-Party Relationships and Payment Processors – The OCC and the other banking agencies have been reviewing closely third-party and payment processor relationships

and a number of enforcement actions have been taken in recent years. Banks need to be especially aware of the risks presented by payment processors and the extent of their franchising relationships (RTN numbers, routing numbers, and ATM machines).

- Evolving Payments Activities – Prepaid access, mobile phone banking, smart ATM machines and kiosks, mobile wallets, and Internet cloud-based payment processes are all technologies that are developing rapidly, and senior bank compliance personnel need to be engaged in the product development processes. OFAC monitoring is especially important and challenging in this area.
- Migration to Smaller Banks – As some large or mid-size banks have attempted to lower their risk profiles, money launderers have tried to enlist community banks to step in and provide key payments functions. This raises concern as these institutions may lack the resources and personnel necessary to successfully manage higher risk activities.

Many of the practical problems seen in recent years with respect to BSA compliance can be summed up within four areas: (i) culture of compliance within the organization, (ii) commitment of sufficient and expert resources, (iii) strength of information technology and monitoring processes, and (iv) sound risk management. The OCC will continue to identify these trends, communicate them to the industry, and ensure that BSA/AML supervision stays current.

## **V. Improvements Undertaken to Improve BSA/AML Supervision**

The OCC is committed to rigorous supervision, strong enforcement, and continuous improvement to our supervisory approach to BSA/AML compliance. While we have previously discussed herein some recent BSA/AML related initiatives, other current initiatives include the following:

- We are implementing changes to our LB Review Team process to make it more effective in supporting and ensuring consistency of the supervisory processes for the larger banks we supervise.
- We are reviewing the manner in which MRAs are reported to ensure that banks with high numbers of MRAs in one particular CAMELS/ITCC area are receiving additional supervisory attention and, in the case of BSA/AML, consideration of formal enforcement action.
- The OCC's MLR database includes a detailed inventory of the products and services being offered by each community bank so that the OCC can assess the BSA/AML risks within each particular institution for use in scoping and staffing examinations. We will annually update the information collection processes pertaining to this tool to ensure that it captures higher risk and novel products. We will also consider whether similar tools should be implemented to our Large Bank and Midsize Bank portfolios.
- As previously described, we are strengthening and reinforcing the expectation that BSA/AML and OFAC deficiencies are taken into consideration in determining the

Management rating. We will also instruct our examiners to cease the practice of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating.

- As described in Section III, we will also look closely at the Report's recommendation concerning citing BSA/AML compliance violations.

In addition, we are committed to keeping abreast of how new technologies and payment systems may affect BSA/AML compliance and to provide the industry and examiners with guidance on these emerging risks. For example, in 2006 the OCC issued comprehensive risk management guidance for Automated Clearing House (ACH) transactions, and the OCC continues to work with the other regulators to ensure that international ACH transactions are properly monitored for both BSA/AML and OFAC compliance. In June of last year, the OCC issued risk management guidance for prepaid access programs and continues to develop guidance for banks with regard to this rapidly growing product. And earlier this month, the OCC worked with the FFIEC to issue a statement on outsourced Internet cloud computing services that discusses key risk considerations associated with outsourced cloud computing activities, including cloud based payment processes and systems, and identifies applicable risk mitigation considerations contained in the various booklets that comprise the FFIEC IT Examination Handbook.

## **VI. Overview of HSBC and OCC's BSA/AML Examinations**

HSBC North America Holdings Inc. (HNAH) is the holding company for HSBC's operations in the U.S. HNAH is controlled by HSBC plc, London, England (HSBC Group), a \$2.5 trillion global banking company with hundreds of financial institution subsidiaries throughout the world. The principal subsidiaries of HNAH at December 31, 2011 were HSBC USA Inc. (HUSI), HSBC Markets (USA) Inc, a holding company for certain global banking and markets subsidiaries, HSBC Finance Corporation, a holding company for consumer finance businesses, and HSBC Technology and Services (USA) Inc, a provider of information technology and centralized operational and support services among the subsidiaries of HNAH. The Bank is a subsidiary of HUSI. "Group Entities" are foreign affiliates of the Bank in which HSBC Group holds a majority interest.

The Bank serves 3.8 million customers through its personal financial services, commercial banking, private banking, asset management, and global banking and markets segments. It operates several hundred bank branches throughout the U.S., predominantly in New York State as well as branches and/or representative offices in California, Connecticut, Delaware, Florida, Georgia, Illinois, Maryland, Massachusetts, New Jersey, North Carolina, Oregon, Pennsylvania, Texas, Virginia, Washington, and the District of Columbia. The Bank has five main lines of business as follows:

- (i) Retail Banking and Wealth Management provides a broad range of financial products and services including loans, residential mortgages, deposits, branch services and brokerage products and services;
- (ii) Commercial Banking offers global banking services, along with financial planning to companies, government entities and non-profit organizations. In addition to deposits,

services include payments and cash management (PCM), merchant services, trade, supply chain, receivables finance, corporate finance, global markets and risk advisory;

- (iii) Global Banking and Markets is an emerging markets-led and financing focused business that provides tailored financial solutions to government, corporate and institutional clients worldwide, and the Bank manages its Global Banking and Markets operations as a global business and maintains offices in more than 60 countries and territories;
- (iv) HSBC Global Asset Management is the core investment business of the HSBC Group managing assets totaling \$429.4 billion; and
- (v) HSBC Private Bank, a division of the Bank, offers wealth management and specialist advisory services for high net worth individuals and families with local and international needs.

On April 30, 2003, the then HSBC Bank USA entered into a written agreement with the Federal Reserve Bank of New York and the New York State Banking Department regarding its compliance with AML requirements. When HSBC Bank USA merged with HSBC Bank & Trust (Delaware) N.A., on July 1, 2004, the OCC, as the regulator of the surviving national bank, made the merger conditional on the Bank's continuing compliance with the requirements of the written agreement. On February 6, 2006, the OCC determined that the Bank had satisfied the requirements of the written agreement and the agreement was terminated.

Between 2004 and 2009, on-site OCC examiners conducted numerous examinations and issued Supervisory Letters covering, among other areas, pouch activity, embassy banking, foreign correspondent banking, PCM, SAR monitoring systems, and risk assessment processes and systems. During these examinations, the OCC followed the FFIEC Manual examination procedures and conducted transaction testing. Over the course of this five year period, the OCC issued Supervisory Letters that contained a significant number of MRAs that the Bank committed to resolving. The MRAs addressed BSA/AML risk assessments, customer due diligence, compliance leadership, staffing, alert backlogs, and SAR monitoring processes and enhancements.

As described earlier in this testimony, compliance with MRAs is tracked as part of the OCC's supervisory process. In this case, MRAs in the BSA/AML area were reviewed periodically, and determinations were made whether the MRAs had been addressed.

In mid-2009, as a result of the bulk cash findings in the Wachovia investigation, the OCC launched horizontal examinations of banknote operations in other large national banks supervised by the OCC that included HSBC and its transactions with HSBC Mexico. After finding significant deficiencies in the Bank's oversight of its banknote operations and after meeting with law enforcement and obtaining additional information on this activity, the OCC developed a detailed action plan to expand the scope of the ongoing examination of banknote customers. The expanded scope included evaluation of the Bank's compliance with all BSA/AML laws and regulations relating to foreign correspondent activity (including RDC

activity, pouch activity, and specific foreign correspondent relationships), OFAC compliance, and the effectiveness of management's efforts to manage risk on an enterprise wide basis.

The OCC conducted its expanded examination during 2009-10. It encompassed, among other things, an evaluation of specific banknote clientele. The OCC reviewed internal bank policies and procedures, systems and controls, training initiatives, and documentation supporting the Bank's compliance efforts. The examiners reviewed know-your-customer documentation/information pertaining to the sample, customer due diligence documentation/information, enhanced due diligence documentation/information, related account statements, specific transactions, pouch activities, cash letter activities, wire transfer activities, audit report/processes, RDC activity, foreign exchange transactions, trade transactions, monitoring processes, alert processing, SAR and related processes, subpoena documentation/information, the Bank's OFAC program, and all other relevant bank documentation and correspondence from 2004 to the current period.

As a part of the examination, the OCC notified the Bank in March 2010 that it had violated OCC regulations due to a significant backlog of unprocessed alerts. The Bank's subsequent review of the backlogged alerts led it to file a substantial number of late SARs with law enforcement authorities. The OCC also identified a number of previously undisclosed bearer share account relationships. The OCC is currently assessing the consequences of this finding, and the Bank's implementation of corrective measures.

The OCC ultimately determined that the Bank failed to adopt and implement a compliance program that adequately covered the required BSA/AML program elements including, in particular, internal controls for customer due diligence, procedures for monitoring suspicious activity, and independent testing. The Bank's compliance program and its implementation were found to be ineffective, and accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing.

The number of MRAs cited over the preceding years reflected a pattern where the Bank reacted when problems were identified by the OCC, but failed to fulfill its fundamental responsibility of maintaining a program that effectively deterred money laundering and self-identifying and correcting deficiencies in its BSA/AML program. In addition, based on issues we had identified in our exams at other institutions, we began to drill down into specific areas of the Bank's operations. As we did so, we discovered that the Bank had additional and severe pre-existing BSA/AML deficiencies – beyond what we had previously understood. Our work in these areas triggered further discoveries of additional, severe deficiencies. As a result, in the fall of 2010, we took forceful and comprehensive enforcement action. With the benefit of hindsight, the OCC should have taken this action sooner.

## **VII. HSBC C&D Order**

The OCC issued a C&D order against the Bank in October 2010. Concurrent with the OCC's enforcement action, the Federal Reserve issued a C&D order upon consent with the Bank's parent company, HNAH, to ensure the adequacy of the parent company's firm-wide compliance

risk management program. The OCC and the Federal Reserve coordinated closely in drafting the respective orders.

Some of the critical deficiencies in the Bank's BSA/AML compliance program cited in the OCC's order included the following:

- Lack of effective monitoring of wire activity. The Bank, in effect, exempted from automated monitoring wire transfers for customers domiciled in countries risk rated as standard or medium risk. This represented two-thirds of total dollar volume for PCM. While the Bank employed other methods for monitoring wire transactions for customers located in countries risk rated standard or medium, these alternatives provided limited coverage, were not effective, and did not mitigate the BSA/AML risks posed.
- From mid-2006 through mid-2009, the Bank did not perform any BSA/AML monitoring for banknote (or "bulk cash") transactions with Group Entities (affiliates).
- The Bank did not maintain customer due diligence information on Group Entities.
- The Bank failed to resolve its monitoring system alerts in a timely manner, leading to significant backlogs and late SAR filings.
- The Bank did not appropriately designate customers as high risk for purposes of BSA/AML monitoring, even where a customer's association with politically-exposed persons could harm the Bank's reputation.
- Serious weaknesses in Bank's systems and controls constituted violations of 12 C.F.R. 21.21 (program), 21.11 (SAR), and 31 CFR 103.176 (correspondent banking).

As the OCC's order set forth, the violations and failures were the result of a number of factors, including: (i) inadequate staffing and procedures in the alert investigations unit that resulted in a significant backlog of alerts; (ii) the closure of alerts based on ineffective review; (iii) inadequate monitoring of Group Entities' correspondent accounts for purpose and anticipated activity, anti-money laundering record, or consistency between actual and anticipated account activity; (iv) unwarranted reliance on Group Entities' following HSBC Group BSA/AML policies; (v) inadequate monitoring of funds transfers; (vi) inadequate procedures to ensure the timely reporting of suspicious activity; (vii) failure to adequately monitor Group Entities' banknote activity; (viii) inadequate monitoring of correspondent funds transfer activity; and (ix) inadequate collection and analysis of customer due diligence information, including inadequate monitoring of politically exposed persons.

The OCC's C&D order requires the Bank to submit a comprehensive BSA/AML action plan to achieve full compliance and ensure that the Bank has sufficient processes, personnel and control systems to implement and adhere to the order. It requires the Bank to hire a qualified permanent regional compliance officer and a qualified, permanent BSA officer. It further requires the Bank to improve its BSA/AML monitoring systems, including its funds transfer monitoring, and to develop and maintain a management information system (MIS) program that compiles customer

due diligence and enhanced due diligence (know your customer) information that includes the identification of “offshore” correspondent accounts and the identification of politically exposed persons. The order also contains restrictions on growth, new products, and high-risk lines of business, and it requires OCC approval to reenter the bulk cash repatriation business.

The C&D order additionally required the Bank to hire an independent consultant to conduct a comprehensive account/transaction activity review (Look Back). The purpose of the Look Back was to determine whether suspicious activity was timely identified by the Bank and to supplement the OCC’s investigation of specific account relationships, transactions, and products and services that had been identified as potentially problematic. (Transaction reviews and look backs are routinely used by the OCC and the other Federal banking agencies to require banks to review past activities and file SARs as necessary.) Some of the account relationships, transactions, and products and services included in the Subcommittee’s report, were specifically covered within the scope of the Look Back.

The Look Back required the Bank to review 31 specific correspondent account relationships, including several HSBC affiliates and HSBC Mexico, over an eighteen month time period covering banknotes, wire, RDC, and pouch activities.

The Look Back also required the Bank to review specific alerts that had been closed due to a reduction in a country’s risk rating and over a two month time period, including:

- All alerts closed based on “positive internet information;”
- Wire transfers originating in five standard and medium risk countries that were sent to seven high risk countries;
- Wire transfers (originating or terminating) between several pairs of standard and medium risk countries;
- International (cross-border) book entry transfers;
- All account activity during this period for accounts subject at any time during the period to requests pursuant to section 314(a) or section 314(b) of the USA PATRIOT Act, or to subpoenas relating to BSA/AML issues; and
- All alerts closed more than 60 days after generation of the alert including, without limitation, alerts closed in response to the OCC’s Supervisory Letter (over a three month time period).

The C&D order is a remedial document that is designed to obtain correction of violations of law and unsafe or unsound practices at the Bank. The issuance of the order does not preclude the OCC from assessing a civil money penalty at a later time. The OCC is now actively engaged in evaluating the Bank’s compliance with the C&D order and in considering the assessment of CMPs.

## **VIII. Cooperation with Law Enforcement/Regulatory Agencies**

The OCC cooperates and coordinates on an interagency basis to address BSA/AML issues. We actively participate in several interagency groups focusing on BSA/AML compliance, including the Bank Secrecy Act Advisory Group (BSAAG), chaired by FinCEN, which is composed of policy, legal, and operations representatives from the major federal and state law enforcement and regulatory agencies involved in the fight against money laundering, as well as industry representatives; the FFIEC BSA Working Group which, similar to the FFIEC itself, has a rotating chairman and is composed of representatives of federal and state regulatory agencies; and the National Interagency Bank Fraud Working Group, chaired by the Department of Justice, and composed of representatives of the federal law enforcement and regulatory agencies (the OCC has been an active member of this group since its founding in 1984).

To remain in the forefront of new technologies and payment systems, the OCC also participates in various interagency working groups, including the Interagency Cyberfraud Working Group, the Payments Fraud Working Group, the Financial Services Information Sharing and Analysis Center (FS-ISAC), the BSAAG Prepaid Card Subcommittee, and regularly participates in payments conferences and industry forums.

In addition, the OCC works on an international basis with the Financial Action Task Force, an inter-governmental body whose purpose is the development and promotion of policies to combat money laundering. We have participated in various State and Treasury Department missions to assist foreign governments in their anti-money laundering efforts. We expect that these international efforts will continue. The OCC also regularly provides information, documents, and expertise to law enforcement for use in criminal investigations on a case-specific basis.

With respect to HSBC, the OCC has worked closely with the Federal Reserve, FinCEN and law enforcement in addressing the problems identified at HSBC and will continue to do so to ensure that all problems are identified and addressed.

## **IX. Conclusion**

The OCC is committed to rigorous BSA/AML and OFAC supervision, strong enforcement, and continuing improvement in our supervision in this important area. We are closely reviewing the Subcommittee's Report and, as discussed earlier in this statement, we have already identified actions that we will take in response to its recommendations.

The OCC will continue to work with Congress, the other financial institutions regulatory agencies, law enforcement agencies, and the banking industry to develop and implement a coordinated and comprehensive response to the threat posed to the nation's financial system by money launderers, terrorist financiers and criminal organizations. The OCC recognizes that the determination and ingenuity of those who commit financial crimes requires ongoing vigilance. We also recognize that technical innovations, new and more convenient financial services products, and globalization trends are rapidly changing the BSA/AML landscape. These are major challenges for both the financial services industry and its regulators and, for our part, we are committed to meeting them.