May 6, 2005

Ms. Jennifer Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington D.C. 20551

Attention: Docket No. OP-1220

Office of the Comptroller of the Currency
250 E Street, SW
Mailstop 1-5
Washington D.C. 20219

Attention: Docket No. 05-01

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, NW
Washington D.C. 20552

Attention: No. 2005-02

Re: Request for Burden Reduction Recommendations; Money Laundering, Safety and Soundness, and Securities Rules; Economic Growth and Regulatory Paperwork Reduction Act of 1996 Review
70 FR 5571 (February 3, 2005)

Dear Sir or Madam:

America's Community Bankers (ACB)[1] is pleased to comment on the federal banking agencies' (the agencies)[2] review of regulatory burden imposed on insured depository institutions.[3] Required by section 2222 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (EGRPRA),[4] the agencies are reviewing and identifying outdated, unnecessary, and unduly burdensome regulatory requirements. This comment letter responds to the request for comments regarding money laundering, safety and soundness, and securities rules.

[1] America's Community Bankers is the national trade association partner for community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*
[2] Federal Deposit Insurance Corporation ("FDIC"), Federal Reserve Board (the "Board"), Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").
[3] 70 Fed. Reg. 5571 (February 3, 2005).
[4] Pub. L. 104-208, Sept. 30, 1996.

ACB Position

ACB strongly supports the agencies in their ongoing efforts to reduce the regulatory burden on insured depository institutions. Generally, the statutes enacted and the required implementing regulations serve a very useful purpose by themselves, but when layered upon the existing requirements, community banks frequently must comply with overlapping and voluminous regulations. Several of the regulations that are the subject of this request for comment are among those that community bankers raise as the being the most burdensome. We welcome the scrutiny of the agencies on these regulations and we hope that this review results in changes that relieve some of the regulatory burden while preserving the benefits of the requirements.

Anti-money laundering regulations

The anti-money laundering statutes and the implementing regulations were adopted with the best of intentions. The Bank Secrecy Act (BSA) was enacted in 1970 and one of the primary goals was to eliminate or mitigate the laundering of the profits of drug trafficking and other illicit businesses. The USA Patriot Act was enacted to root out terrorists, ensure the safety of the American people, and protect the integrity of the U.S. financial system. ACB supports the goals of these laws, however, inconsistent interpretation of the implementing regulations by examiners and a lack of regulatory guidance have made it increasingly difficult for community banks to comply with anti-money laundering demands and have produced a plethora of unintended consequences.

ACB offers the following suggestions to improve BSA oversight.

<u>Consistent Implementation</u>

Community banks are frustrated by the conflicting messages conveyed by banking regulators. Washington officials repeatedly assure the industry that the banking agencies do not have "zero tolerance" for anti-money laundering deficiencies. Nevertheless, regional offices and individual examiners continue to use this language when conducting BSA examinations and when making presentations during industry conferences. ACB is very pleased that Washington acknowledges that perfect compliance is impossible. We urge the agencies to ensure that all regional offices and examiners understand and adhere to this fundamental principle of regulatory policy.

ACB hopes that the anticipated interagency examination procedures will clarify the regulators' compliance expectations and will provide consistency across and within the agencies. It is important that institutions understand what is expected of them, yet many community banks believe that there are no pre-established standards against which their compliance efforts will be evaluated. Accordingly, we urge the agencies to make every effort to ensure that the examination procedures are made available by June 30, 2005, as promised.

<u>Suspicious Activity Reporting</u>

Examination for compliance with suspicious activity reporting requirements is one specific area where we ask the regulators to be more consistent and provide additional guidance.

Defensive SARs. The federal banking agencies are scrutinizing suspicious activity reporting more closely than ever and anxiety over whether an institution should file a SAR is at an all-time high. As a result, many depository institutions believe that filing more SARs is the key to avoiding regulatory criticism. Many institutions file SARs as a defensive tactic to stave off "second guessing" of an institution's suspicious activity determinations. This mindset is fueled by examiners who criticize institutions for not filing enough SARs based on their asset size. Furthermore, regulators have admitted in public fora that the agencies do not discourage the "when in doubt, fill it out" strategy.[5] Finally, enforcement actions in the past year appear to confirm the idea that it is better to have filed a SAR when it is not necessary than to have not filed one.

It is more time consuming and paperwork intensive for an institution to document why it elected not to file a SAR than to simply file the report. Institutions believe that the risk of regulatory criticism is higher for not filing and that examiners will disapprove of the bank's documentation or its decision not to file.

While institutions feel pressure to file more SARs by their primary regulator, FinCEN director William Fox has warned that the value of SAR data will be less valuable and that the integrity and usefulness of the SAR system will be compromised by the onslaught of "defensive" SARs. In March 2005, financial institutions submitted nearly 43,500 SARs, up 40 percent from March 2004. Director Fox recently wrote in the April 2005 *SAR Activity Review*, "these 'defensive filings' populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns."

The problem of defensive SAR filing is further exacerbated by recent deferred prosecution agreements between the Department of Justice and financial institutions whose SAR reporting programs have been deemed deficient.

In this era of increased regulatory scrutiny, community banks deserve more guidance and information. ACB strongly urges the regulators to work with FinCEN and the Department of Justice to articulate a single, clear policy on suspicious activity reporting that is applied consistently. It is critical that this policy be made clear to the regional offices, bank examiners and officials of the Department of Justice across the country.

Further, we do not believe that insured institutions should be placed in the middle of a harsher enforcement regime when the federal agencies attempt to satisfy their Inspectors General. Rather, the banking regulators, FinCEN, and the Department of Justice should work to help institutions identify activities that are genuinely suspicious and should be reported. We are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

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[5] While most industry feedback indicates that community banks feel pressured to file larger quantities of SARs, some institutions have been cautioned by their regulators against such liberal filing. This approach, too is frustrating.

The current state of affairs is not the best use of the time and resources of all parties involved and is not helping to enhance the security of our country.

SAR Guidance. On December 23, 2004, ACB requested that FinCEN provide updated, centralized SAR reporting guidance (See Attachment A). In a response from FinCEN dated April 22, 2005, we have been assured that many of the points raised are being addressed. We welcome the changes and urge the agencies to work with FinCEN to ensure rapid dissemination of any changes and guidance. ACB continues to believe that not understanding what constitutes suspicious behavior continues to be one of the most burdensome aspects of BSA compliance. Accordingly, we urge the agencies to work with FinCEN to compile a comprehensive guide to SAR filing that includes:

- A list of common suspicious activities and red flags. Community bankers often ask, “What kind of activity is suspicious?” or “What activity is indicative of terrorist finance?” This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question also is important in helping to separate those occurrences that should not be reported. We also encourage the agencies and FinCEN to include examples or case studies where SARs are or are not warranted.

- Centralized Guidance. Over the years, FinCEN and the federal banking agencies have produced helpful guidance, interpretations, and answers to frequently asked questions. While this information is useful, it has not been compiled in a centralized location. Accordingly, we ask the agencies to work with FinCEN to compile and update the issues that have been discussed over the years. Examples of FAQ’s could include:

    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency’s *Money Laundering: A Banker's Guide to Avoiding Problems* (December 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

Account Monitoring Software. Increasing numbers of community banks have been instructed by their examiners to purchase account monitoring software to help identify suspicious activity. However, it is unclear at what point the regulators will expect institutions to install such software. Some institutions have been told that in certain geographic locations, institutions with more than $250 million in assets are “strongly encouraged” to implement an account/customer monitoring software system. Representatives from the federal banking agencies have told ACB that they do not intend to identify the circumstances under which institutions will be expected to install such monitoring software.

We thoroughly agree that a one-size fits all approach is not appropriate. However, it would be very helpful for the agencies to elaborate on the circumstances under which such account monitoring systems should be considered. The cost of purchasing these systems is significant, and helping community banks to better understand when such systems will be required will enable institutions to better budget and plan for this large expense. Account monitoring software packages used by community banks often cost between $30,000 and $50,000 (and sometimes much more), plus a $5,000 per month service charge or maintenance fee. In many cases, institutions must hire additional personnel or take existing staff away from other bank responsibilities to run the software, review flagged accounts, and file SARs when necessary.

Some community banks have been instructed to use their account monitoring software to drill down to the fourth level of an account relationship (i.e. the fourth person listed on a signature card) to study tax identification numbers, names, and addresses for suspicious information. Many institutions report that they have difficulty making those correlations on the second level, let alone the fourth. We believe that the agencies are working with law enforcement to determine how money launderers adjust their techniques and are asking the industry to adjust its account monitoring processes accordingly.

Characterization of BSA Violations

ACB believes that BSA enforcement should be consistent, particularly with regard to whether BSA violations are characterized as "program violations" or "FinCEN violations." The federal banking agencies have indicated that compliance problems identified as "program violations" will result in an automatic written supervisory agreement with the institution, while problems classified as "FinCEN violations" will be addressed more informally.

The characterization of an institution's BSA violations has strong repercussions beyond the formality with which problems will be addressed. The characterization of compliance problems as "program violations" may affect the institution's CAMELS rating, its ability to merge with or purchase other institutions, build or acquire new branches or expand into new product lines. For publicly traded banks, a written, formal agreement may also warrant disclosure in filings with the Securities and Exchange Commission. Because the characterization of BSA violations has such a significant impact on the institution, ACB urges the banking agencies to emphasize the importance of this matter when training and updating their examiners.

We have heard a number of examination experiences that provide useful examples. One community bank that recently underwent a BSA compliance exam was cited by its examiners for failure to identify a local business as an money service business (MSB) and failure to file a suspicious activity report on that same business. The institution is well-capitalized and well managed and filed approximately 4,500 SARs last year. The report of examination devoted one paragraph to BSA issues and the institution took the required corrective actions, believing the matter to be closed. Over six months later, the institution's regional regulator re-characterized the violations as "program violations" and presented the bank with a written supervisory agreement. The bank ultimately persuaded the regional office to address the matter less formally, but the process remains unclear and too subjective.

It is imperative that examiners and regional offices understand how classifying violations as one form or another affects an institution. We urge the regulators to work to ensure that such characterizations are applied correctly, consistently, and in a timely manner.

Money Services Businesses

The provision of banking services to MSBs and an institution's corresponding regulatory requirements have been widely discussed within the banking industry in recent months. ACB believes that the issues underlying the supervision of depository institutions that provide banking services to MSB's are an extension of larger problems that permeate the entire BSA oversight mechanism.

MSB's play an important role in providing financial products and services to persons that do not have a traditional banking relationship with a depository institution. Many small businesses that are now dubbed MSBs have been good customers for community banks. Grocery stores, truck stops, and even feedstores are examples of the types of businesses that now fall within the category of MSBs because they cash checks in excess of $1,000 per person per day.

For example, depository institutions have been pressured by examiners to close accounts of long-time customers that may be considered to be a "money service business." Other institutions believe that the due diligence requirements for these accounts outweigh the benefit of having MSBs as customers. Many institutions are unwilling to take on the compliance risk now associated with MSB accounts. Others do not believe that they have an adequate understanding of what constitutes unusual activity for MSBs in general and have indicated that they will not bank MSB customers until they have more direction from FinCEN and the banking regulators.

On March 8, 2005, ACB was pleased to participate in the joint meeting of the Non-bank Financial Institutions and Examinations Subcommittee of the Bank Secrecy Act Advisory Group to discuss the provision of banking services to MSBs. This meeting explored why financial institutions large and small closed the accounts of their MSB customers. We believe that the meeting helped underscore the need for regulatory guidance and consistent interpretation of enhanced due diligence requirements for depository institutions that have MSB customers.

ACB also is very appreciative of the March 30, 2005 joint statement issued by the federal banking agencies and FinCEN clarifying that depository institutions are not expected to serve as a *de facto* regulator of the money services business industry. Notwithstanding the important policy positions articulated in the joint release, community banks are not re-opening accounts for MSBs in wide numbers. Furthermore, institutions continue to have varying interpretations of the regulatory requirements associated with banking MSBs.

We believe that this problem will be remedied by the joint guidance issued by FinCEN and the banking agencies on April 26, 2005. ACB is very encouraged that the agencies and FinCEN acted on requests for guidance and explained the different kinds of risks and appropriate due diligence required for MSB accounts. We also appreciate the examples of suspicious activity that the guidance provides. We hope that the guidance will help examiners evaluate the banking industry's monitoring of MSB accounts more consistently.

While the guidance on appropriate monitoring of MSB accounts is welcome, we believe that additional compliance questions should be addressed. Namely, how financial institutions should treat those businesses that engage in "MSB activity" in rare circumstances.

For example, a community bank reported that local farmers sometimes take on odd jobs to earn extra money. On occasion, a farmer will endorse his paycheck over to the local feedstore in exchange for goods. An examiner that interpreted the MSB requirements narrowly believed that the feedstore should be treated as an MSB. However, we do not believe that it is reasonable to require the feedstore to register as an MSB, nor is it appropriate to require a financial institution to monitor the account as such. Accordingly, we request the banking agencies to work with FinCEN to identify situations that are exempt or should be exempt from the MSB requirements.

We also encourage the regulators to help institutions recognize unidentified MSBs. Community banks are very concerned that they are unknowingly providing banking services to customers that are operating as MSBs and worry that they will face regulatory criticism for failing to identify these accounts. ACB requests the federal banking agencies to provide guidance on transaction patterns and other indicia of common MSB account activity. This information would help community banks identify business customers that qualify as MSBs and inform them of the associated registration and compliance requirements. In many cases, businesses do not know what an MSB is, much less that there are regulatory requirements for engaging in this activity. Finally, community banks are concerned about allegations of discrimination in connection with MSB accounts. Institutions have deemed some MSBs to pose a higher risk of money laundering than others. In many cases, banks are not equipped to monitor high-risk MSB accounts properly and have terminated these account relationships. Institutions worry that they will be accused of discriminatory practices for maintaining some MSB accounts but not others. Reputation risk in the community is a very real concern to community banks.

<u>OFAC</u>

The prohibition against processing transactions for persons and entities designated by the Office of Foreign Assets Control (OFAC) is not new. However, renewed focus on anti-money laundering efforts has raised many questions regarding an institution's obligations in this area.

OFAC simply prohibits financial institutions from processing a transaction for persons and entities on the OFAC list and institutes a strict liability standard for non-compliance that will result in monetary penalties. This broad standard does not address many practical questions that community banks have about OFAC compliance. For example, what is an institution's obligation regarding checking automated clearing house transactions? Are obligations different for originating or receiving institutions? ACB has heard that the Federal Reserve Board is considering implementing a program that may screen all ACH items and wire transfers against the OFAC list. While there would be many unanswered questions regarding how any "hits" would be addressed and who would have the obligation to freeze a transaction, we believe that

Federal Reserve screening of ACH payments would provide valuable regulatory relief to community banks. ACB urges the Federal Reserve to seriously consider this option.

Community banks also ask how frequently they should check their customer base against the OFAC list or how soon they should check the OFAC list when presented with certain transactions. We understand that the agencies view these decisions as being "risk-based," but community banks need help understanding what the risk factors are. In addition, it would be instructive for the agencies to articulate their approach in the event an institution processes a transaction involving a person or entity on the OFAC list. U.S. banks process millions of financial transactions each day, and it is impossible to screen all interested parties against the OFAC list. Inevitably, some prohibited transactions will be processed. ACB requests the agencies to specify that they will not take regulatory action independent of OFAC sanctions.

ACB is pleased that the banking agencies and FinCEN have been able to work with OFAC to determine that, as a general matter, SAR requirements will be satisfied if an institution files a blocking report with OFAC in accordance with OFAC's Reporting, Penalties, and Procedures Regulations. OFAC will then provide the information to FinCEN for inclusion in the SAR reporting database, where it will be made available to law enforcement. The filing of a blocking report with OFAC, however, will not satisfy an institution's obligation to identify and report suspicious activity beyond the fact of an OFAC match. ACB believes that this clarification provides meaningful regulatory relief for community banks by eliminating what is essentially a duplicative reporting requirement to the U.S. Department of the Treasury.

Currency Transaction Reports

FinCEN regulations require financial institutions to file currency transaction reports for all cash transactions over $10,000.[6] FinCEN's regulations establish an exemption system that relieves financial institutions from filing CTRs on the cash transactions of certain entities, provided certain requirements are met. The exemption system was intended to reduce regulatory burden associated with BSA compliance. The exemption process was well intentioned, but community banks have been reluctant to use the exemption system because:

- It is not cost effective for small institutions that do not file many CTRs.
- They fear regulatory action in the event that an exemption is used incorrectly.
- They lack the time to conduct the research necessary to determine whether a customer is eligible for an exemption.
- It is easier to automate the process and file a CTR on every transaction that triggers a reporting requirement.
- The regulations and the exemption procedures and requirements are overly complex.

As a result, financial institutions have filed over 12 million CTRs each year since 1995.[7] FinCEN and law enforcement report that the CTR database is littered with unhelpful CTRs because financial institutions do not use the exemption procedures that are designed to eliminate

[6] 31 CFR 103.22(b)(1).
[7] FinCEN Report to Congress, *Use of Currency Transaction Reports* (October 2002).

CTRs that are of no interest to law enforcement. As a result, it is more difficult to use the database to investigate possible cases of money laundering or terrorist finance.

ACB believes that currency transaction reporting requirements are ripe for review. We suggest the following reforms to ease regulatory burden on financial institutions and improve the utility of the CTR database for law enforcement.

CTR Reporting Threshold. ACB strongly supports raising the dollar value that triggers CTR filing. Increasing the reporting requirement would dramatically decrease the number of CTRs that are filed each year and would provide much needed relief from BSA regulatory burden.

An update of the CTR regulations is long overdue because the current rules have not kept pace with the economy. Since 1970, institutions have been required to file CTRs on cash transactions over $10,000. When adjusted for inflation, $10,000 in 1970 is equivalent to $50,335 today. [8] We have heard that when the regulations were first implemented, there was very little activity over the $10,000 threshold. Today, however, such transactions are routine, particularly for cash intensive businesses.

Based upon data that FinCEN provided to the Bank Secrecy Act Advisory Group's ("BSAAG") CTR Subcommittee, increasing the reporting threshold to $20,000 would decrease CTR filings by 57 percent and increasing the threshold to $30,000 would decrease filings by 74 percent.[9] The impact of raising the dollar value is even more astonishing for community banks. An informal survey of ACB members conducted in June 2004 indicates that increasing the dollar amount to $20,000 would reduce community bank CTR filings by approximately 80 percent. Even with the dramatic change in the value of $10,000 over the past thirty years, ACB acknowledges that a $10,000 cash transaction is still a substantial amount of cash for an individual customer to deposit or withdraw from an institution. However, businesses of all sizes routinely conduct transactions over $10,000.

Some law enforcement officials strongly oppose adjusting the dollar value that triggers CTR reporting out of a concern that doing so would decrease the amount of data that could potentially assist in a future criminal investigation. As a practical matter, the 30-year old CTR filing requirements need to be updated to reflect today's economic reality. We believe that updating the regulations would help, not hinder the investigatory process. The reduction in the number of CTR filings would meet the Congressional mandate to reduce CTR filings by 30 percent, as required by the Money Laundering Suppression Act of 1994. More importantly, users of CTR data would benefit from a cleaner, more efficient CTR database. Raising the threshold does not mean that institutions will be relieved from monitoring account activity for suspicious transactions below the CTR reporting requirement. Increasing the threshold would enable financial institutions to alert law enforcement about activity that is truly suspicious or indicative of money laundering, as opposed to bogging down the data mining process by filing reports on routine business transactions.

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[8] Federal Reserve Bank of Minneapolis inflation calculator. http://woodrow.mpls.frb.fed.us/research/data/us/calc/
[9] FinCEN. *CTRs Posted By Amount Range*, (2004).

Exemption System. A discussion of solutions to reduce the number of CTR filings would not be complete without addressing the exemption system that relieves financial institutions from filing CTRs on certain entities.[10] While the exemption scheme was designed to minimize the number of CTRs that institutions file, community banks have reported that the cost of using the exemptions outweighs any associated benefits.

The exemption requirements are particularly challenging for community bankers that perform multiple functions within an institution and simply do not have the time to study the requirements and apply them to specific customers. In addition, institutions are reluctant to use the exemptions for fear of applying the rules incorrectly. As a result, many community banks have elected to automate the CTR reporting process and file on every transaction over $10,000.

There has been discussion in the financial community about providing interpretive guidance that provides examples and explains how to apply the rules. While guidance would be helpful, we do not believe that it would lead to a significant reduction in CTR filings. Even if guidance is issued, most community banks that have elected not to use the exemption process will continue to file on all cash transactions over $10,000. This compliance method is cost effective and exposes institutions to minimal compliance risk.

While many community banks do not use the exemption process, those that do would like to exempt customers more quickly than currently permitted by regulation. Before an institution can exempt a customer as a non-listed business or payroll customer, the customer must have maintained a transaction account with the bank for at least twelve months.[11] The 12-month rule was adopted to ensure that an institution is familiar with a customer's currency transactions.

ACB encourages the agencies to work with FinCEN to allow institutions to more quickly exempt business customers. Recent regulations implementing the Patriot Act allow institutions to make risk-based decisions about their anti-money laundering efforts. Likewise, FinCEN should give institutions greater discretion in determining when to exempt a business customer from CTR reporting. A community bank, not a regulatory agency, is in the best position to determine whether it is sufficiently familiar with a customer's account activity.

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[10] Pursuant to the Money Laundering Suppression Act, FinCEN established two categories of transactions that are exempt from CTR reporting. Phase I exemptions (31 CFR 103.22 (d)(2)(i)-(v)) apply to banks, government agencies, government instrumentalities, publicly traded businesses (referred to in the regulations as a "listed business") and certain subsidiaries of publicly traded businesses. A business that does not fall into any of the above categories may still be exempted under the Phase II exemptions (31 CFR 103.22 (d) (2) (vi)-(vii)) if it qualifies as either a "non-listed business" or as a "payroll customer." The new rules also established specific procedures for exempting eligible customers. In determining whether to exempt a customer, a depository institution must document such steps a reasonable and prudent institution would take to protect itself from loan or other fraud or loss based on misidentification of a person's status. The institution must document the basis for its decision to exempt a customer from currency transaction reporting and maintain such documents for five years. After an institution has decided to exempt a customer, the bank must file a Designation of Exempt Person form within 30 days after the first customer transaction the institution wishes to exempt. For Phase I customers, the form has to be filed only once (though the institution must annually review the customer's status). For Phase II customers, the form must be refiled every two years as part of the biennial renewal process. As with Phase I customers, the bank must also annually review the status of Phase II customers.

[11] 31 C.F.R. 103.22(d)(2)(vi)(A), (d)(2)(vii)(A).

While allowing institutions to take a risk-based approach would not significantly reduce CTR filings, it would provide regulatory relief to those institutions that elect to use the exemption process.

<u>Compliance Costs</u>

Depository institutions are pillars of their communities and are an important part of the larger U.S. economy. As such, community banks are committed to ensuring our nation's physical security and the integrity of our financial system. BSA compliance costs have skyrocketed since the Patriot Act was signed into law. Increasingly, financial institutions believe that the federal government has little regard for the amount of time, personnel, and monetary resources that BSA compliance drains from a institution's ability to serve its community.

As mentioned earlier, institutions that purchase account monitoring software to flag suspicious transactions or other unusual circumstances easily costs $30,000 (and sometimes hundreds of thousands of dollars) upfront and $5,000 each month thereafter. Sometimes, institutions hire new personnel just to study the "red flags" identified by the software to determine if the flagged activity warrants a SAR filing. Furthermore, community banks commonly spend an initial $5,000 plus transaction fees to access identity "verification" databases to help satisfy the Patriot Act's customer identification requirements.

To put these figures into context, the monthly fee for suspicious activity monitoring software is money that an institution could have spent to hire multiple tellers, hire a new loan officer to reach out to the community's small businesses, or develop and market a new product. What may seem like insignificant costs to lawmakers in Washington have very real business implications for community banks and their communities.

The opportunity costs of BSA compliance go beyond hampering an institution's ability to expand and hire new employees. In some cases, fear of regulatory criticism has led some institutions to sever ties with existing banking customers or forego the opportunity to develop banking relationships with new customers. In recent months, waves of depository institutions severed ties with MSB customers due to pressure from examiners, regulatory uncertainty, or simply being overwhelmed by regulatory requirements associated with these accounts. Community banks have also opted not to open accounts for non-resident aliens and other persons out of fear that the institution will not be able to meet the "reasonable belief" standard established in the customer identification requirements. While many institutions accept the matricula consular as a form of identification, others have taken a cautious approach to compliance and have elected not to accept the card. As a result, come community banks forego opportunities to establish banking relationships with the unbanked and promote financial literacy among this segment of the population – all because of concerns that the bank will not be able to satisfy regulatory requirements.

Reporting Requirements Under the Securities Exchange Act of 1934

The Sarbanes-Oxley Act of 2002 (SOX) significantly increased the burden of reporting under the Securities Exchange Act of 1934 for all public companies, but particularly for community banks.

Much of that burden was imposed by the Securities and Exchange Commission (SEC) in implementing regulations. We believe that the SEC has issued final rules that include expanded the reporting requirements that go beyond what was required by SOX. ACB understands that many of the regulations addressed in this section of the letter have been promulgated by the SEC and that the agencies incorporate these regulations by reference into their regulations. We strongly urge the agencies to work with the SEC to minimize the reporting burden for community banks.

Two areas of great concern are internal control requirements under section 404 of SOX and the acceleration of filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and beneficial ownership reports under Section 16 of the Securities Exchange Act. In each of these cases, in adopting implementing regulations, the SEC went beyond the requirements of SOX. Under the Securities Exchange Act, the agencies have the ability to revise the reporting regulations as they apply to banking organizations if they find that the implementation of substantially similar regulations with respect to insured banks and savings associations are not necessary or appropriate in the public interest or for the protection of investors.

<u>Section 404 Internal Control Reports</u>

Many community banks are expressing serious concern that the cost of section 404 compliance will significantly outweigh the benefits of the resulting improvements in internal control processes and management's understanding of the effectiveness of these controls. In particular, they do not believe that the effort and expense resulting from additional certifications, documentation and testing requirements are commensurate with the risk from operations.

ACB is concerned that many community banks simply do not have the internal resources to meet the high threshold required by the Public Company Accounting Oversight Board's (PCAOB) attestation standard as it is being implemented by auditors. Banks in this position are facing significant external consulting costs, as well as increases in their auditing fees. Some community banks are reporting audit and attestation fee estimates up to 75 percent higher than what they have paid in the past and some community banks are reporting total fees that equal up to 20 percent of net income. Community banks also are facing a significant increase in legal fees associated with section 404. While we understand that companies will incur the most significant costs during the first year of section 404 compliance, there is strong evidence indicating that compliance costs will remain at a substantial level.

Many small companies already have made the choice to go private, for example, Sturgis Bancorp, Madison Bancshares, Home Financial Bancorp and Fidelity Federal Bancorp. Others are looking for merger partners. To the extent that the goals of SOX are laudable and the statute serves a useful purpose, we believe that the loss of a community bank to a local community is an example of the worst kind of unintended consequence.

The time devoted to section 404 compliance is taking time away from other matters. Executive officers must spend a great deal of time on the minutia required by the auditors at the expense of a focus on daily operations, long-term performance and strategic planning. Internal audit and other departments also are spending significant time with 404, taking away focus and efforts from other required activities. For example, we have heard reports that, in some instances, community banks have abandoned regular risk audits for this fiscal year to concentrate on 404 compliance. Also, compliance with 404 is adversely affecting the way companies are managed. Some members are indicating that they are being forced to centralize decision-making because the price to be paid for a problem or gap in an area would be too high. Without explicit and reasonable relief from these requirements, many community banks face significant costs and strains on resources that could erode retained earnings and weaken capital adequacy, creating very real safety and soundness issues.

In our recent letter to the SEC on section 404 and our participation in the SEC's public roundtable on April 13, we made the following suggestions for changes to the requirements:

We believe that insured depository institutions should be able to follow the requirements of Part 363 of the FDIC regulations in lieu of compliance with section 404. The PCAOB's requirement for a separate audit of internal controls by the external auditor has created much of the unnecessary burden of the section 404 requirements. Conducting a thorough and detailed review of how management reaches its conclusions about internal controls can be as effective, but considerably more efficient and less burdensome, than the required audit. Requiring an independent audit of internal control over financial reporting is duplicative of work performed by a company's internal audit function and senior management and has resulted in the cost, burden and frustration arising from the PCAOB's Auditing Standard No. 2. Public auditors are interpreting their responsibilities under the standard quite broadly and, in an effort to avoid future liability, are erring on the side of doing too much, rather than not doing enough.

We urged the PCAOB to rethink whether a separate audit of internal controls is really necessary and scale back these standards to a reasonable level of inquiry that allows an auditor to opine on the conclusions reached by management. There are other protections recently put in place that will protect the investing public and that make a more burdensome standard inappropriate. For instance, the chief executive officer and chief financial officer must certify each quarter as to the accuracy of the company's financial statements and their responsibility for establishing and maintaining internal controls. They also must certify that the internal controls have been designed to provide reasonable assurance about the reliability of the financial statements and that they have evaluated the effectiveness of the internal controls. The certifications with regard to the accuracy of the financial statements are made under the threat of criminal liability if the officer knowingly makes a false certification. These new requirements coupled with a thorough review of management's assessment of the internal control environment by the external auditor should provide the protections needed by investors.

If the SEC and the PCAOB do not extend a full exemption to depository institutions, we urge the agencies to consider revising the section 404 approach for them in light of the other significant protections available to investors of a highly regulated depository institution. If the agencies do not believe that this would be warranted for all public depository institutions, then we urge that a partial exemption from section 404 for the depository institutions exempt from the Part 363 internal control reporting requirements be granted either through a change in the regulations or a change in the law by Congress. The federal banking regulators recognized years ago that internal control reporting and attestation requirements for the smaller community banks would be unduly burdensome, so the requirements were applied only to those institutions with $500 million or more in assets. The agencies felt comfortable with this approach because these smaller institutions are still subject to the full scope of banking laws and regulations, are required to have an adequate internal control structure in place, and, most importantly, are subject to regular safety and soundness examinations.

Acceleration of Filing Deadlines

Over the course of the last few years after passage of SOX, the SEC has accelerated the filing deadlines for periodic reports on Forms 10-Q and 10-K, current reports on Form 8-K, and insider beneficial ownership reports under section 16. Unlike larger companies, smaller public community banks do not have employees on staff dedicated to filing these reports so either have to divert attention from other matters to meet stringent deadlines or hire outside help. The two business day deadline for section 16 reports is particularly difficult because these reports are required from principal shareholders, directors and executive officers, and a certain amount of coordination with these parties must be arranged. Also, in light of the significant number of items that now must be reported on Form 8-K, the new four-business day filing requirement takes its toll on staff. Smaller companies do not have the staff resources to handle the increasing amount of information that has to be filed. Also, shorter deadlines only encourage those investors who already have a short-term outlook on investments when it seems prudent to encourage longer-term investment objectives.

We suggest that the deadlines for insured depository institutions be changed to 10 calendar days for filing current reports on Form 8-K and section 16 beneficial ownership reports.

When the SEC accelerated the deadlines for periodic reports, it provided an exemption from the new deadlines for smaller companies. However, larger companies are also now experiencing problems with the deadlines in light of the substantial work that must be done to comply with SOX section 404. Therefore, the SEC and the agencies should consider freezing the current deadlines that are now in place rather than phasing in the final step in the acceleration schedule that would require annual reports be filed within 60 days and interim reports be filed within 35 days.

Annual Independent Audits and Reporting Requirements (Part 363)

In 1991, the exemption from the external independent audit and internal control requirements in Part 363 for depository institutions with less than $500 million in assets was adequate. With the increasing consolidation of the banking industry, coupled with the application by external auditors of the public company auditing standard to FDICIA banks, this exemption threshold needs to be increased to reduce burden on the smaller institutions. We have heard that many privately held and mutual community banks with assets between $500 million and $1 billion are experiencing substantial audit fee increases coupled with serious strains on internal resources in complying with the FDICIA requirements. We believe an increase in the threshold to $1 billion in assets will provide much needed relief for these institutions.

Transactions with Affiliates

The Federal Reserve Board issued Regulation W at the end of 2002 to implement sections 23A and 23B of the Federal Reserve Act. ACB has the following suggestions for reducing the burden of this regulation.

All state bank subsidiaries should be exempt from the requirements and restrictions of Regulation W, other than those subsidiaries that engage in activities specifically mentioned in section 121(d) of the Gramm-Leach-Bliley Act (i.e., subsidiaries engaging as principal in activities that would only be permissible for a national bank to conduct through a financial subsidiary). Also, Regulation W should exempt any subsidiary relationship that would not have been subject to sections 23A and 23B prior to the date that Regulation W was issued. These exemptions were supported by an FDIC proposed rulemaking in 2004. The activities of these subsidiaries, while not authorized for national banks to perform directly, have been conducted safely and prudently for some time. The activities are authorized by state law and must comply with the requirements of the Federal Deposit Insurance Act, the FDIC's regulations, and prudential conditions in any approval order. Nothing in the history of these subsidiaries' operations suggests safety and soundness concerns that would warrant wholesale application of Regulation W.

If this exemption is deemed to be too broad, then we request an exemption to be extended at least for those state bank subsidiaries that engage only in agency activities. Agency activities typically do not require the same level of capital investment as other subsidiaries and generally do not pose significant risks to their parent depository institutions. The regulatory burden associated with applying Regulation W to these types of subsidiaries is not justified by any incremental supervisory benefits that might result.

The definition of "general purpose credit card" set forth in section 223.16(c)(4) is unduly restrictive in limiting the percentage of transactions involving the purchase of goods and services from an affiliate to 25 percent. So long as a majority of these transactions is between bank customers and nonaffiliated parties, this exemption should be available.

Frequency of Safety and Soundness Examinations

Safety and soundness exams are conducted on an annual basis, except that smaller depository institutions that meet certain requirements are examined on an 18-month cycle. One of those requirements is that the institution have assets of $250 million or less. ACB believes that this threshold should be increased to at least $500 million. Institutions that cross over the $250 threshold experience significantly increased burden from more intense examinations conducted more frequently. These institutions still are quite small and they have limited staff resources to devote to the examination process. We believe a higher threshold would be appropriate in light of the protection afforded by the other requirements of the less frequent exam cycle: the institution must be well capitalized and well managed, have one of the two highest ratings from its previous examination, and not be subject to any formal enforcement proceeding or order. Furthermore, the regulators have the authority to conduct more frequent examinations, as they may deem necessary.

Financial Management Policies

Section 563.170(d) of the rules and regulations of the OTS requires a savings association to have a resolution passed by its board of directors and a certified copy sent to the Regional Director before transferring records, or the maintenance of records, from or between the home office or any branch or service office. ACB recommends that this requirement be deleted or that only an after-the-fact written notice of a transfer to the Regional Director be required if records are transferred from a home office to a branch or service office, or from a branch or service office to the home office or another branch or service office. As long as maintenance and possession of the records are kept under the control of the savings association and not sent to a third party, an after-the-fact letter should be sufficient.

Section 563.170(e) requires that a savings association provide at least 90 days notice prior to maintaining any of its records by means of data processing services. This notice requirement should be deleted or reduced to 30 days.

Rules on the Issuance and Sale of Institution Securities

The requirement in section 563.5 that savings association certificates must include a statement about the lack of FDIC insurance should be moved to a place where it is adjacent to relevant material and can be more easily found. For example, the requirement would be more appropriate in section 552.6-3, which discusses the certificates for savings association shares generally.

Securities Offerings.

The notice requirements in sections 563g.4(c) and 563g.12 should be deleted as it should not be necessary to report the results of an offering 30 days after the first sale, every six months during the offering, and then again 30 days after the last sale.

Recordkeeping and Confirmation of Securities Transactions Effected by Banks

The FDIC, OCC and the Federal Reserve should conform their rules to those of the OTS and permit quarterly statements, rather than monthly statements, be sent for transactions in cash management sweep accounts. This will reduce the burden for national and state-chartered banks without adversely affecting bank customers. Most investment companies provide statements on a quarterly basis and customers are comfortable with this level of frequency.

Appraisal Standards for Federally Related Transactions

Each of the agencies requires that appraisals on residential real estate be conducted by state certified or state licensed appraisers for federally related transactions in excess of $250,000. We urge each of the agencies to amend its regulations to reflect the home price appreciation and inflation that has occurred in the years since the adoption of the final appraisal regulations in 1992. We suggest amending the regulation to aligning the threshold with the current conforming loan limits for Fannie Mae and Freddie Mac. As the conforming loan limit increases (or decreases), the threshold would increase (or decrease). When the final regulation was adopted the conforming loan limit was $202,300. Today it is $359,650, but the exemption threshold has remained unchanged.

This disparity puts federally regulated institutions at a disadvantage to their non-regulated competitors. It also disregards the innovations in automated loan underwriting and automated valuation models that are in such wide usage today. These innovations in underwriting and valuing property help lenders compete for business by providing simplified property evaluations, reducing borrowers' costs, and accelerating the loan approval process. For example, a typical automated valuation report obtained via the Internet costs about $30 and is very reliable, while it costs approximately $300 to hire a state certified appraiser.

Conclusion

We live in a world where criminals seek to abuse our financial system and terrorists plot to change our way of life. We understand that anti-money laundering laws and regulations are necessary, but believe that the implementation of anti-money laundering requirements can be improved. Bottomline, the intentions behind these rules may be grounded in doing good yet their implementation is causing very real and measurable harm. Legitimate customers are being denied service and banks are being forced to adhere to an unattainable standard of perfect compliance. Without real regulatory relief our country will lose more community banks that opt out of burden.

ACB strongly urges the federal banking agencies to use this stage of the EGRPRA project to look at BSA oversight anew. We specifically request the agencies to articulate clear policy and ensure that the regional offices carry out that policy consistently. We again express our appreciation for the newly released MSB guidance and urge the agencies to work with FinCEN to produce further guidance on suspicious activity reporting and OFAC compliance.

We also urge the agencies to review the requirements of SOX as they are imposed on insured depository institutions. We stand ready to work with the agencies as this regulatory relief project progresses. We appreciate the opportunity to provide comments on all of these important matters. Please do not hesitate to contact the undersigned at (202) 857 3121 or cbahin@acbankers.org if you have questions about any of the issues addressed in this letter.

Sincerely,

Charlotte M. Bal

Charlotte M. Bahin
Senior Vice President, Regulatory Affairs

December 23, 2004

William J. Fox
Director
Financial Crimes Enforcement Network
2070 Chain Bridge Road, Suite 200
Vienna, VA 22182

Re: SAR Resource Guide and Regulatory Issues

Dear Director Fox:

America's Community Bankers (ACB)[12] has been pleased to work with the Financial Crimes Enforcement Network (FinCEN) to provide feedback regarding various Bank Secrecy Act (BSA) related issues, including the development of new regulations to implement the USA Patriot Act. We wish to continue that relationship by making additional suggestions for improving BSA compliance, particularly in the area of suspicious activity reporting.

ACB requests FinCEN, as administrator of the BSA, to provide an updated, centralized resource guide regarding suspicious activity reporting that 1) helps institutions understand what kinds of transactions and occurrences are suspicious and reportable and 2) addresses other SAR related issues and frequently asked questions (FAQ's). We believe that such centralized guidance would be a helpful resource to community bankers and may be one way to help reduce the problem of defensive SAR filing.

Suspicious activity reporting has taken on new significance in our post-September 11th world, and FinCEN and the federal banking regulators expect institutions of all sizes and geographic locations to institute policies and procedures to detect possible illegal activity. In this era of increased regulatory scrutiny, community banks deserve more guidance and information. Otherwise, the anti-money laundering demands imposed on them are very unfair.

Accordingly, we request FinCEN to compile a comprehensive guide to SAR reporting that includes:

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[12] America's Community Bankers is the member driven national trade association representing community banks that pursue progressive, entrepreneurial and service-oriented strategies to benefit their customers and communities. To learn more about ACB, visit *www.AmericasCommunityBankers.com.*

1. A list of common suspicious activities and red flags. Community bankers often ask, "What kind of activity is suspicious?" or "What activity triggers a SAR filing?" This is an important question for financial institutions that do not have legal departments or sophisticated compliance teams dedicated to BSA compliance. This question is also important in helping to separate those occurrences that should not be reported to FinCEN. We also encourage FinCEN to include examples or case studies where SARs are or are not warranted.

2. FAQ's and key points made by previous SAR Activity Reviews. We appreciate the efforts of FinCEN to compile the semi-annual SAR Activity Review. This publication has been helpful in communicating SAR tips, trends, and issues, and we strongly urge FinCEN to continue to publish this document. However, we believe that it would be helpful to compile and update the issues that have been discussed over the years. Examples of FAQ's could include:

    - How to handle SAR subpoenas.
    - How much information bank managers should provide their boards of directors concerning SAR filings.
    - Whether institutions should file SARs retroactively after being notified by law enforcement that funds may have been laundered through an account.
    - Whether a SAR should be filed on a name found on the 314(a) list.
    - Whether a SAR should be filed on an OFAC hit.

Many publications exist about SAR filing, but the information contained in these materials would be more valuable to the banking industry if it were updated, supplemented, and centralized. We understand that the federal banking agencies are working to finalize interagency BSA examination procedures. We believe that the exam procedures will help clarify the regulators' BSA expectations, but we are skeptical that the procedures will provide a comprehensive suspicious activity reporting guide for community bankers. Additionally, over the years, the federal banking agencies have issued various booklets and other publications (e.g. the Office of the Comptroller of the Currency's *Money Laundering: A Banker's Guide to Avoiding Problems* (Dec 2002)). Nevertheless, we believe that community bankers would find real value in a comprehensive SAR guidance publication.

The uncertainty surrounding whether to file a SAR is compounded by the fact that many bankers have heard FinCEN's plea not to file defensive SARs. Simply requesting institutions not to file defensive SARs will not eliminate this problem. FinCEN must help institutions understand how to separate the wheat from the chaff and must work to ensure that the banking regulators do not create a culture that motivates institutions to file unnecessarily. ACB members are generally sympathetic to the problems created by defensive SAR filing. However, without additional guidance regarding what events trigger a SAR and what events do not, institutions will ultimately choose a course of action that protects them from a vigorous regulatory environment.

One community banker recently told of an instance where he was unsure whether certain activity should be deemed suspicious. He called FinCEN's regulatory helpline only to be told that

FinCEN does not comment on whether a particular activity triggers a SAR reporting obligation. While FinCEN obviously cannot comment without knowing all of the facts and circumstances surrounding a particular case, this instance is illustrative of the dilemma faced by many community bankers who are unsure whether to file a SAR.

ACB urges FinCEN to give serious consideration to our request for the development of an updated, centralized, comprehensive guide to suspicious activity reporting. Such a resource would be helpful to community banks, and ultimately law enforcement, as we pursue our common goal of preventing terrorism and other crimes. We also trust that FinCEN will work with the federal banking agencies to help eliminate the contradictory messages that are being sent about suspicious activity reporting.

ACB looks forward to working with FinCEN on this and other issues pertaining to BSA compliance. Please contact the undersigned at 202-857-3121 or Krista Shonk at 202-857-3187 should you have any questions. Thank you for your consideration.

Sincerely,

Charlotte M. Ba

Charlotte M. Bahin
Senior Vice President
Regulatory Affairs