

**STATEMENT OF TIMOTHY R. BURNISTON, MANAGING DIRECTOR  
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**ON PROPOSED “KNOW YOUR CUSTOMER” RULES**

**March 4, 1999**

Good morning, Chairman Gekas and Members of the Subcommittee. Thank you for the opportunity to discuss the Office of Thrift Supervision's (OTS) views on the proposed “Know Your Customer” regulation. The OTS, the Board of Governors of the Federal Reserve System, the Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corporation published the proposed regulation for public comment on December 7, 1998. The comment period closes four days from now, on March 8.

I would like to share with you this morning our thoughts on where we are, how we got here, and where we go next. I will discuss our goals in issuing the proposal and briefly summarize the comments we have received so far. Next, I will discuss our Regulatory Flexibility Act analysis of the proposed rule and our use of “plain English” drafting techniques in preparing the proposal. Finally, I will outline how we are planning to proceed once the comment period closes.

We issued the proposed Know Your Customer rule because of concerns that illicit activities, such as money laundering, fraud and other transactions that assist criminals in their illegal ventures, pose a serious threat to the integrity of financial institutions. We support the anti-money laundering provisions of the Bank Secrecy Act, and we are committed to helping banks and savings associations develop anti-money laundering

programs to fulfill their obligations to identify and report known and suspected violations of law.

The primary goals of the proposed rule are to ensure that banks and savings associations develop and maintain procedures reasonably designed to facilitate compliance with anti-money laundering statutes and their existing requirements on reporting suspicious activities. The rule is intended to protect the integrity of insured financial institutions by reducing the likelihood that such institutions might become unwitting participants in any customer's illicit activities. The rule is aimed at assisting the efforts of law enforcement authorities to combat illicit activities. The proposed rule was intended to provide useful but flexible guidance for institutions to follow as they develop and implement programs to meet these goals.

OTS has received over 4,000 comments on the proposed rule and I understand the tally has reached over 100,000 at the FDIC. The overwhelming majority of individual comments reflect public concern about the privacy of information that would be collected and held by financial institutions. Simply stated, these individuals view the proposed rule as an unwarranted intrusion into their financial privacy. A lesser but still substantial number of individuals believe the proposed rule amounts to an unwarranted search and seizure and is therefore unconstitutional. This is particularly troubling to us, since we know that customer trust is a thrift's stock in trade.

By contrast, most of the financial institution commenters are concerned about the expected burden imposed by the proposed rule. These commenters discuss the dollar cost and resource burden necessary to implement the proposed rule, such as purchasing new computer software.

A number of financial institutions are also concerned about a level playing field. That is, while banks and savings associations would be subject to a “Know Your Customer” rule, non-bank financial institutions such as brokerages, money transmitters, and check cashers would not. This raises the related concern that the proposed rule might simply cause illegal activities to migrate from banks to non-banks. Moreover, law-abiding bank customers may migrate to nonbanks to protect their privacy interests.

We took three steps to try to ensure that the process by which we issued our proposed rule would provide sufficient time for the industry to understand the rule and suggest alternatives. First, we went out for a 90-day comment period – 30 days longer than our usual comment periods on regulations -- to give institutions ample time to evaluate the proposal and suggest alternatives. That comment period closes next Monday and we will then have the benefit of all of the comments to help us to decide how best to proceed. It would be premature now for me to attempt to state with certainty what OTS will do next, but I can assure you we are well aware of the level of interest the proposal has generated.

Second, we drafted our regulation using a question and answer format and other plain English techniques to make it easier for institutions to understand the proposed requirements and, in turn, give us good feedback about how the proposal would affect them and how it could be improved. We did not want to hide potential burdens behind regulatory ambiguities.

Third, we consulted with the Small Business Administration's Office of Advocacy and performed an Initial Regulatory Flexibility Analysis. The goal of that analysis was to obtain additional information about the potential burden on small institutions and about other alternatives that would accomplish our objectives.

We also indicated that any final regulation would not be effective until, at the earliest, April 2000, over a year after the close of the comment period. This was intended to give institutions ample time to prepare to comply with any rule that may be implemented. And I am not suggesting that this is imminent.

As I mentioned, we included an Initial Regulatory Flexibility Analysis to identify the burden associated with our proposed rule. That analysis is also instructive in understanding what we were trying to accomplish by issuing the proposal. The proposed rule emphasizes the flexibility that we intended to have available to each savings association to design a program appropriate for its size and resources. A flexible approach has distinct advantages over other alternatives. For example, since the rule would apply to all savings associations, regardless of size, criminals could not choose a

savings association without a “Know Your Customer” program as a vehicle to conduct illegal activities. It also avoids requirements that are beyond the means of small institutions. Small institutions could use simpler, less costly, and less burdensome programs than those implemented by larger institutions to achieve compliance.

We mentioned in our analysis that Know Your Customer monitoring would be similar to monitoring already conducted by savings associations. For example, savings associations currently monitor customer transactions to ensure that cash transactions exceeding \$10,000 are reported under the Bank Secrecy Act, to ensure that customers do not overdraw their accounts, and to ensure that loan payments are accurate and timely. Consequently, Know Your Customer monitoring would to some extent rely on skills that savings association personnel already have and regularly use.

Our cover letter transmitting the Know Your Customer proposal to the thrift industry further emphasized that we purposefully designed the proposed rule so that each savings association could design a Know Your Customer program appropriate for its size and resources. We specifically asked for comment on the proposed rule’s economic impact on small institutions.

Let me emphasize that we are mindful of the burden that the proposed rule may place on large and small savings associations. We will give great weight to the letters that commented on this issue, and we will strive for a reasonable balance among the goals of

helping institutions meet their responsibilities, competitive equity and minimizing burden, and respecting the legitimate privacy concerns of bank customers.

There are two words that will guide our efforts as we move forward: “sensitivity” and “balance.” We are sensitive to the privacy concerns raised by the comment letters. We are also sensitive to the need for a supervisory framework that ensures that the institutions we regulate adhere to the nation’s anti-money laundering statutes, including the Bank Secrecy Act. We will seek an appropriate balance between these legitimate interests.

We are sensitive to the burden that may be placed on institutions, particularly smaller ones, by the proposed rule. We also want to ensure that whatever supervisory framework we may impose will minimize the potential for illicit activities to be conducted at savings associations. Here too, we will seek an appropriate balance between these legitimate interests.

Perhaps your colleague, Representative Jim Leach, Chairman of the House Banking Committee, said it best in his letter to the Federal banking agencies on February 3. Chairman Leach stated, and I quote:

I recognize that the ability of criminal elements to enter the proceeds of their illicit activities into the legitimate financial system corrodes the integrity of that system, and demands an aggressive response from relevant regulatory agencies and law enforcement authorities. However, in developing strategies to counter money laundering, the government must also be vigilant in its defense of Constitutional

liberties, and ensure that proposals that rely on financial institutions to monitor their customers' account activity accord proper deference to the privacy concerns of those customers. Banking depends on confidence of depositors in financial institutions.

We will be guided by Chairman Leach's wise words as we move forward. We will work with the banking industry, other federal agencies, and other interested parties, including those representing consumers, to explore alternatives, including nonregulatory approaches, that are responsive to the comments received and to supervisory objectives.

Thank you. I would be happy to answer any questions you may have.