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Statement by  
Scott G. Alvarez  
General Counsel  
Board of Governors of the Federal Reserve System  
before the  
Subcommittee on Oversight and Investigations  
of the  
Committee on Financial Services  
U.S. House of Representatives  
Washington, D.C.  
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Chairman McHenry, Ranking Member Green, and other members of the subcommittee, thank you for the opportunity to testify about the Federal Reserve's supervisory activities pertaining to banking organizations and their account relationships with law-abiding businesses. In my testimony, I will describe the legal framework governing the establishment and maintenance of customer accounts and the regulatory expectations the Federal Reserve has established for the banking organizations we supervise. I will also highlight related aspects of our examination and enforcement process in this area.

Let me begin by saying that the Federal Reserve believes it is important that banking organizations provide services to consumers and businesses whose activities comply with applicable laws. It is equally important that the banks we supervise do not facilitate or participate in illegal activity. Indeed, during the past several years the Federal Reserve has provided information to the banking organizations we supervise to clarify the requirements for providing account services to law-abiding businesses.

### **Legal Framework and the Federal Reserve's Regulatory Expectations**

Congress, through the Bank Secrecy Act (BSA), requires banking organizations to establish and maintain anti-money-laundering (AML) programs designed to detect when services provided by the organization are being used for illegal purposes. By law, each Federal Reserve-regulated institution, like other depository institutions, must have a BSA program that contains four critical elements, including a system of internal controls to ensure ongoing compliance with the BSA, independent testing of the bank's compliance with the BSA, training of appropriate bank personnel, and the designation of an individual responsible for coordinating and monitoring day-to-day compliance with the BSA.<sup>1</sup> Under the general rubric of "know your customer" laws

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<sup>1</sup> See 31 U.S.C. § 5318(h) and Board of Governors Regulation H (12 C.F.R. § 208.63) (BSA program requirements for state member banks).

and regulations, each banking organization is also required to maintain a customer identification program as part of the BSA compliance program and perform due diligence on its customers.<sup>2</sup>

In addition, a banking organization must identify and report known or suspected criminal violations of the BSA or certain other federal laws and suspicious transactions related to money-laundering activity.<sup>3</sup> Criminal prosecutors at the Department of Justice and other law enforcement officials have direct access to the database that holds these Suspicious Activity Reports and rely on this information to initiate criminal investigations.

The Federal Reserve and the other federal banking agencies have published an examination manual intended to provide practical and flexible guidance to examiners and banking organizations regarding acceptable customer due-diligence and risk-mitigation practices as part of an effective BSA program.<sup>4</sup> The Federal Reserve expects a banking organization to maintain adequate policies and procedures to address risks associated with customer relationships. The scope of these policies and procedures will depend on the banking organization's ongoing assessment of the risks posed by the particular customer relationship. A banking organization takes many factors into account when conducting a customer risk assessment including, in particular, the standards the customer has in place to ensure compliance with applicable laws and regulations, and the relationship the customer seeks with the banking organization. It is essential that banking organizations make a judgment as to customers with respect to the level of risk they pose.

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<sup>2</sup> See 31 C.F.R. § 103.121 and Board of Governors Regulations H and K at 12 C.F.R. §§ 208.63(b)(2), 211.5(m)(2), and 211.24(j)(2) (customer identification requirements).

<sup>3</sup> See 12 C.F.R. § 208.62 and Regulations K and Y at 12 C.F.R. §§ 211.5(k), 211.24(f), and 225.4(f) (suspicious activity reporting requirements).

<sup>4</sup> See Federal Financial Institutions Examination Council (2010), "Bank Secrecy Act/Anti-Money Laundering Examination Manual" (April 29).

The purpose of these policies is to ensure banking organizations provide services to law-abiding customers. The decision to establish, limit, or terminate a particular customer relationship is a decision for the banking organization. This decision may be based on various factors, including a banking organization's assessment of the risks associated with offering banking services to a particular customer, and its capacity and systems to effectively manage those risks. It is not the Board's policy to discourage banking organizations from offering services to any class of law-abiding financial services consumers or businesses.

### **Payment Services Offered by Nonbanks**

Many of the questions that have arisen with respect to the customer due-diligence expectations of the federal banking agencies relate to the involvement of nonbanks as intermediaries or providers of financial services, including money services businesses (MSBs) and third-party payment processors (TPPPs). MSBs provide financial services, such as check cashing, money remittance, and other services, to customers that do not have traditional bank accounts. Some MSBs include large, globally active companies while others are small businesses such as gas stations and convenience stores offering financial products and services. By comparison, TPPPs are bank customers that provide payment-processing services to merchants and other entities such as telemarketers and online businesses. Both MSBs and TPPPs engage in transactions with individuals and companies who are not direct customers of the bank.

The Federal Reserve follows guidance issued in 2005 by the federal banking agencies and the Financial Crimes Enforcement Network (FinCEN) governing account relationships with

MSBs.<sup>5</sup> That guidance confirms that banking organizations may provide banking services to MSBs that operate lawfully. The guidance is intended to assist banks in the decision to open and maintain accounts for legitimate businesses by identifying the programs and procedures they should have in place to perform customer due diligence and monitoring of these customers for suspicious activity.

The Federal Reserve also follows the interagency examination manual and related guidance issued by FinCEN when evaluating the procedures banking organizations use to manage account relationships with TPPPs.<sup>6</sup> These entities often use their commercial bank accounts to conduct payment processing for their merchant clients. The guidance is designed to assist banking organizations in designing and implementing policies and systems for monitoring and managing the risks associated with the payment and lending products they offer. The objective of the guidance and the Federal Reserve's supervisory activities is to direct banking organizations to take appropriate steps to offer their services to legitimate and law-abiding customers, and to minimize the risk of facilitating money laundering, terrorist financing, or other illicit activity.

### **Examination and Enforcement Process**

In 1986, Congress included in the Money Laundering Control Act the requirement that the Federal Reserve and other federal banking agencies examine the AML program and procedures banking organizations use to assure compliance with the BSA and report problems

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<sup>5</sup> See Financial Crimes Enforcement Network, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the National Credit Union Administration, the Office of the Comptroller of the Currency, and the Office of Thrift Supervision (2005), "Interagency Interpretive Guidance on Providing Banking Services to Money Services Businesses Operating in the United States" (April 26).

<sup>6</sup> See *infra* note 4 at pp. 239-242. See also Financial Crimes Enforcement Network (2012) "Risk Associated with Third-Party Payment Processors" (October 22).

with a bank's procedures to management. Under the Money Laundering Control Act, the federal banking agencies are required to take formal, public action against a financial institution that fails to establish and maintain the required program or correct problems with the program that were previously reported to the institution by the supervisors.

Consistent with this mandate, the Federal Reserve generally conducts regular on-site examinations of each bank it is charged with supervising on an alternating basis with state banking supervisors. As part of these examinations, examiners review the institution's AML procedures and its compliance with the BSA. For large, complex banking organizations, the safety and soundness examination process is continuous, and anti-money-laundering and BSA compliance is incorporated into the examination process.

When we find that a bank has not adopted a program and procedures that properly meet the bank's BSA obligations, the matter is discussed with bank management and noted in the institution's report of examination. The Federal Reserve's enforcement actions under the BSA typically are aimed at correcting deficiencies in an organization's policies and procedures for monitoring account activities and identifying unlawful or suspicious transactions.

### **Recent Justice Department Initiative**

Finally, regarding the focus of this hearing, Operation Choke Point is an initiative of the Department of Justice and not an initiative of the Federal Reserve. The Department of Justice has the sole authority to indict or seek criminal fines or other sanctions and to criminally prosecute individuals and businesses for their actions. As we have testified previously, the Federal Reserve cooperates with other agencies in various enforcement actions, including by

providing information in response to subpoenas issued by the Justice Department or other federal law enforcement authorities.<sup>7</sup>

Thank you very much for inviting me to present the Federal Reserve's views on these important issues. I would be pleased to answer any questions you may have.

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<sup>7</sup> "Patterns of Abuse: Assessing Bank Secrecy Act Compliance and Enforcement": Hearing before the S. Comm. on Banking, Housing and Urban Affairs, 113<sup>th</sup> Congress (2013) (statement of Jerome H. Powell, Governor, Board of Governors of the Federal Reserve System).