

**WRITTEN TESTIMONY OF
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DIRECTOR OF FRAUD/BANK SECRECY ACT
INTERNAL REVENUE SERVICE
BEFORE
SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN
AFFAIRS
ON
EXAMINING TREASURY'S ROLE IN COMBATING TERRORIST
FINANCING FIVE YEARS AFTER 9/11
SEPTEMBER 12, 2006**

Good morning Chairman Shelby, Ranking Member Sarbanes, and the members of the Senate Committee on Banking, Housing, and Urban Affairs. My name is Eileen C. Mayer and I am the Director of Fraud/Bank Secrecy Act (BSA) within the Small Business/Self Employed (SB/SE) division of the Internal Revenue Service (IRS). My office is assigned the responsibility to fulfill the IRS' obligations under the Bank Secrecy Act as well as coordinating the establishment of Service-wide fraud strategies, policies, and procedures. My office also provides fraud referral coordination for all operating divisions of the IRS.

IRS' role in administering the BSA is derived from statutory authority given to the Secretary of the Treasury to administer the provisions of the Act. He in turn delegated that authority to the Director of the Financial Crimes Enforcement Network (FinCEN). FinCEN retained some authorities but delegated others. Specifically, the IRS was delegated the authority to examine, for BSA compliance, all financial institutions not currently examined by a Federal functional regulator. These entities include money services businesses (MSBs), such as check cashers, issuers of traveler's checks, and money transmitters, casinos, certain credit unions that are not otherwise regulated by the Federal Government, dealers in jewelry and precious metals and insurance companies.

Emphasis on Customer Service

Under the leadership of Commissioner Everson, the IRS has taken a balanced approach to tax compliance, one that emphasizes service as well as enforcement. Many MSBs are small businesses and in some cases sole proprietorships. As a result, they may not fully understand their responsibilities under the BSA.

An important part of fulfilling our responsibilities under the BSA is to work closely with our office of Communications, Liaison and Disclosure (CLD) to identify those areas where education and outreach efforts can be most productive. We also have BSA outreach specialists within Stakeholder Liaison (SL), located in the six top high risk money laundering and related financial crime areas – Miami, New York, Chicago, Houston, San Francisco, and Los Angeles.

Stakeholder Liaison has expended a great deal of its resources during FY 06 in reaching out to MSBs on two fronts: one through local/regional/national outreach events and the other through direct contacts with MSB entities. To date, our BSA Stakeholder Liaisons have spoken at 41 events hosted by various MSB organizations and associations on such topics as MSB registration and BSA compliance program requirements. In addition to key-note speaker requests, they have also appeared on radio talk shows, phone forums and taped industry educational programs.

In July 2006, our BSA outreach specialists began contacting MSBs that either have failed to renew their registration or who may be unaware of their registration obligation. The entities are being sent a FinCEN-approved letter and fact sheet, along with an MSB registration form (FinCEN 107). These contact letters will be followed by a personal phone call by a BSA Stakeholder Liaison in order to determine the correct status of the business and to answer any questions they may have about the registration process. The combination of outreach and direct interaction with MSBs is establishing a strong bond with the MSB community that will only grow stronger over time.

In addition, we are revising our BSA Internal Revenue Manual and once it is finalized we will make it available to all MSBs – including via the internet. We plan to convert the manual to a more user-friendly format similar to the manual created by the Federal Financial Institutions Examination Council.

Coordination with Other Groups

In our efforts to assure compliance with the provisions of the BSA, we have been pleased to partner with the other agencies represented at the hearing today. While each of the groups has distinct responsibilities relative to the BSA, we all must work cooperatively to be most effective in monitoring and preventing questionable transactions.

For example, we are working with the Office of Foreign Assets Control (OFAC) to leverage our resources. OFAC has an information sheet for MSBs on its web site. In order to reach MSBs about the OFAC requirements, we are printing 10,000 of these information sheets, and will include them in the letter we send to MSBs that informs them that they may be subject to regulatory requirements under the BSA. Our examiners will also give the sheet to any MSB that they examine.

We are working with Treasury and OFAC on a delegation that would allow us to ask OFAC-compliance-related questions during our BSA examinations of MSBs. In addition, to increase the awareness of our examiners about the OFAC requirements, OFAC provided a speaker for our Continuing Professional Education (CPE) session this summer. The audience included all BSA managers and examiners.

We are also working closely with the states. As evidence of that cooperation, Commissioner Everson was pleased to announce in late April that we had reached agreements with 33 states and Puerto Rico to begin sharing BSA information. The agreements will allow the IRS and the participating states to leverage their resources to

ensure that MSBs are complying with their federal and state responsibilities to register with the government, to create and maintain anti-money laundering programs, and to report cash transactions and suspicious activities. This would have not been possible without the support and assistance of FinCEN.

And, we, of course, have a very close working relationship with FinCEN. We have a memorandum of understanding in place which provides for exchanges of information to help FinCEN fulfill its role as administrator of the BSA and to assist us in conducting examinations of MSBs to assess BSA compliance. IRS and FinCEN work closely on such things as setting examination priorities, reviewing the BSA Internal Revenue Manual, and training. As I will discuss in more detail later, we also refer all potential BSA civil penalty cases to FinCEN for appropriate action.

IRS also is a member of the Money Laundering Threat Assessment working group, along with FinCEN. The focus of this group is to identify money laundering threats throughout the United States through investigations conducted by all law enforcement agencies.

IRS Enforcement

In recent years, the IRS has strengthened the focus on enforcement, while maintaining appropriate service to taxpayers. Detecting and investigating money laundering activity is an important part of tax compliance for the IRS. In addition, the failure to file forms required by the BSA and criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, often have a direct link to tax evasion and money laundering. In some cases, because the schemes are sophisticated and because we may not be able to obtain evidence from some foreign countries, it is almost impossible to conduct traditional tax investigations. In these circumstances, money-laundering violations frequently are the only possible means to detect tax evaders.

Money laundering not only is used by domestic and international criminal enterprises to conceal the illegal, untaxed proceeds of narcotics trafficking, arms trafficking, extortion, public corruption, terrorist financing, and other criminal activities; it is also an essential element of many tax evasion schemes. With the globalization of the world economy and financial systems, many tax evaders exploit domestic and international funds transfer methods to hide untaxed income. These schemes often involve the same methods to hide money from illegal sources and to hide unreported income. Both activities generally use nominees, wire transfers, multiple bank accounts, and international “tax havens” to avoid detection.

Money laundering is the financial side of virtually all crime for profit. To enjoy the fruits of their crime, criminals must find a way to insert the illicit proceeds of that activity into the stream of legitimate commerce in order to provide the resources necessary for criminal organizations to conduct their ongoing affairs.

IRS' Role in BSA Compliance

As part of its core tax administration mission, the IRS addresses both the civil and criminal aspects of money laundering. On the civil side, the Department of the Treasury, through FinCEN, has delegated to the IRS responsibility for ensuring compliance with the BSA for all non-bank financial institutions (NBFIs) not otherwise subject to examination by another federal functional regulator, including MSBs.

Under this FinCEN delegation, the IRS is responsible for three elements of compliance: – (i) the identification of MSBs, (ii) educational outreach to all NBFIs, and (iii) the examination of those entities for compliance.

Currently, there are nearly 27,000 MSBs registered and posted on the FinCEN website. However because the true universe of potential MSBs is unknown, we utilize several methods to identify unregistered MSBs. One method is to utilize information from the states that identifies businesses that are registered at the state level but not with FinCEN. We also review our Currency Banking and Retrieval System (CBRS) data base to discover suspicious activity reports (SARs) or currency transaction reports (CTRs) that emanate from or are filed on entities that should be registered. We also get leads from other Federal agencies such as Immigration and Customs Enforcement. Finally, we receive anecdotal reports on entities that are not registered but who are doing check cashing or other financial activities that would subject them to registration requirements

In FY 2006, we started a special initiative to identify businesses that should be registered but are not. We built 2000 real cases that were used to train our newest examiners. We have been pleased with the results and plan to continue this type of initiative in the future.

Our outreach program is designed to reach both registered and unregistered MSBs. We focus special attention on those industries that FinCEN has referred to us. For example, currently we are working with convenience store owners and gasoline retailers, many of whom are MSBs and may not even realize it. We work closely with the trade associations that represent specific MSBs, making sure they understand the requirements that their members face. We also make ourselves available for seminars at association events and as exhibitors at their trade shows. We also look at industries where we suspect that there may be high incidences of non-registration and work closely with them to make sure they understand the registration requirements.

From a criminal perspective, IRS' Criminal Investigation (CI) Division is responsible for the criminal enforcement of the BSA and money laundering statutes related to tax crimes. CI uses the BSA and money laundering statutes to detect, investigate, and prosecute criminal conduct related to tax administration, such as abusive schemes, offshore tax evasion, and corporate fraud. CI also investigates criminal violations of the BSA, including the structuring of deposits to avoid currency transaction reporting requirements, which frequently have a direct link to both tax evasion and money laundering.

The IRS CI Division has increased its emphasis on BSA responsibilities significantly, with particular focus on improving the effectiveness and efficiency of SAR Review Teams. CI now hosts approximately 80 SAR Review Teams located throughout its 30 field offices. These teams are made up of federal, state and local law enforcement officials and work closely with Assistant United States Attorneys. The expansion in the number of teams significantly enhances analysis of SARs because each team can focus on the geographical area with which it is most familiar. Increased use of technology, primarily data-mining tools, is assisting teams in efficiently analyzing the ever-increasing number of SARs being filed.

MSB Compliance

The BSA imposes several requirements on money services businesses. These include:

- The development and implementation of an adequate Anti-Money Laundering (AML) compliance program. An effective program is one that is reasonably designed to prevent the money services business from being used to facilitate money laundering and the financing of terrorist activities. Such a plan must include the following elements: (a) a system of internal controls to assure compliance; (b) the designation of an individual responsible for coordinating and monitoring day-to-day compliance; (c) the provision of training for appropriate personnel; and (d) the provision for independent review to monitor and maintain an adequate program.
- A requirement that MSBs file a report of each deposit, withdrawal, exchange of currency or other payment or transfer which involves a transaction of currency of more than \$10,000; and,
- A requirement that “suspicious transactions” be reported. The BSA and its implementing regulations have defined what might be classified as a suspicious transaction. They include such things as transactions that involve funds gained from illegal activities or that are designed to evade reporting or recordkeeping requirements under the BSA, or transactions in which the particular customer would normally not engage.

IRS Examinations

It is important to point out that all of the IRS BSA examiners and their managers devote 100 percent of their examination time to examinations of BSA-related cases. This contrasts with our efforts in 2004 and before when BSA work was a collateral duty of revenue agents who were engaged in traditional income tax audits.

We currently have 353 BSA examiners on board. We had hoped to have 385 by the end of FY 2006, but we will not make that goal despite our best efforts. We will be recruiting actively on a number of fronts in FY 2007 to increase our workforce to the maximum level, and to keep it there.

As the BSA program has grown, we have changed some of the focus of our exams. Today, we examine both the corporate headquarters of MSBs and their agents which, according to the BSA, are MSBs in their own right. In addition, unlike the federal banking and securities regulators, the IRS is not obligated to undertake examinations on any particular cycle. And due to the size of the MSB population, that would be prohibitive. As a result, our examination plan is largely determined on a risk basis and by the relative size of the institutions for which we are responsible. Large MSBs are examined as a matter of course, with the IRS performing a centralized examination of the MSBs corporate headquarters. Smaller MSBs are targeted for an audit if they have been identified as high risk, including at risk for terrorist financing, as determined by leads from other federal or state agencies and the entity's SAR filing history. Once we determine what entity to examine, as explained below, the extent of our exam is based on an analysis of the risks posed in that particular institution.

We are also now utilizing a centralized case selection process. The Treasury Inspector General for Tax Administration (TIGTA) has previously scrutinized our work selection process, observing that current processes create a significant risk of undetected non-compliance and inconsistent program delivery. As a result, we are developing a systematic, risk-based inventory selection process. This process is based on a scoring system that uses data from the CBRS to identify the best candidates for examination. We are currently field testing that scoring system.

Once we identify a particular MSB for examination, our first step is to request from the entity a copy of its anti-money laundering compliance program and a copy of the independent audit of the compliance program. The examiner will then prepare a risk-based assessment that essentially determines the scope of the rest of the examination.

During the course of the exam, the examiner will identify the entity's AML risks, evaluate policies, procedures, and internal controls and assess whether breakdowns in the AML compliance program place the institution at risk for money laundering or terrorist financing. We will then always perform selective transactional testing.

Upon completion of the examination, one of four outcomes will occur. First, if no violations are found, we will issue what we call Letter 4029, which gives the entity documentation that a review has occurred and that no violations were identified. This is important because we are well aware that many MSBs are facing increasing difficulty in finding banks willing to do business with them. These banks, both large and small, seem to believe that opening new or maintaining existing accounts for money services businesses will be too costly, pose a potential threat to their reputation, or expose them to greater regulatory scrutiny.

This is regrettable. The money services business industry provides valuable financial services, especially to individuals who may not have ready access to the formal banking sector. It is long-standing Treasury policy that a transparent, well-regulated money services business sector is vital to the health of the world's economy. It is important that money services businesses that comply with the requirements of the Bank Secrecy Act and applicable state laws remain within the formal financial sector, subject to appropriate anti-money laundering controls.

It is equally important to ensure that the money services business industry maintains the same level of transparency, including the implementation of a full range of anti-money laundering controls required by law, as do other financial institutions. If account relationships are terminated on a wide-spread basis, we believe many of these businesses could go “underground.” This potential loss of transparency would significantly damage our collective efforts to protect the U.S. financial system from money laundering and other financial crimes – including terrorist financing.

The second possible outcome of an examination would be the issuance of a Letter 1112 (L-1112). The L-1112 would be issued if violations are found, but they are technical, minor, infrequent, isolated, and non-substantive. This letter will detail the violations and ask that the entity commit to correct the apparent violations. It also provides the business with the opportunity to disagree with the findings and to provide us within 30 days an explanation of any disagreement.

It is important to realize that the issuance of an L-1112 involves no fines or other penalties on the MSB. It merely says that we have found these violations and that by signing the letter, the business agrees to correct the deficiencies that were noted.

The third potential outcome of an examination is an instance where a significant BSA violation or deficiency is identified. In this instance, the case is referred to FinCEN for consideration of civil penalties. Examples in this category are violations that are flagrant, demonstrated bad faith, or were committed with disregard for the law or the consequences to the institution. Other factors in considering whether to refer a matter to FinCEN include: (a) the frequency of violations; (b) whether the violation is intentionally concealed; (c) whether the business fails to cooperate in correcting the violation; and (d) the history of prior violations and/or poor compliance. Thus, field examiners are given a clear list of criteria to consider in determining whether to refer a case to FinCEN.

Once a case is referred to FinCEN, the IRS is no longer involved. FinCEN makes the determination of what, if any, civil penalty is appropriate.

Finally, if the examiner believes that there may be a willful criminal violation involved, the case would immediately be referred to IRS-Criminal Investigation when the relevant facts have been developed. CI will evaluate the case and determine whether it reaches the level of criminal behavior and meets certain minimum case selection criteria. From a legal perspective, one of the most difficult issues facing CI in deciding if a case is worthy of a criminal investigation is documenting sufficient evidence of affirmative acts to establish willfulness. Willfulness can be difficult to prove and when dealing with the Bank Secrecy Act violations, it often requires documenting a subject’s knowledge of their obligations under the BSA.

From a practical perspective, case selection is another key factor in determining whether a case will be successfully prosecuted. Our CI division has vast experience in determining the prosecution potential of cases selected for investigation, evidenced by a

96.3% acceptance rate at the Department of Justice and a 92.2% acceptance rate at the United States Attorneys Offices for Fiscal Year 2005.

If CI makes the determination that they will not refer the case to the Department of Justice for review, it comes back to us and we decide whether to then refer it to FinCEN for consideration of possible civil penalties.

If an MSB believes that an examiner has made a mistake in his or her assessment of potential violations, there is recourse. As noted above, if the MSB is issued an L-1112 letter, it has 30 days in which to respond, explaining why the examiner is wrong. The MSB can also elevate the issue to the BSA Territory Manager or contact FinCEN through their hot line number, posted on their website.

To give you an idea of the universe of MSB cases we audit, in FY 2005, we examined 3,680 MSBs. We issued L-1112 violation letters to 1,337 of these. We referred 21 cases for criminal investigation and referred 7 cases to FinCEN.

As of August 25, of this fiscal year, we had already examined 5,481 MSBs and issued violation letters to 3,585 entities. We have also issued 1,744 Letters 4029, indicating clean examinations. We have referred 14 cases to CI and 17 cases to FinCEN.

Our draft BSA workplan for FY 2007 includes the examination of 6,756 MSBs. This is in addition to casinos, credit unions, insurance companies and jewelers. The FY 2007 plan represents an 8 percent increase over FY 2006 and a 83 percent increase from the FY 2005 workplan. The FY 2007 plan is premised on the assumption that we accomplish our aggressive hiring initiative.

New Industries

One of the questions raised by the Committee's staff prior to this hearing was how we are addressing the new FinCEN regulations of jewelers and insurance companies. In terms of jewelers, FinCEN has advised us that these regulations are not final. Until they are, we have been told by FinCEN not to conduct exams. In the meantime, the Service has developed an implementation strategy which encompasses examinations, monitoring, and training. We have met with representatives from the industry to discuss what they plan to do to implement the regulations and to also discuss their concerns.

For the insurance industry, in conjunction with the BSA examinations, we are assisting insurance companies, as necessary, through our partnership with FinCEN, in understanding their obligations under the BSA. We have developed a strategy and implementation plan for insurance companies that encompass examinations, monitoring and training. The training curriculum is in the development stage. We have added a Technical Advisor/Program Analyst Position, within the BSA policy operation, with specific responsibility for insurance companies. Examiners will be trained in the first quarter of FY 07 and the examinations are scheduled to start right after the training.

FinCEN has provided the Service a listing, by name, of each insurance company that may come under Service jurisdiction. In addition, based upon criteria that we have established, we have identified the initial insurance companies for BSA examination.

After establishing a baseline measure on industry compliance, we will conduct an analytical review of examination results, and evaluate the efficacy and efficiency of these examinations in conjunction with an industry risk. Based on this review, adjustments to the examination plan can be anticipated in FY2008.

BSA Direct and Web-CBRS

The IRS is now making information required by the Bank Secrecy Act and the USA PATRIOT Act available to FinCEN and other Federal and organizations through an application called Web-CBRS (Web-Currency Banking and Retrieval System).

The IRS began developing a web application for the CBRS approximately five years ago. Its intent was to take advantage of efficiencies from relational data base software and secure Web interfaces. Web-CBRS is critical to our efforts in Fraud/BSA to bring about compliance with both the BSA and the USA PATRIOT Act. We have a skilled and experienced information technology (IT) application development staff in Detroit. They have demonstrated that, with clear requirements, they can bring large projects to completion on schedule.

The implementation of Web-CBRS is on or ahead of schedule. On September 30, 2006, the IRS intends to take the old integrated database management system off-line. At this point, Web-CBRS will be the only first-hand source of Bank Secrecy Act and USA PATRIOT Act information available.

This is critical in that FinCEN announced on July 13, 2006 that they had permanently halted the BSA Direct Retrieval and Sharing Component Project (BSA Direct).

When problems with FinCEN's BSA Direct application began to surface in May 2006, FinCEN's IT staff approached the IRS' Modernization and Information Technology Systems (MITS) Application Development organization to discuss the feasibility of providing Web-CBRS to their users in the event that BSA Direct was not operational as planned.

As it became evident that BSA Direct would not be delivered on schedule, FinCEN and the IRS signed an Interagency Service Agreement (ISA) to share data, and began to take the steps necessary to make Web-CBRS available to FinCEN and its customers. These steps included adding the FinCEN Gateway requirements to Web-CBRS, conducting acceptance testing of the FinCEN requirements, training key FinCEN users (FinCEN trainers) on Web-CBRS, and adding FinCEN users to Web-CBRS. FinCEN transferred \$300,000 to the IRS to complete these actions. The IRS provided \$450,000 in additional development funds to make sure that other work, primarily the revision of BSA forms, did not slip because of the unexpected need to replace BSA Direct. The IRS has also

devoted an additional \$1,000,000 to cover the cost of processing a significantly higher volume of paper returns.

In addition, as part of the final review of BSA Direct, we met with FinCEN in June, 2006 to review the capabilities of Web-CBRS as compared to those proposed for BSA Direct. We agreed at this meeting that we would work with FinCEN to modify the Web-CBRS data base to meet reasonable additional needs that they may have.

We are committed to cooperate with FinCEN to improve both the usefulness and the quality of the BSA data that is available through Web-CBRS. Our joint working group, Tiger Team, has identified many small systemic changes to processing requirements and BSA forms that will make the data clearer, more consistent, and more useful to law enforcement.

Conclusion

As I stated earlier in this testimony, the fight against money laundering and terrorist financing are top priorities for the Internal Revenue Service. We are prepared to increase our commitment to the BSA Program, and we will continue to coordinate our efforts closely with FinCEN and the other groups represented here this morning.

We will also not forget the importance of assisting MSBs whenever possible in understanding and complying with their responsibilities under the BSA. As Commissioner Everson has said often, service plus enforcement equals compliance.

Mr. Chairman, I thank you for this opportunity to appear before you this morning and will be happy to respond to any questions that you or other members of the Committee may have.