

**BANK SECRECY ACT:
OCC Examination Coverage of Trust
And Private Banking Services**

OIG-02-016

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Office of Inspector General

The Department of the Treasury

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Abbreviations

BSA	Bank Secrecy Act
CTR	Currency Transaction Report
FATF	Financial Action Task Force
FCB	Foreign Correspondent Banking
HIDTA	High Intensity Drug Trafficking Area
OCC	Office of the Comptroller of the Currency

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Abbreviations continued

OIG	Office of Inspector General
SAR	Suspicious Activity Report
SMS	Supervisory Monitoring System

*The Department of the Treasury
Office of Inspector General*

November 29, 2001

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The Office of the Comptroller of the Currency (OCC) is responsible for ensuring that the financial institutions under its supervision comply with the Bank Secrecy Act (BSA). In recent years, trust and private banking services have become an increasingly important component of the BSA and have provided the banking industry an increased stream of revenue.

This is the third in a series of Office of Inspector General (OIG) audits covering BSA examinations conducted by OCC. Our earlier audits focused on bank wide BSA controls at domestic and foreign banks. The overall objective of this audit was to evaluate OCC's examination coverage and supervision of trust and private banking services under the BSA. To conduct our audit, we visited OCC headquarters and field offices, reviewed examination files and interviewed responsible officials and examiners. Our audit covered a sample of BSA examinations completed between March 1996 to June 2000. A detailed description of the objectives, scope and methodology is presented in Appendix 1.

Results in Brief

We believe that OCC has taken many important steps to improve BSA examinations. For example, OCC recently revised the agency's BSA examination handbooks and created a Deputy Comptroller position to supervise among other things BSA work performed by compliance examiners. OCC also issued guidance

which requires each supervisory office to be responsible for planning, staffing and coordinating BSA and anti-money laundering examinations of bank asset management services. We believe these and other changes will provide OCC with a more focused approach to performing BSA examinations. However, as discussed below, we found that greater OCC attention is warranted in the trust and private banking areas.

First, trust and private banking services were not always included as a part of a bank's overall BSA examination. Specifically, 17.6 percent of the trust examinations reviewed (6 of 34) did not show evidence of BSA examination coverage. Similarly, BSA examinations at 60 percent of the banks offering private banking services (12 of 20) did not cover the private banking services. The examinations identified that OCC management were not always closely monitoring the results of BSA examinations. (see page 10).

Second, 32 percent (9 of 28) of the examinations performing BSA reviews did not fully comply with OCC BSA examination guidelines. We identified examinations where the wrong examination handbook had been followed, and instances where examiners did not perform the applicable examination procedures. This is similar to findings identified in our prior BSA audit report issued in January 2000. However, our prior report covered bank wide BSA reviews and did not specifically examine trust and private banking services. (see page 17).

Third, some of the BSA examinations lacked sufficient testing of high-risk transactions commonly associated with money laundering or lacked review and evaluation of critical BSA reports that banks are required to file. Specifically, examiners did not always test wire transfers, transactions with foreign correspondent banks, currency transaction reports or suspicious activity reports. For example, in both trust and compliance examinations where transaction testing was performed, examiners reviewed these areas generally less than 40 percent of the time. (see page 20).

Fourth, we believe the BSA examination procedures contained in OCC's newly revised handbooks could be improved through a few enhancements, clarifications and reassessment. For example,

during our audit examiners were using the older BSA handbook that contained 12 mandatory procedures, the revised BSA handbook contains over 45 mandatory procedures. Similarly, the Community Bank handbook grew from 18 to over 30 mandatory procedures. In our opinion, the number of new mandatory procedures may be too rigid in light of the varying degrees of compliance risk at different banks and OCC's own strategic plan, which calls for using risk-focused examination procedures. (see page 23).

Accordingly, we make several recommendations in the report. We believe OCC could improve its supervision and BSA examinations of trust and private banking services by (1) requiring coverage in all BSA examinations, (2) improving the monitoring process used in management oversight, (3) completing all mandatory examination procedures, (4) ensuring that examiners use the correct examination handbook, (5) ensuring that examiners complete testing of high risk areas, (6) reassessing whether the new BSA examination procedures should be mandatory or optional, and (7) reassessing whether the same examination sampling methodology contained in the large bank handbook should be used in the Community Bank handbook. Our recommendations take into account OCC's risk focused examination approach.

OCC concurred with our reported findings and recommendations and has committed to undertake various management actions in response to the report. For the full text of OCC's response to our draft report see Appendix 4. Under separate correspondence, OCC has committed to take corrective action within 90 days after issuance of the final report.

Background

Trust and private banking services are growing increasingly important to the banking industry as a source of revenue. However, there is growing worldwide concern that these services may be conduits for criminal money laundering. The BSA was enacted as one means to stem such activity. OCC is actively conducting bank wide BSA examinations that focus on the effectiveness of bank internal controls to detect and prevent money-laundering activity.

Trust Services

Trust services involve a fiduciary relationship in which the trustee, such as a bank, holds and/or manages property for their clients and any beneficiaries. Trust accounts are generally set up to achieve long term goals in accordance with a trust agreement and offer privacy and confidentiality to their bank customers.

As of September 30, 2000, there were 907 OCC regulated National Banks with trust charters whose aggregate trust assets exceeded \$3 trillion.

Although typical trust activity may not result in the large, quick movement of funds as with private banking activity, trust activity can involve all of the high-risk circumstances conducive to money laundering. In October 2000, 11 of the world's largest banks agreed to a set of global anti-money laundering guidelines for international private banks including those offering trusts.

In February 2001, the Financial Action Task Force (FATF) on Money Laundering, an international policy coordination group, issued a report on money laundering methods¹. Trusts were identified as vehicles that were easy to establish but difficult to monitor. Most governments have no registration requirement or central registry. In fact, trusts may be formed with the intention of taking advantage of strict privacy or secrecy rules in order to conceal the identity of the true owner or beneficiary of the trust assets. For these reasons, trust accounts are viewed as potential vehicles that criminals can use to launder money. The FATF also noted that trusts have also been used as a layering technique to disguise illicit proceeds of criminal activity and create the impression of legitimacy.

Private Banking

In contrast to the tangible nature of bank trust services, private banking generally refers to arrangements or relationships between a bank and select clients rather than to specific products or services. Private banking services are tailored for high net worth individuals

¹ Financial Action Task Force on Money Laundering, *Report on Money Laundering Typologies 2000-2001*, February 1, 2001 FATF-XII.

and include personalized services such as money management, financial advice and investment services. Private banking activities are generally conducted through relationship managers who provide the client the expertise to utilize the various services the bank offers.

In essence, there is no industry wide reporting of private banking assets or private banking accounts. Unlike trust charters, OCC does not issue a separate charter to those institutions offering private banking and the banking industry has no standard definition for private banking services. Thus, we were unable to identify the total number of OCC regulated banks that offer private banking or to estimate the value of the assets covered by private banking arrangements. However, a 1999 Washington Post article estimated that private banking units manage \$15.5 trillion worldwide.

Confidentiality is an attractive and important feature of private banking arrangements. Private banking is thought to be particularly sensitive to money laundering because large sums of money are managed through these confidential private banking arrangements. For example, a study found that private banking customers have, on average, a minimum investment account of \$300,000, and a net worth of \$2.3 million².

Law enforcement and bank regulators have expressed concern about offshore private banking activities and their potential to be a banking "soft spot" for money laundering³. Some private banking customers are known to reside in countries identified as high-risk areas for drug trafficking and money laundering. Concerns about private banking activities have also been raised in Congress. For example, in November 1999, the Senate Permanent Subcommittee on Investigations heard testimony that criminals were using certain private banking services in attempts to launder money. Recently, Congress investigated high profile money laundering cases involving private banking customers using offshore accounts or

² *Information on Private Banking and Its Vulnerability to Money Laundering*, GAO/GGD-98-19R, Oct. 30, 1997.

³ *Money Laundering: Regulatory Oversight of Offshore Private Banking Activities*, GAO/GGD-98-154, June 29, 1998.

transactions to facilitate the movement of illicit funds through the banking system.

Money Laundering and the Bank Secrecy Act

Money laundering is the means by which criminals transform their illicit proceeds into legitimate appearing assets. This in turn allows them to continue to operate and expand their criminal enterprises. Money laundering worldwide is estimated to exceed \$500 billion a year, and more than 170 crimes are identified in the federal money laundering statutes.

Congress enacted The Currency and Foreign Transactions Reporting Act⁴, also known as the BSA, to prevent banks and other financial institutions from acting as intermediaries for the transfer or deposit of money derived from criminal activity. Congress delegated to the Secretary of the Treasury the authority for administering the BSA regulations. The implementing regulation, 31 CFR Part 103, requires financial institutions to file certain currency and suspicious activity reports and to maintain certain records for possible use in criminal, tax and regulatory proceedings. These BSA record keeping and reporting requirements provide a paper trail to help law enforcement agencies investigate money laundering activities.

The OCC and other bank regulatory agencies are responsible for monitoring financial institutions' BSA compliance through their examination and supervision activities. A primary regulation for OCC is 12 CFR § 21.21, which was issued to ensure that all national banks establish and maintain procedures reasonably designed to ensure and monitor compliance with the BSA and 31 CFR Part 103. Banks are expected to have a written BSA compliance program with at a minimum, a system of internal controls to ensure compliance, testing for compliance, coordination and monitoring of day-to-day compliance and personnel training.

OCC BSA Examinations

Generally compliance examiners, who are specifically trained in the BSA, reviewed and evaluated bank wide controls including those

⁴ Title 31 USC Sections 5311-5330 and 12 USC Sections 1818(s), 1829(b), and 1951-1959.

covering private banking, while trust examiners reviewed specific trust accounts for compliance and unusual activity. Depending on asset size, and other factors such as a risk assessment of each bank, BSA examinations are generally completed every 12 to 36 months.

OCC examiners conduct BSA examinations of trust and private banking units based on procedures in 3 handbooks: Community Bank Consumer Compliance (updated November 2000), Bank Secrecy Act (updated September 2000), and the Community Bank Fiduciary Activities Supervision handbook (dated September 1998).

During our review separate exams were not required at banks offering trust and private banking services, although it's likely that trust exams were performed at a different time than the commercial BSA exam and by different examiners.

During our review period, BSA examinations for banks with total commercial assets over \$1 billion primarily focused on a bank's internal controls over its bank-wide operations. Also included are optional tests of bank transactions such as testing whether BSA reporting forms were fully and accurately completed. Community bank examination procedures can be used for banks with commercial assets up to \$1 billion. These examinations rely heavily on transactional testing to assess BSA compliance.

Findings and Recommendations

Finding 1 Trust and Private Banking Services Were Not Always Covered In A BSA Examination

We could find no evidence that trust and private banking services were being covered as a part of a bank's BSA examination for some of the 34 sampled banks. OCC BSA examination guidelines require examiners to cover "specialty areas" such as trust and private banking services in all BSA large bank examinations. However, no such requirement exists in the community bank handbook because of the banks smaller size and they may not have specialty areas.

No Evidence of Trust BSA Examination Coverage At Some Banks

To determine whether there had been BSA examination coverage of either trust or private banking services, we reviewed the latest trust and compliance examinations completed at our sample of 34 banks. We looked for instances where BSA examination documentation indicated trust and/or private banking services were covered during the bank's BSA examination process. Where examination work was not clearly documented, we asked responsible examiners about the extent of such work completed in either area.

We found no evidence of BSA examination coverage of trust services at six (17.6%) of the 34 sampled banks. Based on various factors reflecting BSA compliance risk, we considered 4 of the 6 to be of moderate risk and 2 low risk. (See appendix 2 for our risk assessment ratings). The trust assets managed by these 6 banks ranged from about \$660 million to over \$30 billion.

Table 1 below shows a breakout across three asset size categories of the sampled banks.

Table 1		
Evidence of Trust Examination Coverage		
Sampled Banks Asset Size	Trust Banks in Sample	No Evidence of Trust Coverage
Over \$1 Billion In Trust Assets	24	5 (20.8 %)
\$250 Million to \$1 Billion In Trust Assets	9	1 (11.1%)
Under \$250 Million In Trust Assets	1	0 (0.0%)
Totals	<u>34</u>	<u>6</u> (17.6%)

Source: OIG Analysis of OCC examination records

Table 1 identifies the number of banks based on trust assets because this review focused on BSA coverage of trust services. Prior OIG BSA audits identified banks based on commercial assets.

The applicable OCC guidance for BSA trust examinations during our review period was the BSA handbook (dated September 1996) and the Community Bank Consumer Compliance handbook (dated August 1995). In OCC BSA examinations, the use of one handbook or the other is generally dependent on the amount of commercial assets rather than trust assets managed by a bank. The number of banks in our sample based on commercial assets included 12 banks over \$1 billion, 11 between \$250 million to \$1 billion and 11 banks under \$250 million.

For banks with over \$1 billion in commercial assets, OCC policy stipulates that examiners are to use procedures from the BSA handbook. These procedures are commonly called the large bank procedures. For banks with total assets of less than \$250 million with no regional or multinational affiliation examiners are required to use the Community Bank handbook. For banks with commercial assets between \$250 million to \$1 billion the examiners can use either handbook depending on the bank's structure and examiner judgment.

According to the BSA large bank handbook, the examination scope requires examiners performing BSA examinations to ensure coverage for all banking units of the bank being examined. This includes specialty areas such as trust, private banking, correspondent banking, currency operations, credit card, international and discount brokerage. The Community Bank handbook does not specifically require examination coverage of trust services even though there is the potential money laundering risk associated with trust services.

Aside from the BSA handbooks, we identified other factors suggesting that BSA examination coverage was warranted.

- One bank with a moderate risk of money laundering had not received BSA trust coverage in either of its 2 most recent trust examinations. This covered a span of almost five years.
- The six banks with no evidence of trust coverage contained over \$67 billion in trust assets.

The absence of BSA examination coverage was similarly noted in two internal OCC quality assurance reviews in year 2000. The Central District's community bank quality assurance program review found 8 (53 percent) of the reviewed examinations failed to contain any evidence that the bank BSA review included the trust department. The Southwestern District's quality assurance review found 4 (40 percent) of the Asset Management (trust) examinations did not evaluate compliance with the BSA. The quality assurance report opined that this was a systemic deficiency.

Private Banking Examination Coverage Also Lacking

We also found the absence of BSA coverage for many of the banks' private banking activities. As shown in Table 2, we found this for 12 (60%) of the 20 banks offering private banking services.

Table 2		
Evidence of Private Banking Examination Coverage		
Sampled Banks	Sampled Banks With Private Banking	No Evidence Of Private Banking Coverage
Over \$1 Billion In Commercial Assets*	14	7 (50%)
Under \$1 Billion In Commercial Assets*	6	5 (83.3%)
Totals	<u>20</u>	<u>12</u> (60%)

* Commercial asset size includes regional or multinational affiliation

Source: OIG Analysis of OCC examination records

As with our review of trust services, we found this condition by reviewing the examination workpapers and interviewing responsible examiners. Appendix 3 summarizes the BSA coverage for private banking services for the sampled banks.

Weaknesses In Examination Process

Based on our review of examination workpapers, discussions with examiners, and a review of OCC's supervisory monitoring system, we believe that several factors contributed to the observed gaps in

BSA examination coverage of trust and private banking services. These included handbook guidance, which do not specifically require coverage of trust and private banking services, and OCC's supervisory monitoring system's limited informational capacity to monitor BSA examination coverage.

OCC handbook guidance does not specifically require detailed BSA examination procedures be applied to either specialty area. For example, the large bank handbook only requires that examiners review bank wide policies that address all business units. It does not require examiners to specifically cover trust or private banking and does not require mandatory transactional testing in these areas. The Community Bank handbook examination requirements do not require examiners to cover specialty areas because the banks are smaller and less likely to offer trust and private banking services.

Given the widely acknowledged risk of money laundering with regard to trust and private banking services, we believe OCC could enhance its supervision of bank BSA compliance for both services by covering these areas in the banks' risk analysis. Examination coverage in these areas should be mandatory unless the examiner's risk assessment documents why coverage is not warranted. As we were told by some OCC officials, BSA compliance risks are affected by various factors such as the effectiveness of internal and/or external audits, the nature and extent of trust and private banking services provided, and the presence of bank BSA policies and procedures. Expanded clarification on how these various factors are to be assessed and documented could provide not only examiner flexibility but also BSA coverage.

We also inquired about OCC's examination monitoring system to determine how supervisors and/or managers monitor BSA examinations to ensure sufficient coverage, and whether they were aware of the lack of BSA coverage we found. We found that another contributing factor to the gap in BSA examination coverage may be the informational limitations of OCC's examination monitoring system.

For supervision and monitoring purposes, the results of BSA examinations are recorded into OCC's Supervisory Monitoring System (SMS). This is an automated system used to record and

communicate narrative and statistical information on institutions of supervisory interest. During our review, SMS was the primary monitoring system that OCC management used to track examinations. However, in March 2001, OCC initiated a new monitoring system called Examiner View.

The new monitoring system is an integrated system used by most examiners to plan and record the results of supervisory activities, including workpaper documentation. OCC personnel told us Examiner View can query information at all but the largest banks that OCC supervises. Unlike Examiner View, the older SMS is unable to query and track specialty areas of BSA examinations. If managers wanted to follow up on work completed in trust or private banking they would need to read the narrative for the entire compliance examination and then possibly call the examiner who completed the work to identify what was specifically completed.

SMS also does not have the capability to automatically search examination records and generate reports to management alerting them that required BSA coverage was lacking. We believe these SMS system limitations did not allow managers to readily oversee or monitor BSA examinations to ensure required trust and private banking services were covered and examination procedures were fully implemented. However, the new Examiner View monitoring system should be more effective given its ability to query and track all specialty areas of most BSA examinations.

OCC officials do not believe that mandatory examination coverage for trust and private banking services is needed in all BSA examinations. However, they agreed these services should be reviewed and included in the bank risk analysis. The officials also believe that the frequency of examination coverage for trust and private banking should depend on the level of risk relative to BSA compliance and money laundering.

Recommendations

1. The Comptroller of the Currency should establish mandatory BSA examination coverage for trust and private banking services in all BSA examinations in the absence of a documented risk assessment to the contrary.

OCC Management Comment

OCC concurred that in some cases, their examination teams could have expanded the scope of BSA examinations to include trust and private banking services. To address future examination coverage of trust and private banking services, OCC emphasized they would hold ongoing discussions with the examination staff on the need to perform and document risk assessments for each institution. OCC also plans to place a notice on their internal website to communicate to examiners the results and concerns of this audit.

2. The Comptroller of the Currency needs to improve the examination monitoring process used by management to ensure adequate oversight of BSA examinations covering trust and private banking services.

OCC Management Comment

OCC concurred and stated they would communicate to managers the need to periodically monitor and identify, through Examiner View, examinations where examination procedures were performed on high-risk areas such as private banking and trust. OCC also stated that internal targeted quality assurance reviews of private banking and trust services would be conducted in 2002.

OIG Comment

We believe the management actions planned by OCC, if properly implemented, address the intent and conditions of recommendations 1 & 2. Furthermore, OCC plans to take the corrective actions within 90 days after issuance of this report.

Finding 2 Trust BSA Examinations Did Not Always Comply With OCC Examination Policy

When BSA examinations covered trust services, examiners did not always follow OCC's applicable BSA handbook guidelines.

Examiners did not always use the appropriate set of examination procedures or the complete set of procedures.

Trust Examinations Were Not Always Complete

OCC's BSA examinations covered trust services at 28 of the 34 sampled banks. We found that the examination files generally identified and documented the work completed in an understandable manner and we were able to evaluate the actual work performed. But we found that in 9 (32.1%) instances the examination was incomplete because either none or only some of the mandatory procedures had been completed. During our review, OCC's BSA handbooks required 12 mandatory procedures for the large banks and 18 mandatory procedures for the community banks.

Table 3 shows the nature and extent of incomplete trust examinations.

Table 3				
Nature of Incomplete Trust Examinations				
	Banks Receiving BSA Trust Exams	None of the Mandatory Procedures Were Completed	Mandatory Procedures Were Only Partially Completed	Examinations Properly Following OCC Guidelines
Totals	28	2 (7.1%)	7 (25%)	19 (67.8%)

Source: OIG Analysis of OCC examination records.

Similar findings were identified in an OCC Community Bank quality assurance follow-up review for the Western District in March 2000. The quality assurance review found that 6 of 16 (37.5%) examinations did not utilize the 12 mandatory steps for large bank examinations. The quality assurance review states in part that "confusion exists among examiners as to what is required to be performed for BSA".

Contrary to OCC policy, examination workpapers usually did not adequately document why applicable large or community bank examination procedures were not completed. We asked OCC examiners to explain the omission of any required handbook procedures. Examiners cited various reasons such as: (1) the

examiner did not believe the step was mandatory in all examinations, (2) the examiner-in-charge waived the step, (3) the procedures were completed in earlier examinations with no identified problems, and (4) the BSA large bank procedures do not apply to banks having limited trust powers. When we inquired, one OCC policy official told us that these were not valid explanations for not documenting why a required BSA examination procedure was not performed.

Examination Guidance Needs Clarification

In reviewing the BSA examinations, we found that examiners did not always use the correct BSA handbook in completing the examinations. The Community Bank handbook with 18 mandatory procedures can be used for banks with assets up to \$1 billion and must be used for banks with total assets under \$250 million with no regional or multinational affiliation. For banks over \$1 billion, examiners are to use the large bank handbook with 12 mandatory procedures.

The Community Bank handbook does not specifically define what is to be included in determining asset size. The large bank handbook does not mention asset size. Neither handbook specifies whether the term bank assets is to be applied based on the bank's commercial assets, the trust department's managed or held assets, or some combination of these, or whether off-balance sheet assets are included. Another handbook offering guidance on handbook selection is the Overview handbook. However, even this handbook does not give the examiner a definition of which type of asset to use. We found that examiners had interpreted the asset size guidance differently.

For example, in one case the trust and compliance examiners used different handbooks. The compliance examiners followed the community bank procedures because the commercial assets were under \$250 million and the trust examiners used the large bank procedures because the trust assets were over \$1 billion. In another examination, we found that the trust examiners used community bank procedures though the bank was affiliated with other banks having commercial assets over \$1 billion.

Incomplete BSA Examinations Previously Reported By OIG

In a prior January 2000 OIG audit report⁵ we noted that OCC had not performed a complete BSA examination for 38 of the 82 examinations we reviewed. Those examinations generally occurred in 1996 and 1997 and were based on bank wide BSA examinations, not specifically trust and private banking.

Our current audit of trust and private banking services suggest that OCC has not fully implemented corrective action regarding incomplete BSA examinations and this has become a lingering weakness. In responding to our prior audit, OCC agreed to (1) emphasize, through ongoing discussions with the examining staff, the need to perform all of the required examination procedures and (2) monitor examiner compliance through their quality assurance program beginning in 2000.

Recent OCC quality assurance reviews have identified improving conditions relating to BSA examinations. However, corrective actions are still needed to ensure that BSA examiners follow and complete all applicable mandatory examination handbook procedures.

Recommendations

3. The Comptroller of the Currency needs to ensure that all required BSA examination procedures are completed when covering trust and private banking services. If examiners determine that a required procedure is not needed, the work papers should be annotated documenting the exceptions consistent with OCC's working paper policies.

OCC Management Comment

OCC concurred and stated they would communicate to examiners the need to perform all required examination procedures, as well as the results and concerns raised in this report.

⁵ *Office of the Comptroller of the Currency Bank Secrecy Act Examinations Did Not Always Meet Requirements*, OIG 00-027, January 3, 2000.

OIG Comment

Our audit found that OCC had previously communicated to examiners the need to perform all required examination procedures and that this communication was not always followed. However in their response to this report, OCC also agreed to increase oversight and monitoring by managers through Examiner View. We believe that along with the implementation of Examiner View, OCC's planned corrective actions address the recommendation and underlying conditions.

4. To better ensure that examiners use the correct examination handbook, the Comptroller of the Currency should clarify examination guidance as to what is to be specifically included in determining total assets. In addition, consideration should be given to covering this clarifying language in any associated BSA examination training.

OCC Management Comments

OCC concurred and stated they would communicate to examiners the definition of total assets and provide guidance on using the appropriate examination procedures for community and large banks. OCC also stated they planned to expand the training modules for BSA to provide guidance on using the appropriate examination procedures for community and large banks.

OIG Comment

We believe OCC's planned corrective actions adequately address the recommendation.

Finding 3

Certain High-Risk BSA Areas Are Seldom Tested

Examiners did not always test certain high-risk transactions commonly associated with money laundering or evaluate available BSA reports that banks are required to file. These high-risk areas were foreign correspondent banking and wire transfers; the reports

were the currency transaction reports and suspicious activity reports.

Testing these high-risk areas could provide a more reliable assessment of a bank's BSA controls and could disclose situations that indicate potential money laundering. Testing normally involves reviewing a sample of trust or private banking customer transactions. OCC's prior BSA handbooks did not require transactional testing for trust or private banking services regardless of bank size or risk. In our sample, we believe that over 80 percent of the banks reviewed were moderate to low risk.

Fourteen of the banks in our sample maintained correspondent accounts with foreign banks to facilitate the transfer of customer funds between countries. Foreign correspondent accounts may face increased risk for money laundering due to the activities and services they provide, particularly if they are located in a secrecy haven.

Money launderers may use wire transfers to quickly move funds through multiple accounts and banks making it difficult to trace their origin. Criminals can also use wires to move money out of the country through a bank account in a country where laws are designed to facilitate secrecy.

Large currency transactions are also subject to special bank reporting as a means for law enforcement to detect potential money laundering. Examiners can also review the Currency Transaction Reports (CTR) as a means of detecting potential money laundering and test bank compliance with the reporting requirement.

Similarly, banks are required to file Suspicious Activity Reports (SAR) for any suspicious transaction relating to a possible violation of law, including money laundering. As with CTRs, SARs also provide law enforcement an audit trail for investigative purposes.

Table 4 below shows the frequency these high-risk areas were tested and/or available reports were evaluated for our sampled banks.

Table 4			
Testing of High Risk Transactions			
Transactions Applicable to Business Unit	Banks Offering Service	Instances Where Transactions Tested	Rate Of Coverage as a Percent
<i>Trust Services (28 banks)</i>			
Foreign Correspondent Banking	12	1	8.3 %
Wire Transfers	26	13	50 %
Large Cash Transactions	21	7	33 %
Suspicious Activity Reports	28	3	10.7 %
<i>Private Banking Services (8 banks)</i>			
Foreign Correspondent Banking	7	0	0 %
Wire Transfers	8	4	50 %
Large Cash Transactions	8	3	37.5 %
Suspicious Activity Reports	8	2	25 %

Source: OIG Analysis of OCC examination records

Table 4 excludes the 6 banks where there was no BSA examination coverage of trust services, as well as the 12 banks where the BSA examination did not cover private banking.

We believe that transactional testing in high-risk areas is a reliable means of assessing BSA program compliance. Transactional testing in these areas also provides examiners some assurance that bank wide internal controls are working as intended.

OCC officials at the exit conference agreed that testing of high-risk areas is important in BSA examinations. However, they believe that mandatory transactional testing for the noted high-risk areas is not necessary in all situations. OCC officials also noted that the new BSA handbooks contain examination procedures that include a review of CTRs, SARs, and foreign correspondence accounts in high-risk banks in order to draw a sample for testing compliance. The sample size of the high-risk areas is to be based on the overall risk profile of the bank.

Recommendation

5. The Comptroller of the Currency should ensure that examiners complete transactional testing of high-risk BSA areas in trust

and private banking unless the documented bank risk assessment deems it unnecessary.

OCC Management Comments

OCC concurred and stated they would convey to examination staff the need to perform transactional testing procedures, using the recently issued BSA/AML examination procedures, on areas identified in the risk assessment as high-risk.

OIG Comment

We believe OCC's planned corrective actions will address the recommendation and underlying conditions if properly implemented.

Finding 4

Opportunities To Improve BSA Handbook Guidance

In late 2000, OCC revised its BSA examination handbook procedures for both large and community banks. We reviewed the new handbooks to see whether the new procedures would address the examination weaknesses we noted in this audit. We identified 2 areas where there appears to be an opportunity to further enhance the BSA examination handbooks.

First, the new BSA handbook now has over 45 mandatory procedures while the new Community Bank handbook has over 30 mandatory BSA procedures. We believe these mandatory procedures may not always be warranted because the risk of BSA compliance and a given bank's exposure to money laundering varies across banks. For example, the type of bank internal controls likely vary from very elaborate sophisticated systems to minimal published policies that might be reviewed based on available staffing. Examination efficiencies may accrue by affording examiners greater discretion in applying the mandatory procedures to the specific risk of a given bank.

Second, the Community Bank handbook recommends a sample size of only 5 accounts or transactions for testing purposes. We believe this number may be too small to provide a reliable basis for

an examiner's conclusions. We believe that OCC examiners could improve transactional testing effectiveness by basing the sample size selection on the bank's risk profile similar to that used in OCC's large bank handbook. The primary advantage is that the large bank handbook links the sample size to risk and not an arbitrary number. Furthermore, the large bank handbook sampling provides sufficient flexibility to use a small sample size should conditions and risk warrant a smaller sample.

OCC officials at the exit conference stated they believed this finding was somewhat inconsistent in that findings 1 through 3 identify lack of examination effort while this finding suggests OCC may be expending too much effort. We believe this inconsistency is one of context. Our prior observations took into account the risk of each sampled bank. The purpose of our report recommendations is to ensure coverage for trust and private banking services unless the documented risk assessment deems it unnecessary. Furthermore OCC's strategic plan calls for using risk focused examination resources based on need and risk while the new BSA handbooks mandate the same minimum coverage for every bank regardless of need and risk.

OCC officials also stated they realize the new number of mandatory BSA procedures is higher than those in the older handbooks but reasonable because the procedures cover many basic preliminary steps. The officials noted a review could be conducted to consider scaling back the procedures should it become apparent that the increased numbers of mandatory procedures were burdensome or impractical.

Further, OCC officials believed the recommended sample size of 5 for transactional testing in the Community Bank handbook is reasonable because community banks are usually small, have fewer transactions than large banks and offer fewer services to their customers.

Recommendations

6. The Comptroller of the Currency should reassess whether making the new examination procedures optional rather than mandatory would provide examiners greater flexibility in aligning examination procedures with the bank's BSA compliance risk.

This would not be contrary to OCC's Strategic Plan calling for risk focused examination procedures. Furthermore, if the procedures are made optional, OCC must ensure that the basis for not completing an examination procedure is adequately annotated in the working papers in line with OCC's working paper documentation policies.

OCC Management Comments

OCC concurred and stated during 2002, they will reevaluate the effectiveness of the new procedures and revise the procedures as warranted. During this review, they will also consider a number of factors, including feedback from the examination staff, examination results, review findings, and examination efficiency measures.

7. The Comptroller of the Currency should reassess whether the large bank sampling methodology for BSA transactional testing should be used for community banks to replace the current arbitrary sample size of 5 currently used. The large bank sampling approach should provide sufficient sampling flexibility for smaller samples given the focus on risk.

OCC Management Comments

OCC concurred and stated they will closely evaluate appropriate changes to the community bank examination approach, including sampling methods, in the context of risk-based supervision.

OIG Comment

We believe that OCC's planned corrective actions address the intent of recommendations 6 & 7. It should also be noted that OCC's planned internal targeted quality assurance reviews of both private banking and trust for 2002 should provide added insights from which to further assess the OIG's recommendations.

* * * * *

We would like to extend our appreciation to OCC for the cooperation and courtesies extended to our staff during the audit. If you have any questions, please contact me at (415) 977-8810 ext. 222 or John A. Richards, Audit Manager, at (415) 977-8810 ext. 225. Major contributors to the report are listed in Appendix 5.

/S/

Benny W. Lee

Regional Inspector General for Audit

Appendix 1

Objectives, Scope, and Methodology

The objective of the audit was to evaluate OCC's BSA examination coverage over trust and private banking services. Specifically, we sought to determine if BSA examination procedures were adequate to ensure that national banks had sufficient controls and procedures to comply with the BSA, and prevent and detect money laundering through trust and private banking activities. We also sought to determine if examiners were complying with OCC examination guidelines and if additional examination procedures or supervision were needed.

We visited OCC Headquarters in Washington, D.C., and 7 OCC district or field offices located in Charlotte, North Carolina, Dallas, Texas, Glendale and San Francisco, California, Miami, Florida, New York City, New York, and Pittsburgh, Pennsylvania. At OCC headquarters, we obtained BSA guidance provided to field examiners, including specific examination procedures to be used in conducting all BSA examinations. At each field location visited, we reviewed and discussed bank examination strategies and BSA policies and procedures with managers and examiners.

Additionally, we reviewed a judgmentally selected sample of 34 recent BSA examinations completed on national banks holding trust charters. Our sample included 5 banks that were supervised by OCC's large bank supervision group, 7 other banks with commercial assets over \$1 billion and 22 banks with commercial assets under \$1 billion. Twenty of the 34 banks in our sample offered private banking services. The examinations we reviewed were completed between March 1996 and June 2000. OCC Headquarters personnel in the compliance and policy groups helped us to identify banks that would be generally representative of banks with trust powers. Accordingly, most banks selected offered a wide range of trust services, such as estate planning and administration, retirement accounts, and investment services. Further, many of the 34 banks were located in High Intensity Drug Trafficking Areas (HIDTA) as designated by the Office of National Drug Control Policy.

The 34 banks with trust charters had assets ranging from about \$124.7 million to \$694.6 billion. These banks held a total of over \$2 trillion in trust assets. OCC does not issue a separate charter to those banks offering private banking and therefore was unable to provide us the number of banks offering private banking services or the estimated asset size of private banking accounts.

Appendix 1

Objectives, Scope, and Methodology

Our sample also contained two of the twenty banks surveyed for correspondent banking by the Minority Members of the Permanent Subcommittee on Investigations⁶.

With many of the sampled banks located in HIDTA areas we expected each trust examination to have full compliance with OCC BSA guidelines and complete minimal trust BSA work at each bank regardless of risk. Further, as the bank risk increased for potential money laundering activities we looked to see if the number of BSA examination procedures and work performed increased proportionately.

To help us assess the adequacy of BSA examinations, we developed a risk profile of each bank in our sample. We used the profiles to evaluate institutional risk including the risk of the bank violating BSA regulations, or the bank's clients using their trust or private banking accounts to launder money. Factors we considered in developing the risk profile included:

- the products and services offered to trust and private banking customers;
- the typical trust or private banking client having an account with the institution;
- the number of clients who were non-resident aliens, especially those residing in bank secrecy havens, or countries known to be heavily involved in drug trafficking;
- whether trust or private banking accounts included high risk business entities, such as check cashing or currency exchange facilities;
- whether the bank had off-shore accounts, foreign branches, and foreign correspondent banking relationships (especially with banks located in bank secrecy havens, or countries known to be heavily involved in drug trafficking);
- identifying the level of cash transactions processed by the bank; and
- Identifying the bank's procedures for controlling and monitoring transactions initiated by trust administrators and private bankers.

We obtained information for the risk profiles from OCC's Supervisory Monitoring System printouts, BSA examination workpaper files, interviews with OCC examiners-in-charge and portfolio managers and background information from the bank's web site. Further, we primarily ranked the institutions as high, moderate or low risk according to the type of services and products offered, type of clientele served and locations of business operations worldwide. We identified and evaluated OCC's

⁶ *Correspondent Banking: A Gateway For Money Laundering*, S.Prt. 107-1 February 5, 2001, Minority Staff Report.

Appendix 1

Objectives, Scope, and Methodology

examination procedures based on our bank profile and activities that pose the highest risk for money laundering.

Finally, we also reviewed OCC's Policies and Procedures Manual 5400-8, dated February 4, 1997 to identify minimum examiner documentation standards. Our review evaluated all OCC examination work contained in workpaper files that directly focused on trust and private banking services. Our opinions are based on documentation found in the examination workpaper files and through discussions held with knowledgeable OCC examiners for each institution reviewed.

We conducted our fieldwork between July 2000 and June 2001 in accordance with generally accepted government auditing standards.

Appendix 2
Summary Of Trust Examination Coverage

Sample Bank No.	OIG Assigned BSA Risk Rating	Did Examiners Apply Correct Handbook Procedures?	Extent Mandatory BSA Procedures Completed	Evidence of Trust Coverage?
01	HIGH	YES	ALL	YES
02	LOW	NO	NONE	NO
03	LOW	NO	NONE	NO
04	HIGH	YES	ALL	YES
05	MODERATE	YES	SOME	YES
06	MODERATE	YES	ALL	NO
07	MODERATE	YES	ALL	YES
08	LOW	YES	ALL	YES
09	MODERATE	YES	SOME	YES
10	MODERATE	NO	NONE	NO
11	MODERATE	YES	SOME	YES
12	MODERATE	YES	ALL	YES
13	LOW	NO	NONE	YES
14	LOW	YES	ALL	YES
15	HIGH	YES	ALL	YES
16	HIGH	YES	ALL	YES
17	MODERATE	YES	ALL	YES
18	MODERATE	YES	ALL	YES
19	LOW	YES	ALL	YES
20	MODERATE	YES	ALL	YES
21	MODERATE	YES	ALL	YES
22	MODERATE	YES	ALL	YES
23	MODERATE	YES	SOME	NO
24	MODERATE	NO	NONE	YES
25	MODERATE	YES	ALL	YES
26	MODERATE	YES	SOME	YES
27	MODERATE	YES	ALL	NO
28	MODERATE	YES	SOME	YES
29	LOW	YES	ALL	YES
30	MODERATE	YES	ALL	YES
31	MODERATE	YES	SOME	YES
32	MODERATE	YES	ALL	YES
33	HIGH	YES	ALL	YES
34	<u>HIGH</u>	<u>YES</u>	<u>SOME</u>	<u>YES</u>
			21 All	
		29 YES	8 some	28 YES
		5 NO	5 None	6 NO

Appendix 3 Summary Of Private Banking Examination Coverage

Sample Bank No.	OCC District	Bank Offers Private Banking Services	Size of Bank Based On Commercial Assets*	Evidence of Private Banking Coverage
01	NE	YES	LARGE	YES
02	NE	N/A		
03	NE	YES	COMM./LARGE	NO
04	NE	YES	COMM./LARGE	YES
05	NE	N/A		
06	NE	N/A		
07	NE	N/A		
08	W	N/A		
09	W	YES	LARGE	NO
10	W	YES	LARGE	NO
11	W	YES	LARGE	YES
12	W	YES	LARGE	NO
13	W	N/A		
14	W	N/A		
15	W	YES	COMM./LARGE	NO
16	SE	YES	LARGE	YES
17	SE	YES	LARGE	YES
18	SE	YES	LARGE	NO
19	SE	N/A		
20	SE	YES	COMMUNITY	NO
21	SE	N/A		
22	SE	N/A		
23	SE	YES	LARGE	NO
24	SE	YES	COMMUNITY	NO
25	SW	YES	LARGE	YES
26	SW	N/A		
27	SW	YES	LARGE	NO
28	SW	YES	LARGE	NO
29	SW	N/A		
30	SW	N/A		
31	SW	N/A		
32	SW	YES	COMM./LARGE	NO
33	SW	YES	LARGE	YES
34	W	YES	LARGE	YES
			14 LARGE	
			2 COMMUNITY	8 YES
		20 YES	4 COMM./LARGE	12 NO

*Large: over \$1 billion, Comm./Large: from \$250 million to \$1 billion, Community: under \$250 million.

Appendix 4 Management Comments



MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Benny W. Lee, Regional Inspector General for Audit

From: John D. Hawke, Jr., Comptroller of the Currency

Date: November 9, 2001

Subject: Draft Audit Report -- BSA Examination Coverage of Trust and Private Banking Services

We have reviewed your draft audit report titled *Bank Secrecy Act: OCC Examination Coverage of Trust and Private Banking Services*. We welcome the opportunity to respond to your findings and recommendations.

The OIG report represents a review of 34 Bank Secrecy Act (BSA) examinations of national banks holding trust charters that were conducted by the OCC between 1996 and 2000. We are pleased with the OIG's finding that BSA examination files generally identified and documented the work completed in an understandable manner.

Your report contains recommendations to address the audit exceptions and to revise our examination approach for BSA examinations. As detailed below, we will take steps to address your findings and recommendations.

Examination Coverage and Scope

Your report states that not all of the sampled BSA examinations included:

- Coverage of trust and private banking services;
- Testing in certain high-risk situations, and
- Performance of all mandatory procedures.

We concur that, in some cases, the examination team could have expanded the scope of their BSA examinations to cover all required procedures, trust activities, private banking services, or other high-risk situations. Also, it should be noted that the appropriate scope of review should be risk-based. The foundation of the OCC's risk-based philosophy is that all banks must have risk management systems in place to identify, measure, control and monitor risks. These systems should be commensurate with the size and complexity of, and risks assumed by, the institution. As noted in your report, examiners should include coverage of high-risk situations unless the risk assessment deems it unnecessary. We rely on the examiner's judgment to determine if the scope of the review should be expanded beyond the minimum procedures to ensure quality supervision.

Appendix 4

Management Comments

In response to the OIG's findings regarding examination coverage and scope, the OCC will take the following actions:

- Communicate to examiners the results and concerns identified by the OIG by placing a notice on our internal website.
- Emphasize, through ongoing discussions with the examination staff, the need to: 1) perform and document risk assessments for each institution, 2) perform all required examination procedures, and 3) perform transactional testing procedures, using the recently issued BSA/AML examination procedures, on areas identified in the risk assessment as high-risk.
- Communicate to managers the need to periodically monitor and identify, through Examiner View, examinations where examination procedures were performed on high-risk areas such as private banking and trust.
- Communicate to examiners the definition of total assets and provide guidance on using the appropriate examination procedures for community and large banks.
- Request that internal targeted quality assurance reviews of private banking and trust be conducted during 2002.
- Expand training modules for BSA to provide guidance on using the appropriate examination procedures for community and large banks.

Examination Approach

Your report recommends that we reassess the mandatory nature of our examination procedures and reassess the sampling methodology used in community bank examinations. As you know, the OCC recently updated and published its BSA/anti-money laundering (AML) examination procedures for both community and large banks. During 2002, we will reevaluate the effectiveness of the new procedures and revise the procedures as warranted. During this review, we will consider a number of factors, including feedback from the examination staff, examination results, review findings, and examination efficiency measures. Also, we will closely evaluate appropriate changes to the community bank examination approach, including sampling methods, in the context of risk-based supervision.

We are committed to ensuring that our supervisory efforts with respect to the Bank Secrecy Act and anti-money laundering activities are comprehensive and effective. We believe we have demonstrated that commitment through our expanded examination programs. While we feel we have made significant progress in this area in the past few years, we will continue to address identified shortcomings and strengthen our policies and practices.

Technical corrections and editorial suggestions were provided to your auditors separately. We appreciate the opportunity to review and comment on the report.

Appendix 5
Major Contributors to this Report

Western Region

John A. Richards – Audit Manager
John E. Carnahan – Auditor-in-Charge
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Chief National Bank Examiner
Senior Deputy Comptroller for Large Banks
Deputy Comptroller for Compliance Operations and Policy
Director, Enforcement and Compliance
Director, Management Improvement
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