**GAO Responses to Questions for the Record**

**from Senator Charles E. Grassley**

Question: The October 2010 GAO report recommended Treasury revise its guidance manual to include specific examination policies and procedure for MSB examiners to follow. Are you confident that this update will happen expeditiously?

GAO Response: As administrator of the Bank Secrecy Act (BSA), [[1]](#footnote-1) FinCEN is responsible for, among other things, developing regulatory policies for agencies that examine financial institutions and businesses for compliance with BSA regulations. FinCEN is also responsible for overseeing agency compliance examination activities and provides these agencies with assistance to ensure they are able to carry out their compliance exams. Treasury, through FinCEN, has delegated the authority to conduct compliance examinations of certain nonfederally regulated nonbank financial institutions (NBFI), including money services businesses (MSBs), to the Office of Fraud/BSA, within IRS’ Small Business/Self-Employed Division.

FinCEN’s guidance for these examiners lacks specific information to follow when assessing MSB compliance by issuers, sellers, and redeemers of stored value. To provide guidance for performing MSB examinations to these examiners, in December 2008, FinCEN issued, jointly with the IRS, the *Bank Secrecy Act/Anti-Money Laundering Examination Manual For Money Services Businesses.* FinCEN’s goal was to ensure consistency in the application of the anti-money laundering requirements called for by the BSA. The manual includes general procedures that are applicable to all MSBs, such as procedures for reviewing an anti-money laundering program, but it does not specifically address transaction testing procedures for examining issuers, sellers, and redeemers of stored value. Developing policies and procedures for monitoring entities that issue, sell, and redeem stored value could help ensure that such entities carry out current and future anti-money laundering requirements. IRS Fraud/BSA officials acknowledged that there are no specific transaction testing procedures in the manual for examiners to follow at a MSB that issues, sells, and redeems stored value. According to officials, at the time the manual was developed, FinCEN did not have sufficient information on the stored value industry and it wanted to get a better understanding of the industry before including examination procedures in the manual. However, according to FinCEN, several years ago FinCEN began working with its law enforcement and regulatory counterparts, as well as the financial services industries to study the stored value/prepaid card industry in the context of expanding anti-money laundering obligations to emerging payment systems.

On May 22, 2009, the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act) [[2]](#footnote-2) was enacted which, among other things, required the Secretary of the Treasury,[[3]](#footnote-3) in consultation with the Secretary of Homeland Security, to issue regulations in final form implementing the BSA, regarding the sale, issuance, redemption, or international transport of stored value, including stored value cards no later than 270 days after the date of enactment of the Credit CARD Act (February 16, 2010). As part of the process for issuing regulations in final form, the Financial Crimes Enforcement Network (FinCEN) developed a Notice of Proposed Rulemaking (NPRM). In preparing the NPRM, FinCEN consulted with Treasury components and obtained input from external stakeholders including members of the stored value industry and financial industry, law enforcement, and federal agencies and departments. FinCEN published the NPRM on “stored value” or “prepaid access” on June 28, 2010, after the deadline set by the Credit CARD Act of 2009 to issue regulations in final form. As of March 2011, FinCEN has not issued regulations in final form on stored value and it is unclear when the regulations will be finalized.

In response to the recommendation that the Director of FinCEN revise its guidance manual to include specific examination policies and procedures, including for transaction testing, for IRS examiners to follow at a MSB that issues, sells, and/or redeems stored value, FinCEN stated that it will proceed with its plan to update the Money Services Business examination manual when the initial rule is finalized.

Question: In your opinion, how much of a factor does the financial industry play in causing the delays at Treasury in issuing regulations on prepaid access and stored value?

GAO Response: FinCEN exempted money services businesses (MSBs) that offer stored value products from many of the anti-money laundering provisions of the BSA regulations. According to FinCEN, they provided these exemptions in a 1999 rulemaking to “eliminate the ‘chilling effect’ on the technology industry to which commenters objected” and due to the “complexity of the industry and the desire to avoid unintended consequences with respect to an industry then in its infancy.”[[4]](#footnote-4) Further, according to FinCEN, having recognized the emergence of sophisticated payment methods and the potential for abuse by criminal actors, several years ago FinCEN began working with its law enforcement and regulatory counterparts, as well as the financial services industries that FinCEN regulates to study the stored value/prepaid card industry in the context of expanding anti-money laundering obligations to emerging payment systems. In 2008, FinCEN noted the significant growth over the previous 10 years in the development and use of stored value products, recognizing that the exemptions for MSBs created a situation whereby issuers, sellers, and redeemers of stored value are subject to a less comprehensive Bank Secrecy Act/Anti-Money Laundering regime than other actors falling within the scope of FinCEN’s regulations. On April 26, 2010, in the Treasury’s Semiannual Regulatory Agenda, FinCEN stated that “if these [regulatory] gaps are not addressed, there is increased potential for the use of [stored value] as a means for furthering money laundering, terrorist financing, and other illicit transactions through the financial system.”[[5]](#footnote-5) In preparing the NPRM, FinCEN consulted with Treasury components and obtained input from external stakeholders including members of the stored value industry and financial industry, law enforcement, and federal agencies and departments. In June 2010, FinCEN issued the NPRM and once the NPRM was published in the Federal Register, FinCEN provided an opportunity for comment on the proposed rule. FinCEN extended the comment period and received over 150 comments from representatives of the financial services industry, law enforcement, and other interested stakeholders.

Question: Do you believe that if Treasury continues to face delay after delay in issuing prepaid access regulations, Congress should step in and clarify federal money laundering laws to address prepaid access? If so, how long do you believe Congress should wait?

GAO Response: FinCEN is in the process of developing and issuing regulations to address the risk associated with the illicit use of stored value, as required by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), but much work remains and it is unclear when the agency will issue the final regulations. In June 2010, FinCEN issued a Notice of Proposed Rulemaking (NPRM) that addressed certain regulatory gaps related to the use of stored value. However, FinCEN has not yet issued the final rule. Further, this NPRM does not address the international transport of stored value.

In our October 2010 report, we recommended that FinCEN update its written plan for addressing the requirements of the Credit CARD Act to include target dates for issuing the final regulations related to stored value. At the time of this response, FinCEN has not publicly updated its plan in accordance with our recommendation and it remains unclear when the final regulations on stored value will be issued.

As Congress considers taking action and enacting additional legislation related to addressing the risks associated with the illicit use of stored value and the stored value industry, knowing FinCEN’s timeline for issuing the final rule on stored value and a rule on the cross-border transport of stored value will be an important consideration. If FinCEN is unable to provide you with a satisfactory timeline, Congress may always consider legislation.

Question: What other problems exist for dealing with prepaid access and stored value?

GAO Response: Recognizing that stored value products are vulnerable to money laundering, FinCEN’s June 2010 NPRM proposes to address three regulatory gaps related to MSBs involved in stored value or “prepaid access.” However, as discussed in our October 2010 report, after FinCEN issues the June 2010 NPRM in final form, it will face at least four challenges in ensuring industry compliance with the new rules: (1) Updating the MSB Examination Manual; (2) Tracking suspicious activities related to stored value; (3) Developing a more complete database of MSBs; and (4) Regulating off-shore entities providing stored value services.

First, FinCEN will need to update their guidance for monitoring MSB compliance with anti-money laundering requirements, which is currently silent on stored value. In our October 2010 report, we recommended that FinCEN revise its guidance manual to include specific examination policies and procedures for MSBs that issue, sell, and/or redeem stored value. FinCEN concurred with our recommendation and stated that they plan to update the examination manual after the rulemaking is finalized.

Second, FinCEN needs to follow-through with planned revisions to the suspicious activity report (SAR) form in order to improve the tracking of suspicious activities related to stored value. Currently, SAR forms do not contain a systematic mechanism to indicate that stored value was the financial service involved in the suspicious activity and as a result, it is difficult to track and monitor suspicious activity and the risks related to the use of stored value. FinCEN plans to implement a revised SAR form intended to correct this challenge in fiscal year 2012; however, it is too early to tell if the revised form, once implemented, will improve the tracking of suspicious activities related to stored value.

Third, FinCEN does not have a complete database on MSBs, including those that issue, sell, and/or redeem stored value. Lacking full knowledge of the MSB population will complicate FinCEN’s ability to educate all MSBs about the new rule and its anti-money laundering regulations. Additionally, the degree to which MSBs involved in stored value will be monitored for compliance with the new rules remains an open question.

Fourth, in order to fully combat the illicit use of stored value, efforts to implement anti-money laundering practices must be extended to international financial markets. Prior to the enactment of the Credit CARD Act, FinCEN had begun the process of proposing a new rule to address, among other things, off-shore MSBs that market stored value products in the United States. However, FinCEN officials told us that the final rule related to off-shore MSBs will be delayed and issued at the time FinCEN issues the final rule addressing the requirements under the Credit CARD Act. In the meantime, FinCEN continues to participate in an intergovernmental entity called the Financial Action Task Force (FATF), whose purpose is to establish international standards for combating money laundering and terrorist financing.

While the June 2010 NPRM will face the challenges described above, additional challenges will be faced if FinCEN decides to regulate the international transport of stored value at a later date. These challenges involve: (1) detecting illegitimate stored value cards, which often resemble traditional debit or credit cards; (2) obtaining proper traveler declarations and verifying the value on a stored value card; and (3) seizing the funds connected to the card, rather than just seizing the physical card.

Question: Aside from stored value and prepaid access, what other developing technologies should we in Congress be paying attention to?

GAO Response: Beyond cards, new forms of stored value have surfaced in recent years. In 2008, the World Bank issued a report that identified the risk of international smuggling and money laundering of illegal proceeds through the use of financial transactions initiated from a mobile phone, also called mobile financial services.[[6]](#footnote-6) The World Bank report describes how technology is now available in countries such as South Korea, the Philippines, and Malaysia that allows individuals to make transactions from an account in one country to an account in another country through a mobile phone. This technology has begun to penetrate the market in the United States and will become more readily available to consumers in the next several years. According to the report, the risks of money laundering with the use of such devices include (1) user identity may not be known, (2) “smurfing,” or splitting large financial transactions into smaller transactions, can be carried out to evade scrutiny and reporting by the financial institution, and (3) mobile financial services fall outside of anti-money laundering regulations.

Question: In your estimation, what percentage of money headed across the Southwest Border is currently moved in stored value? Do you believe that this will continue to increase in the future?

GAO response: In our October 2010 report on cross-border currency smuggling, we stated that little was known about whether Mexican criminal enterprises are making use of stored value technologies. However, in his March 2010 testimony before the House Appropriations Committee, the FBI Director stated that recent money laundering investigations demonstrate that criminals are able to exploit existing vulnerabilities in the reporting requirements in order to move criminal proceeds using stored value devices, such as prepaid cards. While the extent to which stored value is used for illicit purposes is unknown, law enforcement case examples and reported suspicious activities demonstrate that stored value has been used for cross-border currency smuggling and other illicit activities. History has shown that when criminal organizations identify potential vulnerabilities in financial regulatory controls, they try to exploit them. For example, when the Bank Secrecy Act began requiring financial institutions to report cash deposits of $10,000 or more, criminal organizations began making multiple deposits of less than $10,000 to evade the reporting requirement, a method known as structuring.

Question:In your opinion, how big of a problem is corruption in Mexico? Particularly, among Mexican law enforcement agencies?

GAO Response:Corruption in Mexico has been and continues to be a significant problem. According to the State Department’s 2010 International Narcotics Control Strategy Report, despite some progress corruption remains a significant impediment to counternarcotics efforts in Mexico. According to the report, their influence is greatest among lower paid municipal and state police who have had historically lower hiring standards and fewer controls in place to check for corruption. This is a significant problem given that these police organizations represent roughly 90 percent of Mexico’s total police force. In 2009, we reported that according to Mexican government officials, corruption pervades all levels of Mexican law enforcement—federal, state, and local, however, corruption is more of a problem at the state and local levels than federal.[[7]](#footnote-7)

Corruption has also infiltrated Mexico’s judiciary system. In our 2007 testimony on U.S. support to Mexican counternarcotics efforts, we stated that the criminal procedures system in Mexico is based on the Napoleonic inquisitorial written model, with judges working independently using evidence submitted in writing by the prosecution and defense to arrive at a ruling.[[8]](#footnote-8) According to U.S. officials, this system has been vulnerable to the corrupting influence of powerful interests, particularly criminal organizations. To promote greater transparency in judicial proceedings, the U.S. Agency for International Development (USAID) has supported initiatives to introduce adversarial trials that would entail oral presentation of prosecution and defense arguments before a judge in a public courtroom. Since this system is open to public scrutiny, USAID officials explained that it should be less vulnerable to corruption.

Question: How does it affect, or undermine, our country’s efforts to combat money laundering and the drug trade when nations are not taking the necessary internal actions to support our shared effort?

GAO Response: In our 2009 report on firearms trafficking, we reported that U.S. government and law enforcement officials told us that corruption inhibits their efforts to ensure a capable and reliable partnership with Mexican government entities in combating arms trafficking.[[9]](#footnote-9) For instance, U.S. law enforcement officials we met with along the Southwest border and in Mexico told us they attempt to work with Mexican counterparts in law enforcement, the military, and Attorney General’s Office whenever possible. However, incidents of corruption among Mexican officials compel them to be selective about the information they share and with whom they share it. Similarly, Customs and Border Protection officials and Border Patrol officials told us that, on the border, collaboration between Mexican and U.S. counterparts has been limited due to concerns about corruption among Government of Mexico customs officers. CBP officers at one major border crossing location told us they had not been in contact with their Mexican customs counterparts and would not know who they could trust if they were. Mexican federal authorities are implementing anticorruption measures—including polygraph and psychological testing, background checks, and salary increases— but U.S. and Mexican officials acknowledge fully implementing these reforms will take considerable time, and may take years to affect comprehensive change.

Question: How does not being able to share intelligence with uncooperative nations, impact the ability to work with foreign governments to combat the money laundering schemes that finance the drug trade?

GAO Response: The lack of a country’s cooperation can severely hinder efforts to combat narcotics trafficking. In 2009, we reported that although Venezuela is one of the major drug transit countries in the Western Hemisphere, U.S. cooperation with Venezuela has declined.[[10]](#footnote-10) The U.S. and Venezuela cooperated closely on counternarcotics between 2002 and 2005, but beginning in 2005, the government of Venezuela took a number of actions that have weakened U.S.-Venezuelan counternarcotics cooperation such as withdrawing from a task force and an intelligence sharing initiative, no longer participating in anti-money laundering training programs, and denying visas to US personnel, particularly law enforcement. The lack of Venezuelan counternarcotics cooperation with the U.S. has been a significant impediment to the U.S. capacity to interdict drugs en route to the United States.

The lack of cooperation can also undermine gains made in other locations. According to U.S. and Colombian officials, Venezuela has extended a lifeline to Colombian illegal armed groups by providing significant support and safe haven along the border. As a result, these groups, which traffic in illicit drugs, remain viable threats to Colombian security. According to U.S. officials if illegal armed groups continue to find safe haven in Venezuela and receive support from Venezuela, the permissive atmosphere and lack of cooperation will likely adversely affect the security gains made in Colombia since 2000.

1. Bank Secrecy Act, titles I and II of Pub. L. No. 91-508, 84 Stat. 1114 (1970) (codified as amended in 12 U.S.C. §§ 1829b, 1951-1959; 31 U.S.C. §§ 5311-5332). [↑](#footnote-ref-1)
2. Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (2009). [↑](#footnote-ref-2)
3. The Secretary of the Treasury has the authority to administer the Bank Secrecy Act and its implementing regulations. This authority has been delegated by the Secretary to the Director of the Financial Crimes Enforcement Network. [↑](#footnote-ref-3)
4. Amendment to the Bank Secrecy Act Regulations-Definitions Relating to, and Registration of, Money Services Businesses, 64 Fed. Reg. 45438, 45442 (proposed Aug. 20, 1999); Amendment to the Bank Secrecy Act Regulations-Definitions and Other Regulations Relating to Money Services Businesses, 74 Fed. Reg. 22129, 22136 (proposed May 12, 2009). [↑](#footnote-ref-4)
5. 75 Fed. Reg. 21868, 21869 (April 26, 2010). [↑](#footnote-ref-5)
6. The World Bank, *Integrity in Mobile Phone Financial Services: Measures for Mitigating Risks from Money Laundering and Terrorist Financing* (Washington D.C.: 2008). [↑](#footnote-ref-6)
7. GAO*, Firearms Trafficking: U.S. Efforts to Combat Arms Trafficking to Mexico Face Planning and Coordination Challenges*, GAO-09-709, (Washington, D.C.: June 18, 2009) [↑](#footnote-ref-7)
8. GAO, *Drug Control: U.S. Assistance Has Helped Mexican Counternarcotics Efforts, but the Flow of Illicit Drugs into the United States Remains High,* GAO-08-215T, (Washington, D.C.: October 25, 2007) [↑](#footnote-ref-8)
9. GAO-09-709. [↑](#footnote-ref-9)
10. GAO, *Drug Control: U.S. Counternarcotics Cooperation with Venezuela Has Declined*, GAO-09-806, (Washington, D.C.: July 20, 2009) [↑](#footnote-ref-10)