

**OTS: Enforcement Actions
Taken for
Bank Secrecy Act Violations**

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Abbreviations

BSA	Bank Secrecy Act
CTR	Currency Transaction Report
EDS	Examination Data System
FinCEN	Financial Crimes Enforcement Network
FFIEC	Federal Financial Institutions Examination Council
OIG	Office of Inspector General
SAR	Suspicious Activity Report
TIMS	Thrift Information Management System
ROE	Report of Examination

*The Department of the Treasury
Office of Inspector General*

September 23, 2003

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This report presents the results of the Office of Inspector General's (OIG) review of the Office of Thrift Supervision's (OTS) use of enforcement actions taken against thrifts with substantive violations of the Bank Secrecy Act (BSA). According to OTS supervisory records, as of October 2002, 321 (or 33%) of the 986 supervised thrifts had a record of some type of BSA violation that had been identified during an OTS examination. Of the 321, examiners found 180 (56%) thrifts had substantive BSA violations. For those 180 thrifts with substantive BSA deficiencies, OTS issued enforcement actions against 11 thrifts.

The objectives of this audit were to determine if: 1) OTS took timely and sufficient supervisory enforcement actions against thrifts with substantive BSA violations; 2) enforcement actions, when taken, adequately addressed all substantive BSA violations identified by examiners; and 3) OTS' systems to track and monitor BSA examination results were accurate and reliable. As indicated, the audit focused only on thrifts with substantive BSA violations identified during an examination as reflected in either the Report of Examination (ROE) or the underlying examination workpapers. We did not attempt to gauge the adequacy of the underlying BSA examinations, which is the focus of another OIG audit.

We conducted fieldwork at three of the four OTS regions and reviewed a sample of 128 thrifts totaling 256 BSA examinations completed from January 2000 through October 2002. We expanded the audit period for some of the sampled thrifts when it was necessary to identify any recurring BSA violations. A detailed discussion of the audit objectives, scope, and methodology is provided in Appendix 1.

Results in Brief

According to OTS' Thrift Information Management System (TIMS), examiners found substantive BSA violations at 180 (or 18%) of the 986 thrifts examined during the audited period. Of the 180 thrifts with substantive violations (e.g., lacking a BSA policy or systems to ensure compliance), OTS had issued written enforcement actions against 11 thrifts.

From the remaining 169 thrifts with substantive violations and without a written enforcement action in place, we sampled 68 thrifts for detailed review. In all 68 cases, we found OTS relied on moral suasion and thrift management assurances to comply with the BSA. In 47 (69%) of the 68 cases, thrift management took corrective actions to resolve the substantive BSA violations. However, thrift management was not responsive and did not correct its BSA violations for the remaining 21 (31%) thrifts. We believe that the ROEs and underlying examination workpapers supported OTS taking more forceful and timely enforcement actions against the 21 thrifts.

We believe the absence of more forceful enforcement actions did little if anything to prevent the 21 thrifts from continuing to violate the BSA and or from taking an inordinate number of years before substantively addressing the BSA violations. In some cases, BSA compliance actually worsened from the time the BSA violations were first identified. As of October 2002, all 21 thrifts still had not fully addressed the BSA violations even though, in some cases, OTS had first identified the substantive violations as long as six years ago.

We also reviewed in detail 9 of the 11 cases where OTS issued written enforcement actions in response to substantive BSA violations. We found in 5 instances enforcement documents were either not taken timely or did not address all the substantive violations found by examiners. BSA violations continued for years or BSA compliance worsened. For two of the five cases, enforcement actions were not effective in correcting the thrifts' BSA violations as of the end of our fieldwork in May 2003.

Lastly, we found material data inaccuracies with the BSA records of thrifts in the TIMS. From a sample of 182 examination records in TIMS, we found nearly half contained an error when compared to the underlying ROE. These data discrepancies included omissions and or inaccuracies. Consequently, we believe that using aggregated TIMS data to gauge thrift industry compliance with BSA is largely unreliable. This condition could adversely impact supervisory decisions and BSA program initiatives to the extent OTS senior managers or regional supervisors use TIMS to monitor the thrift industry's BSA compliance, as well as plan, monitor, or review individual BSA examination results. Of equal importance is using TIMS data to report on the industry's BSA compliance to external parties such as the Financial Crimes Enforcement Network (FinCEN).

The report includes several recommendations aimed at enhancing the enforcement process over thrifts found to be in substantive noncompliance with the BSA. These include (1) providing clarifying guidance to supervisory staff on when to initiate a written (both informal and formal) enforcement action for substantive BSA violations, (2) enhancing management controls to better ensure that OTS' enforcement documents are complete and timely, (3) enhancing controls over the process of entering BSA information into the management information system, and (4) advising external users of TIMS BSA data of the potential data inaccuracies until OTS is able to fully assess the reliability of the existing TIMS BSA data.

OTS concurred with our recommendations. If properly implemented, we believe that OTS' planned corrective management actions are responsive to the reported conditions and weaknesses. In their response to the draft report, OTS also noted several factual items that OTS felt mitigated some of the risks and reported weaknesses, as well as actions that had been initiated prior to the completion of this audit. The full text of OTS' response to the report is included in Appendix 3.

Background

In 1970, Congress enacted the Bank Secrecy Act (BSA) to prevent financial institutions from being used as intermediaries for the transfer or deposit of money derived from criminal activity. Over the years, the BSA has been amended several times to strengthen its anti-money laundering provisions. The most recent changes arose in October 2001 with the passage of the USA PATRIOT Act. The Act currently contains expanded provisions to prevent, detect, and prosecute terrorism and international money laundering by requiring financial institutions to take certain actions such as establishing an anti-money laundering program.

OTS conducted 1,261 compliance examinations from January 2000 to October 2002. Assessing BSA compliance is one of over 30 areas that could be covered during a compliance examination. Other compliance areas, to name a few, include Equal Credit Opportunity Act, Truth in Lending Act, and Community Reinvestment Act. After each compliance examination, OTS examiners assign an overall compliance rating, but there are no individual component ratings for each of the areas covered. The interval between compliance examinations ranges from 6 to 36 months depending on the thrift's prior compliance performance as reflected by its ratings. Generally, those thrifts with unsatisfactory compliance ratings are examined more frequently.

12 CFR §563.177 requires thrifts to establish and maintain a program to monitor compliance with the BSA. During an examination, OTS focuses on whether thrifts have (1) sufficient internal controls to ensure compliance with the BSA, (2) independent testing of compliance, (3) individuals to coordinate and monitor the program, and (4) BSA training for appropriate personnel. OTS examiners also assess whether the program includes adequate record-keeping procedures for several required BSA report filings such as the Currency Transaction Report (CTR) and Suspicious Activity Report (SAR). Thrifts are also required to maintain documentation in support of the required reports for possible use in criminal, tax and regulatory proceedings.

When a thrift is in violation of the BSA, OTS may take various enforcement actions to effect corrective action and or sanction the thrift. These enforcement actions range from informal actions such

as a Director's Resolution and Supervisory Directive to formal actions such as a Cease and Desist Order (C&D) and Civil Money Penalties (CMPs). FinCEN also levies CMPs against depository institutions (banks, credit unions and thrifts) as well as money service businesses and casinos for failing to file CTRs and SARs¹.

There are no guidelines linking a specific enforcement action to certain types or levels of BSA violations. Instead, OTS exercises judgments taking into account various circumstances and considerations. The effectiveness of an informal enforcement action depends in part on the commitment and ability of thrift management to correct identified deficiencies. The consequence of failing to fully comply with an informal enforcement action is that OTS, in nearly all instances can recommend the use of one or more formal actions. The advantage of issuing a more formal action is that OTS can set specific timeframes for when the thrift needs to be in full compliance. If violations are egregious enough, OTS can assess CMPs against either the thrift or its employees.

Findings and Recommendations

Finding 1 Greater Use of Forceful and Timely Enforcement Sanctions Warranted for BSA Violations

Prior to and during the audited period, OTS used the Thrift Information Management System (TIMS) to track the number of specific BSA violations found during an examination. According to TIMS, examiners identified 2,315 BSA violations at 321 of the 986 regulated thrifts as of October 2002. The 2,315 violations included both minor technical and substantive BSA violations. At the start of the audit, we discussed and reached agreement with OTS officials as to the types of BSA violations that constituted a technical versus a substantive violation. Accordingly, technical violations cited in this report refer to violations that were not policy or programmatic problems such as minor errors and omissions in filling out CTRs and SARs. Whereas the failure to develop and implement a BSA program with the basic BSA minimum requirements and the non-filing of CTRs and SARs were deemed to be substantive violations.

¹ From January 2000 to May 2003, FinCEN issued 13 CMPs totaling \$24.6 million, with 1 CMP totaling \$700,000 levied on an OTS-regulated thrift.

From TIMS, we identified 180 thrifts with at least one substantive BSA violation as of October 2002. OTS issued enforcement actions to specifically correct the BSA problems at 11 thrifts. From the remaining 169 thrifts without any written enforcement action, we sampled 68 thrifts to determine the type and effectiveness of the supervisory response. In all 68 cases, we found OTS relied on moral suasion and thrift management assurances to comply with the BSA.

For 47 (69%) of the 68 sampled thrifts, we believe OTS' supervisory response was appropriate taking into account the nature of the BSA violations, the thrift's BSA program, and or the thrift-management's responsiveness to the examiner's findings as reflected in the ROE and underlying workpapers. The supervisory responses were also generally effective in getting thrift management to either correct or make substantive progress in correcting the BSA problems.

Stronger Actions Warranted for 21 Thrifts

Twenty-one (31%) of the 68 sampled thrifts were not responsive to OTS' supervisory concerns and continued to violate substantive aspects of BSA. The 21 thrifts ranged in asset size from \$20 million to \$205 million. As previously noted, we focused only on the 21 thrifts' substantive BSA violations. The following table summarizes these violations, and in all 21 cases, thrifts had violations in multiple areas.

Table 1
Types of Substantive BSA Violations Committed by 21 Thrifts

Substantive BSA Violations ²	Number of Thrifts
1. Absence of a written and adequate BSA program	16
2. Absence of internal controls to assure compliance with BSA	9
3. Failure to conduct independent testing to assure compliance with BSA	20
4. Lack of a designated individual responsible for coordination of compliance with BSA	7
5. Failure to train personnel for BSA compliance	17
6. Failure to file Currency Transaction Reports (CTRs)	2
7. Failure to file Suspicious Activity Reports (SARs)	1

Source: OTS ROEs and TIMS

The 21 thrifts did not meet the minimum requirements set forth by the BSA regulations. OTS examiners found that the first 5 violations were recurring in at least two consecutive examinations (i.e., 12 to 18 months later). Fourteen of the 21 thrifts showed a pattern of having repetitive BSA violations for at least three consecutive examinations; two thrifts had the same BSA policy problem in four consecutive examinations (6 years); five thrifts had four or more BSA violations in at least two examinations. However, the 3 instances of failure to file CTRs and SARs were not recurring violations. OTS examiners found them in an earlier examination and verified that they were corrected by the next examination. For further details on the 21 thrifts, see Appendix 2.

We believe stronger enforcement actions were warranted in the 21 cases given the substantive nature of the BSA violations, the repetitive nature of the violations and deficiencies, and the prolonged history of non-compliance with the most fundamental BSA requirements. In discussing these cases with the responsible supervisory officials, two primary reasons were cited for not taking enforcement actions:

² The substantive nature of the first five BSA violations are reaffirmed in that they are also the basic anti-money laundering program requirements for financial institutions under §352 of the USA PATRIOT Act.

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- Thrifts' overall compliance (i.e., other than BSA) performances were adequate, and thrift management could be entrusted to correct the deficiencies, and
 - Some of the smaller thrifts had limited resources and thus would have more difficulty in complying with the minimum BSA requirements, particularly the BSA requirement on independent testing.

We also identified two practices, which were likely contributing factors for OTS not using more forceful enforcement actions.

Enforcement actions were seldom taken unless a thrift's overall compliance rating³ was poor (i.e., 4 or 5). We noted that when OTS took enforcement actions, the thrifts' compliance rating was either a '4' or '5' as reflected in 10 of the 11 cases. Of the 21 thrifts with substantive BSA violations, their overall compliance rating was '3' or better. Indeed, these thrifts tended to be in better compliance with many or all of the other areas covered during a compliance examination. OTS supervisory officials also noted that BSA violations alone were not enough to lower the rating below a '3'. Our observed relationship between a thrift's overall compliance rating and whether OTS used a written enforcement action for substantive violations may be coincidental. Nevertheless, it should be noted that OTS Regulatory Section 150, RB 18-1B provides for issuing an enforcement action regardless of the ratings as long as OTS believes significant and ongoing problems exist.

Another observed contributing factor for not taking enforcement actions for substantive BSA violations involved OTS not ensuring that all violations found during an examination were incorporated into the ROE. We found in 14 of the 21 cases where substantive BSA violations were omitted from the final ROE. These omissions included BSA violations and deficiencies such as the lack of internal controls, independent testing and a weak BSA policy. These BSA violations and deficiencies were clearly documented in the underlying examination workpapers but omitted from the ROEs. OTS supervisory officials were not aware of the omissions and could not provide an explanation as to how or why the omissions

³ OTS' compliance examinations encompass many areas of laws and regulations, including BSA, Community Reinvestment Act, Fair Lending, etc. Performance is rated on a scale of '1' to '5' with '5' being the worst.

occurred. We believe these omissions should have been identified under normal supervisory review. By omitting these BSA violations from the ROE, OTS managers, who reviewed the ROEs to assess the need for enforcement actions, were not fully aware of the severity, breadth, or nature of the thrift's BSA violations. Consequently, the need for a more forceful enforcement action may not have been as apparent. Moreover, the need for corrective action and the severity of the BSA violations may not have been brought to thrift management's attention.

We believe the lack of forceful enforcement actions contributed to the 21 thrifts' continued BSA violations, the inordinate number of years before any substantive progress in addressing the BSA violations, and or a worsening BSA compliance record. Indeed, as of October 2002, all 21 thrifts still had not fully addressed the BSA violations from the time examiners originally identified the violations.

We found for 12 of the 21 thrifts BSA problems actually got worse, with examiners identifying additional substantive BSA problems in subsequent examinations. For these 12 thrifts, OTS examiners found an additional 16 substantive violations in later examinations, such as the lack of independent testing and inadequate training. For one thrift, problems existed as far back as 1998 and remained uncorrected in the next examination.

Recommendations

The OTS Director needs to:

1. Assess whether added clarification or guidance is needed for examiners over the following areas:
 - a. When to initiate stronger supervisory action when substantive BSA violations are found independent of the overall compliance rating.
 - b. Timeframes for expecting corrective action to avoid the observed thrift practices of repeatedly violating the BSA, a deteriorating record of BSA compliance, and or the inordinate number of years before meaningful progress is made towards addressing BSA violations.
 - c. Whether a thrift's resource constraints resulting in noncompliance with substantive aspects of BSA should

be used as an offsetting consideration for not pursuing enforcement actions.

Management Response and OIG Comments

OTS concurred and will issue supplemental examiner guidance in the first calendar quarter of 2004. If properly implemented, we believe that OTS' planned management corrective action adequately addresses the recommendation and reported condition.

2. Institute enhanced supervisory review over the examination process to better ensure that substantive BSA violations identified in an examination are incorporated into the ROE as currently provided in OTS Regulation (Compliance Handbook Section 125). Consideration should also be given to incorporating this aspect of the compliance examination on future quality assurance reviews.

Management Response and OIG Comments

OTS concurred and will implement enhanced regional reviews over the examination process to ensure that substantive BSA violations are incorporated into the ROE. OTS also plans to ensure that BSA violations are appropriately followed up prior to the subsequent examination cycle. If properly implemented, we believe that OTS' planned management corrective actions adequately address the recommendation and reported condition.

In its response to the draft report, OTS also cited two observations to add perspective to the OIG findings. One area indicated that the number of thrifts with substantive BSA violations impacted only 6 percent of the thrift industry and that the frequency of substantive CTR and SAR filing deficiencies was de minimis. The 6 percent figure is an OTS extrapolation, and OTS did not provide us with any of the supporting calculations or underlying assumptions. Nevertheless, as a point of clarification, we note on page 4 of the report that OTS records showed 18 percent (180) of the 986 supervised thrifts had substantive BSA violations for the audited period of January 2000 to October 2002. Furthermore, we had no basis for assessing the implied lack of severity of the number of thrifts failing to substantively meet the CTR and SAR filing requirements.

OTS also noted that all of the 21 thrifts cited in the report with substantive BSA violations were all smaller than \$250 million in assets. Although OTS was not excusing BSA violations based on thrift size, OTS indicated that the OIG report demonstrated their application of risk-based supervision over thrifts that displayed minimal operational exposure to money laundering or terrorist financing activity.

On page 8 of the report, we cite the range of asset size for the 21 thrifts only as added information. The OIG did not intend to suggest, as OTS may have interpreted, that asset size was an indicator of risk for either money laundering or terrorist financing. In fact, the OIG would caution against the notion that such risks are proportionate to asset size. Rather than asset size, the OIG believes the risk of money laundering and terrorist financing are influenced or mitigated by thrifts business activities and the controls underlying the BSA regulatory requirements as noted in the report. Also as reported, the 21 thrifts not only had substantive BSA violations but subsequent examinations revealed uncorrected violations or an increasing number of violations. Further, it was these examiner findings that formed the basis for believing that more timely and forceful enforcement actions had been warranted in addressing the substantive BSA violations.

Finding 2

Enforcement Actions Not Always Taken Timely or Thorough for Substantive BSA Violations

From January 1999 through October 2002, OTS issued written enforcement actions against 11 thrifts found to have substantive BSA violations. We reviewed 9 of the 11 cases that were supervised at one of the three OTS regions we visited. To assess the timeliness and thoroughness of the enforcement actions, we reviewed the ROEs and underlying workpapers, and also interviewed supervisory personnel familiar with the cases. The 9 thrifts ranged in asset size from \$25 million to \$2.6 billion, and were geographically dispersed throughout the country.

We found that 4 of 9 enforcement actions were issued timely when the BSA violations had been identified, sufficiently addressed all the identified BSA violations, and were generally effective in getting the thrifts to comply with the BSA requirements. In 3 of the 4 cases, the thrifts subsequently corrected the BSA

deficiencies, as reflected in subsequent ROEs and corresponding workpapers. However, for the remaining thrift, we were unable to fully assess the effectiveness of the enforcement action because OTS had not yet conducted a compliance examination subsequent to the enforcement action.

We found the other 5 of 9 enforcement actions were not thorough or timely, as described below:

- One enforcement action did not specifically include all the BSA violations identified during the examination. The BSA violations dealing with deficient BSA policies and independent testing had been omitted from the ROE. As a result, OTS enforcement officials who developed and crafted the enforcement action had not been aware of the omissions and did not require the thrift to specifically correct those BSA violations. Officials could not explain the reporting omissions.
- Two actions entailed using Formal Enforcement Action Waivers because there had been outstanding enforcement actions at the time. Although a waiver is considered an enforcement action it is basically a memorandum refraining from initiating additional action. However, for these two cases, the Waivers only made reference to the outstanding enforcement actions, which only covered previously identified BSA violations. As a result, the Waivers did not cover directly or by reference any of the subsequent BSA violations dealing with BSA policies and procedures, independent testing, internal controls, and SAR and CTR reporting.
- The form of another enforcement action was not sufficiently forceful in light of the nature of the BSA violations. In February 2000, examiners found the thrift had several BSA deficiencies and also suspected some structuring transaction schemes. Structuring occurs when a person engages in multiple cash transactions divided into amounts low enough to avoid the filing of a CTR or other BSA reporting or recordkeeping requirement. In response, OTS obtained managerial assurances for corrective actions through a Board Resolution, but without specific timeframes for achieving compliance. By the following examination the thrift had not made sufficient progress and had not fully implemented its BSA policies, continued to file SARs incorrectly, and also allowed non-customers to place wire

transfers without adequate verification. Indeed, the continued BSA violations prompted OTS to issue a more forceful enforcement action, a Supervisory Directive, in March 2003, three years after the initial identification of substantive BSA violations.

- Lastly, 1 of the 5 enforcement actions was not issued timely. This action was not taken until five years after examiners had first identified substantive BSA violations. As the following table shows, OTS examiners found repeated and growing BSA violations over three succeeding examination cycles covering 5 years.

Table 2
Five Years of Continued BSA Violations

Year of Exam	Exam Rating	BSA Problems Noted in ROE	OTS Enforcement Response
1996	2	1. BSA Policy Weaknesses 2. Internal Control Weaknesses 3. Inadequate Training 4. CTR Problems	Obtained management assurances to correct violations, but issued no written enforcement document
1998	3	1. BSA Policy Weaknesses 2. Internal Control Weaknesses 3. Inadequate Training 4. CTR Problems	Again obtained management assurances to correct violations, but issued no written enforcement document
1999	3	1. BSA Policy Weaknesses 2. Internal Control Weaknesses 3. Inadequate Training	Again obtained management assurances to correct violations, but issued no written enforcement document
2001	4	1. BSA Policy Weaknesses 2. Internal Control Weaknesses 3. CTR Problems 4. Not Filing SARS	Supervisory Agreement Issued

Source: OIG Analysis of OTS ROEs and Workpapers

In addition to not being thorough or timely, enforcement actions were also not effective in 2 of the 5 cases. These two thrifts continued to violate the BSA violations and neither thrift had fully complied with the BSA by the end of our audit fieldwork in May 2003. Aside from the continued violations, the 2 thrifts likely exposed the financial system to a greater risk of money laundering than thrifts complying with the BSA.

Recommendation

3. The OTS Director needs to better ensure that enforcement documents taken against thrifts for substantive BSA violations are thorough and timely. To that end, the OTS Director needs to:
 - a. Assess the adequacy of existing supervisory reviews to ensure that all BSA violations identified during an examination are carried forward into the ROE, and when applicable incorporated into the enforcement document.
 - b. Ensure that Enforcement Action Waivers include BSA violations identified subsequent to previously issued enforcement actions.
 - c. Include coverage of the aforementioned weaknesses as a part of any planned quality assurance reviews.

Management Response and OIG Comments

OTS concurred and will supplement existing guidance as to when substantive BSA violations should be identified in the ROE, ensure that enforcement actions waivers address BSA violations identified subsequent to previously issued enforcement actions, and include the above items in future quality assurance reviews. OTS plans to have these corrective actions implemented in the first quarter of 2004 and included in periodic quality assurance reviews thereafter. If properly implemented, we believe that OTS' planned management corrective actions adequately address the recommendations and reported conditions.

Finding 3

BSA Examination Data Errors with OTS' Thrift Information Management System

During and prior to the audited period, OTS used the Thrift Information Management System (TIMS) to monitor the results of all examinations, including BSA. In the course of our fieldwork, we identified significant TIMS data errors related to the results of BSA examinations. We believe these data inaccuracies could impair OTS supervisory and senior officials' ability to effectively monitor thrift industry BSA compliance and examination results.

Furthermore, OTS is at risk of providing erroneous information to external parties such as FinCEN.

At the completion of our fieldwork, OTS informed us that TIMS was being replaced with a new data base system referred to as the revised Examination Data System III (EDS III) and that certain system enhancements and less detailed BSA information would be captured under the revised EDS III. While these system changes should reduce some of the data inaccuracies, EDS III will likely experience similar data accuracies unless data entry controls are enhanced.

TIMS provides an automated means for OTS senior managers in headquarters and in the regions to quickly aggregate information to assess overall thrift industry compliance with the BSA. Although regional senior officials have access to similar BSA examination data by contacting examination staff directly, TIMS provides a quicker and automated means to monitor BSA examination results in the normal course of supervisory oversight. During the early phase of our audit, we noticed data discrepancies with the information recorded in TIMS. Because of the observed data discrepancies, we expanded our original fieldwork to assess the general reliability of TIMS BSA data.

We sampled 182 compliance examinations conducted from January 1996 to October 2002. We then compared the TIMS BSA information to the ROEs. Our tests included checking for both accuracy and completeness. The following table shows the results of our data comparisons.

Table 3
TIMS BSA Examination Records with Data Errors

(1)	(2)	(3)	(4)	(5)	(6)
Total Exams Reviewed.	TIMS Examination Records Where BSA Violations Were Omitted	TMS Examination Records Where BSA Violations Were Overstated	TIMS Examination Records with Erroneous Recorded BSA Violations	Total Examinations Records with an Error	Overall Error Rate (Col 5/ Col 1)
182	34	38	24	83*	46%

Source: OIG Analysis from Review of OTS ROEs and Workpapers

* Due to examinations with multiple errors, columns 2-4 do not sum to 83.

As Table 3 shows, nearly 50 percent of the examinations tested contained some type of data error as reflected in TIMS. The types of errors were mixed. Although not reflected in the table, the 83 examinations had a total of 133 data errors, involving only substantive BSA violations. While all three types of errors adversely affected the general usefulness of TIMS, of note was that 34 (or 19%) of 182 examinations had omitted substantive BSA violations found during an examination. As a result, these omissions could lead TIMS users to erroneous conclusions as to the thrift industry's general compliance with major requirements of the BSA.

The main reason for these TIMS data errors was that examiners did not have guidance as to how to record certain BSA violations for TIMS. As a result, filling out the data entry forms was left to individual interpretations resulting in inconsistent and incomplete reporting of certain BSA violations. This type of error typically occurred when examiners had to distinguish in TIMS if the BSA violation(s) was a policy or procedural (implementation) problem. For example, if a thrift's BSA policy lacked a specific section on independent testing, some examiners would only cite a violation associated with the overall BSA policy requirement, while others would only record the lack of independent testing, while still other examiners might record both types of violations. Again, these inconsistencies could be attributed to the lack of guidance as to how certain BSA violations were to be recorded in TIMS.

The lack of guidance resulted in examiners submitting erroneous BSA data entry forms to clerks, who, in turn, entered inaccurate and incomplete BSA data into TIMS. This process lacked

supervisory oversight to ensure that examiners accurately completed the data entry forms, and there was also an absence of internal controls to prevent such erroneous information from being entered into TIMS. Similarly, there were no internal controls to detect these data errors after the data entry process.

Recommendations

The OTS Director needs to:

4. Provide guidance to its examiners regarding the submission of BSA violations into the system.

Management Response and OIG Comments

OTS concurred and will provide guidance to examiners regarding the submission of BSA violations into the appropriate OTS database. The guidance will be issued and implemented in the first calendar quarter of 2004. If properly implemented, we believe that OTS' planned management corrective action adequately addresses the recommendation and reported condition.

5. Implement supervisory oversight controls to ensure that BSA data reported in TIMS accurately reflect the BSA violations in the examinations. Such enhancements to supervisory oversight should ensure that OTS has adequate controls to monitor the accuracy of TIMS and the newly implemented Examination Data System.

Management Response and OIG Comments

OTS concurred and will implement appropriate controls to ensure the accuracy of BSA violation data contained in the appropriate database. These controls will be issued and implemented in the first calendar quarter of 2004. If properly implemented, we believe that OTS' planned management corrective action adequately addresses the recommendation and reported condition.

6. To the extent TIMS data is being used for external reporting purposes and or updating EDS III, ascertain the extent of the BSA errors and apprise external users of any data reliability limitations.

Management Response and OIG Comments

OTS concurred and will apprise any recipient of reliability limitations to the extent that TIMS data is being used for external reporting purposes. This information will be conveyed in the first calendar quarter of 2004. If properly implemented, we believe that OTS' planned management corrective action adequately addresses the recommendation and reported condition.

In response to the draft report, OTS also cited an observation to add perspective to the OIG finding. Specifically, OTS indicated that they were aware of the database quality concerns and instituted a new system and methodology for recording BSA violation data. They stated that this new system continues to be refined and provides better quality and more useful supervisory information than contained in the TIMS data system.

As cited on page 17 of this report, we had acknowledged OTS' ongoing and plans to replace TIMS with the new Examination Data System III (EDS III). We also noted that while the system changes should reduce some of the data inaccuracies, EDS III would likely experience similar data accuracies unless data entry controls are enhanced. Accordingly, the recommendations under Finding 3 were made with the new system in mind.

* * * * *

We would like to extend our appreciation to OTS for its cooperation and courtesies extended to our audit staff during the audit. If you have any questions, please contact me at (415) 977-8810 ext. 222 or Garrett W. Gee, Audit Manager, at (415) 977-8810 ext. 227. Major contributors to the report are listed in Appendix 4.

Benny W. Lee /S/
Director, Western Field Audit Office

Appendix 1

Objectives, Scope, and Methodology

The objective of the audit was to evaluate whether OTS could have taken more appropriate enforcement actions against those thrifts with substantive BSA deficiencies. Additionally, for those thrifts with compliance-related enforcement actions, we sought to determine whether these actions were issued comprehensively and promptly. Finally, we sought to determine if the BSA supervisory information captured in OTS TIMS was accurate and complete.

The OIG conducted its fieldwork between August 2002 and May 2003 at OTS Headquarters in Washington D.C. as well as 3 of the 4 OTS regional offices located in San Francisco, California; Jersey City, New Jersey; and Atlanta, Georgia. We obtained general BSA guidance, including Treasury and OTS BSA regulations, as well as the enforcement actions issued against thrifts for deficiencies in compliance and in some cases, specifically in the area of BSA. At each regional office visited, we identified those thrifts with substantive BSA violations per TIMS and ROEs that were not issued a written enforcement action as well as those cases when OTS initiated an enforcement action as a result of BSA problems. We also discussed the process for capturing and inputting BSA citations into the BSA tracking system with regional officials and assessed the reliability of the BSA data captured in OTS' tracking system.

We identified 986 OTS-regulated thrifts totaling 1,261 compliance examinations for our review period from January 2000 to October 2002. We then identified 321 of the 986 thrifts that had at least one BSA violation during one of their compliance examinations. Further analysis found that 180 of the 321 thrifts had at least one substantive BSA violation. The other 141 had only minor technical violations.

We identified BSA violations to be either substantive or technical based on the description provided in the Treasury and OTS BSA Regulations. We discussed with OTS Headquarters personnel, and they concurred with our terminology and conclusions as to which violations were substantive or technical. We defined substantive violations to be those programmatic problems, such as inadequate BSA policy and weaknesses in internal controls or failure to file CTRs and SARs. Technical violations were defined as those

Appendix 1 Objectives, Scope, and Methodology

instances when thrifts submitted CTRs and SARs with minor errors and discrepancies.

Of the 180 thrifts with substantive BSA violations, we found OTS issued BSA-related enforcement actions for 11 thrifts. To assess whether stronger actions were warranted for the remaining 169 cases, we judgmentally sampled 68 of the thrifts. Once the sample was selected, we expanded our review coverage period from January 1996 to October 2002 so that we could review additional compliance examinations to determine if there were any recurring substantive BSA violations in the prior examinations. In evaluating whether stronger actions were warranted for these 68 sampled thrifts, we reviewed the ROEs and corresponding workpapers to assess the number and types of BSA deficiencies found as well as actions taken by OTS. In performing this objective, we attempted to identify the first time examiners identified BSA problems, assessed OTS' role in assisting thrift management to correct the problems, and reviewed subsequent examinations to determine if these BSA problems were subsequently resolved. We were unable to project the 68 sampled thrift results to the total universe of 986 thrifts.

OTS has at its discretion to use informal and formal enforcement actions to aid in carrying out its supervisory responsibilities when addressing violations of law and regulation including BSA. We were able to directly identify the number of BSA related actions from our review of TIMS and corresponding enforcement documents. Specifically, from TIMS, we identified 23 compliance related enforcement actions from January 1999 to October 2002. We then had to directly review all 23 enforcement action documents and found 11 contained a specific BSA provision. We sampled 9 of the 11 enforcement actions to assess the timeliness and completeness of these actions. To meet our objective, we reviewed ROEs, corresponding workpapers and the enforcement action documents. Specifically, we reviewed ROEs prior to the issuance of the enforcement action to determine if all BSA deficiencies found during the examination were addressed in the written action, and ROEs after issuance to assess the effectiveness of the actions in resolving the thrift's BSA problems.

Appendix 1 Objectives, Scope, and Methodology

To assess the reliability of the TIMS data information, we sampled 182 of the 1,261 compliance examinations for our review period. We selected 131 examinations with at least one BSA violation and 51 examinations without BSA violations per TIMS. In performing this objective, we compared the list of BSA violations noted in TIMS to the BSA violations addressed in the corresponding ROEs. For this objective, we did not review workpapers. We again judgmentally selected our sample, and therefore, we could not project our results to the total universe of 1,261 examinations.

The OIG discussed the results with OTS Headquarters and regional personnel, including senior BSA compliance officials to obtain their understanding as to why (1) enforcement actions were not issued for recurring BSA deficiencies, (2) enforcement actions were not always timely and comprehensive, and (3) BSA data reliability was lacking in some cases.

The audit was conducted in accordance with generally accepted government auditing standards.

Appendix 2 Substantive BSA Violations Found at the 21 Sampled Thrifts

Thrifts	Asset Size (in mill)	Date of Exam	Substantive BSA Violations							
			No BSA Policy	Lack of Internal Controls	Lack of Ind. Testing	Not Having a BSA Officer	Lack of BSA Training	CTR Omissions	SAR Omissions	
1	\$57	01/16/96 06/25/99 08/22/01	X X		X X			X X X		
2	\$119	02/20/96 01/11/99 02/12/01		X X				X X X		
3	\$35	12/23/96 04/07/91 02/17/01	X X X	X X X	X X X	X		X X X		
4	\$75	04/05/99 08/13/01	X X	X X	X X	X		X X		
5	\$44	12/09/96 03/18/98 04/26/99 04/23/01	X X X X		X X X X					
6	\$30	07/12/99 08/15/01	X X		X X			X X		
7	\$44	05/03/99 06/26/01	X X		X X			X		
8	\$166	06/03/96 01/19/99 02/20/01	X X X		X X X		X	X		X
9	\$205	03/03/97 06/15/99 10/15/01	X		X X				X	
10	\$84	09/04/96 10/08/97 08/28/00 01/15/02	X X X X	X	X X X	X		X		
11	\$105	10/15/96 03/15/99 02/26/01		X	X X X			X	X	
12	\$91	10/29/96 03/31/99 04/29/02	X X X	X X X	X X X	X X		X X X		
13	\$47	02/10/97 10/26/98 01/08/01			X X X			X		
14	\$131	02/08/99 05/15/00 07/08/02		X	X X X					
15	\$115	03/03/97 10/27/99 11/05/01		X	X X X	X		X X		
16	\$74	09/28/98 11/20/00	X		X X			X		
17	\$20	01/29/96 05/26/98 07/05/00	X X X		X X			X		
18	\$35	11/04/96 03/08/99 08/14/01	X X		X X X			X X X		
19	\$32	12/16/98 01/08/01	X X		X X			X		
20	\$64	06/29/98 07/31/00 10/22/01	X X X		X X X		X X	X X X		
21	\$46	09/14/98 01/24/00	X X		X X					

Source: OIG Analysis from OTS ROEs and Workpapers

Appendix 3 Management Comments



Office of Thrift Supervision
Department of the Treasury

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James E. Gilleran
Director

September 2, 2003

Mr. Benny W. Lee
Regional Inspector General for Audit
Office of Inspector General
Department of the Treasury
333 Market Street, Suite 275
San Francisco, CA 94105

Dear Mr. Lee:

Thank you for the opportunity to comment on the draft report, OTS Enforcement Actions Taken for Bank Secrecy Act Violations. Your report demonstrates that the thrift industry and OTS supervision on the whole have achieved a record of sound BSA compliance. We believe our record of risk-based supervisory responsiveness to identified institutional deficiencies, combined with the enhancements you suggest, place us in an excellent position for ensuring that the thrift industry continues to meet its BSA obligations, especially as new requirements are implemented under the USA PATRIOT Act.

The examination process is most often successful in obtaining improvements in thrift performance by exercising supervisory authority within the examination framework and obtaining commitments for necessary corrective action from reliable institution management. Management cooperation with examiner recommendations is often the direct result of the institution's recognition of OTS's extensive authority over thrift operations, combined with an underlying desire to conduct their operations in compliance with the law.

Your review focuses on a segment of institutions that displayed an apparent lack of responsiveness to OTS's initial supervisory actions to obtain improved BSA performance. Accordingly, your report recommends OTS take stronger enforcement action than evidenced by the audit record in a minority of cases where examiners identify substantive BSA regulatory violations. It should be noted that in cases of substantive BSA violations, OTS routinely requires institutions to undertake corrective action in the course of the examination process itself.

Before addressing the report's recommendations, I would like to highlight several facts not mentioned in the text of your report.

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- Extrapolating from your numbers, institutions that are not compliant with a substantive BSA requirement within an exam cycle of a violation being cited would impact only about 6% of OTS institutions. Even then, the frequency of substantive CTR or SAR filing deficiencies was de minimis.
- Of the 21 institutions contained in your sample of institutions that did not institute corrective action sufficient to eliminate substantive BSA violations within one exam cycle, all were less than \$250 million in assets, and 18 had assets between \$20 million and \$120 million. Although the BSA regulation does not excuse violations based on institution size (and neither does OTS), the report demonstrates OTS's application of risk-based supervision over institutions that display minimal operational exposure to money laundering or terrorist financing activity. Moreover, substantive violations can vary in significance. Such violations do not all warrant the same degree of supervisory response, merit an adverse compliance rating or require enforcement action.
- OTS identified database quality concerns prior to your audit and instituted a new system and methodology for recording BSA violation data covering exams begun January 2002 or after. While this system continues to be refined, it provides better quality and more useful supervisory information than contained in the TIMS data system referred to in your report.

Considering the findings in your report and the factors described above, we accept each of your recommendations and will implement the following corrective measures as follows:

Finding 1: Greater Use of Enforcement Sanctions

Recommendation 1: We will supplement existing examiner guidance to address (a) when to initiate stronger supervisory action for substantive BSA violations, (b) the timeframe for expecting corrective action implementation to avoid repeated thrift BSA violations, and (c) whether thrift resource constraints should be used as an offsetting consideration for not pursuing enforcement actions. *This supplemental guidance will be issued and implemented in the first calendar quarter of 2004.*

Recommendation 2: We will implement enhanced regional review over the examination process to ensure that substantive BSA violations are incorporated into the Report of Examination (ROE) in accordance with applicable standards established by OTS for ROE contents. In addition, we will ensure these violations are appropriately followed up prior to the next examination cycle. *This enhanced review will be implemented contemporaneously with the issuance of the guidance described in response to Recommendation 1.*

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Finding 2: Enforcement Timeliness

Recommendation 3: We will (a) supplement existing guidance as to when substantive BSA violations should be identified in the ROE and when they should be incorporated into enforcement documents, (b) ensure that enforcement action waivers address correction of BSA violations identified subsequent to previously issued enforcement actions, and (c) include the above items in future regional quality assurance reviews. *These standards will be implemented in the first calendar quarter of 2004 and included in periodic quality assurance reviews thereafter.*

Finding 3: Examination Data Quality

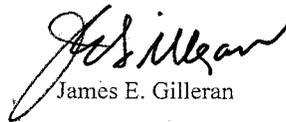
Recommendation 4: We will provide guidance to examiners regarding the submission of BSA violations into the appropriate OTS database. *This guidance will be issued and implemented in the first calendar quarter of 2004.*

Recommendation 5: We will implement appropriate controls to ensure the accuracy of BSA violation data contained in the appropriate database. *These controls will be issued and implemented in the first calendar quarter of 2004.*

Recommendation 6: To the extent that TIMS data is being used for external report purposes, we will apprise any recipient of reliability limitations. *This information will be conveyed in the first calendar quarter of 2004.*

In conclusion, we appreciate the effort made by your audit team and the constructive recommendations that your report contains.

Sincerely,



James E. Gilleran

Appendix 4 Major Contributors To This Report

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Garrett W. Gee, Audit Manager
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Appendix 5 Report Distribution

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