February 22, 2021

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, D.C. 20551

Submitted via email: regs.comments@federalreserve.gov

Re: **Exemptions to Suspicious Activity Report Requirements**
Docket No. R-1738; RIN 7100-AG08

Dear Ms. Misback:

The purpose of this letter is to express opposition to a proposed rule which would enable the Board of Governors of the Federal Research System (Federal Reserve or Board) to exempt bank holding companies, state member banks, the U.S. offices of foreign banking organizations, and other entities it supervises from longstanding requirements related to the filing of Suspicious Activity Reports (SARs).[1] The Federal Reserve has never before proposed authorizing itself to exempt individual or whole categories of financial institutions from their SAR obligations. The proposed rule provides no persuasive justification for such authority and no workable standards or process. In addition, the proposed rule fails to acknowledge or take into account new statutory provisions in the Anti-Money Laundering Act (AML Act) directing the Federal Reserve, as well as the Treasury Department, Financial Crimes Enforcement Network (FinCEN), and other federal financial regulators to address SAR and AML technology issues in other ways.[2]

As currently drafted, the proposed rule is subject to legal challenge as arbitrary, capricious, and unsupported by substantial evidence. This letter respectfully requests that the Federal Reserve withdraw the proposed rule and re-evaluate it in light of the AML Act's new provisions or, alternatively, authorize an additional 90 days for public comment.

A. Background

From 1999 to 2014, I worked for the U.S. Senate Permanent Subcommittee on Investigations on behalf of Senator Carl Levin (D-MI), including over a decade as his subcommittee staff director and chief counsel. During that period, the Subcommittee conducted multiple bipartisan investigations into money laundering and related misconduct at a variety of financial institutions, including some supervised by the Federal Reserve.[3] As part of that work, I

[1] "Membership of State Banking Institutions in the Federal Reserve System; Reports of Suspicious Activities Under Bank Secrecy Act," Federal Reserve, 86 Fed. Reg. 6576 (1/22/2021) (hereinafter "proposed rule").
[2] The AML Act was enacted into law as Division F of the William M. (Mac) Thornberry National Defense Authorization Act for Fiscal Year 2021, P.L. 116-283 (1-1-2021).
[3] See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History," S.Hrg. 112-597 (7-17-2012); "Keeping Foreign Corruption Out of the United States," S.Hrg. 111-540 (2-4-2010); "Role of U.S. Correspondent Banking in International Money Laundering," S.Hrg. 107-84 (3-1, 2&6-2001); "Money Laundering and Foreign Corruption: Enforcement and

reviewed multiple SARs and used those reports to investigate and analyze misconduct by both financial institutions and their clients. Over the years, I also gained expertise related to the filing of SARs by financial institutions and the use of SARs by law enforcement.

B. Unfettered Exemptive Authority

Currently, financial institutions supervised by the Federal Reserve are required to file SARs under its Regulations H, K, and Y, 12 CFR §§ 208.62; 211.5(k), 211.24(f) and 225.4(f).[4] The Federal Reserve's SAR requirements have an explicit statutory basis under a longstanding law authorizing the Treasury Secretary to "require any financial institution, and any director, officer, employee, or agent of any financial institution, to report any suspicious transaction relevant to a possible violation of law or regulation."[5]

Under the proposed rule, the Federal Reserve, for the first time, seeks to authorize itself to exempt a specific financial institution or whole categories of financial institutions from their legal obligations to file SARs. The proposed implementing provision states: "The Board may exempt any member bank from the requirements of this section."[6] The explanatory text of the proposed rule is equally direct, stating that the rule is intended to permit the Federal Reserve to issue exemptions from its Suspicious Activity Report regulations "in full or in part."[7]

The proposed exemptive authority contains no limitations or caveats; it is all-encompassing. The plain language would authorize the Federal Reserve to exempt any or all of the financial institutions it supervises from complying with any or all of the Federal Reserve's SAR requirements. On its face, the proposal would enable the Federal Reserve to exempt financial institutions from filing any SARs at all, despite the lack of statutory authority to do so. While the Federal Reserve may not intend the proposed rule to go that far, there is no language precluding that outcome.

The proposal states it is intended to enable the Federal Reserve to issue SAR exemptions to "state member banks, Edge and agreement corporations, U.S. offices of foreign banking organizations supervised by the Federal Reserve, and bank holding companies and their nonbank subsidiaries" – in other words thousands of different types of financial institutions supervised by the Federal Reserve, whether large or small, formed in the United States or abroad.[8]

C. No Persuasive Justification

The Administrative Procedure Act ("APA"), which governs the federal rulemaking process and defines the scope of judicial review of new regulations, "requires [courts] to hold unlawful agency action that is 'arbitrary, capricious, an abuse of discretion, or otherwise not in

---

Effectiveness of the Patriot Act," S.Hrg. 108-633 (7-15-2004); and "Private Banking and Money Laundering: A Case Study of Opportunities and Vulnerabilities," S.Hrg. 106-428 (11-9&10-1999).

[4] Proposed rule at 6577 and n.1.

[5] 31 U.S.C. § 5318(g).

[6] Proposed rule at 6580 (in proposed Sec. 208.62(l)(1)(i)).

[7] Id. at 6576.

[8] Id.

accordance with law' or that is 'unsupported by substantial evidence.'"[9] The Supreme Court has ruled that, to meet the APA's standards, an agency "must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made.'"[10] As currently drafted, however, the proposed rule fails to provide "relevant data," a "satisfactory explanation," or the "substantial evidence" required to justify its provisions.

The proposed rule acknowledges that for more than 30 years the Federal Reserve has required financial institutions under its supervision to report suspected violations of law.[11] It acknowledges that, since 1996, the Federal Reserve has required financial institutions to file SARs in conformance with federal law and regulations promulgated by itself and FinCEN.[12] In all that time, the Federal Reserve never sought authority to exempt any financial institution from any SAR requirement. Yet now, the Federal Reserve proposes awarding itself sweeping authority to exempt potentially thousands of financial institutions from their SAR obligations, a dramatic shift in SAR authority that is not presaged by any congressional direction or founded upon any explicit statutory authority.

Lack of Relevant Data. The Federal Reserve's proposed rule fails to offer any data demonstrating why the Federal Reserve should deviate from more than 30 years of operation and begin offering SAR exemptions. Indeed, it fails to provide some of the basic data needed to evaluate the scope, cost, and impact of the proposed rule, such as the total number of financial institutions supervised by the Federal Reserve, the number of institutions in each specific category, the number of SARs they file, and the categories of financial institutions that may request SAR exemptions.[13] The proposed rule does not provide any data on costs or cost savings that may accrue at a financial institution if a SAR exemption were granted, nor data on what financial institutions, if any, have requested SAR exemptions in the past.

The proposed rule estimates that only three financial institutions per year would request a SAR exemption,[14] but provides no basis in research or data for that prediction, which seems disproportionately small in light of the Federal Reserve's estimate that it now regulates "2,975 small bank holding companies, 132 small savings and loan holding companies, and 472 small state member banks."[15] The proposal also fails to explain why it is not forseeable that every single one of the Federal Reserve-supervised institutions would seek a SAR exemption.

---

[9] *Susquehanna International Group v. SEC*, 866 F.3d 442, 446 (D.C. Cir. 2017) (citing 5 U.S.C. § 706(2)(A), (E); *NetCoalition v. SEC*, 615 F.3d 525, 532 (D.C. Cir. 2010)).

[10] *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co*., 463 U.S. 29, 43 (1983) (quoting *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)).

[11] Proposed rule at 6577 and n. 2.

[12] Id. at 6577 and n. 6.

[13] At least some of that data appears to be readily available. See, e.g., Federal Reserve Annual Report – 2019, Table 1, Summary of organizations supervised by the Federal Reserve, and Table 2, Savings and loan holding companies, 2015-19, https://www.federalreserve.gov/publications/2019-ar-supervision-and-regulation.htm#xsubsection-13-f5a1b866.

[14] Proposed rule at 6579 ("Estimated number of respondents … 3").

[15] Id. at 6579. The proposed rule does not provide comparable data on the number of small Edge Act and agreement corporations, U.S. offices of foreign banking organizations, or nonbank subsidiaries that are under Federal Reserve supervision, nor on the number of mid-sized or large financial institutions under its supervision.

Technology and Innovation as a Failed Explanation. In addition to insufficient data, the proposed rule fails to "articulate a satisfactory explanation for its action" as required by the APA. It currently offers only one justification for the rule, that SAR exemptions are needed to "facilitate" the "development" of BSA-related "innovation solutions."[16] The proposed rule does not explain why or how. Instead, it offers the following two paragraphs to justify imbuing the Federal Reserve with expansive SAR exemption authority:

> "[T]he Board's view is that these exemptions would facilitate supervised institutions to meet BSA requirements more efficiently and effectively, including through development of innovative solutions. Financial technology and innovation continue to develop in the area of monitoring and reporting financial crime and terrorist financing, and the Board recognizes the increasing importance of regulatory flexibility to such efforts. Recently, the Board, along with the other federal banking agencies and FinCEN, issued a statement encouraging banks to take innovative approaches to meet their BSA/anti-money laundering (BSA/AML) compliance obligations. The statement explained that banks are encouraged to consider, evaluate, and where appropriate, responsibly implement innovative approaches in this area.
>
> Today, innovative approaches and technological developments in the area of SAR monitoring, investigation, and filings may involve, among other things: (i) Automated form population using natural language processing, transaction data, and customer due diligence information; (ii) automated or limited investigation processes depending on the complexity and risk of a particular transaction and appropriate safeguards; and (iii) enhanced monitoring processes using more and better data, optical scanning, artificial intelligence, or machine learning capabilities. Accordingly, exemptive relief may be helpful to foster innovation in this area, as the Board expects that new technologies will continue to prompt additional innovative approaches related to SAR filing and monitoring."[17]

This portion of the proposed rule, replete with SAR jargon, is difficult to understand. It fails to articulate exactly how or why SAR-related "innovative approaches" or "technological developments" necessitate SAR exemptions. It does not lay out how current SAR requirements impede innovation, especially since SAR-related technological innovations seem to be proliferating. The proposal fails, for example, to convey exactly how "exemptive relief" would "foster innovation" or alleviate any particular SAR innovation or technology problem.

More striking yet is that the proposed implementing language never once mentions fostering innovation or testing new technology as factors to consider when deciding whether to grant a SAR exemption or when fashioning a specific form of exemptive relief. If the proposed exemptive authority is intended to address situations where a financial institution needs a temporary SAR exemption to test a new SAR technology, that situation is never discussed in the implementing language. To the contrary, the proposed section uses the broadest possible terms to provide the Federal Reserve with unfettered authority to exempt any and all financial institutions under its supervision from any and all aspects of their SAR obligations.

---

[16] Proposed rule at 6576-6577.
[17] Id. at 6578 (footnotes omitted).

History of AML and SAR Deficiencies. In addition to failing to articulate a persuasive justification for granting SAR exemptions, the proposed rule fails to explain why SAR exemptions are justified in the context of longstanding U.S. financial institution involvement with money laundering and other misconduct, including some institutions under Federal Reserve supervision. For years, the media has reported scandals and U.S. enforcement actions involving financial institutions supervised by the Federal Reserve, including, for example, Commerzbank,[18] Credit Suisse,[19] JPMorgan Chase,[20] Sumitomo Mitsui,[21] and Standard Chartered Bank.[22] Those problems have occurred not only at some of the Federal Reserve's largest banks, but also at smaller financial institutions.[23] Despite concerted effort, the Federal Reserve has been unable to prevent serious AML deficiencies, money laundering, and other wrongdoing from affecting financial institutions operating in the United States. Yet the proposed rule fails to acknowledge or grapple with that history or offer any explanation why, in light of that history, the Federal Reserve should award itself sweeping new authority to exempt some or all of the financial institutions it supervises from some or all of their SAR obligations.

Undermining Law Enforcement and National Security. The proposed rule also fails to acknowledge the important role that SARs play in U.S. law enforcement and national security or analyze how SAR exemptions might affect SAR usefulness or law enforcement effectiveness. Just a few months ago, the U.S. Government Accountability Office (GAO) issued a lengthy report on SARs and other filings, such as Currency Transaction Reports, required by the Bank

---

[18] See In re Commerzbank AG, No. 15-001-B-FB, 15-001-CMP-FB, Federal Reserve, Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the Federal Deposit Insurance Act, as Amended (3-12-2015) (imposing $200 million fine for AML deficiencies and failure to comply with a 2013 consent order, including a failure to file SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20150312a1.pdf.

[19] See In re Credit Suisse, No. 20-022-WA/RB-FB, 20-022-WA/RB-HC, 20-022-WA/RB-FBR, Federal Reserve, Written Agreement (12-22-2020) (requiring corrective actions to address AML deficiencies, including with respect to SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20201222a1.pdf.

[20] See In re JPMorgan Chase & Co., No. 13-002-B-HC, Federal Reserve, Consent Order (1-14-2013) (requiring corrective actions to address AML deficiencies at JPMorgan entities, including banks, Edge Act corporations, and "multiple nonbank subsidiaries," including with respect to SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20130114a1.pdf; "Nigeria case against JP Morgan over OPL 245 oil deal to go to trial," Reuters (11-12-2020) (describing an ongoing lawsuit filed by the government of Nigeria against JPMorgan related to a corrupt oil deal and related suspicious financial activity), https://www.reuters.com/article/nigeria-jp-morgan-trial/nigeria-case-against-jp-morgan-over-opl-245-oil-deal-to-go-to-trial-idUSKBN27S23R.

[21] See In re Sumitomo Mitsui Banking Corp., No. 19-013-WA/RB-FB, 19-013-WA/RB-FBR, Federal Reserve, Written Agreement (requiring corrective actions to address AML deficiencies, including with respect to SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20190425a1.pdf.

[22] See In re Standard Chartered, No. 19-011-B-FB, 19-011-CMP-FB, Federal Reserve, Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the Federal Deposit Insurance Act, as Amended (4-9-2019) (imposing a $164 million fine for U.S. sanctions deficiencies and a failure to comply with a 2012 consent order), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20190409a1.pdf.

[23] See, e.g., In re U.S. Bancorp, No. 18-005-B-HC, 18-005-B-AC, 18-005-CMP-B-HC, Federal Reserve, Order to Cease and Desist and Order of Assessment of a Civil Money Penalty Issued Upon Consent Pursuant to the Federal Deposit Insurance Act, as Amended (2-15-2018) (imposing a $15 million fine for AML deficiencies and a failure to comply with a 2015 consent order, including deficiencies with respect to SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20180215a1.pdf; In re M&T Bank Corp., No. 13-013-WA/RB-HC, 13-013-WA/RB-SM, Federal Reserve, Written Agreement (6-17-2013) (requiring corrective actions to address AML deficiencies, including with respect to SARs), https://www.federalreserve.gov/newsevents/pressreleases/files/enf20130617a1.pdf.

Secrecy Act (BSA). GAO determined that "[m]any federal, state, and local law enforcement agencies use [BSA] reports for investigations" and that a survey of more than 5,000 employees at six federal law enforcement agencies "found that more than 72 percent of their personnel reported using BSA reports to investigate money laundering or other crimes, such as drug trafficking, fraud, and terrorism."[24] In addition, GAO found that bank costs for complying with U.S. AML requirements – costs not isolated to filing SARs, but encompassing the entire panoply of AML requirements – comprised only "about 2 percent of the operating expenses" at smaller banks and "less than 1 percent" at the larger banks reviewed by the study.[25]

Despite that recent, relevant data, the proposed rule does not mention the GAO report. Nor does it examine other SAR-related research or offer its own data analysis of such matters as how many SARs filed by Federal Reserve-supervised financial institutions would be eliminated, altered, or delayed under the proposed rule; what types of SAR exemptions are most likely; or what negative impacts SAR exemptions might have on U.S. law enforcement and national security.

Still another concern not addressed in the proposed rule is what happens once a financial institution is known to be exempt from some or all SAR requirements. The proposed rule does not address, for example, whether criminals might seek out financial institutions with reduced SAR requirements, thereby increasing U.S. law enforcement and national security concerns. The proposal also does not discuss what steps could be taken by the Federal Reserve, affected financial institutions, law enforcement, or others to prevent those types of negative outcomes. In fact, as currently drafted, the proposed rule does not indicate the extent to which the Federal Reserve has consulted with the Department of Justice or other law enforcement, national security, or intelligence agencies about its approach, including possible unintended consequences. The Federal Reserve's failure to present and discuss the law enforcement and national security implications of its granting SAR exemptions is an unacceptable omission from the proposed rule.

Under the APA, the proposed rule's lack of supporting data, rational explanation of why the rule makes sense, and how the proposal can be managed to avoid undermining U.S. law enforcement and national security objectives leaves it vulnerable to legal challenge as arbitrary, capricious, and unsupported by substantial evidence.

D. Insufficient Standards, Criteria, and Process

In addition to poor justification, the proposed rule suffers from a lack of meaningful standards, criteria, and procedures establishing how and when a SAR exemption might be granted. The absence of needed standards, criteria, and procedures renders the proposed rule unworkable and, again, susceptible to legal challenge.

---

[24] "Anti-Money Laundering: Opportunities Exist to Increase Law Enforcement Use of Bank Secrecy Act Reports, and Banks' Costs to Comply with the Act Varied," GAO, No. GAO-20-574, "GAO Highlights" at 1 (9-2020), https://www.gao.gov/products/GAO-20-574.

[25] Id., "GAO Highlights," at 2.

Process Questions. One set of issues involves the proposed rule's failure to detail the process that would be used to grant a SAR exemption. The proposal indicates that a financial institution would initiate the process by submitting "a written request" to the Federal Reserve.[26] The proposed rule fails, however, to provide a sample application form, specify the information to be supplied by the financial institution, or identify where the application should be submitted within the Federal Reserve. It also fails to identify which Federal Reserve office or officials would be responsible for reviewing and making final determinations on the applications as well as any extension requests or revocations, saying only that the Federal Reserve "Board" will make the decisions. The Federal Reserve is a large, complex agency with 12 Reserve Banks located across the country, headquarters in Washington, D.C., and over 22,000 employees;[27] its regulations need to provide more procedural specificity than now appears in the proposal.

Exemption Standards. A second set of issues centers on the proposal's failure to provide meaningful standards or criteria to guide Federal Reserve decisionmaking on whether and when to grant a specific SAR exemption. The proposed implementing section provides only the most general guidance to the unnamed Federal Reserve office and officials reviewing applications for SAR exemptions:

> "Upon receiving a written request from a member bank, the Board will consider whether the exemption is consistent with safe and sound banking and may consider other appropriate factors. The Board also would seek FinCEN's determination whether the exemption is consistent with the purposes of the Bank Secrecy Act, if applicable."[28]

Neither the proposed rule nor the proposed implementing section contains any further guidance.[29] Neither provides guidance, for example, on how to determine whether a SAR exemption request is "consistent with safe and sound banking." If a Federal Reserve official knows the requesting financial institution has a record of AML violations or deficiencies or has outstanding AML supervisory concerns, the proposal does not indicate what the official should do with that information. Should that history or those outstanding concerns preclude a SAR exemption? The proposal does not say. The proposal similarly fails to indicate what to do if a financial institution has a lower management score in its CAMEL rating due to repeated AML deficiencies or mismanagement. Lower CAMEL ratings are usually seen as raising safety and soundness concerns, but the proposed rule offers no guidance on how a lower CAMEL score should affect a SAR exemption request.

The proposed implementing section also fails to provide any useful guidance related to the "other appropriate factors" Federal Reserve officials "may consider" when reviewing a request for a SAR exemption. The explanatory text of the proposed rule identifies only one such factor: whether the financial institution is seeking to develop, test, or implement a new SAR-

---

[26] Proposed rule at 6578 and 6580 (in proposed Sec. 208.62(l)(1)(i)).
[27] Federal Reserve Annual Report - 2019, Table 2, Employment in the Federal Reserve System, 2019-20, https://www.federalreserve.gov/publications/2019-ar-federal-system-budgets.htm#xsystembudgetsoverview-f419a871.
[28] Proposed rule at 6580 (in proposed Sec. 208.62 (l)(1)(i)).
[29] The explanatory text in the proposed rule simply states: "The decision to grant or deny such an exemption would be made from a safety-and-soundness and anti-money laundering regulatory perspective." Id. at 6578.

related technology or innovation.[30] The proposed implementing section, however, does not mention that factor or, indeed, provide any examples at all of "appropriate factors" that may be considered by Federal Reserve officials reviewing SAR exemption applications. Instead, the proposal leaves that very general phrase completely open to interpretation.

The end result is that decisions on whether to grant SAR exemptions are essentially left to the discretion of individual, unspecified Federal Reserve officials. It is also worth noting that the proposed implementing section provides no process for an internal supervisory review or audit of the SAR exemption decisions being made by those unspecified officials, which means there is no agency process to encourage consistent decisionmaking across the country.

The proposed implementing section does require Federal Reserve officials to seek "FinCEN's determination whether the exemption is consistent with the purposes of the Bank Secrecy Act." But if Federal Reserve officials are to be guided primarily or perhaps solely by FinCEN's determinations, the question arises as to why the Federal Reserve needs its own exemptive authority in addition to the exemptive authority that already resides with FinCEN. The proposed rule offers no answer to that question.

Specific Exemptive Relief. A related issue is the failure of the proposed rule to provide guidance on how the Federal Reserve, once its officials determine to grant a SAR exemption, should go about fashioning specific exemptive relief for the requesting financial institution. The proposed implementing section provides only this broad statement:

> "An exemption shall be applicable only as expressly stated in the exemption, may be conditional or unconditional, may apply to particular persons or to classes of persons, and may apply to transactions or classes of transactions."[31]

The provision makes clear that Federal Reserve officials have substantial discretion when drafting SAR exemptive relief, but it offers no guidance at all on the menu of available relief measures or which measures should be used in which circumstances. Given the fact that the Federal Reserve has never before issued a SAR exemption and the proposed implementing section lays out no internal audit process, the failure to delineate the available types of exemptive relief and the criteria for selecting among them threatens to produce inconsistent and even chaotic results.

Extensions and Revocations. The same is true for proposed provisions authorizing the Federal Reserve to extend or revoke SAR exemptions, once granted. The proposed implementing section provides only the following:

> "The Board may extend the period of time or may revoke an exemption granted under paragraph (1) of this section. Exemptions may be revoked at the sole discretion of the Board. The Board will provide written notice to the member bank of the Board's intention to revoke an exemption. Such notice will include the basis for the revocation and will provide an opportunity for the member bank to submit a response to the Board.

---

[30] Id. at 6578.
[31] Id. at 6580 (in proposed Sec. 208.62(l)(1)(i)).

> The Board will consider the response prior to deciding whether to revoke an exemption, and will notify the member bank of the Board's final decision to revoke an exemption in writing."[32]

The proposal provides unspecified Federal Reserve officials with absolutely no standards or criteria for determining when to extend a SAR exemption granted earlier. On revocations, it states that the decision is "at the sole discretion" of the Federal Reserve Board, but then requires the Federal Reserve to tell the financial institution the "basis for the revocation" and provide an opportunity for the financial institution to contest the action. At the same time, the implementing section offers no standards, criteria, or guidance related to when a revocation would be appropriate. Again, as with the determinations to grant SAR exemptions, the proposed rule provides no internal audit process to bring consistency to Federal Reserve extension and revocation decisions.

Notification and Consultation Issues. Still another set of process issues involves notifying and consulting with other government agencies about a pending SAR exemption request. While the proposed implementing section requires the Federal Reserve to notify and obtain FinCEN's concurrence before granting a Federal Reserve SAR exemption (when the situation would also require an exemption from FinCEN's SAR regulations), the proposed section does not impose a similar requirement with respect to other financial regulators. It states only that the Federal Reserve "may consult with the other state and federal banking agencies and consider comments before granting any exemption."[33] Nowhere does the proposal indicate the circumstances under which Federal Reserve officials should notify and consult with other state and federal banking agencies regarding a pending SAR exemption request; nor does it acknowledge that Federal Reserve officials may be unaware of AML deficiencies known to other regulators. As to notifying relevant foreign banking regulators, law enforcement agencies, or the U.S. national security or intelligence communities, the proposal is silent. Again, needed guidance is absent.

Coordination with FinCEN. The proposed rule does acknowledge that most of the financial institutions supervised by the Federal Reserve are subject to SAR requirements imposed by both the Federal Reserve and FinCEN. If a financial institution is subject to dual SAR requirements, the proposed rule is clear that the financial institution must gain permission from both the Federal Reserve and FinCEN to secure a SAR exemption. At the same time, the proposed rule contains no FinCEN-related forms, procedures, or standards. It also fails to describe the extent to which FinCEN has provided SAR exemptions in the past and, if it has done so, under what circumstances. In addition, the proposed rule fails to offer any data on such basic issues as how many financial institutions are subject to dual Federal Reserve and FinCEN SAR rules, the types of financial institutions involved, or what stance FinCEN has taken on granting SAR exemptions. The failure to present FinCEN's views, procedures, and standards as part of the proposed implementing section raises additional questions about the viability and practicality of the proposed rule.

---

[32] Id. (in proposed Sec. 208.62(l)(3)).
[33] Id.

E. Premature and Unauthorized

Finally, the proposed rule fails to acknowledge or take into consideration the raft of new provisions enacted by Congress at the beginning of the year to address the very SAR and AML technology concerns that appear to be the animus for the Federal Reserve's proposal.

Sections 6202, 6204, and 6205 of the new AML Act require the Treasury Department, in consultation with the Federal Reserve, other financial regulators, and other specified agencies to conduct a formal review of existing SAR requirements; issue a report by the end of the year on options for creating a more streamlined SAR reporting system; and consider the need for new regulations. All of those steps – mandated by law – should take place before the Federal Reserve grants itself sweeping new SAR exemptive authority that is nowhere authorized by law, including by the new AML Act. At a minimum, the proposed rule needs to acknowledge and explain how its proposed exemptive authority relates to the new SAR requirements mandated by Congress and why the Federal Reserve cannot wait for the new Treasury rulemaking that may address the very same issues.

In addition, Sections 6207-6210 of the AML Act explicitly address the AML technology issues that the Federal Reserve appears to be relying on to justify its proposed rule. Among other provisions, Section 6209 requires Treasury to engage in a new rulemaking to develop procedures to test technologies that would facilitate AML compliance. That mandatory rulemaking, which presumably would apply to all federal financial regulators handling AML technology testing, may end up conflicting with the Federal Reserve's proposal. Other AML Act provisions require the Federal Reserve and other financial regulators to conduct a joint AML technology assessment culminating in a report by the end of the year; hire their own BSA Innovation Officers to help analyze AML technology issues; and consider advice from a new BSA Advisory Subcommittee on Innovation and Technology. All of those measures – mandated by law – need to be implemented and should be allowed to get underway before the Federal Reserve grants itself new SAR exemptive authority.

If the SAR or technology rulemakings mandated by the AML Act determine that federal financial regulators need to be able to grant SAR exemptions on a case-by-case basis, the rulemaking should do so with appropriate limits, criteria, and procedures. Those limits should include, for example, that a SAR exemption may be granted only for the purpose of testing a new SAR reporting technology, the exemption automatically expires once the testing concludes, the exemption applies only to named financial institutions, and it will not alleviate any financial institution's obligation to file SAR reports with FinCEN throughout the testing period. The criteria should specify, at a minimum, whether an exemption may be given to a financial institution with outstanding AML deficiencies, a lower CAMEL score attributable to AML mismanagement, or a recent history of substandard AML performance. Procedures should include, at a minimum, a template application form specifying the information to be supplied by the financial institution seeking to obtain a SAR exemption such as the type of AML technology test to be administered, the expected duration of the test not to exceed, perhaps, three months, the financial institution's AML track record, and whether or not FinCEN concurs in the exemption. The procedures should also specify which agency office will make the exemption decisions and

establish an internal audit process to ensure agency personnel apply appropriate standards in a consistent manner across the country.

Two months ago, Congress enacted sweeping new statutory provisions to deal with SAR and AML technology issues. Nowhere do those provisions authorize the Federal Reserve or any other federal financial regulator, on its own, to award itself unfettered authority to exempt any financial institution from any SAR requirement. Instead, Congress mandated a very different and more limited approach for addressing SAR and AML technology concerns. The Federal Reserve should respect the directions provided by Congress and withdraw its proposal which has no statutory authorization or congressional support.

F. Abbreviated Comment Period

The Federal Reserve is proposing a fundamental and novel change to the U.S. SAR system that could weaken U.S. AML safeguards. Yet it has provided only an abbreviated period for public comment – 30 days in the midst of a transition to a new Administration and implementation of the new AML Act. The 30-day comment period is both insufficient and poorly timed.

Conclusion

For decades, financial institutions operating in the United States have been filing Suspicious Activity Reports, and U.S. law enforcement and national security agencies have been using SARs to identify criminals, curb money laundering, and prosecute crime. The 2020 GAO report has documented the extent to which U.S. regulators and law enforcement agencies rely on SARs to carry out their duties. The Federal Reserve offers no compelling reason to enable it to exempt any state member bank, bank holding company or nonbank subsidiary, Edge Act corporation, agreement corporation, or the U.S. office of a foreign banking organization from their legal SAR obligations. Nor does the Federal Reserve discuss what to do if the SAR exemptions it grants were to attract more criminals to U.S. financial institutions, threatening the integrity of the U.S. financial system and U.S. national security.

Due to the problematic wording, support, and timing of the proposed rule, it is respectfully suggested that the best course of action at this point is to withdraw and reconsider the rule's provisions in light of the AML Act. At a minimum, the Federal Reserve should give the AML community additional time to analyze the rule's flaws and suggest improvements.

Thank you for this opportunity to comment on the proposed rule.

Sincerely,

Elise J. Bean
Former Staff Director and Chief Counsel of the
U.S. Senate Permanent Subcommittee on Investigations