Anti-Corruption Report

Anti-Money Laundering

Rethinking Monetary Thresholds and Regulations

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By Emily Sachs, *Anti-Corruption Report*

For more than a decade, Merrill Lynch erroneously followed Bank Secrecy Act (BSA) suspicious activity laws intended for national banks instead of for broker-dealers, resulting in the firm short-changing law enforcement and regulators by some 1,500 reports of possible criminal activity. The confusion was costly. In July 2023, Merrill Lynch was fined a combined $12 million by the SEC and FINRA for conflating rules and failing to provide suspicious transactions reports.

This is far from the first time that a financial institution has misapplied and misunderstood common but confusing regulatory reporting rules that are meant to protect against fraud but, either by accident or abuse, are creating additional risks. These rules, notably those pertaining to Suspicious Activity Reports (SARs) and Currency Transaction Reports (CTRs), date back to the roots of the BSA, when cash was king, before transactions became lightning-fast.

With a view to how financial institutions can navigate the rules, and whether the related dollar figures are outdated, this article distills insights from three regulatory experts: Davis Polk partner Daniel P. Stipano, Perkins Coie senior counsel James Vivenzio, and RegTech Consulting LLC founder and principal Jim Richards.

See "SEC Risk Alert Highlights Continuing Broker-Dealer AML Shortcomings" (Oct. 11, 2023).

Complicated Corrections

Following the 2009 merger between Merrill Lynch and Bank of America, N.A., Merrill Lynch reportedly started applying the wrong monetary threshold to determine if a SAR should be filed. Instead of the $5,000 threshold, applicable to broker-dealers as well as banks when a suspect can be identified, it followed the $25,000 monetary threshold applicable to national banks when a suspect cannot be identified.

As a result, Merrill Lynch failed to file approximately 1,500 SARs from January 2009 to November 2019, when the firm discovered and corrected its mistake. The suspicious activities that went unreported included alleged unauthorized debit card withdrawals, forged or altered checks, account intrusions, identity theft, internet scams and account intrusions or hacks.

"Are they deliberately doing things incorrectly, or is the regime just so complicated that it's impossible to really adhere to? It's a bit of both," said Richards, who founded RegTech Consulting after 30 years of financial crimes compliance and BSA experience. His tenure as an anti-money laundering operations director at Bank of America pre-dated the fined infractions.

"Based on some experience I've had, I think that the broker-dealer world is less inclined to follow what they see as 'compliance pageantry' than is the banking world," added Richards.

A couple of factors may have contributed to the events, Richards surmised. First, a series of operational handoffs and handshakes occurred between Merrill Lynch and Bank of America after the merger, creating a form of dependence such that the only separation between the two entities was the legal entity differentiation, he said. The second, and more insidious, contributor is a pervasive mindset within the managed client space, whether broker-dealers or private banking. Relationship managers consider themselves to be more "sophisticated," Richards said.

"Private bankers or brokers have a little bit more disdain for the rules. They're 'just smarter' than everybody else. The rules 'don't apply' to them," he added.

It is very common for business and operations people to make the error of applying "one set of rules for one legal entity, another set of rules for another legal entity, and management applying the wrong rules to the wrong entities," Richards commented.

An organization's compliance and audit teams are responsible for noticing these things, Richards noted. "In this case, compliance officials and auditors at both legal entities failed."

In addition to the SEC and FINRA fines, Merrill Lynch is obligated to supply the missing SARs, a costly and time-consuming process requiring historical research that is typically completed by third-party consultants – at a considerable cost.

These look-backs are very lucrative for consultants, because they are resource-intensive, Stipano explained. "The further back you go in time, the more resource-intensive they are and the more expensive they are. It could cost anywhere from half a million to multiple millions of dollars to do these things," Stipano said.

See "Novel SEC Cash Management Order Provides Potential Relief to Tech Companies" (Apr. 26, 2023).

Valuable Information

When the BSA was passed in 1970 as the standard for anti-money laundering (AML) regulations, the reporting limits were selected as those most likely to provide investigative authorities with "highly valuable information," Richards said.

It is not clear whether they have value to law enforcement. "Law enforcement talks about the value of BSA reports, but doesn't tell us which BSA reports – CTRs, SARs, CMIRs, 8300s, FBARs – or why any or all of them provide value, and what kind of value," he explained.

Furthermore, effective March 2011, the FinCEN Suspicious Activity Reporting requirement under the 31 Code of Federal Regulations (CFR) Chapter X, mandated that financial institutions must report any questionable transaction of at least $5,000 – or $2,000 for money services businesses. The $5,000 figure actually dates back to 1996, according to Stipano.

"The banking dollar thresholds don't really exist anymore because FinCEN's $5,000 threshold swallows them up, Stipano noted. He gave the example of a $10,000 fraud that occurs at a bank with an unknown suspect. While the banking rule would not require a filing because the threshold is $25,000, the FinCEN rule would require a filing because of the $5,000 threshold.

"It probably should just be $5,000 across the board at this point," Stipano said.

Cash Reporting on the Radar

The limits themselves have remained surprisingly static with respect to inflation. CTRs are mandated electronic reports submitted to the government to track cash deposits at banks and other financial institutions. They were assigned a $10,000 threshold in 1972 – two years after the BSA was passed – and implemented in 1974 following a Supreme Court challenge, Richards said. The initial requirement was that the amount was only reportable if it was a single transaction. In 1980, he said, it was changed to multiple transactions aggregating to more than $10,000 in a 24-hour period. In 1984, it was amended to include multiple transactions aggregating to more than $10,000 in a 24-hour period by or on behalf of as many people as were involved in or benefited from the transactions.

In fact, the limits were based on a 1954 regulation for a law passed in 1917. Using 1954 as a baseline, it would be closer to $112,000 today with inflation, Richards said. Yet, he argued, the threshold is still realistic and true to the spirit of the law.

"A $10,000 cash transaction today is as unusual as a $10,000 cash transaction in 1972. When the CTR threshold was set in 1972, there were no ATMs, no mobile banking, no automated check clearing, no ACH [automated clearing house]. Cash transactions were common," Richards said.

The fact remains that Americans are using less cash with every passing year, even if 80 percent still use cash regularly, according to research by Federal Reserve Bank of San Francisco. The average American consumer in 2022 carried $73 in cash, and the average cash transaction was $39. But the median cash transaction was roughly $5 and 95 percent of cash transactions were $50 or less, most commonly for grocery and convenience stores and fast food and coffee shops.

"The CTR threshold of $10,000 is almost 140 times the average amount of cash a person has on their person, almost 250 times the average cash transaction and 2,000 times the median cash transaction," Richards said. Therefore, he argued, any deposit or withdrawal of more than $10,000 in cash – either a single transaction or multiple transactions aggregating more than $10,000 in a 24-hour period – would be unusual.

Not only is it still an unusual figure, but the correlation of large amounts of cash to suspicious activities remains high.

"Look at the CTR reporting threshold through the lens of criminal activity, not inflation. With $10,000 in cash you can pay for 10 assault rifles, traffic four human beings or buy enough fentanyl to kill everyone in Richmond, Virginia," Richards said.

Complex Process

Meanwhile, banks have their own reasons for seeking a change to the reporting requirements.

"If you actually look at the form, and you look at the regulation, and you look at the way FinCEN has sort of set it up over the years, it's really complicated, and it's a very manual process," Richards noted. Bank employees want to see a simpler process, he explained.

CTRs are also expensive to complete and have limited long-term value, he added. It creates a lot of additional work for banks to aggregate multiple transactions over 24 hours and from multiple parties.

At the very least, if the thresholds for CTRs and SARs were both set to $5,000, it could save banks some time, Richards said.

Structuring, or the intentional act of reducing cash deposits to avoid the reporting requirements for exceeding $10,000, is illegal but sometimes has understandable rationale. For example, cash businesses can routinely make cash deposits below the threshold for various reasons, or an employee making a deposit can change the amount, because they forgot their requested ID or do not have time to wait for a teller to complete the form. Some statistics suggest that as much as 40 percent of SAR alerts generated by banks involve structured transactions, said Vivenzio, who earlier served as director of BSA/Anti-Money Laundering policy at the Office of the Comptroller of the Currency (OCC).

"That is an extraordinary amount of follow up and manual investigation that the banks have to do, just related to one category of alerted transactions," Vivenzio stressed. This burden would not go away, but it would be decreased if the threshold were made greater, he said.

Regulators have taken steps to at least make the process easier, even if the thresholds remain untouched. In 2019, the OCC issued Interpretive Letter 1166, which permitted an unnamed large bank to automate its structuring SAR process so that staff would not have to manually investigate the transactions.

Using artificial intelligence and machine learning processes, they could easily identify structuring transactions and then populate the SARs through natural language processing, thus saving significant funds in staffing costs in an already costly BSA/AML program. This letter could be used as a basis for process changes, explained Vivenzio, who was intimately involved in this regulatory approval.

"Everybody, including FinCEN and law enforcement, was on board with using the latest technologies to enhance AML programs and the approach set forth in Interpretive Letter 1166," Vivenzio said.

Moreover, some concepts in that letter were adopted by Congress in the AML Act of 2020. It has a section that requires FinCEN to consider whether streamlined SARs, including those involving structured transactions, would be appropriate, he pointed out.

Also in the AML Act, Section 6205 requires that FinCEN conduct a review of CTR and SAR thresholds within a year of the law's enactment and then every five years thereafter.

"They were supposed to have done that a year ago, but they haven't done it yet. But supposedly they're doing it," Richards said.

Congress laid out five things that must be considered, including how useful the reports are today, and how important the thresholds are, he added.

"They're also supposed to look at what does it cost today and what would the cost be if you changed the thresholds. So there is work going on," Richards noted.

Indeed, this seems to support the efforts of banks that have done their share of lobbying around the requirements.

In March 2021, U.S. Representative Barry Loudermilk (R), then a member of the U.S. House Financial Services Committee, introduced H.R. 2040, the Financial Reporting Threshold Modernization Act. The bill called for an increase of the CTR threshold to $30,000 and the SAR to $10,000 for most financial institutions and to $3,000 for money services businesses. It was backed by the Credit Union National Association, which said the administration of regulatory reporting is "burdensome" and "dilutes the intent of the BSA." The bill did not receive any votes, however, and died in the 117th Congress.

"This topic has been getting kicked around for decades now. I've been in AML for 32 years – my entire career – and it's always been a big controversy concerning the thresholds and the complexity around the currency transaction reporting," Vivenzio said. This specifically pertains to exemptions from reporting, he clarified.

"There's complexity surrounding who's exempt from these reports. It's a very challenging area," he noted.

See "Progress and Challenges in Implementation of Anti-Money Laundering Act of 2020" (Jun. 21, 2023).

Looking Forward

In Richards' opinion, the CTR threshold should be restored to single cash transactions over $10,000, if not $5,000, along with the relegation of structuring and other time-consuming risks and reviews to the category of SARs.

"It would just be a straight-through shot electronically to FinCEN. We can take all those hundreds of people that the big banks currently have processing CTRs, and redeploy those people to investigate human trafficking or fentanyl trafficking or whatever it might be," he said.

As impactful as this might be for fighting society's biggest ills, there are even larger forces at play that are protecting the thresholds for SARs and CTRs.

"Law enforcement is adamantly opposed to any increase in the dollar thresholds for SARS or CTRs because they say that they need each and every one of these reports, and that even low dollar transactions could be related to more significant financial crimes," Stipano observed.

Terrorist financing is some of subtlest and hardest to catch, he added. The 19 terrorists behind the September 11th attacks, for example, funneled an estimated $300,000 of the $500,000 plot cost through U.S. bank accounts. That averages out to $15,800 per terrorist.

Internally, the U.S. is a key member of the Financial Action Task Force, the international standard-setting body for AML and anti-terrorist funding. Among the 40 recommendations to global regulators is that there should be a zero-dollar threshold on SARs if the true spirit of AML investigations is to root out every possible incidence and every possible bad actor.

"The U.S. is out of step with those debates on both sides of the aisle," Stipano said.

The financial services industry would favor raising the thresholds, but law enforcement and the Financial Action Task Force is on the other side, he argued. "Because of that, I don't think that we will see an increase in these dollar thresholds anytime soon, if ever."

See "Navigating the Intersection of Digital Assets and AML" (Jul. 20, 2022).

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