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Money Laundering

Making SARs More Effective: Broader Based Feedback From Law Enforcement Needed by Financial Institutions

BY ROBERT M. AXELROD

If the purpose of criminal laws is to define crime, lay the groundwork for criminal prosecutions, and, ultimately, reduce criminal behavior, the functionality of the money laundering laws[1] (and their associated regulations[2]) should be evaluated at least in part by how effective they are at facilitating criminal prosecutions. For that purpose, the Suspicious Activity Report ("SAR") that covered[3] financial institutions must file when potential criminal or "unusual" activity is identified, plays a starring role. Law enforcement can use the information and analysis in SARs to initiate or support investigations and prosecutions of criminal activity.[4] Institutions can file more effective SARs if they know overall the following: Was the activity they identified as suspicious frequently helpful in furthering a criminal investigation? That information is not presently available to them. For this goal, no specific SAR by SAR scorecard for the institutions would be necessary, only an overall understanding of how effective their SAR filing process has been.

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[1] See, e.g., the Bank Secrecy Act and 18 USC §§ 1956, 1957.
[2] See, e.g., 31 CFR Chapter X.

Robert M. Axelrod is director in the New York office of the Forensic and Dispute Services practice of Deloitte Financial Advisory Services LLP. Mr. Axelrod specializes in projects addressing financial transactions in regulatory and compliance contexts, including anti-money laundering and anti-terrorist financing as well as anti-corruption concerns in the financial services industry, specifically addressing banks, insurance companies and broker dealers.

[3] The Bank Secrecy Act anticipates that various kinds of institutions, such as banks, broker dealers, futures commission merchants, insurance companies, mutual funds and money services businesses may be covered by Treasury regulations requiring them to have anti-money laundering programs, which will generally include surveillance for suspicious activity and reports to the government regarding such activity. See, e.g., Section 313, and 31 USC § 5312.

[4] SARs address the movement of money that may be the proceeds of crime. This is the principal definition of money laundering in 18 USC § 1986, although there are others in the statute, and SARs are filed for events broader than the definitions for money laundering.

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tion. FinCEN[5] would then track the hit rate of SARs in the following categories: (1) the nature of the covered institution (bank, broker, mutual fund etc.) that filed the SAR that has been used; (2) specific institutions within those categories (XYZ Insurance Company, ABC insurance company, for example); and (3) across both categories, the subsets for particular SAR types, such as terrorist financing, structuring or identity theft. These subsets may be driven by the categories in the current SAR forms.[6] Various ways are also proposed to improve the evaluation of the SAR aspect of an AML program, including, ultimately, the use of more detailed feedback from law enforcement. More informed SAR evaluation by both regulators and the filing institutions themselves will likely support a more specific analysis of which parts of programs are effective, what the true leading practices across institutions are, different approaches that may make sense across different industries, and, overall, better allocation of the resources of covered institutions.

The regulatory rationale for filing SARs is to assist law enforcement in identifying, disabling and prosecuting criminal and terrorist elements. The correlates of useful SARs — correlates that will have to be examined to see if they identify valid causative factors — do not appear to be currently able to be measured systematically in SAR evaluation by regulators. These useful correlates could include resulting criminal prosecutions, identification of new typologies, and confirmation for law enforcement of intelligence otherwise gathered. Instead, the current evaluation of SARs is largely in terms of what can be gleaned at the point of filing, before any law enforcement involvement. What is employed reflects an operational definition of ''quality,'' measuring such SAR aspects as clear writing, the presence in the narrative of the who-what-why-where information, and reasonable checking of boxes. Nonetheless, the qualities are only capable of measuring how well an institution crafts credible narratives around transaction data, transaction monitoring alerts and investigation results. They do not address how well or even whether the SARs have assisted law enforcement with the investigation[7] of criminal activity. None of these evaluation criteria responds to anything law enforcement does with the SARs or learns from the SARs. The current criteria for suspicious activity surveillance programs thus fall short of the actual goal of filing a SAR.

Just as a large bank needs to identify suspicious activity by looking at the totality of the information before it, including activity in all of its various business lines, the stakeholders making up the context of the SAR filing program — the filing institution, institution-specific regulators, FinCEN and law enforcement, should make use of *their* aggregate knowledge to deliver the feedback that lets the whole team — institutions, regulators, FinCEN and law enforcement — do its best with the information it has, collectively, before it. The law enforcement feedback proposed here would greatly aid this integration, and it does not appear unduly difficult.

There is now no formal and systematic process by which a given institution can understand whether its SAR effort is overall particularly successful. It cannot tell if its filed SARs have been, in the aggregate, highly constructive for criminal investigation, and whether it is doing better or worse than its peers in this respect. It cannot tell whether changes in its program are associated with improvements in this regard. While FinCEN currently provides very valuable[8] feedback regarding various indices of SAR quality, and vigorous and creative use of the data that SARs provide, the feedback is not focused on these issues. Since no law enforcement effort beyond the SARs actually consulted is implicated by the proposed feedback, no significant extra effort should be involved. For example, as to SARs currently not examined at all, no change would be required.[9]

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[5] The Financial Crimes Enforcement Network (''FinCEN'') is a bureau of the U.S. Treasury that, inter alia, provides anti-money laundering guidance and takes part in money laundering regulatory enforcement actions.

[6] While categories change from time to time, basic aspects, such as theft, fraud, drugs and organized crime, are likely to provide continuity. The categories vary not only over time, but, in some measure, across different filing industries. The current FinCEN form for SARs for depository institutions includes categories such as check fraud, check kiting, bribery, commercial loan fraud, computer intrusion, mortgage loan fraud, and the typical categories of terrorist financing and Bank Secrecy Act/money laundering/structuring. It can be found at http://www.fincen.gov/forms/files/f9022-47_sar-di.pdf. By contrast, the current form for Casinos and Card Clubs largely, but not entirely overlaps in categories, and includes categories of money laundering, structuring, bribery, embezzlement, unusual use of negotiable instruments, terrorist financing and minimal gaming with large transactions. It can be found at http://www.fincen.gov/forms/files/fin102_sar-c.pdf. FinCEN has updated the SAR form to incorporate a number of multiple industry formats, as opposed to having a separate form for separate industries. This is part of a substantial data upgrade to the SAR form, coincident with the requirement for electronic filing. See, e.g., http://www.fincen.gov/whatsnew/html/20120928.html. The use of the new form is mandatory at the end of March, 2013.

[7] It is recognized that some elements of law enforcement may not use the same criterion as others for what is useful in a criminal investigation. However, law enforcement would presumably be motivated by increasing the filing of those sorts of SARs they found useful. The resolution of this ambiguity would tend to be aligned with the national interest in having useful SARs. As this feedback is explored, the costs to law enforcement to delineate the nature and extent of usefulness — e.g., serious crimes, critical information, information that initiates rather than supplements an existing investigation — can be better understood, and a judgment as to how far for law enforcement to go in this regard can be better made, and there could be a further refinement of the definition of what is useful. At this stage, it is proposed to consider the most basic function that law enforcement will indicate whether a SAR that it has looked at facilitates a criminal investigation.

[8] For example, the categories of SARs filed and the characteristics of SAR subjects across different institutions and SAR types. See, e.g., FinCEN SAR Guidance Package, at http://www.fincen.gov/statutes_regs/guidance/pdf/narrativeguidance_webintro.pdf (Nov. 2003); FinCEN Mortgage Loan Fraud Update, Suspicious Activity Report Filings in Third Quarter, 2011 (March, 2012); A BSA Filing Study, Assessing Suspicious Activity Reports and Suspicious Form 8300 Filings Related to Real Estate, Title and Escrow Businesses 2003-2011, at http://www.fincen.gov/news_room/rp/files/Title_and_Escrow_508.pdf (July, 2012); FFIEC BSA/AML Examination Manual, at http://www.ffiec.gov/bsa_aml_infobase/documents/BSA_AML_Man_2010.pdf (Suspicious Activity Reporting Overview, at pp. 67 et seq)(2010).

[9] Some of the benefits of a more intense review can be accomplished through sampling, although this would not likely benefit any specific institution. See, for example, ''UK Law Enforcement Agency Use and Management of Suspicious Activity Reporting: Toward Determining the Value of the Regime,''

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Imagine an aspiring baseball player who, after getting up to bat 500 times in a season, only learns how many swings he took — not how many hits, singles, triples, home runs or double plays he caused, only the swings. Of course, if you don't swing, you won't get a hit, and players with more swings have satisfied a necessary (but not sufficient) condition to making a hit. Financial institutions need to know what their real SAR batting average[10] is. They do not now learn that from the combination of their regulators, law enforcement contacts or others, except perhaps (and to a very limited extent) anecdotally. By analogy, one can imagine that at the end of the season, the manager says, ''We haven't told you your batting average, but on that June day in Cincinnati, boy, you hit a terrific home run.'' Covered institutions are in that same situation regarding the SARs the file because of the lack of feedback on the overall value of the SARs they file.

[An institution] cannot tell if its filed SARs have been, in the aggregate, highly constructive for criminal investigation, and whether it is doing better or worse than its peers in this respect.

This article also proposes that apart from the proposed law enforcement feedback, other quality indicators, such as communication with law enforcement, closed accounts, new typologies discovered and more complete explanations of problematic activity should be emphasized. The result of this proposed supplement (both with and without law enforcement feedback) to the current SAR effectiveness appraisal process is a large part of the answer to an ultimate question: *How well is an AML Program working*? If the end game is to find the ''bad guys,'' does the program locate them with any regularity? Benchmark comparisons between institutions can point to positive AML program characteristics in this regard. Is a program just turning out large numbers of SARs that end up as statistics independent of any demonstrated link to real criminal activity? If so, the program might pass with flying colors the current regimen of quality and quantity checks, but it might nonetheless be a prime candidate for improvement. A SAR evaluation process better connected to actual criminal investigations may also better address some ongoing shortcomings of the current SAR process, namely, the potential tautology[11] of some risk indicators and ambiguity as to the pros and cons of filing ''defensive''[12] SARs. Accordingly, this article looks at the nature of SAR requirements in Part I, the current SAR

Matthew H. Fleming (University College London) (June 30, 2005) at pp. 20-42, which focuses on law enforcement agencies' use of a studied population of SARs, though not upon those who filed the SARs.

[10] Some SARs may never be reviewed at all by law enforcement, or they may be seen in such a summary or cursory fashion that one never knows whether they ''might'' have been useful in a criminal investigation. There is no question framed here as to whether law enforcement has under-consulted the SARs filed, and the proposal here is not intended to guarantee review of each SAR filed. On the other hand, if indeed one can learn from this feedback how to file SARs that law enforcement finds more useful and uses more often, it is likely that law enforcement itself will be incented to consult SARs more frequently and more comprehensively than at present.

[11] A tautology occurs when the correctness of a premise is demonstrated through the premise itself, rather than independently. For SARs, this may occur when a presumed high risk factor creates a greater frequency of SARs all by itself, thus (tautologically) demonstrating that the high risk factor is an accurate predictor of SARs. For example, one can start with the premise that Indonesia, Thailand and Nigeria are high risk jurisdictions for money laundering. This is a legitimate premise to postulate because these countries have been studied and so identified by the Financial Action Task Force (''FATF''). See June 22, 2012 FATF Public Statement, found at http://www.fatf-gafi.org/topics/high-riskandnon-cooperativejurisdictions/documents/fatfpublicstatement-22june2012.html However, without further information, one does not know whether a bank with customers from these countries has, in light of its intake procedures and self-selection procedures, actually taken on additional risk of criminal activity, and if so, how much additional risk. Payments flowing through a high risk jurisdiction are more likely as a result to be deemed suspect by a bank. If the payment cannot be explained, it may be SARed, in the very least, as activity for which a legitimate economic explanation cannot be found. However, the same ambiguity of payment is often resolved against a SAR if like circumstances occur in a jurisdiction that is low risk for money laundering risk. In this context, finding more SARs associated with these countries does not prove the customers from these countries are higher risk (or how much higher risk they are), except by tautology. If one knew that the SARs filed for these countries in fact gave rise to a relatively more frequent series of criminal investigations and prosecutions, one would have a largely independent ''proof'' of the original premise. The same issues will apply to high risk products and services like Remote Deposit Capture and Private Banking. While the foundations for the premises of high risk cannot be doubted, the actual level of risk, in a given institutional environment, deserves to be evaluated more directly, as the proposed feedback would facilitate.

[12] Defensive SARs have defied precise definition or consistent treatment from regulators and law enforcement. Much financial activity (particularly in the correspondent banking context, where there is little or no familiarity between the reviewing bank and the transacting parties) does not readily fit the SAR definition pattern of a transaction with no apparent legitimate basis. After all, a bank or broker or money services business rarely knows enough about the transacting parties to make a firm and consistent judgment in this regard, and different banks may make different (good faith and well informed) judgments. A defensive SAR is one where the SAR is filed to defend against the notion that the activity might later be deemed to have been needed to be filed, rather than any clear match at the time of filing to the defined regulatory criteria for filing a SAR. ''Depository institution representatives with whom we spoke cited a third factor for [SAR filing] increases—concerns they would receive criticisms during examinations about decisions not to file SARs. To avoid such criticism, they said their institutions filed SARs even when they thought them unnecessary—a practice sometimes called 'defensive SAR filing.' '' Statement of Richard Hillman, Managing Director Financial Markets and Community Investments, April 28, 2010 before the Subcommittee on Oversight and Investigation of the House of Representatives at p. 7 (Explanation supplied]. These frequently occur when there are high risk factors at play, as discussed above.

evaluation process in Part II, and suggests a set of improvements to the SAR evaluation process in Part III.

Part I: What Requires a SAR?

The general requirements for a SAR extend to covered institutions under the USA Patriot Act[13], with some requirements specific to members of a given industry. For purposes of this article, the regulatory definition for bank requirements is sufficiently illustrative, and found at 31 CFR § 1020.320:

(a) General. (1) Every bank shall file with the Treasury Department, to the extent and in the manner required by this section, a report of any suspicious transaction relevant to a possible violation of law or regulation. A bank may also file with the Treasury Department by using the Suspicious Activity Report specified in paragraph (b)(1) of this section or otherwise, a report of any suspicious transaction that it believes is relevant to the possible violation of any law or regulation but whose reporting is not required by this section.

(2) A transaction requires reporting under the terms of this section if it is conducted or attempted by, at, or through the bank, it involves or aggregates at least $5,000 in funds or other assets, and the bank knows, suspects, or has reason to suspect that:

(i) The transaction involves funds derived from illegal activities or is intended or conducted in order to hide or disguise funds or assets derived from illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any Federal law or regulation or to avoid any transaction reporting requirement under Federal law or regulation;

(ii) The transaction is designed to evade any requirements of this chapter or of any other regulations promulgated under the Bank Secrecy Act; or

(iii) The transaction has no business or apparent lawful purpose or is not the sort in which the particular customer would normally be expected to engage, and the bank knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

The significance for this article is that, with further information from SAR feedback, Treasury could decide to refine the SAR formulation now sitting in the regulations it has promulgated.

It is useful to note, initially, that this formulation comes from a regulation, not a statute. The U.S. Treasury is, however, *statutorily* explicitly authorized by statute to create regulations for the production and requirements of suspicious activity reports, 31 USC § 5318(g) that have a ''high degree of usefulness''[14] for criminal prosecutions. The significance for this article is that, with further information from SAR feedback, Treasury could decide to refine the SAR formulation now sitting in the regulations it has promulgated. There is no recommendation in this regard, only the observation that once significant additional data as to the functionality of SARs is added, as proposed here, Treasury might indeed be better placed to decide whether refinement of this definition, to better accomplish statutory purposes, is in order. In any event, gathering better information about how SARs actually intersect with criminal investigations and prosecutions can only better inform Treasury's role over time in further delineating the optimum requirements for and role of this form of reporting.

For present purposes, the regulatory SAR criteria boil down to two issues: (1) Does the bank suspect or have reason to suspect that a transacting party is moving illegally derived funds, using the transaction to further illegal activity or to avoid a reporting requirement? or (2) Is the bank unable to reasonably posit an economically viable rationale for the transaction? The first item foots to the intuitive rationale for a SAR, that there is some ongoing or now discovered discrete crime or other federal legal violation. The second item is far more ambiguous. Is the activity unusual or suspicious in that it does not make sense, and therefore, may it actually be a cleverly disguised form of the first category, even if there is no reason for the bank to so suspect? This second category, being ambiguous in relation to the first, is what most often forms the occasion for ''defensive'' SARs, as there is no commonly accepted criterion for the level of certainty of the potential explanation that the institution needs to posit in determining not to file. Defensive SARs are filed because the institution, while not confident the SAR definition has been met, files to ''defend'' against the prospect that others (such as regulators) may later disagree. There are of course always guiding examples given in training, such as the anecdotal school teacher with a $60,000 annual income who deposits $1,000,000 into his savings account one day, with no explanation made available. Nonetheless, even such an egregious example does not clearly define this category, and institutions vary in the application of their judgment in this regard. FinCEN itself has noted the problem with defensive SARs.[15] However, ambigu-

[13] There are additional sources of SAR requirements, as for banks (see, e.g., 12 CFR § 208.62), but these do not add to this discussion.

[14] 53 USC § 5311. The current requirement for when a SAR must be filed now in use is responsive to, though certainly not uniquely required by, this mission.

[15] ''This brings up the issue of defensive SAR filings. Out of fear of punishment for failing to file an SAR when required, some have come to believe that it is better to err on the side of caution and file an SAR in much less clear circumstances than others. This deters the law enforcement value of SARs in general as it will result in many filings where there is no actual illegal activity even though an SAR may be called for because there is some aspect of the transaction creating suspicion and causing the need for a filing.'' SAR Activity Review, Issue No. 12 at p. 41 (discussing SAR reporting issues for Money Services Businesses). The matter has continued to be one of concern to institutions that want to file useful SARs but also do not wish to court a violation: ''A number of institutions raised the term ''defensive filings'' of SARs, but almost always in the context of assuring FinCEN representatives that their respective institutions did not file SARs other than as appropriate and required.'' Financial Institution Outreach Initiative (Report of

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ity, to a lesser extent, also exists for the first category. For example, structuring (splitting a set of cash transactions into smaller pieces over time to avoid the reporting requirement of a one day aggregate $10,000 cash transaction) may be considered the subject of a SAR based on (1) a single $9,999 (cash) deposit, (2) two cash deposits over several days of $6,000 each, or (3) only when there are three or more occasions in a year of the second sort of event. Banks differ in their approach.

In any event, it is clear that to file a SAR, the institution need not actually know or be certain that a crime has been committed, only that a transaction be suspicious in that there is reason to suspect there may be associated illegal activity, or that the transaction is not susceptible of a rational explanation. This wide scope of SAR-able activity feeds several policy aspects for law enforcement. First, law enforcement may gather SARs from various institutions, no one of which understood the full extent of the behavior of the involved parties. What was merely a suspicion at three banks may be, for law enforcement, a strong case with the three SARs fitted together, like pieces of a jigsaw puzzle, particularly as supplemented by other law enforcement investigation material. Making the standard for filing a SAR broader than actual belief there is criminal activity responds to the fact that institutions often have useful information, although not complete information, regarding potential criminal activity. Second, by implication, the information that is part of the jigsaw puzzle may not get completed for months or years, by events that haven't yet occurred at the time the SAR is filed. Indeed, some of this information may be the result of an investigation that the SAR causes law enforcement to initiate. While each of these advantages may impose a cost by creating a raft of irrelevant SARs through which law enforcement has to sift to get to the good ones, time is on the side of the broad filing standard. The cost of filing a ''defensive'' SAR when the level of suspicion is relatively low will likely decrease over time with the improvement of data storage and retrieval capabilities, as law enforcement is better able to store SARs so that they are searchable as against other investigation leads. In other words, regardless of the expense to the filing institution for putting together what may seem a dubious SAR, the problem that law enforcement has with dealing with the noise these SARs constitute in the system, goes down as data processing ability goes up.[16]

Part II: How Are SARs Evaluated?

In the current process, SARs are evaluated by covered institutions, their regulators, law enforcement and occasionally Congress.[17] Covered institutions acknowledge that illegal proceeds inevitably creep into their transaction flow, and anticipate that their surveillance processes will identify transactions that meet the SAR filing criteria. There is no guidance on the number of SARs an institution ''should'' file based on transaction volume or particular risk factors, but an institution will expect that there will be proportionately more SARs for higher risk (and higher volume) products, services, customers and jurisdictions served, and that transactions arising out of those business lines with more risk should be more frequently implicated in SARs. Over time, institutions should coordinate SAR production with risk — if a given product produces many SARs, the institution may assign it a higher risk rating, for example. Overall numbers of SARs by the type of institution making the filing (e.g., bank, casino, insurance company) are compiled by FinCEN and regularly distributed.[18] Other than anecdotally, however, institutions do not now have information as to the proportion of their SARs that are actually useful. Consequently, they cannot match developments in their programs to production of proportionately more or absolutely more useful SARs. This means that they are handicapped in improving their programs, and in recognizing whether any steps they have taken already have improved their program.

Regulators also monitor the SAR output of an institution. They should have the risk assessment[19] of the institution available to assist them. Like the institution, they can read the SARs, but unlike the institution, they can know the number and nature of SARs being produced by peer institutions with comparable risk factors and business models. They may also know the institution has a set of SAR productive customers that have migrated from other institutions with which the regulators are familiar, or that there are particular transactions that have been deemed criminal that passed through the institution without a SAR.[20] Regulators would be expected to guide the institution, perhaps to the point of an enforcement action, when there is an extreme paucity of SARs, when there are expected categories of SARs missing, or when the basic requirements of SARs are missing.

On particular occasions, regulators may identify to the institution specific transactions that should have been the subject of a SAR, but these are exceptional circumstances. Requirements failures more often cited include missing information about the subjects and the transactions, misallocation (by checkbox) to a given type of suspicious activity (e.g., structuring, check kiting or terrorist financing), timing issues (filing the SAR beyond the required 30 days of knowing or having reason to know of suspicious activity), poor writing, or the failure to identify the nature of suspicion. On a sampled basis, regulatory examiners assess SARs across a variety of these qualities, presumably taking into account

Outreach to Depository Institutions with Assets Under $5 Billion'' FinCEN, February, 2011, at p. 29, found at http://op.bna.com/bar.nsf/r?Open=jtin-94fqfq.

[16] Whether defensive SARs are a good idea, however, remains to be tested, something that would be possible with the current proposed feedback, as discussed in Section III. Moreover, unfortunately, the cost-benefit for the filing institutions regarding SARs that may be ineffective is opaque to law enforcement, which sits in an independent universe, from a cost benefit perspective.

[17] See generally, Permanent Subcommittee on Investigations, U.S. Vulnerability to Money Laundering, Drugs and Terrorist Financing: HSBC Case History (2012).

[18] See generally FinCEN's SAR Activity Review series, issues 1-21, found at http://www.fincen.gov/news_room/rp/sar_tti.html .

[19] Either by requirement or implication, institutions covered by the Bank Secrecy Act are expected by their regulators to have a formal assessment of the money laundering risks imposed by their business model, the controls employed to mitigate the risks, and the residual risks remaining.

[20] Note that institutions are not expected to file a SAR for all criminal transactions regardless of their awareness, but rather to file a SAR based on the information available to them in applying the SAR criteria.

their knowledge of the institution's business model, products, customer set and other aspects.[21] A full scale review, involving information as to transactions and clients for every SAR, would be both labor intensive and quite challenging, given regulatory resources and traditional roles.[22] However, even if regulators were to make such a review, they would still be flying blind as to whether these SARs were effective (e.g., Did they initiate or become part of real criminal investigations with any frequency?), and regulators would still be dependent upon FinCEN style statistics that never address the frequency that a SAR is actually helpful in a criminal investigation. With the proposed law enforcement feedback, regulators would likely rapidly increase their understanding of the sorts of SARs that are actually effective, and be far more able to provide guidance to institutions and to evaluate the strengths and weaknesses of various SAR filing programs. Indeed, with this feedback, regulators would likely be able to identify some quality measures that more directly correlated with useful SARs than the ones now in use.

On particular occasions, regulators may identify to the institution specific transactions that should have been the subject of a SAR, but these are exceptional circumstances.

FinCEN, the U.S. Treasury bureau that issues anti-money laundering regulations, receives all the SARs in its filing process. It provides guidance as to SAR regulations. It may be involved in enforcement actions regarding the regulations and it also has a role in national SAR monitoring. It is of course more distant from any covered institution's particular business model, clients and day to day operations than the regulators, but it provides extensive guidance and information on various aspects of how to file a SAR, what the SAR should contain, how many SARs are filed by which categories of institutions and emerging patterns in SAR filing. Armed with SAR data, FinCEN has played a highly constructive role. For example, FinCEN has noted the rise of mortgage fraud related SARs as the financial crisis deepened, and the frequency with which mortgage fraud SAR suspects appeared as suspects in non mortgage fraud related SARs, and their reported occupations. It has also sorted, for the covered institutions, the jurisdictions associated with suspicious activity, and the distribution of the filings on various kinds of SAR categories built into the SAR forms.

Perhaps most important from the standpoint of this article, FinCEN has played a substantial role in identifying the link between the filing of SARs and an obvious benefit, the assistance to law enforcement finding and punishing crime. FinCEN identifies numerous *examples* of criminal prosecutions aided by SARs filed by banks, brokers, money services business, casinos, insurance companies and other covered institutions.[23] It establishes a link between the enormous resources and effort invested into systems and personnel and attention from covered institutions on the one hand, and a clearly constructive result — specific prosecutions of criminals — on the other. However, the nexus drawn is, even for just the examples, somewhat incomplete.

SARs are highly confidential. Therefore, it is generally illegal to identify and track a specific SAR outside the government community.[24] What FinCEN does for the institutional community is to identify a successful criminal prosecution and to state that some light was shed upon it (generally in initiating or supplementing an investigation) by a SAR. It does not identify the specific filing institution. The information for this nexus comes from the law enforcement agencies that carry out the investigations and prosecutions. What FinCEN does not (and, it would appear at this time, cannot) do, is to keep a scorecard of the effectiveness of SAR output on an industry or an institution specific basis. To draw back to the analogy of the baseball player who is only told how many at bats he has had, or swings he has taken in a season, FinCEN identifies *some* home runs, and perhaps some home runs for left handers and right handers, but does not allow a judgment about which kind of batter hits home runs with more regularity. In some instances, of course, the criminal or terrorist activity pointed to by a SAR may never be ripe for public reference, because the government does not intend to have a prosecution or to make known that it was aided by a SAR, as opposed to an informant or other device. Thus, even as anecdotal reporting, what FinCEN provides is incomplete. It is proposed here that FinCEN compile statistics on SARs, *not* that FinCEN reveal the role of any particular SAR to the filing institution or the public. Since most institutions file many SARs, this distinction should resolve confidentiality concerns.[25]

[21] See Bank Secrecy Act/Anti-Money Laundering Examination Manual (2010), Federal Financial Institutions Examination Council at pp. 67 et seq.

[22] See FFIEC manual, id. Sometimes regulators will suspect, based upon low SAR production or SAR delays, that suspicious activity that should have been captured was not. However, rather than charging a particular SAR omission, regulators more often ask the institutions to conduct a separate transaction review or lookback, often with an independent consultant, to re-check transactions in a specific time period or other category for suspicious activity. This generally results in the institution filing additional SARs, which, of course, are no more vetted by law enforcement as useful than the prior (presumably inadequate or incomplete) SARs, although if there were specific transactions the regulators were looking to have a SAR filed on, the transaction review may be successful at that level.

[23] For example, the prosecution of a military officer taking bribes and the subject of SARs from a money services business SAR involving multiple $5,000 payments emanating from the Middle East (FinCEN, SARs by the Numbers, March, 2012, at p. 52), or a real estate fraud investigation that turned into an embezzlement investigation in light of a SAR (FinCEN. SAR Activity Review, Issue 10 at p. 21 (2006)).

[24] These constraints are well summarized in: SAR Confidentiality Reminder for Internal and External Counsel for Financial Institutions,'' found at http://www.fincen.gov/statutes_regs/guidance/html/FIN-2012-A002.html (2012).

[25] Obviously, instances when law enforcement follows up with the filing institution that result in a public prosecution (or, one revealed to the filer informally by law enforcement) give the institution valuable feedback. However, this is no substitute for a systematic approach, and, as indicated, one cannot be sanguine at the notion that law enforcement would either have the resources to make a SAR by SAR feedback process to

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Law enforcement, in this context, is focused on its job of finding and responding to criminal activity, including terrorism. It evaluates many SARs, but does not provide systematic feedback on them to the filing institutions. Various law enforcement agencies have access to SARs and the ability to follow up directly with the institutions that filed them with FinCEN. There are two principal ways that SARs are used. First, they may be consulted to initiate an investigation or to be paired with an existing typology. For example, an agency concerned with terrorist financing may sort SARs into groups that did and did not check the terrorist financing box, and then review the terrorist financing ones to establish whether they are actionable — i.e., whether the information they provide appears like it might be useful for an investigation. There may then be follow-up with the filing institution, and/or use of the information about the transactions and parties listed in an ongoing investigation. Second, the SARs may be part of a database that is consulted at some time in the future as an investigation ostensibly unrelated to the SAR unfolds.

Suspect A robs a bank. No one knows who put together the robbery plan. The FBI is able to look up SARs that include suspect A, including ones that occurred 5 years ago. It finds that Suspect A sent $3,000 to each of 5 people on the same day (suspicious or ''unusual'' behavior, under the circumstances, as it had no rational explanation, but appeared to warrant one), but no crime was recognized and nothing came of it. However, one of the 5 people mentioned in the SAR is also one of the people who was seen in the vicinity of the bank robbery, but was not otherwise connected to Suspect A. Investigation shows Suspect A is the mastermind of the bank robbery. The SAR thus provides useful information in focusing law enforcement resources on the person mentioned in the five-year-old SAR. This example illustrates two points. First, the SAR criteria were wisely designed to stop short of the institution's actually suspecting a crime, and, second, the usefulness of a SAR may not be apparent until years after it is filed.

To carry out the proposed feedback, systematic feedback from law enforcement itself would be critical, but such feedback is not now seen as directly critical to the law enforcement prosecution function. It is proposed here that the ultimate impact on effectiveness of SARs makes the additional feedback suggested worthy of the consideration by law enforcement, however.[26] In other words, it is suggested law enforcement treat the interest of the institutions to file more effective SARs as a direct law enforcement interest and, accordingly, make the effort to provide feedback toward that end, and materially help the institutions to help law enforcement.

a bank or other filing institution, or the desire to directly reveal a tagging of its investigation inventory to the private sector, even in some small part to a filing institution.

[26] What is proposed here addresses feedback as to the overall success of producing SARs that assist in any criminal investigation. Should law enforcement believe a more elaborate feedback to institutions is justified, such as producing systematic feedback that isolates SARs that become part of serious (e.g., felony drug or terrorist related investigations), the same framework proposed would apply. Covered institutions are likely to be responsive, in any event, and would likely be guided by regulators to take advantage of what was available.

III. Proposed Improvements for SAR evaluation

The potential value of law enforcement feedback

Law enforcement is the only group that knows, sooner or later, whether a SAR is useful. If one were to begin tracking whether and when a SAR becomes part of a criminal investigation, one could draw some very useful conclusions, and these conclusions could occur without having any commentary on specific SARs or specific investigations. This last point is important because enhanced feedback cannot come at the expense of compromising the confidentiality of any specific SAR, or at the expense of encumbering law enforcement by saddling it with what would likely, in effect, be a reporting obligation to specific financial institutions. It is proposed that this is a multi-year process,[27] because SARs may be useful long after they are filed, and, indeed, one of the benefits of the information sought is to get a better understanding of the benefits and costs of SARs according to whether their use is immediate or latent. For most of the anticipated benefits, it would be necessary to combine two aspects: (1) the law enforcement feedback as to when SARs are useful; and (2) the proposed FinCEN analysis of that data across different categories of filing institutions, making comparisons within institution categories, and comparisons across different SAR suspicious activity types.

Consider the following applications of the proposed law enforcement feedback:

1. Which Specific Institutions Are Filing More Effective SARs? Within a given kind of covered institution, who are the winners, the ones with the highest ''batting average''? If two global banks[28] file 1000 SARs per year, does one of them file twice as many useful SARs, and why? What proportion of those SARs are defensive SARs? Is a bank whose SAR production appears low in terms of the sheer number, nonetheless up to or ahead of its peers in terms of useful SARs? What are the correlates of (and thus leading candidates to explain the cause of) a program with more useful SARs – the maturity of its investigators, the particular transaction monitoring rules and their tuning, the nature of available case management applications, the availability of information from relationship managers, the length of time spent on investigations, the ratio of supervisors to investigators, the nature of the ongoing relationship with local law enforcement or the relationship between business personnel and investigators? This conclusion may be the most important of all.

[27] This undertaking may be started on a sampled basis with one kind of institution, such as banks, but a full scale approach is still deemed advisable. While some SARs may only prove useful more than five years later, for example, it is suggested that, for illustrating SAR effectiveness, the vast majority of SARs not used after five years need not be considered initially. There is no publically available factual basis to suggest here a five year or other year length of time, but law enforcement would have an informed opinion now as to when the vast majority of SARs will have been used, if they are ever going to be used, in terms of time after filing, and could fairly be expected to provide a good line of demarcation.

[28] One would need to be alert to the prospect that the apt comparison is the retail arm of the two banks, the correspondent banking arm of the two banks, etc. Once comparisons are available, there can be ready analysis of the level of organization upon which to focus.

Knowing who the winners are and being able to compare programs at peer institutions based on their actual effectiveness may help us discern the more successful aspects of an anti-money laundering program to better understand and to reduce criminal activity. The underlying analysis would be carried out largely by FinCEN, which would be the natural place to collect the information about the SARS filed with it, and which it in turn makes available to law enforcement. This would merely be an extension of FinCEN's current SAR analytics role.

It is proposed here that FinCEN compile statistics on SARs, *not* that FinCEN reveal the role of any particular SAR to the filing institution or the public.

This proposed feedback and the suggested FinCEN analysis would greatly facilitate understanding what the elements of a suspicious activity surveillance program are particularly effective to get useful SARs, not simply to satisfy the current quality requirements (SARs with a complete narrative, e.g.) that, while certainly appropriate, are not linked to actual SAR use. It would also allow a comparison across peer institutions about the kinds of SARs that may be more effective. For example, do the more effective programs of broker dealers have a disproportionate number of SARs dealing with organized crime compared to their peers? This aspect also will likely ground the appraisal of a risk based allocation of resources instead of comparing the risk based investment of resources according to the number of well-formed SARs. Instead, one can identify and encourage the greater frequency of effective SARs resulting in aid to criminal investigations from broker dealers, as well as a greater absolute number of useful SARs.

2. Which kinds of covered institutions file SARs that are more productive for given criminal activity? Per 100 SARs marked ''terrorist financing'' from banks, is there more useful information compared with 100 SARs marked ''terrorist financing'' from broker dealers or money services businesses? If so, are there approaches broker dealers are using that might be available to the other institutions? Note that this is a different question than which kinds of institutions file the most SARs.

3. What combinations of covered institutions are more productive for recognizing criminalactivity? If one sees that SARs for a percentage of drug cartel prosecutions touch *both* casinos and money services businesses, should greater effort go into sharing information between these institution types, or into scrutinizing the transactions at either institutions when the other kind is known to be involved?

4. Do different programs favor SARs that are more immediately useful? Might some institutions be, relatively speaking, more productive in SARS that do not help initiate an investigation, but more often are consulted years later, as placeholders of activity by individuals later suspect under different processes, as in the bank robbery example above? Might this suggest a lack of analysis in these SARs, or some other explanation?

5. Are specific program elements particularly effective? With this feedback, FinCEN could also carry out an analysis across some kinds of program elements, rather than analyzing kinds of institutions or just staying with peer comparisons. For example, are analysts with greater law enforcement experience more successful at writing effective SARs? If so, is their advantage more telling in some kinds of institutions (big/small, national/global, bank/broker, etc.) than others? If FinCEN identifies or classifies levels of training programs, will the presence of the better programs be predictive of better SARs? Will the proportion of useful SARs increase or decrease at institutions in the aftermath of an enforcement action (when there may be an incentive to increase the number of filings), and, if there is a decrease in the proportion or absolute number of useful SARs, should there be any steps taken in shepherding the enforcement aftermath to a better result?

6. Defensive SARs – can the practice be better measured and evaluated? Is it time to acknowledge the prospect that defensive SARs comprise a substantial portion of what is filed, and to come to grips with how useful they are? To do so, one would need not only law enforcement feedback, but some input from institutions as to the role ambiguity and uncertainty (the key elements of a defensive filing) play in the filing each SAR. If that is done, law enforcement feedback can be married to defensive SARs just like it can to SARs labeled for terrorist financing, and Treasury may have a basis to streamline the SAR filing obligation, or alternatively, a basis for continuing the current process.[29]

[29] While the standard approach, both from regulators and law enforcement has been, ''when in doubt, file,'' no one has identified the ramifications of such noise in the SAR system, or whether the corresponding effort to produce such SARs is risk-based. There is no public data on the extent to which these SARs are an effective part of AML programs. This would be difficult to discern at this time, as there is no declaration of a SAR as being defensive, and perhaps there is no groundswell for such a declaration for several reasons. At present, a filing institution, such as a bank, would not want to declare that it is filing a SAR that is ''weak'' because that might disparage the strength of the AML program (particularly if there are many such SARs). Similarly, a bank might prefer not to designate SARs as ''strong'', i.e., referencing a high suspicion of actual criminal activity, because that could suggest an undue frequency with which it has been taken advantage of by criminals or terrorists, and perhaps be the basis of criticism by regulators or other stakeholders.

One of the primary indices for SAR effectiveness is frequency. If two institutions each file 1000 SARs this year, and one (the more conservative) had 200 defensive SARs and the other 500, can anyone now discern that difference? If there is no index as to which program has the more effective SARs (in terms of ultimate assistance with criminal investigations), how should each institution be directed to improve? There may not be an immediate way to measure the effectiveness of previously filed defensive SARs, particularly since they are not even notionally defined by the filers or others. However, it is not too early to start. If one were to create categories of SARs, even rough categories, one could sort the SAR data going forward and identify the value of defensive SARs and ultimately make a more informed judgment about their optimal role in a risk based anti-money laundering program. Such a designation would go on the SAR form, and be filled out by the filing institution, so that any law enforcement feedback on overall SARs for an institution could be so read. It is recognized that part of the SAR requirement is to clearly state the filing rationale, i.e., why is the subject transaction set deemed to be suspicious?

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7. How inclusive should each SAR be? If law enforcement can pair criminal activity with a set of SARs, one may be able to make a judgment about the benefits to law enforcement of the divisibility of a SAR into multiple SARs. For example, if there are 20 suspicious transaction sets between a number of related parties, is it better for the institution to file 20 SARs party by party, or only 1 or 2? If one sees that one of these alternatives is more likely to be a retrospective consultant kind of SAR rather than an immediate investigation initiator or assistant, one may have a productive answer. Here, law enforcement itself might reach a conclusion and supply direct guidance as well.

8. What is the interaction between frequency and seriousness of SARs? For example, might it be the case that a high production environment with relatively barren alerts and frequent defensive SARs leads to investigator malaise and boredom, and, in turn, to a relatively lower production of effective (as measured by law enforcement feedback) SARs? If so, how should institutions protect themselves? Might one become reconciled to the notion that for a risk based system, one may wish to exclude SARs of less frequent value to generate more SARs of more demonstrable value, even though the total number of SAR filings might drop significantly?

If one were to create categories of SARs, even rough categories, one could sort the SAR data going forward and identify the value of defensive SARs and ultimately make a more informed judgment about their optimal role in a risk based anti-money laundering program.

An additional benefit of this law enforcement feedback would likely be to take the onus off institutions that, from a regulatory perspective, may be criticized for making discretionary cost related judgments about the ultimate effectiveness of elements of their SAR program. These judgments are necessary to allocate resources in a risk based fashion, as required. Because institutions incur such a significant expense for anti-money laundering programs, discretionary judgments about the quality of the result and the benefits of productivity are accompanied by an inevitable apparent conflict of interest. For example, should all investigations involve looking back at one month of prior transactions for the involved parties, one year of prior transactions, or something in between? The differences in resources expended can be large.

Should the same institution making such a discretionary judgment be the one that pays the cost differential? If the choice is one month, regulators may be keen to the potential conflict. Should the decision be made by way of peer momentum, i.e., ''Let's do whatever similar sized banks are doing,'' and have regulators draw comfort from the herd? Or would it be better to see where the drop off may be in terms of what law enforcement actually finds effective, looking instead to the correlation between the length of the investigations period in a program and the frequency of useful SARs? That answer may be far (in either direction) from industry practice, but it would appear to be a much more productive rationale than is currently available. One just cannot know without the law enforcement feedback, and, coincidentally, neither is law enforcement able to point except anecdotally to where the better SAR producing institutions are.[30]

SAR Evaluation Improvements without the Proposed Law Enforcement Feedback

The above considerations for SAR effectiveness would be supported by the proposed feedback from law enforcement, namely, keeping data on an institution by institution basis of how many of the SARs actually end up as part of a criminal investigation, separated on a category basis, and what the time lag is between the SAR and the point of its usefulness. However, some additional SAR quality metrics would also enhance the evaluation of SAR effectiveness:

1. Account Closure. Focus on SARs that result in account closure based on the nature of activity, rather than the number of SARs filed. While this measure is not validation by law enforcement, it does show the institution regards the issue serious enough to sacrifice the profit of an account.

2. Law Enforcement Contact. Track Contact with law enforcement as displayed on the current SAR form. This is part of the current SAR form. It is the closest regularly kept thing to feedback from law enforcement that the SAR is actionable, but it is not generated by law enforcement. Note that in this instance, the institution is identifying when it contacts law enforcement independent of the filing of the SAR. There are not those additional instances in which law enforcement contacts the institution about the SAR, or, obviously, those instances in which law enforcement uses the SAR without contacting the institution. One could also ask institutions to track law enforcement contacts on their SARs, though what would result would never be as complete as the law enforcement feedback suggested here.

3. Measuring proactive strategies. Look at approaches to recognizing suspicious activity, such as the nexus to significant current events, such as money flows from Politically Exposed Persons in Arab Spring countries. This measure anticipates the institution has a proactive investigative process. Most institutions recognized the Arab Spring as something to be mindful of for a variety of reasons, including credit risk, but those that were systematic in focusing their anti-money laundering investigations units in this respect would be expected to have found proportionately more suspicious activity.

However, having a ''defensive'' category might lead to greater candor and better information for law enforcement, as law enforcement triages the many SARs it receives. Regulators would still need to acknowledge and carry through with the notion that such a label would not be used to penalize the filing institutions, or else the label would not be used, and better insight would not be gained.

[30] Of course, sophisticated programs will vary the period of prior transactions consulted depending on circumstances, so this comparison in practice will not be as straightforward as described above. There will, nonetheless, be large differences between institutions in this regard.

4. Unexpected relationships. SARs that implicate previously unrelated customers from ostensibly unrelated transactions. These SARs (as where a typology for one set of suspicious transactions alerts a bank to similar patterns carried out by different customers with some connecting point of time or beneficiaries) show a gain in understanding of the nature of suspicious activity in the institution. The same would hold true for SARs that pair activity for one customer across several business lines. If these are set as standards, institutions will reliably keep this data and it will be another indicator of program effectiveness.

5. The Occasion of Control Changes. SARs that result in a change of business controls. These SARs will demonstrate that an institution has learned of new dimension of risk. One would expect a reconsideration of the risk assessment, as well.

6. Back testing against missed criminal activity. As a regular process, institutions should be made aware of (if they are not already aware of) a sample of criminal activity regarding transactions they have processed, or criminal activity of their clientele, that they did not SAR. The sample could be provided by law enforcement directly or through regulators. The receiving institution, presuming it recognized no reasonable basis at the time to file a SAR, looking backward, would ask itself, is there some algorithm that would have been effective? Institutions should be encouraged to make this particular comparison without fearing that they would be penalized for recognizing they could have done better way back when; otherwise, they would have a strong incentive against gaining insight. Giving this assurance would not foreclose action for other criminal activity missed that was not part of this back testing exercise.

Note that many of these suggestions are independent of the sheer number of SARs filed; quality is not necessarily related to quantity. If a scoring sort of SAR program evaluation is used, points have to be allocated accordingly.

Conclusion

If law enforcement were to start tracking when SARs are actually used in criminal investigations, and FinCEN were to track particular institutions as to the hit rate of their SARs, surveillance programs would have the potential for significant improvements. FinCEN could, as well, track this usefulness of SARs according to their category (structuring, identity theft, etc.), institution type and specific institution. Regulators would have a more informed posture from which to evaluate SAR programs, and the institutions themselves would have more concrete evidence of the usefulness of their programs. If it were to turn out that the usefulness of SARs by this measure is way below common expectations, such as they may be, there would be an information foundation to reconsider and/or refine the regulatory requirements from a factual posture. If it were found to be much higher, it might impel greater commitment from the business community to a worthy cause, or concentration on where the greatest successes are and assessment of how to improve (or perhaps abandon) the other areas. In any event, such feedback is likely to pave the way to having the SAR process catch more of the ''bad guys''. This seems like a pretty good prize against the cost of having law enforcement record an analysis that, as a practical matter, it is already engaged in.

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