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Complying With 2 New AML Rules As Deadlines Approach

By **Walter Mix** (March 27, 2018, 3:40 PM EDT)

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Two landmark regulatory rules related to the Bank Secrecy Act and anti-money laundering have deadlines coming up in the next few weeks. The New York Department of Financial Services' transaction monitoring rule for New York financial institutions and the United States Treasury's beneficial ownership rule are part of BSA/AML efforts to thwart terrorist financing; both rules will lead to increased cost of BSA/AML compliance for financial institutions.

Many financial organizations are likely burning the midnight oil as they prepare to comply. The first deadline is April 15, 2018, for filing initial annual certifications under New York's Section 504, which took effect in January 2017. The second deadline is May 11, 2018, for compliance with the beneficial ownership rule. My work with financial institutions across the country and overseas has led me to believe that many of the largest companies will be compliant when the deadlines come. Other financial institutions will be able to show their best efforts. However, some banks will come up short, likely leading to corrective actions imposed by regulators. Remediation and penalties after the fact will be costly.

An ounce of prevention is worth a pound of cure, as the saying goes. Smart executives understand that it is better to be proactive than to be forced into regulatory triage after the regulators come calling. The triage approach often costs as much as 10 times more. Here's a quick primer on the two rules — and what companies can do now and going forward.

How We Got Here

When considering the current regulatory landscape, it is important to remember the events of the spring and summer of 2016.

In April 2016, a tectonic event for BSA/AML occurred — a cyber intrusion at a law firm in Panama. Around 11.5 million documents that detailed attorney-client privileged financial information for more than 214,000 offshore entities were leaked. An international uproar followed after the public learned how wealth may be hidden offshore. This event should have been named the Mossack Fonseca Papers, after the international law firm that was breached. Instead, the event became known as the Panama Papers.

The following month, the Treasury Department announced the beneficial ownership rule as part of an effort to target the pores of the international financial system. Under the rule, banks must collect information about the "real people" — known as beneficial owners — "who own, control and profit from companies when those companies open accounts." There have been many questions as to what bankers may consider sufficient research and documentation work regarding beneficial ownership. Another issue is collecting information from long-standing customers. Guidance released by the regulators has been limited. Bankers are on their own to decide when sufficient analysis has been completed and documented based on their institutions' unique risk profile and varying customer characteristics.

In June 2016, the Department of Financial Services issued a new rule that requires New York-regulated financial institutions to show that they have strong BSA/AML monitoring programs. Financial institutions must show that their programs implemented proper transaction monitoring. As part of this rule, the DFS requires that a board member or senior officer at each company sign an attestation that the company is in compliance.

There are many facets to each of these rules — and they have huge price tags for many financial institutions in an era in which such institutions are already devoting more and more resources to BSA/AML, enhanced prudential standards and compliance, among other requirements. Global BSA/AML spending topped $8 billion in 2017, more than double the total in 2008, according to a report from WealthInsight.

Becoming Compliant

A variety of events may impact a financial institution's ability to be in compliance over the next few weeks and going forward. There has been a lot of merger and acquisition activity in the financial sector in recent years, with more underway. Newly acquired companies might end up being a compliance department's worst nightmare as they prepare for the beneficial ownership change, Section 504 and myriad other regulatory changes. It is also possible that BSA/AML officers, or even a whole team that focuses on BSA/AML matters, are hired away by another company at an inopportune time. Another observed problem is validity of an institution's data. Keep in mind the convergence of financial services and fintech and the related risks.

Importantly, when the Treasury announced the beneficial ownership rule, it did so as part of a push to establish risk-based customer due diligence procedures, which is a positive development. Beneficial ownership is sometimes called the "fifth pillar," an addition to the requirements that a financial institution must have, which include properly drawn policies and procedures, a designated BSA officer, independent testing of the institution's BSA/AML program, and implementation of a BSA training program.

There is clear bipartisan support for anti-terrorist financial programs in Congress and the current White House. The new federal rules on beneficial ownership survived the transition between the Obama and Trump administrations. The focus on BSA/AML by financial regulators and prosecutors remains rigorous as sanctions increase, despite the Trump administration's regulatory reform efforts in other areas of financial regulation.

Organizations Must Go Deeper

In my career, which includes experience as commissioner of the California Department of Financial Institutions and as an executive at Union Bank in California, one thing has become very clear: All the aforementioned BSA/AML pillars must be tailored to the specific risk profile of each individual organization.

In addition to performing due diligence on the myriad vendors they might work with on BSA/AML, financial institutions must ensure an independent look at their own systems and processes based on best practices. They should start by reviewing any regulatory guidance and enforcement actions. Independent experts and counsel can be pivotal in these analyses and can help with an enterprise-level review of the organization's BSA/AML program to make sure the program is properly drawn in accordance with regulatory expectations. Independent partners should also review the meeting minutes for relevant board and management committees, among other items. It is advisable to review software programs and computer systems to help ensure all necessary updates have been implemented.

To create new efficiencies and maximize effectiveness, many financial institutions are preparing to design and implement artificial intelligence in their BSA/AML programs. Transaction volumes are steadily increasing, and some estimates put false-positive alert rates from banks' fraud transaction monitoring systems between 75 and 90 percent.

The industry is looking to the Financial Crimes Enforcement Network with hope that the agency will provide guidance on beneficial ownership in the coming days in the form of FAQs — even though there are less than two months before the beneficial ownership deadline.

In the end, the proof will be in the pudding. My travels around the United States and overseas make it clear that financial institutions are dealing with a panoply of requirements, including cybersecurity, BSA/AML, stress tests and governance. We are at an inflection point this spring. Financial institutions must demonstrate their commitment to ensuring a compliance culture, and that BSA/AML and other risk management efforts are part of each person's daily job at their financial institution.

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