TOP 10 CHANGES TO THE FEDERAL FINANCIAL INSTITUTIONS EXAMINATION COUNCIL (FFIEC) 2014 BANK SECRECY ACT/ANTI-MONEY LAUNDERING (BSA/AML) EXAMINATION MANUAL

By Steven G. Lewis, CPA, MBA, CAMS

A number of changes were recently made to the Bank Secrecy Act/Anti-Money Laundering Examination Manual. Below, we present the "Top 10" revisions to the Manual along with our analysis.



1. Scoping and Planning – Clarified that the independent testing of the BSA Program need not be performed by an "auditor," whether internal or external.

COMMENTARY: This clarification stresses substance over form. The person (not necessarily an "auditor") performing the testing must be independent - that is not "involved" in the bank's BSA/AML compliance program and must present his or her report to the Board of Directors or a Board committee comprised of outside directors.

2. Customer Due Diligence – Added a footnote reference to FIN-2010-G001, 2010 "Guidance on Obtaining and Retaining Beneficial Ownership Information" issued in May 2010. The Guidance consolidated existing regulatory expectations for obtaining beneficial ownership information for certain accounts and customer relationships.

COMMENTARY: The Guidance retained risk based CDD, which may include identifying and verifying beneficial owners. The Guidance also retained private banking account beneficial ownership verification requirements. Note that an ownership threshold was not specified. However, FinCEN's Notice of Proposed Rulemaking (August 4, 2014), "Customer Due Diligence Requirements for Financial Institutions," does specify

a threshold of 25%. This Notice is not included or otherwise referred to in the Manual, presumably since it is still in the proposal stage.

3. Suspicious Activity Reporting (SAR) – Established new guidance on controls over banks' BSA monitoring systems. Specifically, bank policies and procedures should clearly document the authority to "establish or change expected activity profiles" used to detect unusual activity. In addition, controls should ensure limited access to the monitoring systems and access privileges in the system must be appropriate under the circumstances. Furthermore, any changes should require the review and approval of the BSA compliance officer as well as senior management. The Manual also added a requirement that management tests the "filtering criteria" in the monitoring system. Previously management only had to "review" the criteria, now it has to "review and test." Management, however, should still be able to "document and explain" the models in the system. Finally, an "independent validation" of the system's "programming methodology and effectiveness" to ensure that the models are detecting potentially suspicious activity has always been required. Now the scope of the independent validation has been expanded to "verify" the surveillance monitoring policies/procedures and management's compliance with such policies.





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COMMENTARY: BSA systems' filtering criteria, parameters, rules and programming methodology are all considered part of the models used to detect potentially suspicious activity. Therefore, the April 4, 2011, Supervisory Guidance on Model Risk Management (issued by the Board of Governors of the Federal Reserve System and the Office of the Comptroller of the Currency) with its requirement on model documentation and validation also applies.

4. OFAC – The Manual added OFAC's "encourage[ment]" for banks to take a risk-based approach when implementing their OFAC programs.

COMMENTARY: The most interesting part of the Manual as it relates to OFAC is what it does not contain. While the Manual was issued in November 2014, it does not include OFAC's "Revised Guidance on Entities Owned by Persons Whose Property and Interests in Property Are Blocked" (August 13, 2014). This Revised Guidance aggregates ownership interests of SDNs in an entity. If the aggregate direct or indirect ownership of SDNs in an entity reaches 50% or more, then the entity becomes blocked (known as a "shadow" or "deemed" SDN). In other words, if blocked persons own directly or indirectly 50% or more of an entity, then that entity itself becomes blocked. Thus, financial institutions are expected to obtain beneficial ownership information on all entity accounts and many banks already do so. However, that still leaves open the question of what ownership thresholds to use when identifying beneficial owners. FinCEN's Notice of Proposed Rulemaking dated August 4, 2014, "Customer Due Diligence Requirements for Financial Institutions," would seem to

indicate that a 25% threshold would be acceptable. However, OFAC's Q+A #401 implies that a 10% threshold is appropriate, although the actual regulations have yet to be issued. Also, the Internal Revenue Code (FATCA) generally specifies a 10% threshold for foreign entities. Ultimately, which threshold to adopt becomes a risk based decision although banks should be prepared to justify their decision.

5. BSA/AML Compliance Program Structures – Added a caution on restricted transparency across the organization and the need to ensure AML controls are appropriate under the circumstances.

COMMENTARY: This seems consistent with FIN-2010-G001, 2010, "Guidance on Obtaining and Retaining Beneficial Ownership Information, which called for implementing CDD/EDD procedures on an enterprise-wide basis and AML staff "crosschecking" information with other departments.

6. Correspondent Accounts (Foreign) – Added a risk mitigation measure that U.S. banks should determine whether their foreign correspondents have acceptable AML programs, including customer due diligence practices, suspicious activity identification processes, and recordkeeping documentation. This also includes understanding the effectiveness of the AML regime of the foreign jurisdictions in which their foreign correspondent banking customers operate.

COMMENTARY: Based on Appendix H, under Foreign Correspondent Account Recordkeeping, Reporting and Due Diligence, this would also seem to apply to a U.S. bank's accounts with its foreign branches.

7. Prepaid Access – This section underwent major changes.

Of particular interest, banks now need to review the prepaid access third party service providers' BSA compliance programs as well as their BSA monitoring capabilities. Also, banks need to obtain transaction activity from the providers and review transactions for potentially suspicious activity.

COMMENTARY: In accordance with the Manual's guidance on Nonbank Financial Institutions, providers and sellers of prepaid access are now considered MSBs, subject to specified thresholds/exclusions such as the type of prepaid card (open vs. closed loop), amount (maximum value per device per day),





potential usage (domestic vs. international) and method of reloading (depository vs. non-depository source).

8. Third-Party Payment Processors – Added various risk mitigation measures, most notably that banks should "audit" their third party payment processing relationships. Such audits should encompass checking that the processor is fulfilling its contractual obligations and verifying the legitimacy of its merchant clients.

COMMENTARY: This reflects increased recognition that Third-Party Payment Processors are generally considered high risk.

9. Currency Transactions Reporting Exemptions – Added marijuana-related businesses to the list of businesses ineligible for exempting from CTR filing requirements. Also, added a footnote reference to FinCEN's Guidance: "BSA Expectations Regarding Marijuana-Related Businesses, FIN-2014-001," February 14, 2014.

COMMENTARY: As the number of marijuana businesses increases – particularly in Colorado - the Federal Government has taken a "laissez faire" approach to regulating them. Nevertheless, banks need to be aware that, notwithstanding state law, it is a violation of Federal law "to manufacture, distribute or dispense marijuana." Therefore transactions with marijuana related business will require SAR fillings – Limited, Priority and/or Termination fillings, depending on the bank's consideration of the legality of the customer's activities, detection of potentially suspicious activity and compliance with the Cole Memo (U.S. Department of Justice, "Memorandum for All United States Attorneys: Guidance Regarding Marijuana Enforcement," August 29, 2013, authored by James M. Cole, Deputy Attorney General).

10. Nonbank Financial Institutions – In addition to defining providers and sellers of prepaid access as MSBs (see Prepaid Access above), the Manual also considers administrators and exchangers of virtual currency to be MSBs (specifically, a money transmitter) and thus banks are expected to apply appropriate BSA monitoring procedures similar to those for money transmitters.

COMMENTARY: Virtual currency (such as Bitcoin) administrators are now considered MSBs and their accounts should be monitored accordingly.

Please refer to our <u>"Overview of Changes"</u> document and the <u>Manual</u> itself for further details.



CONTACT
Steven G. Lewis, CPA, MBA, CAMS
Senior Manager
646.656.1942
Steven.Lewis@WeiserMazars.com

STEVEN G. LEWIS HAS OVER 35 YEARS OF EXPERIENCE PERFORMING OPERATIONAL, FINANCIAL, AND REGULATORY COMPLIANCE PROJECTS IN THE FINANCIAL SERVICES INDUSTRY. HE IS WELL-VERSED IN BSA/AML, CAPITAL MARKETS, COMPLIANCE AND SARBANES-OXLEY. STEVEN HAS EXTENSIVE EXPERIENCE IN BSA/AML CONTROLS REVIEWS, INTERNAL CONTROL AUDITS, REGULATORY COMPLIANCE REVIEWS, POLICY AND PROCEDURE DEVELOPMENT, BANK OPERATIONS, CAPITAL MARKETS, INVESTMENT PORTFOLIO MANAGEMENT, TRADING FRAUD PREVENTION, AND RISK MANAGEMENT PROGRAMS.





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