ICBA
INDEPENDENT COMMUNITY BANKERS of AMERICA®

MODERNIZING ANTI-MONEY LAUNDERING AND ANTI-TERRORIST FINANCING LAWS AND REGULATIONS

White Paper
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Introduction

In today's world, it is imperative that financial institutions, law enforcement, and our government work together to combat and prevent financial crime, money laundering, and terrorist financing. Community bankers are committed to supporting balanced, effective measures that will prevent terrorists from using the financial system to fund their operations and prevent money launderers from hiding the proceeds of criminal activities. However, anti-money laundering/combatting the financing of terrorism and Bank Secrecy Act ("BSA") compliance programs (collectively "AML/CFT") consume a growing share of community banks' scarce resources.

Since the inception of the anti-money laundering laws in 1970 and anti-terrorist financing laws in 2001, the burdens placed on banks increasingly create an environment where financial institutions are essentially tasked with identifying, investigating, policing, and reporting potential criminal activity. Each year, community banks must invest more time, money and resources to combat this threat. Yet, community banks report that the current outdated framework is more an exercise of completing forms and strictly adhering to policies and procedures developed from regulatory requirements rather than making an impact in combating financial crime.

A primary challenge facing community banks today is the sharply increasing and disproportionate burden of complying with these growing regulatory requirements.

These regulations also diminish community banks' ability to attract capital, support the financial needs of their customers, serve their communities, and contribute to their local economies. Additionally, many of them do not have dedicated legal and compliance departments and they have a smaller asset base over which to spread compliance costs.

Federal regulators are in the early stages of identifying areas in which burdens can be reduced while maintaining the effectiveness of the AML/CFT regime.

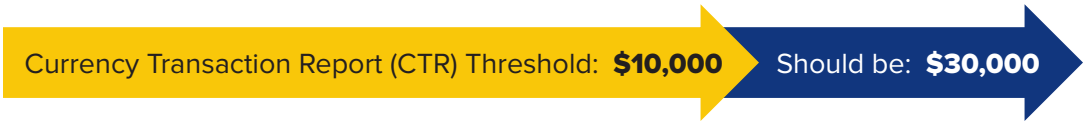
Modernization will produce more useful information while alleviating compliance burden

Modernization and reform of the BSA will produce more useful information for law enforcement while alleviating one of the most significant and costly sources of community bank compliance burdens. Rather than having banks devote their resources to tasks that are inefficient or redundant, a more efficient and technologically advanced framework would better serve law enforcement and enable community banks to more effectively utilize their resources. BSA modernization will free community bank resources to better serve customers and communities.

ICBA recommends several areas in which the AML/BSA framework can be modernized:

Update reporting thresholds

As the federal government combats money laundering and terrorist financing, ICBA strongly recommends an emphasis on quality over quantity for all BSA reporting. Reporting thresholds are significantly outdated and capture far more transactions than originally intended. The currency transaction report (CTR) threshold, which was set in 1970, should be raised from $10,000 to $30,000 with future increases linked to inflation.



CTRs are intended to collect information for investigations in tax evasion, money laundering, terrorist financing and other financial crimes. However, the overwhelming percentage of CTRs relate to ordinary business transactions, which create an enormous burden on financial institutions that is not commensurate with financial crime investigations. While the BSA provides banks with the ability to exempt certain customers from CTR reporting, a higher threshold would produce more targeted, useful information for law enforcement.

Suspicious activity reports ("SARs") are the cornerstone of the BSA system and were established as a way for banks to provide leads to law enforcement. Because community banks have a strong incentive to file SARs as a defensive measure to protect themselves from examiner criticism, SARs are filed in increasing and vast numbers without a commensurate

benefit to law enforcement. As the government combats money laundering and terrorist financing, ICBA strongly recommends an emphasis on quality over quantity for SAR filing. ICBA recommends reforming the SAR process by increasing the reporting thresholds, which have not been adjusted since becoming effective in 1992, and by emphasizing those instances in which an institution may rely on risk-based reporting.

Currently, an institution is required to file a SAR for:

1. criminal violations involving insider abuse in any amount;
2. criminal violations totaling $5,000 or more when a suspect can be identified;
3. criminal violations aggregating $25,000 or more regardless of a potential suspect; and
4. transactions conducted or attempted by, at, or through the bank (or an affiliate) if the bank knows, suspects, or has reason to suspect that the transaction is suspicious.

ICBA recommends the current SARs threshold should be raised from $5,000 to $10,000 which will modernize thresholds by emphasizing quality over quantity in information collection.

In the current regulatory environment, community banks are faced with a cumbersome and overly burdensome process to ensure they are protected and no mistakes are made when reviewed by examiners. They are questioned about the number of SARs filed in relation to the number of accounts and transactions initially identified as suspicious rather than the quality of the bank's monitoring system or investigative process. Additionally, bankers are questioned regarding the total number of SARs filed since the last examination as though a quota is required. As a result, bank employees often file SARs as a defensive measure and to ensure that in hindsight they did not miss or overlook any details and to ensure they filed a requisite number of SARs. The current focus is also a daunting task for banks because it usurps resources by requiring significant time monitoring for thresholds (quantity) and less time focused on actual suspicions (risk).

For each transaction the bank identifies as suspicious, a thorough investigation is conducted that typically includes monitoring and reviewing all documentation and account activity, interviewing appropriate personnel, a review of the investigation by a BSA-trained employee, and sometimes a second review by either a compliance or BSA committee, BSA officer or senior level staff. The investigation is documented, with documents retained on transactions for which a SAR is filed as well as for investigations for which a SAR is not filed. If a SAR is not filed, banks must document and subsequently justify to their examiner why a flagged transaction did not result in a filed SAR. This is done for every suspicious transaction no matter how minor or severe the potential offense. The process is time consuming and labor intensive and community banks are skeptical that the method by which SARs are completed provides commensurate value to law enforcement.

Moreover, the archaic and labor-intensive nature of the SAR process makes the SAR regime ineffective and cumbersome. As stated previously, community banks follow the same SAR procedure for every suspicious transaction no matter how minor the potential offense. This approach leaves community banks skeptical that SARs have real value to law enforcement.

Increasing filing thresholds for both SARs and CTRs would enable community banks to provide more targeted and valuable information to law enforcement.

Collection of beneficial ownership information by federal or state government

On May 11, 2018, the Financial Crimes Enforcement Network's ("FinCEN") new beneficial ownership rule, which requires banks to collect information on the beneficial owners of legal entity accounts, became effective. FinCEN defines a legal entity customer as a corporation, limited liability company, or other entity that is created by the filing of a public document with a Secretary of State or similar office, a general partnership, and any similar entity formed under the laws of a foreign jurisdiction, that opens an account.

FinCEN states that legal entities are at times abused to obfuscate ownership interests and used to engage in illegal activities such as money laundering, corruption, fraud, terrorist financing and sanctions evasion. Criminals have exploited the anonymity that legal entities can provide to engage in a variety of crimes, and often take advantage of shell and front companies to conduct such activity. Making legal entities more transparent by requiring identifying information of natural person owners would likely hinder such

abuses. However, shifting the responsibility and oversight of collecting this information to the private sector—financial institutions—is misguided and ineffective.

Collecting and verifying the identity of all natural-person owners of each entity by either the Internal Revenue Service or other appropriate federal agency and/or state in which the entity is formed would provide uniformity and consistency across the United States. By making the formation of an entity contingent on receiving beneficial owner information, strong incentives would be created for equity owners and investors to provide such information. Additionally, periodic renewal of an entity's state registration would provide an efficient and effective vehicle for updating beneficial ownership information.

The customer due diligence and beneficial ownership rule is a component of Treasury's broader strategy and corresponds with the Administration's and Congress' ongoing work to require the collection of beneficial ownership information at the time that legal entities are formed in the United States. However, requiring both the federal government and financial institutions to collect the same information on the same entities is ineffective, duplicative, unnecessary, and costly. It is important to ensure that any additional requirements maintain a balanced approach that promotes the purposes of BSA with the limited and already strained resources of community banks. This rule does not achieve that balance.

Furthermore, information regarding beneficial owners could be more easily shared between law enforcement and government agencies than between banks and law enforcement. While privacy laws do not permit banks to share personal information with a government agency absent a subpoena or similar directive, inter-agency sharing of personal information is permissible if certain amendments are in place.

Additionally, obtaining beneficial ownership on all legal entity customers, and verifying their identity on certain business accounts, is an onerous task and is difficult to implement. While the ownership interest and management responsibility of a business may be straightforward in certain cases and specified in a legal organizational document in other cases, certain legal structures make determining ownership equity extremely difficult, at best.

Each community bank must have a written customer identification program ("CIP") that enables it to form a reasonable belief that it knows the true identity of each customer. Existing CIP and Enhanced Due Diligence ("EDD") practices apply to natural-person customers as well as legal entity customers. However, incorporating beneficial owners into existing CIP practices and risk assessments creates an implicit requirement for bank employees to understand various legal structures and ownership interests in order to assess risk.

As such, a bank's front-line staff is required to conduct several additional intermediate steps during the account-opening process to ensure they have a reasonable belief they know the true identity of each beneficial owner. This adds significantly more time to each business account opened.

Additionally, the rule requires banks to confirm the beneficial ownership information each time a customer opens an additional account. This is duplicative and extremely burdensome because the bank has already undergone the onerous task of confirming the beneficial ownership information in the first place, and it is on file. To do so each time a new account is opened adds no benefit whatsoever to law enforcement.

Although banks may generally rely on the representations of the customer when answering the financial institution's questions about the natural persons behind the legal entity, bank employees still require some advanced business acumen in order to understand and determine to whom the definition applies.

This rule also requires banks to obtain and verify beneficial ownership information on financial product renewals, such as certificate of deposits and loans, for products established before May 11, 2018. In order to comply with this unreasonable requirement, banks need to stop automatic renewals long enough to obtain a customer's beneficial owner certification (and continue following up with customers who do not respond in a timely manner) because most banks do not require customer interaction for automatic renewals. Not only is this requirement a useless exercise, but there is no reason to believe that a roll over product, loan or certificate of deposit renewal, or automatic renewal is evidence of change in beneficial ownership. These products are scheduled for the customer's convenience and are triggered by maturity or due dates and not changes in ownership. Furthermore, these products are low-risk for financial crimes.

Enhanced communication among industry, law enforcement and the federal government

Communication and cooperation are critical to an effective working partnership among the government, law enforcement, and financial institutions. Community banks seek more current information from the federal government to better understand what specific methods of terrorist financing and money laundering they are trying to prevent so banks can more readily identify and report truly suspicious transactions.

Ensuring a balanced approach to combating financial crimes

Assisting law enforcement in its fight against financial crimes is important to community banks. Currently, however, banks are effectively deputized to identify, investigate, report, and police potential financial crimes. While banks are eager to cooperate with law enforcement, they should not act as police. More balance is needed between the responsibilities of the public versus private sectors to detect and prevent financial crime.

For community banks, BSA compliance represents a significant expense in terms of both direct and indirect costs. BSA compliance, whatever the benefit to society at large, is a governmental, law enforcement function. As such, the costs should be borne by the government. ICBA supports the creation of a tax credit to offset the cost of BSA compliance.

Additionally, community banks spend significant resources—in terms of both direct and indirect costs—complying with the BSA and anti-money-laundering laws and regulations. However, the cumulative impact of these regulations places a burden on community banks that is often disproportionate to the benefits of the additional regulatory requirements. As the government continues to combat money laundering and terrorist financing, it is important to focus on quality over quantity for all BSA reporting.

ABOUT

ICBA

Independent Community Bankers of America® (ICBA), the nation's voice for nearly 5,700 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.

CONTINUE THE CONVERSATION

Lilly Thomas
Senior Vice President, Senior Regulatory Counsel
Independent Community Bankers of America
Lilly.Thomas@icba.org
www.icba.org/advocacy

Rhonda Thomas-Whitley
Independent Community Bankers of America
Assistant Vice President and Regulatory Counsel
Rhonda.Thomas-whitley@icba.org
www.icba.org/advocacy

PRESS INQUIRIES

Nicole Swann
Vice President, Communications
Independent Community Bankers of America
Nicole.Swann@icba.org
202-821-4458