

## AML Trends Signal Changing Times For Regional Banks

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Recent activity involving state and federal bank regulators reflects an upswing in enforcement actions against regional and super-regional banks for Bank Secrecy Act/anti-money laundering compliance failures. Bank of Mingo, Bank of the Orient, First Community Bank of Lexington and Alma Bank, to name just a few, have all been the subject of enforcement actions. These actions indicate that the prudential regulators, as well as multiple law enforcement agencies, are approaching regional and super-regional banks with the same heightened scrutiny that they previously reserved for the largest multinational banks or foreign banks doing business in the United States. Regional and super-regional banks would be well-advised to pay close attention to these trends and to consider taking preventive measures now to ensure they are best positioned for their examinations.

A review of recent enforcement actions provides a useful road map of the current regulatory priorities. Foremost among them are:

**1) Board and Senior Management Oversight and Supervision.** Banks of all sizes are expected to demonstrate a clear and unequivocal tone from the top through effective communication of priorities with respect to AML compliance. This must occur throughout the organization, in compliance departments as well as in business lines. It is clear, however, that words alone are not enough. The message from senior managers must be reflected in actions, including metrics that measure the success of the priorities and employment evaluation incentives. Moreover, enforcement actions have emphasized the importance of BSA and Office of Foreign Assets Control compliance officer qualifications, authority and independence within the organization in order to give effect to board and senior management compliance priorities.

As Comptroller of the Currency Thomas Curry noted in a 2014 speech to the Association of Certified

Anti-Money Laundering Specialists, underlying BSA compliance deficiencies can be traced back to board and senior management decisions in four key areas: “the culture of compliance within an organization, the resources committed to BSA compliance, the strength of the organization’s information technology and monitoring process, and the quality of risk management.” Each of these components has become a critical feature of bank examinations and should serve as the foundation for board and senior management oversight.

**2) Enhanced BSA/AML and OFAC Risk Assessments.** A robust risk assessment is the foundation of an effective BSA/AML and OFAC program for all financial institutions. Regulators have long expected banks to maintain effective risk assessments of their BSA/AML and OFAC sanctions risk, including identification of high-risk business lines, clients and geographies, and continue to require it of regional and super-regional banks. Documented methodologies to support the risk assessments are now essential to understanding every bank’s approach to managing identified risks. Risk assessments and corresponding methodologies must be updated periodically to effectively manage evolving risks and the changing nature of a bank’s products and services.

**3) Customer Due Diligence and Enhanced Due Diligence.** Enforcement actions continue to identify alleged weaknesses in customer due diligence and enhanced due diligence policies and procedures, particularly with respect to high-risk customers within high-risk business segments and in high-risk geographies (domestic and international). As higher-risk customers migrate to regional and super-regional banks, in part because of bank “realignment” of risk, regional and super-regional banks should remain vigilant with respect to internal controls to manage these growing risks.

For example, Bank of Mingo was noted to have “serviced high-risk customers without effectively monitoring their respective accounts, and further failed to detect and report unusual large currency transactions and otherwise suspicious activities.” Mingo used a software system to monitor its accounts for unusual activity, but it was found to not use it effectively to detect and report suspicious activity. As a result, the regulator found that the bank did not have an effective system of internal controls reasonably designed to ensure compliance with the BSA and its implementing regulations. Updating transaction monitoring technology and optimizing the rules that underlie it to effectively evaluate transaction activity is a growing imperative.

**4) Reporting Failures.** Banks must ensure that suspicious activity report (SAR) and currency transaction report (CTR) policies and procedures are clear and precise to promote consistent and timely filing. Backlogs in managing alerts must be identified and rectified expeditiously. Failure to file SARs and CTRs as well as filing deficient SARs has become a frequent hallmark of enforcement actions for financial institutions of all sizes. Often, reporting failures are based on other programmatic failures such as ineffective policies, procedures and systems to identify high-risk customers at account opening and to identify suspicious transactions throughout the customer relationship.

**5) Robust Independent Testing and Remediation Plans.** Banks must have a strong audit function, including appropriate audit coverage and planning, adequate compliance testing and well-trained auditors. The bank’s independent audit should be risk-based, customized to the bank’s operations, and include all the required elements of the BSA/AML and OFAC sanctions programs. Auditors must report directly to the board or a designated committee of the board to ensure that identified issues can be communicated directly to the board. Management should develop effective strategies to adequately track and resolve deficiencies in a timely manner.

Regional and super-regional banks can take a number of steps now to ensure they are well-positioned to

detect and deter illicit activity, and to meet regulatory expectations. This preemptive assessment should include a comprehensive review of the bank's BSA/AML and OFAC programs, including:

- **Policies and Procedures Review.** While a review of policies and procedures should be conducted at least annually, an interim review in light of the heightened enforcement activity would help to ensure policies and procedures have kept pace with regulatory expectations, as well as corporate developments and expansion, and that the various policies integrate with each other. Recent public statements by regulators and law enforcement officials such as Assistant Attorney General Leslie Caldwell indicate that financial institutions must have policies and procedures that are workable, not just written on paper. The policy review should include correlation to the bank's risk assessment to ensure they align or to determine whether the risk assessment or the policies and procedures, or both, need updating.
- **Culture of Compliance.** Banks should assess the culture of compliance at the institution from the top down, including written communications to employees, recipients of such communications and intranet resources, and should ensure that adequate resources are in place to address AML compliance. This expectation has been relayed numerous times, including in the Financial Crimes Enforcement Network's guidance issued in August 2014 (FIN-2014-A007) and Curry's 2014 speech noted above, and was recently reinforced by Caldwell in her speech at the Compliance Week Conference on May 19, 2015. The regulators are certainly getting the message out. Culture of compliance must be reflected not only in policies and procedures but in the actions of the institution. Banks should also train their board of directors on the "tone from the top" and oversight expectations.
- **Audit Assessment.** Banks should review prior audit reports to ensure they address the full scope of the BSA and OFAC programs, and track resulting remediation plans to ensure they are on target and that internal expectations are being met. While self-identifying weaknesses or deficiencies will be viewed favorably, delays in implementing remediation plans will be viewed critically. The board should be regularly apprised of the status of remediation efforts, successes and causes for delay.

Banks must be proactive in their approach to BSA/AML and OFAC compliance, learn from the enforcement actions of others, and get ahead of the issue before they are forced to spend significant amounts of time and money playing catch-up to the expectations of their regulators. Regional and super-regional financial institutions that fail to take notice of these enforcement orders, and the trends within them, risk having to tackle their own costly remediation orders.

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