Statement

For the Record

of

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President

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To the

House Financial Institutions and Consumer Credit Subcommittee

on

"Examining De-risking and its Effect on Access to Financial Services"

February 15, 2018

Chairmen Luetkemeyer and Ranking Member Clay, I am John Byrne, President of Condor Consulting LLC and the previous Executive Vice President of ACAMS (Association of Certified Anti-Money Specialists). I was pleased to have an opportunity to present my views on AML oversight last November before this subcommittee and strongly support this review of the many challenges with financial inclusion. As co-chair of a project with the World Bank and ACAMS addressing the collateral damage to many members of the global economy from so-called "de-risking",[i] I want to note the work being done to add transparency and hopefully clarity regarding getting essential financial services to areas of need.

AML Impact on Financial Access

While there is a myriad of reasons why financial access is unavailable or limited, my focus today is on how risk management in the AML or financial crime prevention areas impacts compliance or business decision-making.

As I indicated in November, when the financial sector receives limited or conflicting advice and counsel regarding how best to manage risk, the logical response by some financial institutions is to exit or not onboard certain classes of customers. The result is that victims such as non-profit organizations (NPOs) in conflict zones and other troubled areas do not receive funding for water, utilities and other life-saving resources that are so desperately needed for survival. Again, make no mistake-- banks and other financial institutions should be free to decide if they can ultimately manage risk, but they shouldn't be forced to exit account relationships because of confusing and conflicting oversight or due to the sometimes-uninformed opinions of some examiners that a financial institution should not bank a type of customer or a specific customer. Sadly, this confusion is both not new and continues today.

For example, as far back as 2005, the money services businesses (MSB) community faced the same barriers to account relationships as charities and humanitarian groups do today. I have included, for the record, testimony I gave that year while with the American Bankers Association (ABA) that covered the confusion regarding banking MSBs and comments that still ring true on risk such as this one from Florida banks:

> *Financial institutions are closing legitimate accounts. Particularly in the area of [MSBs], financial institutions feel compelled to close their accounts. Most of these are the accounts of perfectly legitimate businesses. Many of them in Florida are businesses run by small entrepreneurs. They are gas stations, convenience stores, and grocery stores. They serve as a place where paychecks can be cashed. Some of them serve as agents of regulated money transmitters. These accounts are closed not because there is any evidence that they are engaged in improper activity, but because they fit into a regulatory profile.*

The regulators did respond to these issues with a guidance document designed to assist both MSBs and banks in their risk decisioning.[ii] Unfortunately though, even with added regulatory clarity, some MSBs still struggle with financial access in 2018, due in part to how banks perceive supervisory oversight regarding risk mitigation. This article from ACAMS Today encapsulates the continuing problem. https://www.acamstoday.org/de-risking-fact-or-fiction/

I would suggest that examiner, and overall government inconsistency, regarding expectations are still the main causes of today's challenging compliance environment and what MSBs are grappling with is also harming the NPO community.

For example, even when the federal agencies collaborate to attempt to create consistency in published guidance, confusion may still occur. In August 2016, a "joint fact sheet"[iii] designed to assist those dealing with correspondent banking sent mixed messages to the financial sector. Here is one paragraph that is emblematic of there being themes at cross purposes:

"The goal of BSA compliance programs and OFAC sanctions programs is to ensure a well functioning, transparent, resilient, and safe and sound financial system. While the Treasury and the FBAs [federal banking agencies] do not utilize a zero tolerance philosophy that mandates the strict imposition of formal enforcement action regardless of the facts and circumstances of the situation, Treasury and the FBAs take the threats posed by criminals, money-launderers, and terrorist financers very seriously, and continue to use their authorities—in a proportionate and appropriate manner—to safeguard our financial system against abuse. "The vast majority of BSA/AML compliance deficiencies identified by the FBAs—approximately 95%—are resolved through the supervisory process without the need for an enforcement action."

Remember that this was part of guidance that was supposed to make clear that the agencies favored a "risk-based approach" to correspondent banking, but the comments above certainly give pause to that notion and reinforce that there are risks associated with correspondent banking. I wrote more extensively about this guidance at the time [iv] and while government guidance in many cases is certainly useful, it is only so if the communication is clear and not unnecessarily nuanced.

The World Bank, ACAMS and the Impacted NPO community

The current regulatory environment is certainly challenging, but this subcommittee can take some solace in the fact that impacted stakeholders have been working diligently to create opportunities for improvement in some segments of those needing enhanced financial access.

After bringing together regulators, law enforcement, financial sector representatives and those harmed by limited access in the non-profit community, ACAMS and the World Bank published a report on that dialogue and continue with several "workstreams" that I believe, when completed, will improve this environment.

Upon release of the report, we (the stakeholders) agreed to these recommendations:

Regulatory and Policy landscape

- Develop positive incentives ("carrots") for financial institutions to keep banking humanitarian organizations;
- Repackage regulatory information for NPOs to provide them with clear guidance on financial institution expectations;
- Enhance NPO specific language within existing examiners manual or other regulatory tools to better articulate nuances of risk for NPOs;
- Multi-stakeholder developed training/communication training for examiners; Risk-sharing arrangement between financial institutions and governmental organizations, especially where an NPO is executing a government program. (E.g. partnering with financial institutions to disburse humanitarian aid funds, alternative corridors);
- Engage with authorities and correspondent banks beyond the US.

Since then, in one of the workstreams, we have submitted recommended language to the FFIEC on coverage of NPO's in the next edition of the BSA/AML Examination Manual (attached to this statement). We are also currently working with financial institutions and NPO's on creating training for both sides on how to successfully handle account relationships and to develop a document that would outline the information banks need to process NPO accounts.[v]

All these efforts point to the strong support of the NPO and banking communities to address the confusion on compliance that today harms so many that are **not** in the risk categories that examiners indicate or that is implied by their actions.

Conclusion

As you can see, the challenges with balancing risk and business decisions on certain customers and classes of customers in this environment of increased financial crime is both complicated and in dire need of regulatory clarity. Congress can have a positive impact on this situation by requiring a detailed study with ALL affected stakeholders (law enforcement, NPO's, regulators and the financial sector), taking appropriate steps to implement or encourage the recommendations listed above and to call on the regulators to enforce consistency in AML oversight.

With this hearing on this important issue, we are at a turning point. If nothing changes, those in the most need for funds and resources will continue to suffer. Fortunately, the work of the World Bank and ACAMS is a useful model for how to address financial access and does give us hope that there can be success.

This subcommittee deserves credit for identifying the need to exam the collateral damage caused by AML confusion and we urge continued oversight on this important problem.

Thank you for the opportunity to present the views of those working toward a solution and I am happy to offer additional information as you proceed.

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[i] http://documents.worldbank.org/curated/en/538271487141265874/pdf/112804-WP-SupportingFinancialAccessforHumanitarianOrganizationsandCharities-PUBLIC-ABSTRACT-SENT.pdf
Among many themes and points made throughout the dialogue the key point was "All participants agreed that it is vital that humanitarian organizations and charities (hereafter: NPOs) maintain timely access to financial services in order to provide much needed humanitarian services, particularly in crisis situations."

[ii] https://www.fincen.gov/resources/statutes-regulations/guidance/interagency-interpretive-guidance-providing-banking

[iii] **https://www.treasury.gov/press-center/press-releases/Documents/Foreign%20Correspondent%20Banking%20Fact%20Sheet.pdf,**

[iv] http://www.bankingexchange.com/blogs-3/aml-fraud/item/6448-will-it-go-round-in-circle
Another survey on de-risking and correspondent banking by the IFC is also worth noting.
https://www.ifc.org/wps/wcm/connect/3d215edb-55da-4097-982c-e90409d6621a/IFC+2017+Survey+on+Correspondent+Banking+in+EMs+final.pdf?MOD=AJPERES

[v] There is also an International Stakeholder Dialogue occurring on 2/15 in the Netherlands that is building on other projects and is "is an initiative bringing together public and private sector stakeholders – banks, humanitarian organizations, government policymakers, regulators, and international organizations - to examine what each can do to reverse this phenomenon. The objective is to identify causes, and, more importantly,

share experiences, actions and strategies to ensure that access to financial services is safeguarded for NPOs. Multi-stakeholder dialogues addressing financial access challenges have been underway in the United Kingdom, the Netherlands and the United States in the past year to discuss potential solutions. This event seeks to amplify these efforts, foster greater understanding and collaborative relationships between stakeholders, and, hopefully, ensure that work toward concrete solutions continues." We would offer to submit the outcomes to this subcommittee upon publication.

Testimony of

John J. Byrne

On Behalf of the

American Bankers Association

Before a Joint Hearing of the

House Financial Services Oversight and Investigations Subcommittee

and

The House International Relations International Terrorism and Nonproliferation Subcommittee

United States House of Representatives

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May 4, 2005

Subcommittee Chairwoman Kelly, Subcommittee Chairman Royce, Ranking Member Gutierrez, Ranking Member Sherman, and Members of the subcommittees, I am John Byrne, Director of the Center for Regulatory Compliance of the American Bankers Association (ABA). ABA appreciates this opportunity to discuss how the financial industry is addressing compliance with the USA PATRIOT Act and all of the laws covering financial institutions' anti-money laundering (AML) obligations.

ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

ABA and our members continue to work with our government partners in training financial institution employees to effectively detect and report the myriad of financial crimes that involve money laundering and terrorist financing. We plan to address the expected interagency BSA-AML examination procedures later this summer. We have trained hundreds of thousands of bankers since the passage of the Money Laundering Control Act in 1986.[1] The industry's commitment to deterring money laundering continues unabated.

Among other things, ABA holds an annual conference with the American Bar Association on money laundering enforcement, produces a weekly electronic newsletter on money laundering and terrorist financing issues, offers online training on Bank Secrecy Act (BSA) compliance, and has a standing committee of more than 80 bankers who have AML responsibilities within their

[1] A 2003 survey by ABA Banking Journal and Banker Systems Inc. found that Bank Secrecy/AML/OFAC was the number one compliance area in terms of cost to the banking industry. It is also interesting to note that in banks under $5 billion in assets, 75.6 percent of the employees said that compliance was not their only job.

institutions. In addition, we provide telephone seminars on important and often confusing issues such as money services business (MSBs) relationships and compliance with Section 326 of the USA PATRIOT Act.

In May 2004, ABA repeated a series of recommendations regarding "needed areas of improvement to USA PATRIOT Act oversight." Since then, there has been clear movement and commitment for further action from the highest levels of the federal banking agencies. However, ABA remains concerned about the quality of communication that exists between these same agencies and their examiner forces. Although there are significant signs of improvement, we hope all communication problems will be remedied as soon as possible.

ABA and the 50 state banking associations stressed these themes in a January 10 letter to all federal banking agencies, as well as to the Department of the Treasury and the Financial Crimes Enforcement Network (FinCEN). This letter is attached. Please note that a response was received on April 18. We are hopeful that the major issues are being addressed.

To update Members on the various industry AML challenges, we offer the following observations and recommendations:

1. The detection of terrorist financing by banks or other financial institutions, whether through charities or any other entities, will not be successful without effective government intelligence and continued private sector involvement in organizations such as the Financial Action Task Force (FATF);

2. Whether in terms of BSA compliance or how banks work with MSBs, effective compliance with evolving AML requirements necessitates accompanying guidance. For example, it is counterproductive to label an entity "high risk" without also issuing guidance on how to mitigate that risk; and,

3. Until the financial sector receives improved guidance and a more balanced approach to examiner oversight, the volume of suspicious activity reports (SARs) that banks submit to regulators will continue to skyrocket, frustrating government efforts to accurately detect genuinely threatening activity.

Consistent Examination Procedures, Though Pending, Are Desperately Needed

ABA has previously emphasized to Congress that the banking agencies need to reach agreement on how the financial services industry will be examined for compliance under the PATRIOT Act and the other AML requirements. We are pleased to note that there is formal movement on coordination of examination procedures by the agencies and final procedures are now due out June 30. We will discuss one glaring problem – assessment of the adequacy of SAR programs, later in this testimony.

While we repeat our 2003 and 2004 calls for Congress to ask the regulatory agencies to report on and clarify their efforts in this area, ABA is pleased that the agencies are exhibiting a commitment to greater consistency in 2005. For example, not only has FinCEN Director William Fox expressed public support for uniform assessments, but he has also directed the Bank Secrecy Act Advisory

group (BSAAG) to form a subcommittee on examination issues. This subcommittee, co-chaired by ABA and the Federal Reserve Board, has met several times – as recently as April 29 – to discuss the pending interagency examination procedures.

Uniform exam procedures will assist with the industry concerns about examination inconsistency and the continued threat of "zero tolerance" by these same errant examiners. However, we strongly urge Congress to ensure that all banking agencies engage in industry outreach when the AML exam procedures are made public. The agencies appear committed to such outreach and we believe a nationwide series of "town meeting-type" events will ensure that both sides will know what to expect in this complicated compliance area.

MSBs and Banks: An Example of Regulatory Confusion

A major challenge facing the banking industry is how to fulfill its obligations regarding appropriate relationships with MSBs. The banking industry certainly understands and appreciates the need to analyze the levels of risk involved with maintaining MSB relationships. We know the importance of providing banking services to all segments of society. For some, the remittance services that MSBs frequently provide are an essential financial product. Remittance flows are an important and stable source of funds for many countries and constitute a substantial part of financial inflows for countries that have a large migrant labor force working abroad.

The problem, however, is how much analysis is sufficient. At times, banks appropriately exit relationships due to the risk inherent with a particular MSB. At other times, banks want to continue certain valued relationships.

Officially recorded remittances received by developing countries are estimated to have exceeded $93 billion in 2003. They are now second only to foreign direct investment (around $133 billion) as a source of external finance for developing countries. In 36 out of 153 developing countries, remittances were larger than all capital flows, public and private combined.

Remittance flows go through both formal and informal remittance systems. Because of the importance of such flows to recipient countries, governments have made significant efforts in recent years to remove impediments and increase such flows. At the same time, however, there has been heightened concern about the potential for remittance systems, particularly those operating outside of the formal banking system, to be used as vehicles for money laundering and the financing of terrorism. It is believed that the risk of misuse of remittance systems would be reduced if transfers were channeled through remittance systems that are subject to regulations by governments.

To address the risks, a two-pronged approach is evolving: One prong involves efforts by governments to encourage the use of formal systems (such as banks) by lowering the cost and increasing the access of users and recipients to the formal financial sector. Such efforts should concentrate on the reduction of artificial barriers such as unnecessary regulatory standards that impose costs ultimately borne by consumers.

The second prong includes initiatives by governments to implement anti-money laundering standards for entities such as MSBs. This has clearly been occurring in the United States and, as we have heard from other witnesses, the MSB regulatory infrastructure is robust and effective.

A challenge that underlies this situation is that there exists in most countries a large pool of "unbanked" individuals. Such individuals are often accustomed to using both formal (and regulated) financial institutions and very informal (and unregulated) financial services providers. Economic and social incentives that move this group towards "underground" financial services providers ultimately harm the interests of the unbanked, of law-abiding financial services providers, and of the general public. Moreover, the underground financial services providers may service both law-abiding unbanked persons, as well as criminals. Thus, governmental actions that discourage the unbanked from entering depository institutions may have the effect of also making anti-money laundering goals far more difficult to attain. These facts have helped make it clear that the MSB-bank environment needs radical change.

The necessary services that MSBs provide are being severely hampered by regulatory excess. The federal banking agencies issued an interagency policy statement on March 30 and sorely needed interagency guidance on April 26, but this guidance now must be clearly communicated to examiners.

On March 8, I had the opportunity to co-chair a meeting of BSAAG on the MSB problem. For eight hours, we heard dramatic examples from 44 witnesses of lost business, economic failures and rampant regulatory confusion. The theme of confusion was echoed by all of the banks. For example, Alex Sanchez, head of the Florida Bankers Association told us:

> *Financial institutions are closing legitimate accounts. Particularly in the area of [MSBs], financial institutions feel compelled to close their accounts. Most of these are the accounts of perfectly legitimate businesses. Many of them in Florida are businesses run by small entrepreneurs. They are gas stations, convenience stores, and grocery stores. They serve as a place where paychecks can be cashed. Some of them serve as agents of regulated money transmitters. These accounts are closed not because there is any evidence that they are engaged in improper activity, but because they fit into a regulatory profile.*

The Florida Bankers Association also surveyed its members and found that 58 percent have curtailed their activities with MSBs and 83 percent experienced a change of attitude or approach of examiners conducting examinations in this area.

Another banker emphasized the value of small MSBs:

> *One of the common types of small businesses in our community is the small grocery store or convenience store. These are the businesses that often serve the immigrant and less advantaged community. These businesses are the connecting point for many in our society to the economic system. They are legitimate businesses serving a genuine need. Under the current regulatory scheme, we can no longer serve them.*

FinCEN and the federal banking agencies are to be commended for working toward guidance to address this policy morass. We urge the agencies to act swiftly and inform examiners to adjust their reviews of MSBs that are associated with banks.

Lack of SAR Guidance Results in Unnecessary Filings

With the increased number of entities required to file SARs as well as the heightened scrutiny by regulators on SAR policies and programs, it is essential for the regulatory agencies, law enforcement, and FinCEN to assist filers with issues as they arise.

Government advisories and other publications are a critical source for recognizing trends and typologies for money laundering and other financial crimes. As the industry emphasized in the April 2005 issue of the interagency-authored publication, **SAR Activity Review**, there are a number of examples of activities that are characteristic of financial crimes and that can be used as teaching tools. This information is extremely useful for training purposes. As the private sector co-chair of the **SAR Activity Review**, I can assure you ABA supports the efforts of FinCEN and the participating agencies in crafting a publication that provides necessary statistical feedback to the SAR filing community. The **SAR Activity Review** has provided a variety of examples of suspicious activities that offer tell-tale signs of such diverse activities as identity theft, bank fraud, and computer intrusion.

We are pleased that the 2004 edition of the **SAR Activity Review** provided, for the first time, summary characterizations of all of the major suspicious activity categories. This should assist filers in advancing their understanding of the reporting requirements.

As stated above, there are several problems affecting banks in the AML exam process related to SARs. ABA has previously mentioned the many examples of examiner criticisms received by our members during reviews of their SAR programs. Whether it has been criticism of the number of SARs that the institution has filed or "second-guessing" by examiners as to why a SAR was not filed, this situation demands immediate attention.

Moreover, regulatory scrutiny of SAR filings (and the recent civil penalties assessed against banks for SAR deficiencies) has caused many institutions to file SARs as a purely defensive tactic (the "when in doubt, file" syndrome) to stave off unwarranted criticism or second guessing of an institution's suspicious activity determinations. In fact, the *American Banker* has reported that, in March 2005, the banking industry filed 43,000 SARs: a 40 percent increase from a year earlier.

As FinCEN Director William Fox stated so eloquently in the April **SAR Activity Review**:

> *While the volume of filings alone may not reveal a problem, it fuels our concern that financial institutions are becoming increasingly convinced that the key to avoiding regulatory and criminal scrutiny under the Bank Secrecy Act is to file more reports, regardless of whether the conduct or transaction identified is suspicious. These "defensive filings" populate our database with reports that have little value, degrade the valuable reports in the database and implicate privacy concerns.*

We would like to commend Director Fox for addressing our previous recommendation, which we outlined in testimony in May 2004, by creating a BSAAG subcommittee on SAR issues. We hope and expect that Congress will tackle the issue of SAR confusion head on. I would note that the first meeting is scheduled for later this month.

Our members share the concerns expressed by Director Fox, but without improved examiner training there are no other options to defensive SAR filings. Our hope is that the examination procedures and a mechanism for receiving interpretations on SAR issues will result in returning SARs to their original place – forms filed only after careful analysis and investigations with no second-guessing by regulators.

The Financial Action Task Force and Typologies on Charities

As Congress reviews how best to detect terrorist financing conducted through charities, it must be restated that the financial profile for this crime gives no direction to the financial sector on what can be done to prevent this activity in the absence of additional government information. This crime is difficult, if not impossible, to discern as it often appears as a normal transaction. We have learned from many government experts that the financing of terrorist activities often can occur in fairly low dollar amounts and with basic financial products (e.g., retail checking accounts). Guidance in this area is essential if there is to be effective and accurate industry reporting. The bottom line is that terrorist financing can only be deterred with government intelligence. A renewed commitment by law enforcement to real "information sharing" must become a priority, not a second thought.

The financial industry continues to struggle over how to assess what types of risks are relevant to spotting terrorist financing. To date, the only public examples are the typologies listed by the FATF for charities or "non-government organizations" (NGO's). The FATF "warning indicators" in this area do not, in our opinion, offer any real insight as to what types of activities are inherent to risky charities as opposed to risks in any other entities.

Consider this sample of FATF warning indicators, for example:

- "Incongruities between apparent sources and amount of funds raised or moved, such as situations in which large amounts of funds are apparently raised within communities that have a very modest standard of living;

- A mismatch between the pattern and size of financial transactions on the one hand and the stated purpose and activity of the NGO on the other;

- A sudden increase in the frequency and amounts of financial transactions for the account of an NGO or the inverse, that is, the NGO appears to hold funds in its account for a very long period;

- Large and unexplained cash transactions by NGOs; and,

- The absence of contributions from donors located within the country of origin of the NGO."

And so on. None of these examples are specific to charities; instead the factors are inherent to any suspicious activity. ABA believes that government organizations such as FATF could benefit from developing typologies after active consultation with the private sector, a goal that ABA is pursuing

through the International Banking Federation.[2] There appears to be progress in this area, but we urge Congress to recommend to FATF that there be a formal opportunity for the financial sector to be part of the FATF efforts in the areas of money laundering and terrorist financing.[3]

An Update to ABA's Call for Revamping the Outdated CTR System

As ABA has previously testified, the 35-year-old rules related to cash transaction reporting (CTR) have become redundant and lost their usefulness. ABA believes that the time has come to dramatically address this reporting excess by eliminating CTR filings for transactions conducted by seasoned customers through their bank accounts.

ABA notes that the purpose of Subchapter II of Chapter 53 of Title 31 establishing the BSA regulatory regime is to require certain reports or records when they have "a high degree of usefulness" for the prosecution and investigation of criminal activity, money laundering, counter-intelligence and international terrorism. ABA and its members strongly believe that the current CTR reporting standards have long departed from this goal of achieving a high degree of usefulness.

ABA members believe that CTR filing has been rendered virtually obsolete by several developments:

- formalized customer identification programs;
- more robust suspicious activity reporting; and,
- government use of the 314(a) inquiry/response process.

We believe that CTRs are no longer analyzed to identify unknown criminal agents. Rather they are used, at most, to try to match already known suspects to locate potential account activity. As noted above, section 314(a) is much more efficient for identifying account activity of known suspects because it has the value of capturing accounts involving more than just cash transactions.

We believe that combining improved monitoring conducted by institutions as part of their SAR processes with better mining of SAR data by law enforcement as well as judicious use of the 314(a) process yields a more effective approach to law enforcement investigation of patterns of fraud, money laundering and terrorism funding. Consequently, we believe the time has come to recognize

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[2] The International Banking Federation, or IBFed, was created in March 2004 "to increase the effectiveness of the financial services industry's response to multilateral and national government issues affecting their common interests." The banking associations of Europe, the United States, Australia and Canada make up IBFed and the countries represented by the Federation have more than 18,000 banks, including 700 of the worlds' top 1000 banks. For more information, see: http://www.ibfed.org/bba/jsp/polopoly.jsp?d=306&a=2279

[3] IBFed has met with FATF and while the organization was told that it does not qualify for "Observer" status within FATF because eligibility is confined to governmental groups, the FATF has expressed interest in having regular contact with the private sector to discuss open issues, current developments and to receive feedback on proposals and thoughts. This is a positive development that we hope will eventually lead to formal involvement in issues such as the one we discuss today.

the redundancy of CTR filings for seasoned customers with transaction accounts and to eliminate this inefficient use of resources by bankers and law enforcement.

Changing the thinking about mandating the collection of routine cash data would have the following benefits:

- The vast majority of the over 13 million CTRs filed annually would stop, saving many hours a year in filling out forms;
- Wasteful SARs would cease. These SARs amount to almost 50 percent of all BSA-required SARs. Rather than filing specious structuring reports, banks could focus their energies on detecting suspicious handling of currency regardless of artificial thresholds;
- Bank systems and resources could be redirected from CTR monitoring to support further improvement in suspicious activity reporting;
- Regulatory criticism of technical mistakes with CTR filings would cease;
- Issues surrounding the CTR exemption process would be eliminated; and,
- Law enforcement could redirect resources to better evaluating SARs.

While BSAAG has been reviewing the cash transaction system with an eye toward simply modifying elements such as the exemption process, ABA believes that a more comprehensive approach overall is needed.

Conclusion

ABA has been in the forefront of the industry efforts to develop a strong public-private partnership in the areas of money laundering and now terrorist financing. This partnership has achieved much success, but we know that more can be accomplished. We commend the Treasury Department, banking agencies, and FinCEN for their recent efforts to ensure a workable and efficient process. ABA will continue our support for these efforts.

Thank you and I would be happy to answer any questions.

January 10, 2005

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Chairman Donald E. Powell
550 – 17th Street, NW
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Federal Reserve Board
Chairman Alan Greenspan
Board of Governors
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Financial Crimes Enforcement Network
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Ladies and Gentlemen:

The ABA and the undersigned state banking associations have been long-time partners with the Treasury Department and the federal banking regulators in the effort to prevent money laundering and, more recently, terrorist financing. We are proud of the commendations our industry has received from a number of agency and Administration officials, such as Treasury Under Secretary for Terrorism and Financial Intelligence, Stuart Levey, who stated: "The financial industry has been tremendously helpful in combating terrorist financing and is eager and willing to do more." However, we are concerned that our industry's efforts are being complicated, and in some cases undermined, by a lack of clarity in regulatory examination and enforcement.

While we recognize that there are individual instances where financial institutions may have fallen short and needed to improve their AML (anti-money laundering) and BSA (Bank Secrecy Act) programs and procedures, the lack of consistency in examination oversight and compliance guidance is a major theme of regulatory complaints received by ABA and the state banking associations.

In general, our members report that no standard appears to exist for a proper AML compliance program. What we hear from the regulatory leadership in Washington is often at odds with the information banks receive from field examiners. During conferences, seminars, and examinations throughout the country, bankers have heard language that indicates a "zero tolerance policy" for AML deficiencies. With the millions of daily transactions in the banking industry, a zero tolerance

threshold is simply unachievable, as has been recognized by Administration and regulatory officials in Washington.

Certainly the federal banking agencies and the Treasury Department understand that there is a strong "culture of compliance" in the U.S. banking industry. Our bankers want to work with regulators to address deficiencies wherever they occur, although it is difficult to do this when the standards are unclear and moving. Our compliance professionals are well trained in a variety of regulatory areas, but they are being overwhelmed by the sheer volume of obligations for regulatory compliance.

It must be emphasized that this massive regulatory burden has been so exacerbated by mandates such as Sarbanes-Oxley and the unclear rules on BSA that it is literally driving some community banks to sell to larger institutions. In addition, the difficulty of attracting individuals to serve on bank boards of directors has been increasing due to concerns about regulatory costs and the potential for punitive enforcement actions. It is clear that guidance and communication are essential.

One major area in need of guidance is the filing of suspicious activity reports (SARs). SARs, a major tool for law enforcement to investigate crimes against banks, are in danger of becoming routine filings that simply dilute FinCEN's database. The increase can be attributed to "defensive filing" by banks that fear regulatory criticism or, worse, enforcement actions because of failing to file a SAR. FinCEN Director William Fox has also recognized this problem and urged that BSA compliance be handled correctly by bank examiners. [1]

To achieve that goal, Director Fox has directed the Treasury's Bank Secrecy Act Advisory Group (BSAAG) to look at methods to improve the current examination process. ABA co-chairs this subcommittee and continues to compile examples of what we believe to be erroneous interpretations of the BSA and AML requirements by bank examiners. These examples will be used by the BSAAG subcommittee. We are pleased to note that one crucial goal – to achieve consistent, common examination procedures – is currently being pursued by the bank regulatory agencies through interagency procedures, due mid-year 2005. We respectfully recommend that this process be completed as quickly as possible.

In addition, ABA and the undersigned associations urge the Treasury Department and the bank regulators, to also consider:

- joint industry/government training of bankers and examiners on BSA/AML obligations when the procedures are released;

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[1] Director Fox spoke to the American Bankers Association and American Bar Association in October 2004 and addressed defensive filing of SARs: "We all know this phenomenon is occurring – we have both empirical and anecdotal evidence we can cite. We have seen financial institutions file reports in ever increasing numbers – often upon the recommendation of their lawyers or risk management teams – when the facts as presented do not meet this standard. I suspect that this over compliance is occurring for a reason. It is occurring because financial institutions are – justifiably in my view – unwilling to accept the regulatory or reputational risk associated with an action by the government that would make it appear that the institution is soft on anti-money laundering or, even worse, on terrorist financing."

- a BSA staff commentary, FAQs and/or centralized regulatory guidance to achieve consistency in BSA/AML interpretations; and

- establishment of a BSAAG subcommittee to look at the variety of issues arising from the SAR process, particularly the problem of defensive filing.

The banking industry remains committed to work with the government in any way possible to further our joint goal of fighting money laundering and terrorist financing. The banking industry has always been a willing partner in stemming the flow of illegal funds through legitimate financial institutions. Continued joint efforts in this area must, and will, continue. However, we urge the Administration and the regulatory agencies to address the inconsistency and uncertainty that the industry is facing. Thank you for considering our concerns.

Sincerely,

American Bankers AssociationMontana Bankers Association
Alabama Bankers AssociationNebraska Bankers Association

Alaska Bankers AssociationNevada Bankers Association

Arizona Bankers AssociationNew Hampshire Bankers Association

Arkansas Bankers AssociationNew Jersey Bankers Association

California Bankers AssociationNew Mexico Bankers Association

Colorado Bankers AssociationNew York Bankers Association

Connecticut Bankers AssociationNorth Carolina Bankers Association

Delaware Bankers AssociationNorth Dakota Bankers Association

Florida Bankers AssociationOhio Bankers League

Georgia Bankers AssociationOklahoma Bankers Association

Hawaii Bankers AssociationOregon Bankers Association

Idaho Bankers AssociationPennsylvania Bankers Association

Illinois Bankers AssociationPuerto Rico Bankers Association

Indiana Bankers AssociationRhode Island Bankers Association

Iowa Bankers AssociationSouth Carolina Bankers Association

Kansas Bankers AssociationSouth Dakota Bankers Association

Kentucky Bankers AssociationTennessee Bankers Association

Louisiana Bankers AssociationTexas Bankers Association

Maine Bankers AssociationUtah Bankers Association

Maryland Bankers AssociationVermont Bankers Association

Massachusetts Bankers AssociationVirginia Bankers Association

Michigan Bankers AssociationWashington Bankers Association

Minnesota Bankers AssociationWest Virginia Bankers Association
Mississippi Bankers AssociationWisconsin Bankers Association
Missouri Bankers AssociationWyoming Bankers Association

6 October 2017

Federal Financial Institutions Examination Council
L. William Seidman Center
3501 Fairfax Drive
Arlington, VA 22226-3550
Attention : Lisa Arquette, FDIC, by e-mail

Ladies and Gentlemen,

On behalf of the World Bank/Association of Certified Anti-Money Laundering Specialist (ACAMS) Stakeholder Dialogue on De-risking, we are pleased to submit the attached proposed language for revision to the NGO section of the Bank Secrecy Act/Anti-Money Laundering Examination Manual.

We greatly appreciate the opportunity to meet with the member agencies of the FFEIC this spring, and hope that the enclosed draft developed by both financial institutions and nonprofit organizations (NPOs) will be helpful in your deliberations. We would be pleased to organize a meeting to discuss the draft in detail and respond to any questions, and look forward to continuing to work together.

Sincerely,

Emile J. M. Van Der Does De Willebois
World Bank

John Byrne
ACAMS

cc:
Megan Hodge, Ally Bank
Scott Paul, Oxfam America
Lisa Arquette, FDIC
Suzanne Williams, FRB
Judy Graham, National Credit Union Administration
Donna M. Murphy, OCC
Kathryn Gupta, Department of the Treasury, TFI
Braddock Stevenson, FinCEN

Nonprofit Organizations — Overview

Objective. *Assess the adequacy of the bank's systems to manage risks associated with accounts of nonprofit organizations, and management's ability to implement effective due diligence, monitoring, and reporting systems based on a risk-based approach.*

Nonprofit organizations (NPOs) are entities (legal persons, arrangements or organizations) that engage in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works."[1] NPOs may provide basic social services, work to relieve suffering, promote the interests of the poor, bring citizen concerns to governments, encourage political participation, protect the environment, or undertake community development to serve the needs of citizens, organizations, or groups in the communities in which they operate.

The U.S. NPO sector is extremely diverse, ranging from large regional, national or international charities to small, community-based organizations offering a wide variety of programs and services. Research institutes, churches, professional associations, and lobby groups, are among the many types of NPOs that typically depend, in whole or in part, on donations, dues or voluntary service for support. The IRS recognizes more than two dozen types of NPOs, with charities[2] making up the largest category of exempt organizations.

NPOs are subject to a complex system of regulation and oversight at the federal, state and local levels. The IRS and state authorities require registration, reporting, and monitoring of most NPOs.[3] Many NPOs also adhere to voluntary self-regulatory standards and controls to improve individual governance, management and operational practice, in addition to internal controls required by donors and others.[4] These regimes primarily regulate raising, spending and accounting for funds, seek to protect the public from fraud, and encourage charitable giving. NPOs receiving federal grants undergo additional review by grant making agencies to comply with standards required by OMB (e.g. Agency for International Development [AID] recipients are subject to rigorous scrutiny, compliance, and independent auditing requirements).

The US and FATF support a risk-based approach to the implementation of AML/CFT financial controls, noting the importance of financial institutions understanding the terrorist financing risks to which they are exposed and taking appropriate risk mitigation measures to address them.[5] Both also recognize that not all NPOs are at risk. While FATF initially characterized NPOs generally as being "particularly vulnerable" to terrorist abuse, the threat environment has evolved and it now recognizes that only a small fraction are at risk and recommends a risk-based approach to manage those risks.[6] The risk-based approach is not intended to discourage banks from providing services to NPOs found to be higher risk, but rather to focus risk mitigation and management measures on areas of vulnerability so as to minimize risk.

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[1] FATF Recommendation 8

[2] The IRS defines a charity as a group whose purpose is "relief of the poor, the distressed, or the underprivileged; advancement of religion; advancement of education or science; erection or maintenance of public buildings, monuments, or works; lessening the burdens of government; lessening neighborhood tensions; eliminating prejudice and discrimination; defending human and civil rights secured by law; and combating community deterioration and juvenile delinquency."

[3] Churches automatically qualify for federal income tax exemption under rule 501(c) (3) and therefore are not regulated by the IRS; as part of its regulation of tax-exempt charitable organizations and private foundations, the IRS requires the annual filing of forms and disclosures; for public charities, IRS Form 990 Schedule F provides extensive financial and other details on NPOs' missions, programs, donors and operations, etc. outside the US. NPOs generally must file information to state regulatory authorities where they incorporate. See "Regulation of Nonprofit Organizations in the U.S. – An Overview" at http://www.acams.org/aml-resources/npos/.

[4] See overview of NPO self-regulatory initiatives to ensure accountability and transparency at http://www.acams.org/aml-resources/npos/. These include BBB Wise Giving Alliance, Global Giving, and TechSoupGlobal, in addition to NPO due diligence initiatives to protect the organization, its donors, programs, partners and recipients and prevent abuse by terrorists and criminals (e.g. Principles of International Charity, Sphere Project, and InterAction Private Voluntary Organization Standards.

[5] Joint letter from Departments of Treasury and State to the Charity & Security Network, May 13, 2016

[6] See FATF documents, guidance, in particular, the revised Interpretive Note to Recommendation 8, *Best Practices in Combatting the Abuse of Nonprofit Organizations (Recommendation 8)*, and *Guidance for a Risk-Based Approach*.

Banking Services to NPOs

The charitable sector provides essential services, complementing government initiatives to assist those in need, often in high risk areas, conflict zones, and inaccessible regions. NPOs' charitable activities help to meet vital humanitarian and development needs, and to carry out their missions, NPOs need access to financial services. The U.S. Government recognizes and strongly supports the essential role of charity in communities worldwide, and views provision of financial services to NPOs to be in the public interest and consistent with AML/CFT goals.[7] Many NPOs play a crucial part in fighting conditions conducive to terrorism, reducing the appeal of terrorism by building social structures and increasing intercommunity dialogue and understanding.[8] Inadequate financial access and/or delayed transactions due to concerns for regulatory risk can undermine AML/CFT objectives by driving financial transactions outside of regulated channels, and should be avoided when possible.[9] Protecting the charitable sector from terrorist abuse using a risk-based approach and promoting access to financial services are complementary goals.

Regulatory Expectations

Banks are expected to apply their due diligence obligations reasonably, but not be infallible in doing so.[10] "Government has not advocated a standard of perfection, as such would inhibit financial access promoting neither efficiency nor transparency. Instead banks should establish and maintain appropriate risk-based AML/CFT controls and compliance programs which will enable them to appropriately manage their accounts, detect illicit, transactions, and avoid enforcement actions."[11]

Although NPOs maintain operating accounts at banks, the BSA does not require, and neither do FinCEN nor the federal banking agencies expect, banks to serve as the *de facto* regulator of individual NPO customers. While banks are expected to manage AML and OFAC risk associated with all accounts, including NPO accounts, banks will not be held directly responsible for their customers' compliance with OFAC sanctions or other applicable federal and state laws and regulations.

Assessing Risk

While the extent of the terrorist financing risk for charitable organizations varies dramatically depending on the operations and activities of the NPO, "the vast majority pose little or no terrorist financing risk."[12] Some organizations, particularly those based or operating in higher-risk jurisdictions may be at greater risk of terrorist abuse but vulnerability depends on the specific activities of the NPO, rather than on the simple fact that it is operating on a non-profit basis. Banks should assess risk associated with the NPO itself, in the context of the relationship with the bank, in order to determine the appropriate inherent and/or residual AML/CFT risk.

The following factors, which are not unique to NPOs, may be useful in helping to identify and evaluate relative risk:

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[7] Jennifer Fowler, "Treasury Efforts to Protect and Support the Charitable Sector," Treasury Blog, 28 April 2016.
[8] UN Counter-Terrorism Implementation Task Force Report, "Tackling the Financing of Terrorism"
[9] Comments by Treasury Secretary Jack Lew, World Bank Annual Meetings, 7 October 2016; FATF, *Risk of terrorist abuse in non-profit organisations*, June 2014
[10] Treasury Blog, 28 April 2016.
[11] Remarks By Acting Under Secretary Adam Szubin At The ABA/ABA Money Laundering Enforcement Conference, 16 November 2015.
[12] The National Terrorist Financing Risk Assessment (2015) noted that terrorist organizations may abuse the NPO sector by moving their funds through legitimate NPOs, often without knowledge of donors, management or staff, or may even create sham NPOs to funnel money to fund terrorism related activities.

- Geographic location, including headquarters, operational areas, and geographic areas served by the NPO, or proximity to terrorist threat[13];
- Significant influence or prominent involvement in the NPO of politically exposed persons (PEPs) or other higher-risk persons;
- NPO funding sources and intended use of funds;
- Bank products and services utilized by NPO.

NPO Risk Mitigation

A bank's policies, procedures, and processes should provide for sound due diligence and verification practices, adequate risk assessment of NPO accounts, and ongoing monitoring and reporting of unusual or suspicious activities. A bank that establishes and maintains accounts for NPOs should apply appropriate, specific, risk-based and where necessary, EDD policies, procedures, and controls.
Examples of factors that may reduce or mitigate risk include:

- NPOs carrying out programs on behalf of, or funded by, U.S. Government agencies or programs, that meet rigorous AID criteria;
- NPOs participation in voluntary standard and self-regulatory programs to ensure accountability and transparency[14];
- Demonstration of effective internal controls and due diligence standards to assess and manage risk and screen beneficiaries in higher risk areas;
- Specific activities of NPOs, with expressive organizations (e.g. those engaging in sports and recreation, arts and culture, interest representation and advocacy) being less vulnerable than service NPOs (e.g. those providing housing, social services, education and health care).[15]

Due Diligence Expectations

Due diligence measures by financial institutions should be commensurate with the level of risk of the NPO. Accordingly, if a bank's assessment of a particular NPO indicates a lower risk of illicit activity, a bank is not expected to perform further due diligence beyond minimum expectations. However, if the potential for heightened risks of money laundering or terrorist financing exists, the bank should conduct further due diligence to determine that the NPO has processes and mechanisms in place to deal with risk. Banks are not required to assess the adequacy of NPO internal control procedures, and there is no requirement for banks to conduct due diligence on the customers of NPO clients.[16]

In addition to obtaining required CIP information, additional levels of due diligence for NPOs should, subject to the risk-based approach, focus on aspects of the organization that can increase a bank's confidence in conducting business with the client. The FATF expressly acknowledges that it is important that measures taken to protect the charitable sector do not disrupt or discourage legitimate charitable activities, and should not unduly or inadvertently restrict NPO's ability to access resources, including financial resources, to carry out their legitimate activities. Appropriate due diligence may include, depending on the level of risk, a review of the following*:*

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[13] Charities operating in proximity to an active terrorist threat are generally considered at greater risk. According to the 2014 FATF report, "evidence shows that the incidence of terrorist abuse of NPOs is low;" the "key variable of risk is not geographic, but the proximity to an active threat…Ultimately, the principal considerations for determining which NPOs are at a higher risk of abuse are the value of their resources or activities to terrorist entities, and the proximity to an active terrorist threat that has the capability and intent to abuse NPOs."
[14] See footnote 4. Guidestar makes available IRS Form 990 and Schedule F filings required of all charitable organizations (and is considering assigning badges based on the amount of information an NPO provides). Others such as the Foundation Center and Global Giving offer online platforms tracking donor funds and providing assurances to donors.
[15] 2014 FATF report
[16] U.S. Department of the Treasury and Federal Banking Agencies Joint Fact Sheet on Foreign Correspondent Banking: Approach to BSA/AML and OFAC Sanctions Supervision and Enforcement, 30 August 2016.

- Purpose and nature of NPO, including mission(s), stated objectives, programs, activities, and services;
- Organizational structure, including key principles, management and internal controls of NPO;
- Operational locations, particularly in higher-risk areas where terrorist groups are most active;
- State incorporation, registration and tax-exempt status by the IRS and of required reports with regulatory authorities;
- Voluntary participation in self-regulatory programs to enhance governance, management, and operational practice;
- Documents that articulate internal controls to prevent diversion of resources, results of self-governing evaluations;
- Review of available financial statements and audits;
- General information about funding and criteria for disbursement of funds, including guidelines/standards for qualifying beneficiaries;
- General information about the donor base, and for public charities, level of support from the general public (as defined by the IRS test)[17]
- Financial and program management processes and controls;
- Possible site visits for higher risk NPOs.

Expectations for Ongoing Controls

Banks should be evaluated on their overall program to manage the risk of NPOs, and should ensure that their control infrastructure is appropriately based on the aggregate risk of the portfolio. Generally NPOs are subject to controls that apply to all clients (such as transaction monitoring, client and transaction OFAC screening, etc.) and do not require the creation of specialized monitoring controls specific to NPOs. As it relates to monitoring for suspicious activity, banks are not expected to positively affirm the legitimacy of every transaction conducted by an NPO, but instead banks should ensure that overall processes to conduct transaction monitoring to identify and report suspicious activity, including NPO accounts, is sound. Provided that banks have a reasonable process for understanding the level of risk and commensurate due diligence, decisions to maintain NPO accounts are not considered unduly risky or to be second-guessed, and the program/controls should be viewed as sufficient.

[17] NPOs are required to protect the privacy of their donors, as a matter of good governance and various legal requirements. Although some donor information is included on Form 990, the IRS does not permit publication of donor details but retains such information for enforcement purposes. “Banks are not expected to know the identity of each individual donor for most charities; however, they are expected to conduct enhanced due diligence for accounts the bank considers high risk, to include evaluating large contributors or grantors in those instances.” Joint Letter, 13 May 2016.