Business Better (Season 4, Episode 10): FinCEN's Notice of Proposed Regulations to Strengthen and Modernize AML/CFT Compliance Programs

Speakers: Peter Hardy, Kaley Schafer, and Nick St. John

Steve Burkhart:

Welcome to Business Better, a podcast designed to help businesses navigate the new normal. I'm your host, Steve Burkhart. After a long career at global consumer products company BIC – where I served as Vice President of Administration, General Counsel, and Secretary – I'm now Special Counsel in the Litigation Department at Ballard Spahr, a law firm with clients across industries and throughout the country. Today's episode features a discussion with Nick St. John, Director of Federal Compliance at America's Credit Unions. We discuss the Notice of Proposed Rulemaking issued by FinCEN and federal banking regulators regarding the enhancement and modernization of anti-money laundering/countering the financing of terrorism ("AML/CFT") compliance programs under the Bank Secrecy Act ("BSA"). This discussion focuses on the risk assessment process, the NPRM's impact on the industry, "de-risking" strategies, technological innovation, feedback from law enforcement on the utility of BSA filings, hiring qualified compliance officers, and what it means for an AML/CFT program to be "effective." Leading the discussion is my Ballard Spahr colleague Peter Hardy, a Partner and co-leader of the firm's Anti-Money Laundering team. He is joined by Kaley Schafer, an associate and member of the firm's Anti-Money Laundering team. So now let's turn the episode over to Peter.

Peter Hardy:

Hello everyone. My name is Peter Hardy and I'm a partner at Ballard's Bar in Philadelphia. We want to thank you for joining us. We think that you're going to find this interesting and useful and we are lucky enough to have with us Nick St. John. Nick joined the Credit Union industry in 2020 and he continues to serve the industry with America's Credit Union as the director of Federal Compliance, where he helps Credit Unions with a variety of compliance issues. More generally, America's Credit Unions is an industry group that engages in compliance work, as I just stated, as well as some advocacy work. Nick is particularly passionate about Bank Secrecy Act compliance, which is good because that's what we're talking about here today. Previously, he managed banking and finance content for Bloomberg Law. Graduated from the University of Georgia Law School and he has bachelor's degree from CUNY, John Jay College. So Nick, welcome and thank you very much for joining us.

Nick St. John:

Thank you, Peter. I'm excited to be here.

Peter Hardy:

And like I said, I'm Peter Hardy. I'm one of the co-heads of Ballard's anti-money laundering group. I'm also in the white collar group. I've been in private practice for about 16 years. And before then I was a federal prosecutor both here in Philadelphia and in Washington D.C. for about 11 years. And the third person with us today is Kaley Schafer. Kaley, can you introduce yourself please?

Kaley Schafer:

Thanks, Peter. Hello everyone. My name is Kaley and I am an associate in our Washington D.C. Office. I am in our consumer financial services practice group. So I focus on a broad range of regulatory compliance, but I also have a passion for Bank Secrecy Act compliance. Prior to joining Ballard in 2022, I had the pleasure of working with Nick, our guest at NAFQ. So it's good to see you again, Nick. I'll turn it back to you, Peter.

Peter Hardy:

Great. So I'm just going to set the table and do some introductory remarks in terms of what we're talking about and then I'll turn it over to Kaley and Nick who are going to have a conversation. So in July 3rd of this year, the Financial Crimes Enforcement Network, FinCEN, published a notice of proposed rulemaking. We're going to call it the NPRM. And this is part of a broader initiative to "strengthen, modernize and improve" financial institutions, anti-money laundering and countering the financing of terrorism programs. The NPRM on its own terms, seeks to promote the effectiveness, efficiency, innovation and flexibility with respect to AML and CFT programs. It purports to support the establishment and maintenance of risk-based programs and strengthen the cooperation between financial institutions and government. These at least are the stated goals of the NPRM. And this NPRM implements a section of the Anti-Money Laundering Act of 2020.

So Congress essentially has required FinCEN to do exactly what it is now doing, and we're going to get into it. And so I don't want to get into the details here, but as you're going to hear, the NPRM does a lot of different things. It really is a vehicle to discuss the state of AML/CFT compliance programs at large, which is exactly why we're talking about it. But a big part of the NPRM is risk assessments as part of an effective AML program. So we're going to talk about risk assessments for sure. NPRM also focuses on how consideration of FinCEN's national priorities have to be a part of any risk assessment. We'll talk about those priorities. Deals with a ton of other issues including and perhaps not that successfully, but we'll talk about that in terms of providing comfort to financial institutions to pursue one, technological innovation.

Two, to reduce the de-risking that is basically kicking customers out of the financial institution. Reduce the de-risking of certain customers. And three, meaningful, that's the key word, government feedback on Bank Secrecy Act reporting. And there's other program changes too. And just real quick and then I'll turn it over to you Kaley, bear in mind this NPRM has really broad application. Nick is from a group serving Credit Unions, so we'll obviously talk about that and banks are covered by the Bank Secrecy Act. But bear in mind there's a variety of other financial institutions covered by the BSA that are affected. That includes casinos, money services businesses, broker dealers and securities, mutual funds, insurance companies, future commission merchants, dealers and precious metals, stones and jewels, operators of credit card systems, loan or finance companies. Now here that's currently limited to mortgage brokers and originators, not just any lender or non-bank lender and then housing government-sponsored enterprises like Fannie Mae, Freddie Mac, so tons of folks, tons of businesses.

And after FinCEN issued this NPRM, the federal banking regulators followed suit and issued their own notice of proposed regulations, which essentially mirrored FinCEN's. So that's the Federal Reserve, the FDIC, the National Credit Union Administration and the OCC. FinCEN has published a five-page fact sheet which summarizes the NPRM. But if you're looking for something a little more meaty, try our blog post. Forgive me, I have to peddle it. Money Laundering watch. That is Ballard's blog on all things AML, VSA and money laundering. Kaley and I have published a blog post diving into the NPRM in detail. 60-day comment period, which is closing or has closed depending on the timing of this podcast on September 3rd. Okay, so I hope I've set the table sufficiently well. Kaley, I turn it over to you.

Kaley Schafer:

Thanks, Peter. So you've mentioned the risk assessment process. That's a big piece of this NPRM. So I've got a few questions for you, Nick, on the overall risk assessment process. This is kind of a blanket high-level question, but do you think the NPRM has provided enough guidance to the industry to implement this process? Essentially the proposal gives us a lot of flexibility right now, nothing concrete, so maybe we need a little more from FinCEN, but curious to get your thoughts.

Nick St. John:

Yeah, thanks Kaley. So I think the risk assessment, at least to my mind is sort of the big headline item here of this rule. Many people, including myself originally thought that this rulemaking, which is somewhat of a long time coming, would be more about the AML/CFT priorities because that was something that was required by the AML Act of 2020. FinCEN released those priorities in June of 2021 and then said that they would put out a rulemaking on it, and their agenda is even referred to it as a priorities rulemaking. But really the way the priorities factor into this rulemaking is through the risk assessment. And the risk assessment is important here because that's really a new regulatory requirement. Until now, there was not a regulatory requirement to do a risk assessment, was generally viewed as a best practice. I know NCUA was considered it to be an expectation, but it was not a hard and fast regulatory requirement.

So this is a change for Credit Unions. And I do think interestingly, they give some guidance on the content of the risk assessment. They mentioned that the risk assessment should consider certain things like products, services, geographic locations, customers, intermediaries, distribution channels, but they really don't give much guidance on the process. In fact, really no guidance at all on what process institutions should follow when doing this risk assessment. As you mentioned that in some ways that's good because it's flexibility, right? You could imagine on the other end of the spectrum if they had given a really prescriptive rule that required all these steps and then institutions could have exam findings.

If they don't follow them exactly to the letter, that would definitely be something the industry would not want. But in this situation, it seems to be almost not enough guidance. I think I know in our comment letter that America's Credit Unions will be submitting, we will be asking for a bit more guidance on the process for risk assessments. Just generally some information about what is expected, maybe what examiners will be looking for when they look at the risk assessment process could be helpful.

I know putting my compliance hat on, I tend to see maybe what not to do. That's one of the things we like to look at enforcement actions because it's a good example of where institutions maybe went wrong so that your institution can figure out not to do those things. And so maybe some examples of maybe a risk assessment that would be insufficient, I think that would be helpful information for the industry to have.

Kaley Schafer:

Thanks, Nick. That's sort of what I thought you were going to say. I think when I read this, I agreed there wasn't a lot of information, but you hit the nail on the head. You don't want a full-fledged prescriptive outline of what must be done. You want some flexibility afforded there, but a little more guidance would've been helpful. Going back to the national priorities, you teed up this question, we really did think this rulemaking was going to hit harder on those national priorities. And really, again, flexibility and how we're going to take those into account and then document that in the risk assessment. And these priorities are really broad. They truly encompass most risks that we would see at a financial institution. But curious if you see any other role or utility in those national priorities. Will this help financial institutions maybe have a more robust risk assessment? Maybe they'll identify and uncover some unique risks that are not necessarily unique because they're national priorities, but maybe a priority that they didn't think was a risk that now they've been able to discover?

Nick St. John:

Sure. I think that's certainly possible. Risk assessment, as you mentioned, is very broad. It covers almost any type of financial crime you could really think of. Everything from proliferation financing through fraud, which I mean fraud is so broad by itself. That could cover scams, that could cover check fraud, transnational criminal organization activity. So there's a lot in those risk assessments. It covers pretty much any type of financial crime that I can think of. So it will definitely require institutions to look at basically the whole spectrum of potential crime. But I do think that could lead to them potentially having a more robust compliance program because maybe certain smaller institutions weren't thinking about proliferation financing, and now they have to include that in their mandated risk assessment. So it may require them to consider things that perhaps they weren't considering before.

Kaley Schafer:

Great. So let's drill down on I guess one of the components of the risk assessment process, specifically the identification of reports. So in terms of incorporating those risks identified in our FinCEN-filed reports, do you think this is a big lift for the industry? Obviously, the rule said all reports, right? So that's our SARS our CTRs, anything else that we file to the agency and to some extent, financial institutions were already looking at SARs, identifying any risks and incorporating those. But curious if you think this is a bigger lift for the industry overall or maybe it has less of an impact than I am anticipating.

Nick St. John:

That's a good question. To be honest, I have not heard from our member Credit Unions yet about exactly what impact they think this will have. So this is sort of me speculating here, but I could see it having... It could be a change for them. I understand why this would be a requirement, right? Because if you're an institution and you want to consider the risks facing

your specific institution, then looking at the transactions that have happened at your institution makes sense, right? You might want to look at the trends in your SARs and see what types of criminal activity have been coming in the door at your specific institution.

So I think that it makes sense. I do think there may be a bit of a lift. I don't know how much institutions we're really tracking trends with things like CTRs for example. I know Credit Unions have to keep track of their SARs and report that to their board of directors, and so they usually will probably look at the trends in their SAR reports. But for things like CTRs, I don't know that they are necessarily keeping track of that. So that may be a new requirement where they may have to devote some resources to now tracking trends in all of these reports that maybe they weren't looking at before.

Kaley Schafer:

That was my thought specifically on the CTRs. And like you said, it's already required to track those trends reported up to your board. You're already looking at that. But the CTRs was interesting to me. I think it could be useful if you have a high volume of CTRs in a specific geographical area. Maybe that wasn't part of your overall geographical risk originally in your risk assessment, but now it is because of the amount of CTRs or something. But I had not really heard of a lot of financial institutions doing any sort of trend analysis on CTRs, so I was curious if that was going to be a lift or not. And I do think it'll impact other types of financial institutions other than a traditional Credit Union bank.

Peter Hardy:

I'm going to chime in here real quick. And in terms of financial institutions looking at their filing, specifically SARs, I think they're going to have to be thoughtful when they do that to craft their risk assessments. Because I'm thinking here, the phenomenon of defensive filing of SARs, I think this year it's estimated to be 4 million or more SARs file collectively by financial institutions. And as we all know, not all SARs are equal. And some are indeed important and useful to law enforcement and others maybe not so much. And so I think when financial institutions are looking at their SARs, and obviously it's going to depend on the institution and the volume and all the circumstances, et cetera, et cetera, but they would be well-advised to be kind of choosy and pick out truly the meaningful risks because there are obviously SARs out there that are not very useful or they're repetitive or they're defensive in nature. So I just wanted to kind of add my 2 cents there.

Kaley Schafer:

No. That's a good point, Peter. And actually that tees up my next question to Nick. In the NPRM, this specific component of the overall risk assessment process, the reports filed, the agency FinCEN mentions that they believe that this specific component may minimize defensive SARs. And I wanted to know if you think that this possibly could minimize those defensive SARs or given you mentioned the potential examiner scrutiny, maybe we don't agree with FinCEN's point there.

Nick St. John:

Yeah, that's a good question. I think it remains to be seen what the impact will be. I mean, to my mind... I work in compliance at America's Credit Union, so putting my compliance hat on, we often think of defensive filing as basically a risk mitigation strategy, right? There's very little... There's no penalty for filing a SAR that you didn't have to file. But of course if you don't file a SAR and you were supposed to, then you could have an exam finding enforcement action. So I think most institutions probably defensively file because of that risk. And I don't know that this necessarily takes that risk away. So I don't know that defensive filing would necessarily decrease.

I think so long as there's the risk of examiner scrutiny and enforcement actions for not filing, I think there will still be defensive filing. The question is, I guess, does the risk assessment and having to look at the reports you filed somehow reduce defensive filing? And I think possibly, I think to Peter's point earlier about you have to look at your SARs and they're not all created equal. You may have some SARs that you defensively filed that maybe are not useful to law enforcement or don't really say much about your trends. So to that extent that it maybe affects your trends which go into your risk assessment, maybe institutions will be a little less likely to defensively file. But I think so long as that compliance risk is still there, I think there will still be a defensive filing.

Kaley Schafer:

That's a really good point about overall the risk assessment process may decrease those. And I think time will tell, but I agree with you. I think as long as the compliance risk is there and there's nothing wrong with filing a defensive SAR, so I just don't know. I don't foresee the incorporating your filed reports actually minimizing that number of defensive SARs. Okay, so moving on to our next question, and this is sort of just an observation, not really a question. The NPRM had an interesting observation that information from potentially marketing or business components of the financial institution may be relevant to the overall risk assessment. I wasn't sure if maybe you had heard anything from your members about that, about corporating other components from the financial institution like marketing or business. It wasn't a specific component in the NPRM, but it was an interesting observation that the NPRM made.

Nick St. John:

Yeah, I thought that was a little curious as well. We haven't heard from our members about that. I mean, you could maybe imagine a scenario where certain information coming from a particular business line may be relevant to the risks facing your institution, but they don't really give any specifics. I know they do talk about some of your business departments are using certain technology that then you may want to consider using that technology for BSA and AML, but it doesn't really go into much regarding specifics there. So to be honest, I'm not entirely sure exactly where they were really going with that. And I'm interested to see what the industry does with that.

Kaley Schafer:

That makes sense. It felt like kind of a one-off observation from FinCEN in the NPRM, so without any other guidance or information around it, I'm also curious. All right, so you obviously are in a unique position because your organization represents a broad range of credit unions of all assets sizes. So I'm curious if you think that the impact of the overall risk assessment process, if you think that impact is greater on smaller institutions or if you see any kind of unique risks or impacts to smaller institutions because of the rule.

Nick St. John:

Yes, I think so. So I heard an interesting statistic the other day. So basically the statistic was that 45% of Credit Unions have I think 10 or fewer employees. So nearly half of them are very small. Obviously there are larger Credit Unions that are more complex and operate nationwide in some cases. But many Credit Unions are very small institutions. And I do think this requirement now that it's a concrete regulatory requirement and not just a best practice could affect those smaller institutions. You may have some small institutions that maybe only have one person that handles BSA on staff and now maybe they weren't doing risk assessments because it wasn't required. Now they're going to have to start.

And all the resources and effort that goes into getting that whole process off the ground. You may have other Credit Unions that perhaps were doing risk assessments, but of course now they're going to have to work in those national priorities and consider certain things that maybe they hadn't been considering, like distribution channels and intermediaries. So I do think that this rule doesn't pose some additional requirements even for Credit Unions that were already doing risk assessments and I think it will have an impact on them. But particularly the smaller ones, just because they are limited in their staff and their resources, I think that it will have maybe more of an outsized effect on those institutions for that reason.

Kaley Schafer:

That makes sense. That's also a really interesting fact. I have not heard that statistic before, but I anecdotally have definitely heard of Credit Unions obviously when we were together at NAFQ where I would run across somebody that had exactly like you said, one compliance person, a compliance person also did all BSA/AML compliance. So certainly an impact on those institutions for sure. All right, Peter, I will turn it over to you.

Peter Hardy:

Thank you both. Yeah, so wanted to talk about three topics all rolled together, tracking the NPRM itself, and I do it under the nominal heading of "flexibility." And flexibility is a word that we've already heard on this podcast and it comes up repeatedly in the NPRM. Sounds great, it's a nice value, but sometimes prescriptive rules are nice as well. And also flexibility can lead to vagueness, which can be unhelpful. So I'm going to set the table here a little bit. The AML Act that we've referenced requires the Secretary of Treasury to do many things. And one of them is to set forth minimum standards in regards to AML and CFT compliance programs that take into account multiple factors including the following. I'm going to quote here, "The extension of financial services to the under-banked and the facilitation of financial transactions, etc, etc, etc." In ways that Simultaneously prevent criminal persons from abusing formal or informal financial services networks, but also to permit basically the full use of the financial system.

And this is kind of a long-winded way of noting the issue of de-risking, in which financial institutions will essentially kick clients or customers out of the institution mainly because of perceived concerns regarding regulatory scrutiny. I mean, if you've got somebody who's clearly committing illicit finance, that's clear in my mind at least, de-risking is really more about, well, you're not really sure, but you don't want to take a risk and the compliance costs are high. So I'm dumbing down here, let's just get rid of them. And Department of Treasury has said that's bad. But at the same time of course it's the banking regulators that are driving this phenomenon, at least from the perspective of financial institutions. Okay, so that's one issue. De-risk it. And then another one is Technological innovation. And this is a value and goal that's been bandied about for years. I won't belabor it, but the AML Act also requires consideration of the value of technological innovation and the adoption of new technology to more effectively counter money laundering.

And of course, financial institutions are also looking at technology to reduce costs. So that's their second thing, technology. And then the third thing also directed by the AML Act is for the government at large to enhance feedback by law enforcement to financial institutions. And this is another thing that's been discussed quite a bit for many years. The complaint being that many financial institutions don't really know what SARs are actually useful to law enforcement because law enforcement won't tell them. And of course there's confidentiality on specific SARs, we understand that, but there's kind of a disconnect and there's a further disconnect because my personal opinion, your average regulator is very different in their mindset of what they're looking at than your average federal special agent. So we have feedback to financial institutions in terms of what is or is not a useful SAR. And in part because of the lack of knowledge we have that phenomenon of defensive filing, who knows?

But like you all already said, no one got dinged for filing a SAR. You only get dinged for not filing a SAR. So let's file some more SARs. Okay, we got the three issues. So Congress has said take these factors into account, and this is me, my 2 cents. The NPRM basically says, well, the answer to this dear financial institutions is flexibility. And let's break this down. The NPRM states that flexibility afforded to financial institutions will facilitate technological innovation. Nick, what's your reaction to that? Do you think that's enough? And if the answer is maybe not, what would actually be helpful?

Nick St. John:

Sure. So as you mentioned, the proposed role makes reference to flexibility and innovation in a few different places in the preamble. The actual text of what's actually changing in the regulations themselves is relatively minor. It basically mentions that there's a statement of purpose that talks about innovation, and then it mentions that a financial AML/CFT program could consider... They may consider innovative approaches. And that's pretty much it, it really does not say much else about innovation. So I would say that's probably not enough to really move the needle. I think institutions are already interested in innovative approaches. They work with vendors to come up with automated alerts and things like that. So I don't know that this would necessarily change that trend. I think what is interesting is that... I think what would be more helpful, I should say, in moving the needle on innovation would be something a little bit more concrete, maybe some guidance about what type of innovation would be acceptable or not acceptable.

FinCEN in June of 2022, put out an advanced notice of proposed regarding a no action letter program. I think something like that where an institution could actually get a letter from a regulator saying that they wouldn't be subject to an enforcement action or an exam finding based on their ability to try out some new type of innovative technology, I think that would certainly make the industry feel more at ease with trying new things. I think so long as there's that thread of if you try something new and it ends up creating a violation, you could still be on the hook for an enforcement action or an exam finding. I think that

will still discourage some innovation. So to the extent there could be a no action letter program or some sort of regulatory sandbox type program for innovation, I think that would certainly help more with Credit Unions and other institutions feeling more comfortable approaching innovation.

Peter Hardy:

Yeah, those are really good points. I mean, like you just said, there's really nothing in there. There's concrete, there's no suggestion of any even semi-specific safe harbor. And I had actually forgotten about the no action letter, I guess because ironically there's been no action on the no action letter proposal. So then moving on to the second bucket, the NPRM similarly also states that flexibility furthers treasury de-risking strategy. Same sort of question. What's your reaction to that and do you think the NPRM does assist financial institutions and decisions to de-risk or is it too early to tell or what are your thoughts?

Nick St. John:

Yeah, it's similar to innovation. Again, they mentioned de-risking in the preamble, but the actual changes to the regulations themselves really don't do or say anything really involving de-risking. In fact, it seems that they're saying that there will be a decrease in de-risking because of this encouragement to adopt innovation, which as we talked about is not particularly detailed. So I'm honestly not sure exactly why they feel like this would help with de-risking. FinCEN of course, cares a lot about de-risking. They have talked about it recently. They put out some documents talking about how certain certain businesses like private ATM owners who are having trouble finding financial services because folks wouldn't bank them because of the perceived risk.

So it's definitely an issue. I think with regards to this particular rule, I'm not entirely sure exactly how this would help discourage de-risking. I think doing a risk assessment in some ways actually might even encourage de-risking in some ways. Because if you're looking at your classes of customers and you're categorizing them by low-risk, high-risk, that might cause an institution to say, we don't want to deal with those high-risk customers, which would be de-risking. So I think there potentially could be a unintended effect there of requiring this risk assessment that may actually encourage some de-risking. But it is not entirely clear to me how this rule would necessarily encourage financial institutions to engage in less de-risking.

Peter Hardy:

Got it. And then finally in the third bucket, the NPRM acknowledges the importance of feedback from law enforcement, but again, it really provides few details. So just kind of an open-ended question, what enhancements in this area would be welcome?

Nick St. John:

Sure. I think the encouragement of communication I think would definitely be helpful. I know of some Credit Unions that have... Not through any sort of requirement, but just on their own have taken up this mantle of they've created a local group where financial institutions meet with local law enforcement to talk about trends in their area and what they're seeing. And that's something they've kind of taken on on their own. That seems to be helpful. I think to the extent that FinCEN can encourage those sorts of discussions, I think that would be helpful.

I think in some ways really what's happening here is financial institutions, they follow these SARs and they don't really know where they go after that or what happens to them. And I think to some extent they're really looking for information from law enforcement flowing in that direction, from law enforcement to the financial institutions about what types of SARs are most helpful, what sort of information to include in the SAR narrative would be most helpful to include. So I think to the extent that FinCEN can encourage that sort of communication, I think that would definitely be welcome from the industry.

Peter Hardy:

Yeah. And to be fair, because I've been kind of giving FinCEN a hard time hearing my questions, but I mean they are trying to expand the outreach and there are programs floating around, so I'm correcting myself. It's not as if they're doing nothing.

That's not true and they are doing more. But 4 million SARs a year, and like you said, people don't really know what happens to them. Is this useful, is this not? And I'll just repeat what I said before.

My personal opinion. There's a big difference between your average regulator and examiner and a special agent. When I was at DOJ, I mean I would get SARs and the agents would get SARs, and we really had a much, much more specific view in terms of what was useful because we're worried about investigative Tory resources and burden of proof and things like that. And that was 20 years ago and there wasn't nearly as many SARs filed then as there are now. So on that note, Kaley, I'm going to turn it back to you to kind of bring us home, talking about some of the other grab bag of program changes that we find in this NPRM.

Kaley Schafer:

Great. Thanks, Peter. So like Peter said, this is sort of the grab bag, smaller changes certainly, but albeit still important changes from the NPRM. And the first change is the incorporation of the term countering financial terrorism into the definition of our compliance program. I think it's... Well personally, it's just hard to say AML/CFT program because it has been ingrained in my mind for so many years as BSA/AML compliance. And so on a personal note, just hard to wrap around the idea of changing that term. This is a requirement from the AML Act that we include CFT now. So obviously we're getting rid of any terms such as Anti-Money Laundering program or AML program, and now we will just refer to this as our AML/CFT program. Do you think that the incorporation of that definition, CFT is meaningful? Obviously financial institutions were already countering financial terrorism within their programs. We also have to comply with OFAC and sanctions regulations. So is this a meaningful change or is this really just a small change, not really impactful?

Nick St. John:

Yeah, I'm with you. I've been referring to it as BSA/AML for so long. I mean the FFIEC manual refers to it as BSA/AML. So the switch to calling it AML/CFT feels a little unnatural. And I think there could be a change for institutions if they have to change from calling it their BSA program to their AML/CFT program or their BSA officer is now their AML/CFT officer. So changing all of those things will certainly be, I think, a bit different for some of these institutions. As far as the actual meaningfulness of the change, as you mentioned, it's mandated by Congress, so it's not necessarily something that FinCEN is pushing really. It's something they're doing because Congress mandated it.

But I do think it can be useful at least to display the focus, right? Since the Patriot Act was passed over 20 years ago, countering terrorist financing has been a part of BSA/AML compliance. And so I think this is basically just elevating that now to making sure that it's viewed on equal footing with anti-money laundering. So institutions will know their program is supposed to prevent money laundering and financial crime, but also terrorist financing. And this is basically recognizing that and how they label things. As far as actual substance, I think it's probably more of a nominal change, but I think it is at least useful to remind folks of that focus.

Kaley Schafer:

Great. And that's funny you bring up the BSA officer. I didn't think that... Yeah, you might have to rebrand and call them your AML/CFT officer. I think the NPRM still refers to that person as your BSA officer, but I'm curious if that will be a required change. But there is now... I mean we've always had to have a BSA officer as one of our pillars of our program compliance. The NPRM now notes that this should be a qualified person. I think that was always a best practice beforehand. You wanted somebody qualified that had the requisite skills and knowledge or at least attain those skills and knowledge, but now they have to have the requisite training, expertise and experience that's commensurate with the financial institution's risks.

The NPRM provides the example that a compliance officer or a less complex financial institution may not necessarily have the experience and training as a compliance officer at a more complex financial institution. Which is true, but there is also the opportunity that if you bring somebody on, even if they were at a less complex institution, you could still train that person up potentially. I'm curious if you think this has any impact on the industry in terms of hiring or succession planning. I know oftentimes that sometimes finding a qualified BSA officer is difficult. So curious if you think that Credit Unions will face those difficulties with this change.

Nick St. John:

I think it's possible. I think to your point, finding folks with that experience can be difficult. I do think you also would most likely be expected to compensate them accordingly. So it may increase payroll costs, especially for these smaller Credit Unions, again, that maybe have a limited staff. If they need to bring on somebody who has experience in a AML department, they may need to be expected to perhaps pay that person more than if they had been able to hire someone with perhaps less experience. So I do think it will affect their bottom line to some extent. As far as succession planning goes, I think that also could be affected and not necessarily in a negative way, but I do think if I was at a Credit Union and we had an AML officer who had a certain amount of experience and that person announces they're going to leave, I think it makes sense.

And if you have a department that's more than one person, you at least then know you have someone in your institution who has been working in AML for however much time where you could potentially have a succession plan to promote that person, and then hopefully they'll have that requisite experience because they've been in your institution doing it. So I think that makes sense. I do think where it may become a little bit more difficult for institutions is if they're smaller and they're looking to hire someone who maybe doesn't have quite as much experience, I think that's where this role would potentially close that door for them. But other than that, I think they could potentially plan for succession planning and it may lead to some additional costs just because you would need to hire more experienced folks.

Peter Hardy:

On this issue, when you look at enforcement actions... And this is beyond the Credit Union context, it's really any financial institution. When you look at enforcement actions, whether they're consent orders with banks or it's something with FinCEN, with an MSB or a casino or even a DOJ, one of these big cases for prosecution agreements, invariably, invariably, there is something in the enforcement action filing about insufficient resources. Now part of that is just the government likes to beat that drum, but I think also it's there because there's a reason that that financial institution kind of got into the cross-hairs. And I think that this requirement in the NPRM is really important because it makes the point that it's not just bodies and throwing money at something, but you need somebody who actually knows what they're doing. It's not just wrong numbers, it's real experience and real knowledge. And I certainly understand, I'm sympathetic to smaller institutions because it can be tough to find somebody like that. But I must say, I will concede here, FinCEN has a point.

Kaley Schafer:

That's a good point, Peter. And oftentimes in those enforcement actions, sometimes the BSA officer has made the misstep or they are not acting independently from the board and making business decisions versus compliance focused decisions, so.

Peter Hardy:

Yes, we have certainly seen instances where the nominal BSA officer is actually in the business function, which not a great idea.

Nick St. John:

Yes, and I should say I agree with you. I do think while I mentioned the potential effect on the smaller institutions, I will say you do see those enforcement actions where they hire someone who's maybe just grossly unqualified for the position and has no experience and that leads to some negative outcomes and some regulatory violations. So I definitely understand why FinCEN is requiring this. You want to make sure that you have folks who are able to effectively carry out your BSA program.

Kaley Schafer:

Great, thanks Nick. So I think this next change, also small, but could be very impactful. The NPRM now includes the term effective versus reasonably designed. And this is in terms of our overall AML/CFT programs. Originally, our compliance programs had to be reasonably designed risk-based. Now they have to be only risk-based and reasonably designed. They have to also be effective. Do you think the inclusion of that term... I mean to me effective means potentially more enforcement. But do you think the inclusion of that term has any broader ramifications or do you think that's potentially nominal as well?

Nick St. John:

Yeah, I think that's interesting. As you mentioned, reasonable design almost seems like a process term of art, right? That talks about how you designed your program and was that reasonable? Whereas effective is almost more of an outcome focused terminology. Is your program effective? Are you actually stopping financial crime at your institution, is at least the way I would think of it. So I do think that's interesting. I'd be interested to see exactly what they are planning to...

Our examiners going to be looking at, is your program effective and exactly how would they be measuring that is something that I would be interested in seeing. And I don't believe the proposed rule really goes into that level of detail. I think they just kind of say effective and don't really describe it. But I would be curious to see exactly what they plan to do with that term and what the regulators will be instructing their BSA examiners to be looking for when evaluating the effectiveness of an AML/CFT program. But I definitely think that could lead to some potential more regulatory scrutiny at least, or at least it's one other thing for examiners to be looking at.

Kaley Schafer:

Great. And also when I saw this, I had the thought... And I don't remember when this guidance came out. It was a couple of years ago and I believe it was interagency guidance on enforcement. And essentially it said, if you have a pillar failure, one of the pillars fails, your whole program fails and is essentially not effective. And so I thought, well, we already have guidance out there. Maybe this is just FinCEN's attempt to codify that guidance in here and that's what they meant. But like you said, it's unclear. Because there was not a lot of information in the NPRM, but I think overall that could mean an uptick in enforcement for sure. All right, so my last comment here is really just on the cost estimates and according to the estimates, which are... There's a lot of different figures in the NPRM. What we've discussed, even though some of these changes are small, obviously the biggest changes are to the risk assessment.

It seems like FinCEN is... They're averaging the cost to about $3,556 per financial institution in a "high substantive change year." And this is across all financial institutions that are required to comply. These estimates seem a little bit low. Obviously some of the impacts will be felt more at smaller institutions or other types of financial institutions that maybe didn't have a robust compliance program in place. This is a comment slash a question, I guess. Because I don't know if you heard from anybody on cost, maybe they're anticipating higher cost burdens than potentially what FinCEN is saying here, but I think all in all, this is a pretty low estimate.

Nick St. John:

Right. So to be honest, I have not heard specifically from members yet on their cost estimates. We're still receiving some information from our members about that. So I don't have any hard numbers in front of me. I do know we tend to be a little worried sometimes of the regulator estimates. I think they usually are probably not likely to come out and say this is going to have huge costs for the industry. Usually I think they try to put the cost estimates a little bit on the lower end. And I know at least with other regulators, not with FinCEN specifically, but with some rule makings from the CFPB and other regulators, we've at least heard from our members that the cost estimates were not accurate. And that the actual costs for the institutions were much higher than what the agency estimated. So again, I can't say for sure that's what's happening with this FinCEN proposed rule, but I know at least there is some historical precedent for us not necessarily always agreeing with the cost estimates from the regulators.

I do think for smaller institutions, as you mentioned, the cost could be higher, especially ones that weren't doing risk assessments before now that are going to have to start this up. I don't know exactly the dollar figure that that would be for them, but I do think it could have an impact on them. In particular, we've been hearing a lot from smaller Credit Unions this year about regulatory burden in general, not just in BSA, but across the board with the CFPB's actions on junk fees and other things. And they are very much worried about their ability to stay in the black financially. And we have seen mergers throughout the industry with smaller Credit Unions consolidating, and some of them have claimed that's due to the regulatory burden. And I'm not saying that this rule specifically would necessarily be the straw that breaks the camel's back for a Credit Union, but we are definitely looking at regulatory burden and the costs that come along with that at America's Credit Unions, and it's something that we're concerned about.

So that's something that we'll be looking at. I know one thing in particular that I think we are advocating for in our comment letter that would be helpful in that department as far as cost-cutting measures go, is that we are going to be advocating for the FinCEN to raise the reporting thresholds. The CTR reporting threshold was set in the '70s and hasn't changed since then. And $10,000 definitely does not go nearly as far today as it did 50 years ago. We have advocated in the past and we'll continue to advocate for those thresholds to be raised, and I think that would actually help reduce some of the compliance costs for Credit Unions. So I think to the extent that FinCEN can do that, and I acknowledge that would most likely be a separate rulemaking from this one, I think to the extent that they could do that, I think that would definitely help offset any of the additional costs that may come from this particular rulemaking. So that's something we'll be advocating for.

Peter Hardy:

Is that also for that advocacy pertaining to the SAR filing threshold, which is generally 5,000?

Nick St. John:

Yes. So our comment letter suggests the CTR threshold be raised to 30,000, which even that is if you adjusted for inflation, it actually should be, I think around 75,000 compared to 1970s cost figures. But we're advocating for it to be 30,000 for CTRs and to lift the $5,000 threshold for SARs to 10,000. So raising both of the thresholds.

Peter Hardy:

Okay. Well, and one last comment on the cost section. When FinCEN goes through all these numbers, and like Kaley said, there's a lot of numbers floating around. But that average, whether it's accurate or wildly unrealistically low, they also note that there's almost 300,000 financial institutions that are being affected by this NPRM. So just to kind of bring it back to the comment in the beginning, this thing has very broad application across a number of industries. So we look forward to the final, or I should say to the proposed regs and then I guess the actual regs. But Nick, thank you very, very much to you and also to America's Credit Unions for participating here with us today. It was really interesting to hear what you have to say and really helpful.

Nick St. John:

Yeah, thank you for inviting me. I really enjoyed the discussion.

Peter Hardy:

All right, thanks everyone for listening. Hope you all have a good day.

Steve Burkhart:

Thanks again to Peter Hardy, Kaley Schafer and Nick St. John. Make sure to visit our website, www.ballardspahr.com where you can find the latest news and guidance from our attorneys. Subscribe to the show in Apple Podcasts, Spotify, YouTube, or your favorite podcast platform. If you have any questions or suggestions for the show, please email podcast@ballardspahr.com. Stay tuned for a new episode coming soon. Thank you for listening.