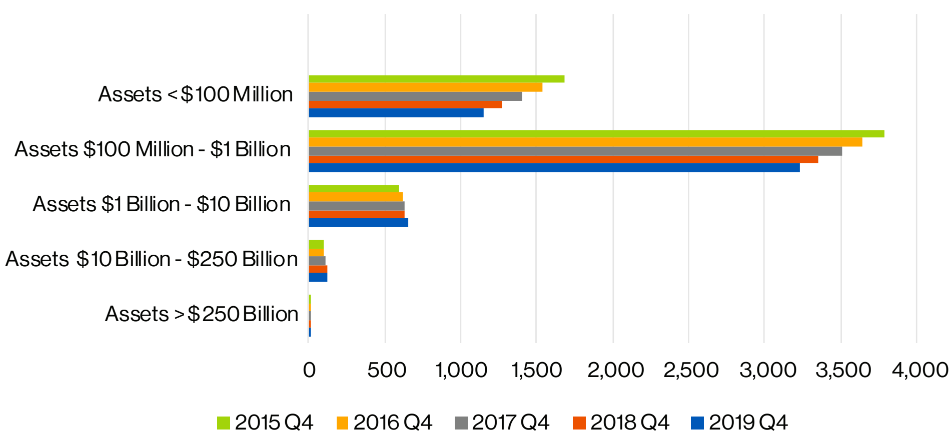
Guidehouse

Financial Services

Calling Midsize Financial Institutions: BSA/AML/OFAC Opportunities and Challenges

The Mid-Sized Bank Coalition of America (MBCA) is an alliance composed of midsize banking institutions conducting business in the United States and averaging less than $20 billion assets under management.[1] The MBCA highlights the importance of midsize financial institutions' connectedness to its patrons, the community, and small businesses that help generate jobs and economic strength across the U.S. Although the definition and asset size of midsize financial institutions varies, they are an integral part of the economy and, according to the Federal Deposit Insurance Corporation (FDIC), there are approximately 656 midsize financial reporting institutions in the U.S. as of Q4 2019. The chart below illustrates the number of financial reporting institutions by asset size over the past five years. Of these institutions, midsize financial institutions have grown by approximately 10% in that time.[2]

FDIC Insured Institutions Asset Size Group



Source: FDIC

How should midsize financial institutions respond to Bank Secrecy Act (BSA)/Anti-Money Laundering (AML)/Office of Foreign Assets Control (OFAC) opportunities and challenges?

1. Mid-Size Bank Coalition of America, "About Us," Accessed April 10, 2020, https://www.midsizebanks.com/about-us/.
2. FDIC: Bank Data Guide, Accessed April 10, 2020, https://www.fdic.gov/bank/statistical/guide/data.html.

Road Map to Better Practices

Managing the BSA/AML Regulatory Landscape

Financial institutions face ever-changing regulatory expectations, with federal and state regulatory obligations and increased scrutiny, monetary penalties, and enforcement actions. The most common types of fines implemented against financial institutions by regulators are for AML violations, specifically for BSA regulatory failings within the U.S., followed by fines for sanctions, Know Your Customer (KYC), and transaction reporting failures.[3] In addition to state regulators, financial institutions are also under the scrutiny of any number of federal regulators.

The size of a financial institution does not necessarily translate into less stringent BSA/AML regulatory expectations; therefore, midsize financial institutions need to meet regulatory expectations by implementing a risk-based approach that fits the institution's scale, product offerings, customer base, and geographic and sanctions exposure. Specifically, financial institutions are expected to align their program with guidance of the Federal Financial Institutions Examination Council (FFIEC). Furthermore, regulatory bodies such as the FRB and the OCC[4] have provided guidance for safety and soundness tailored to both the examination frequency and methods to align with a risk-focused approach based on the institution's complexity, activities, and asset size.[5] The OCC's Midsize and Community Bank Supervision leverages the FFIEC BSA/AML Examination Manual to ensure domestic midsize financial institutions comply with applicable laws and regulations scaled from large financial institutions. BSA compliance programs will vary in magnitude, size of deposits, and sophistication, based on risk exposure and access to an appropriate budget.

Midsize financial institutions can face challenges appropriately staffing their teams with qualified compliance professionals due to the highly competitive marketplace for such professionals and the ability of larger financial institutions with deeper pockets to solicit experienced employees. As such, it is imperative that midsize financial institutions maintain rigorous governance, including desktop operating procedures, such that high attrition rates are less likely to adversely affect the compliance program.

Adequate and Specialized Staffing

During an economic downturn, midsize financial institutions may find structuring and maintaining compliance staff to be difficult due to an institution's budget restrictions. Alternatively, during an economic boom, geographic location and limited access to experienced candidates or technical resources could present challenges.

Due to the scarcity of people with technology backgrounds, including data analytics, and developers who can seamlessly coordinate with compliance personnel, midsize institutions should focus on retention of their tech talent. Midsize financial institutions struggling to retain highly specialized, full-time resources may opt for pooled resources or external advisors as an alternative that will allow for cross-collaboration, exposure to industry better practices, and broader expertise. While regulators have encouraged small and midsize institutions to collaborate and share resources to efficiently manage their BSA/AML obligations, legal and operational challenges have made this sort of activity difficult to sustain.

For midsize financial institutions operating with a reduced number of compliance resources, it is important to act as quickly as possible when filling vacancies. In some cases, midsize financial institutions may look to seconded roles until the appropriate personnel are hired and onboarded to maintain day-to-day activities. Midsize financial institutions can leverage consultants with prior experience as a compliance officer or sanctions officer, for example, in a seconded role to uphold responsibility on behalf of the financial institution.

These roles are typically contracted for a specific period of time and have a slight overlap, once the vacancy has been filled, to ensure appropriate transition and long-term success for the institution.

Authentically Knowing Your Customer Base

Midsize financial institutions with customized, personal relationships will be in a better position to know their customers than large financial institutions. Specifically, community-based relationships might allow a financial institution to gain insight into its customer base and understand the common behaviors, customer expectations, and transaction activity more specifically than larger institutions. Alternatively, midsize financial institutions may not have access to sophisticated monitoring of their customers, which could inhibit their ability to meet compliance requirements. Finally, smaller financial institutions with less technological savvy may occasionally find themselves inadvertently onboarding high-risk customers demarketed by larger financial institutions.

An essential component of a midsize institution's compliance program is applying its knowledge of the customer base and aligning it with the sophistication of a meaningful customer risk-rating methodology. Financial institutions should conduct periodic reviews of customer due diligence, leveraging a risk-based approach and trigger events that may cause a change in the customer's risk profile.

3. Fenergo "Ten-Year Analysis of AML/KYC/Sanctions Fines," Accessed April 10, 2020, https://www.fenergo.com/resources/whitepapers/a-fine-mess-were-in-aml-kyc-sanctions-fines.html.
4. The Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Financial Crimes Enforcement Network, National Credit Union Administration, and the Office of the Comptroller of the Currency, "Interagency Statement on Sharing Bank Secrecy Act Resources," October 3, 2018, https://www.fincen.gov/sites/default/files/2018-10/Interagency%20Statement%20on%20Sharing%20BSA%20Resources%20-%20%28Final%2010-3-18%29%20%28003%29.pdf; and Office of the Comptroller of the Currency, January 13, 2015, https://www.occ.gov/publications-and-resources/publications/banker-education/files/pub-opp-comm-banks-working-together-collab.PDF.
5. The Board of Governors of the Federal Reserve System, Division of Supervision and Regulation, "Commercial Bank Examination Manual," Supplement 51 – April 2020, https://www.federalreserve.gov/publications/files/cbem.pdf; and "SR -1-19 (SUP)," August 10, 2001. https://www.federalreserve.gov/boarddocs/srletters/2001/sr0119.htm; and The Office of the Comptroller of the Currency, "Midsize Bank Supervision," https://www.occ.treas.gov/about/who-we-are/locations/midsize-bank-supervision/index-midsize-bank-supervision.html.

New Products and Services

Midsize financial institutions face competition from large financial institutions, evolving consumer behaviors, and digital disruptors, including finance companies, financial technology companies (FinTechs) and online banking companies offering modern-day banking alternatives. When introducing new products and services, financial institutions should conduct a product risk assessment to uncover potential risk exposure to the institution. Furthermore, financial institutions should vet the new offerings through appropriate governance committees to serve as an open forum for conflicts, risk areas, formal review, and decision-making.

Digital product offerings including mobile-based customer service, online banking, and online loan applications are the new normal. Midsize financial institutions may choose to serve their customers by offering digital products and services, while maintaining a sense of personal connection and assurance; however, financial institutions should evaluate risks and controls in tandem.

Governing Documents and Risk Assessments

Financial institutions should keep policies and procedures current, comprehensive, and consistent. As a financial institution's regulatory commitments, product offerings, risk appetite, staffing, and processes evolve, its policies and procedures must be aligned appropriately. Policies and procedures should clearly delineate roles and responsibilities and outline both preventive and detective controls. Furthermore, policies and procedures must be subject to rigorous testing to ensure they are being followed as intended.

It is critical that an organization develop a thorough understanding of its current product offerings, customers, and geographies before it can understand the potential impact of new business. A comprehensive risk assessment is critical to understanding the overall risk of an organization's business. Midsize financial institutions can benefit from leveraging the results of the risk assessment when discussing future compliance spending with senior management and its board of directors.

Based on the assessment of existing business, an organization should make informed decisions when considering future growth and that it aligns with its overall AML and sanctions risk appetite. U.S.-based financial institutions should incorporate risk measures and potential exposure to international sanctions and High Intensity Drug Trafficking Areas and High Intensity Financial Crime Areas. Finally, an institution should implement risk-based controls to comply with laws and regulations, and test them to detect weaknesses and control failures.

Systems Integration and Meaningful Metrics

For institutions that are growing with reduced budgets and fewer resources, systems integration and navigating investments in technology can be a challenge. Midsize financial institutions should ensure data is centralized, complete, and consistent. Institutions should be nimble, enhance existing technology as much as possible, and leverage systems that are fit-for-purpose to allow the institution to automate manual processes. Midsize financial institutions will benefit from having a flexible core banking system that will allow for ease of integration as their business lines and services evolve.

Furthermore, it is important that an institution's systems can be leveraged for meaningful automated reporting and transparency, both internally and externally. This is particularly important for midsize financial institutions where they may have limited information technology resources. Internal metrics and reporting provide key information for senior management to assess how the institution is doing in meeting its risk management-related objectives and highlights where it is doing well, where it is falling short, and how it can improve.

How Guidehouse Can Help

Guidehouse has experience working with financial institutions of various sizes, including, but not limited to, banks, broker dealers, money services businesses, marketplace lenders, insurance companies, and FinTechs.

Guidehouse consultants include former compliance officers, bankers, senior regulators and prosecutors, law enforcement officials, accountants, and lawyers, all of whom bring significant experience in risk management and financial crimes compliance.

Guidehouse has broad expertise working with domestic and international-based financial institutions managing an everchanging regulatory landscape and better practices, including:

- ✓ Staffing Assessment
- ✓ Compliance Technology Assessment
- ✓ BSA/AML, Sanctions, Product Risk Assessments
- ✓ Know Your Customer/Customer Due Diligence/Enhanced Due Diligence Customer Reviews and File Remediation
- ✓ Transaction Monitoring and Sanctions Reviews
- ✓ Seconded Compliance Roles and Financial Intelligence Unit) Augmentation
- ✓ Risk Management Gap Analysis
- ✓ Lookbacks
- ✓ Investigative Due Diligence
- ✓ Customize and Administer Training
- ✓ Operational Effectiveness and Efficiency
- ✓ System Implementation
- ✓ Independent Assessment

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About Guidehouse

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