Debevoise Insight: Round-up of Recent Anti-Money Laundering Developments

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The anti-money laundering ("AML") regulatory landscape is quickly evolving, and AML compliance remains a focus across the federal government. In this Debevoise In Depth, we review recent AML developments affecting financial institutions and the regulatory implementation of the Corporate Transparency Act ("CTA"), which was enacted along with the "Anti-Money Laundering Act of 2020" ("AML Act") as part of the National Defense Authorization Act for Fiscal Year 2021 ("NDAA") and makes the most significant changes to U.S. AML laws since the USA PATRIOT Act of 2001.[1]

Specific developments highlighted in this Debevoise In Depth:

- **FinCEN ANPRM on Beneficial Ownership**. On April 1, 2021, the Financial Crimes Enforcement Network ("FinCEN") issued an Advance Notice of Proposed Rulemaking ("ANPRM") to solicit public comment regarding the beneficial ownership reporting obligations as required by the CTA.

- **Interagency Statement on Model Risk Management and Request for Comment**. On April 9, 2021, the federal banking regulators in consultation with FinCEN released an interagency statement clarifying how the "Supervisory Guidance on Model Risk Management" ("MRMG")[2] may be a used to guide a bank's model risk management framework and assist with Bank Secrecy Act/AML ("BSA/AML") compliance and requested comment on the extent to which risk management principles discussed in the MRMG relate to the systems and models used by banks to comply with BSA and Office of Foreign Assets Control ("OFAC") requirements.[3]

- **EXAMS Risk Alert on Suspicious Activity Reporting and Related Topics**. On March 29, 2021, the Securities and Exchange Commission's Division of Examinations ("EXAMS") released a Risk Alert highlighting recent observations of

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1 Refer to our previous guidance summarizing the NDAA, here.

2 *See* the MRMG, here.

3 *See* the Interagency Statement on Model Risk Management for Bank Systems Supporting BSA/AML Compliance, here and the Request for Information and Comment, here.

common compliance issues among broker-dealers with respect to AML policies and procedures.

- **FFEIC BSA/AML Manual Update**. On February 25, 2021, the Federal Financial Institutions Examination Council ("FFIEC") updated its BSA/AML Examination Manual (the "BSA/AML Manual").[4] The FFIEC made mostly technical changes to existing sections within the BSA/AML Manual and added a new section titled "Assessing Compliance with Bank Secrecy Act Regulatory Requirements," which made clear that covered institutions must cultivate and encourage practices that correspond to policies, procedures and processes, which, in turn, should reflect an institution's unique risk profile and appetite.

FinCEN Requests Public Comment on Beneficial Ownership Reporting Requirements

On April 1, 2021, FinCEN issued an ANPRM to solicit public comments regarding how it should implement forthcoming beneficial ownership information reporting requirements for certain legal entities.[5] The ANPRM begins the process of establishing beneficial ownership reporting obligations as required by the CTA. Comments are due on May 5, 2021.

As background, the CTA requires broad categories of companies organized in the United States or required to register to do business in the United States to report beneficial ownership information to FinCEN at formation, for new entities, or, for companies already in existence, two years after the Treasury Department issues implementing regulations. Reporting companies also will be required to report changes in their beneficial ownership on a going-forward basis. FinCEN is required to maintain a secure, nonpublic database of beneficial ownership information for use, under varying restrictions, by national security, intelligence and law enforcement agencies, federal functional regulators and financial institutions.

The creation of a corporate registry at FinCEN signals a landmark change to corporate law in the United States, which international bodies have long criticized for insufficient transparency. The purpose of the new reporting requirement is to enhance national security by making it more difficult for "malign actors to exploit opaque legal structures."[6] The work to create the registry is a particular focus of the Treasury Department and the Biden Administration, as evidenced by the proposed budget

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4 For a summary of the prior update, *see* Debevoise Client Update, Banking Regulators Release Updates to BSA/AML Examination Manual (Apr. 17, 2020) *available* here.

5 *See* FinCEN's ANPRM, here.

6 *See* FinCEN's related press release, here.

released by the administration, which calls for a 50 percent increase in funding for FinCEN for fiscal year 2021 in large part to allow it to devote resources to this work.

The ANPRM gives a comprehensive overview of the issues that FinCEN is contemplating as part of the forthcoming implementing regulations. The ANPRM requests comment generally on how FinCEN should implement the CTA. FinCEN specifically includes 48 questions organized into five general groups: definitions; reporting of beneficial ownership information; FinCEN identifier; security and use of beneficial ownership and applicant information; and cost, process, outreach and partnership. The questions ask about the scope and breadth of the new reporting obligations, including which entities may be subject to the obligations, which entities may qualify for exemptions, and how access to the data should be granted. The questions also ask about how FinCEN can seek to minimize the regulatory burdens of the new requirements.

Interagency Statement on Model Risk Management and Request for Comment

On April 12, 2021, the Federal Reserve Board, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, in consultation with the National Credit Union Administration and FinCEN (the "Agencies"), released an interagency statement and requested information and comment on model risk management and the extent to which the principles discussed in the interagency MRMG support compliance by banks with BSA/AML and OFAC requirements. Comments on the request for information are due June 11, 2021.

As background, the MRMG sets out principles for sound model risk management in three key areas: (1) model development, implementation and use; (2) model validation; and (3) governance, policies and controls. The MRMG describes responsibilities for different parties within a bank, based on their roles, including those building models, those reviewing the models and those providing a governance framework for model risk management. The MRMG, like all supervisory guidance, does not have the force or effect of law.

- In the Interagency Statement, the Agencies recognize that model risk varies across different models and banks, and the Agencies clarify that there is no required categorization of particular bank BSA/AML systems as models. The Agencies also note that the MRMG does not establish any requirements or supervisory expectations that banks have duplicative processes for complying with BSA/AML regulatory requirements. The Agencies also explain that banks may use third party models to assist with their BSA/AML compliance and "may

consider" aspects of the MRMG that address third-party models. In this regard, the Agencies note that it is important the banks using third-party models have contingency plans in place in case those models are no longer available or reliable.

The Agencies also issued a request for comment with respect to the MRMG. The purpose of the request is to enhance the Agencies' understanding of bank practices and determine whether additional explanation or clarification may increase transparency, effectiveness or efficiency with respect to BSA/AML statutory and regulatory requirements. The Agencies request comment on any aspects of the relationship between BSA/AML and OFAC compliance and the principles conveyed in the MRMG, including how those principles may support compliance and any differences in perceptions regarding their application. The Agencies request commenters provide specific discussion of the below topics.

- Suggested changes to guidance or regulation; and
- Aspects of the Agencies' approach to BSA/AML and OFAC compliance as it relates to MRMG that are working well and those that could be improved, including, in as much detail as possible, supporting data or other information on impacts, costs and benefits.

The Agencies also pose 12 specific questions that cover a wide range of topics, including, but not limited to, the risk management principles discussed in the MRMG, suspicious activity monitoring system validation, and system implementation, delay and innovation.

SEC Division of Examinations Notes Compliance Issues Related to Suspicious Activity Monitoring and Reporting at Broker-Dealers

On March 29, 2021, EXAMS released a Risk Alert highlighting recurring compliance issues at broker-dealers related to AML compliance programs and suspicious activity monitoring and reporting.[7] EXAMS identified common deficiencies in each of the following categories, each with select relevant observations below.

- **AML Policies and Procedures and Internal Controls**. EXAMS observed broker-dealers that did not establish reasonably designed policies and procedures and

[7] See EXAM's Risk Report, here.

internal controls necessary to identify and report suspicious activity. Among the issues that EXAMS observed:

- Inadequate Policies and Procedures.
  - Failing to include red flags in policies and procedures, or not including those associated with securities transactions;
  - Firms with large volumes of trading relying on manual reviews;
  - Failing to monitor transactions in securities priced from $1 to $5 per share and those low-priced securities occurring on an exchange;
  - Utilizing monitoring thresholds higher than the $5,000 SAR threshold; and
  - Introducing firms appropriately deferring to clearing firms and failing to adopt their procedures "that take into account the high-risk nature of their customers' activity."
- Failure to Implement Procedures. EXAMS noted that some firms that had reasonably designed written policies and procedures but did not implement their procedures adequately. EXAMS cited the following deficiencies:
  - Inconsistent reporting of patterns of identical suspicious transactions;
  - Failing to use available transaction reports and systems to monitor for suspicious activity;
  - Follow-up on red flags identified in their procedures, such as prearranged or non-competitive trading, including wash or cross trades or potential insider trading; and
  - Failing to comply with firm prohibitions on accepting trades for penny stocks and not conducting due diligence to determine whether to file SARs on those transactions.

- **Suspicious Activity Monitoring and Reporting**. EXAMS observed that some firms did not file SARs when it appeared that the broker-dealers "knew, suspected, or had reason to suspect that they were being used to facilitate unlawful activity." EXAMS also saw deficiencies in filed SARs, including

observing firms that "filed hundreds of SARs … containing the same generic boilerplate language, which failed to make clear the true nature of the suspicious activity and the securities involved." Deficiencies cited included:

- Failing to Respond to Suspicious Activity.
  - Large deposits of low-priced securities, followed by the near-immediate liquidations of those securities and then wiring out the proceeds;
  - Trading in thinly traded, low-priced securities that results in sudden spikes in price or that represents most, if not all, of the securities' daily trading volumes;
  - Trading in the stock of shell companies;
  - Trading in the stock of suspended securities;
  - Trading in the stock of companies whose affiliates, officers or other insiders have a history of securities law violations;
  - Trading in the stock of issuers for which over-the-counter stock quotation systems have published warnings because the issuers had ceased to comply with their SEC financial reporting obligations; and
  - Trading in the stock of issuers for which the firms relied on a "freely tradeable" legal opinion that was inconsistent with publicly available information.
- Filing Inaccurate or Incomplete SARs. Providing reports that fail to include:
  - Key information despite having such information available in the firm's own internal records;
  - A description of relevant transactions before or after the transaction at hand; and
  - For cyber-intrusions, the known method and manner of cyber-intrusions and schemes to "take over" customer accounts.

These common deficiencies are published by EXAMS to remind firms of their obligations under AML rules and to assist broker-dealers in reviewing and enhancing

their AML programs. We also expect these common pitfalls may apply to and help inform AML standards across the financial institution industry.

FFIEC Emphasizes Importance of Risk-Based Compliance in Revised BSA/AML Examination Manual

On February 25, 2021, the FFIEC updated certain sections of the BSA/AML Manual for the second time in less than a year. Although it is a guidance document that does not carry the force of law, the BSA/AML Manual serves as an important reference tool by outlining federal bank regulatory expectations regarding BSA/AML compliance programs and providing transparency with respect to the examination process.

In this update, the FFIEC makes mostly technical changes to existing sections within the BSA/AML Manual concerning policies and procedures related to: Customer Identification Program ("CIP") compliance and Currency Transaction Reporting ("CTR").

It also adds a new, and important, section titled "Assessing Compliance with Bank Secrecy Act Regulatory Requirements." Here, the FFIEC make clear that covered institutions must not only deploy BSA/AML compliance *programs*, they also must cultivate and encourage "*[p]ractices* that correspond to policies, procedures, and processes" that, in turn, should reflect an institution's unique risk profile and appetite.[8] In assessing these programs, moreover, the revised BSA/AML Manual directs bank examiners to take a risk-based method.

By promoting an individualized, risk-based approach to BSA/AML compliance, and regulatory assessments thereof, the FFIEC formalizes what has long been an informal tenet among financial crimes compliance professionals. It also echoes the recently-enacted AML Act of 2020, which requires "reasonably designed" and "risk-based" AML programs.

The revised BSA/AML Manual also clarifies expectations regarding various CIP and CTR compliance requirements, including those highlighted briefly below.

- **CIP Updates.** The CIP-related sections of the BSA/AML Manual have been updated to make note of exceptions in relevant regulation and guidance that had not previously been discussed in this guidance.

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[8] FFIEC BSA/AML Examination Manual, Assessing Compliance with the BSA Regulatory Requirements, Assessing Compliance with Bank Secrecy Act Regulatory Requirements (Feb. 2021) at 1 (emphasis added).

- **CTR Clarifications**, including:

    - Aggregation. Depository institutions should use beneficial ownership information of legal entity customers to help determine whether transactions may have been conducted by or on behalf of the same person and, therefore, should be aggregated for CTR purposes.

    - Structured Transactions. A SAR must be filed when a bank suspects that a customer is structuring transactions to evade CTR requirements.

    - Backfiling and Amendment. A bank that has filed CTRs with errors must take action to come into compliance with the CTR rules and should do so proactively; in most cases, this will not require consulting FinCEN, although the agency's Resource Center is available as a resource.

    - Exempt Person Transactions. Banks are required to take reasonable and prudent steps to assure a person is, in fact, exempt from CTR requirements and should document the basis for their conclusion and periodically revisit their "Exempt Person" designations.

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We will continue monitoring updates to the BSA/AML regulatory landscape. Please do not hesitate to contact us with any questions.

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