

# Client Update

## Regulatory Focus on AML Continues – New Actions at the State and Federal Levels

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Federal and state regulators continue their focus on financial institutions' compliance with anti-money laundering ("AML") requirements. Within the past month, regulators have taken a number of new measures:

- The U.S. Treasury Department and federal banking agencies issued a "joint fact sheet" that discusses their supervisory expectations and enforcement standards regarding AML requirements for correspondent banking and related obligations under U.S. sanctions programs;
- The Office of the Comptroller of the Currency ("OCC") issued a new *Comptroller's Handbook* booklet, "Corporate and Risk Governance," that describes supervisory expectations related to risk governance and AML;
- The New York Department of Financial Services ("NYDFS") entered into a consent order with Mega Bank International Commercial Bank Co., Ltd. and its New York branch ("Mega Bank") for violations of New State AML requirements; and
- The U.S. Treasury Department's Financial Crimes Enforcement Network ("FinCEN") issued a new proposed rule to require banks that lack a federal functional regulator to adopt AML programs and expanded geographic targeting orders for high-end residential real estate markets.

Below, we briefly discuss each regulator's action in turn.

### TREASURY AND FEDERAL BANKING AGENCIES COMMUNICATE EXPECTATIONS FOR CORRESPONDENT BANKING DUE DILIGENCE

On August 30, 2016, the U.S. Department of the Treasury and the federal banking agencies issued guidance, unusually referred to as a "joint fact sheet,"

summarizing the key aspects of federal supervisory and enforcement strategy and practices regarding correspondent banking.<sup>1</sup>

- *Due Diligence Expectations.* U.S. depository institutions are expected to obtain and review sufficient information about their correspondent banking customers, including an understanding of their markets and types of customers, to make informed decisions regarding the associated risks and requirements for suspicious activity monitoring; however, there is no requirement that U.S. banks conduct diligence on individual customers of foreign financial institutions.
- *Supervisory and Enforcement Strategy.* The Treasury Department and federal banking agencies emphasized that they do not utilize a “zero tolerance” policy but rather employ a risk-based approach to supervision and enforcement that sees approximately 95% of identified compliance deficiencies resolved without enforcement action. Penalties are more likely if corrective action does not occur within a reasonable amount of time after identification of an issue, if there are serious violations or unsafe or unsound practices, breaches of fiduciary duty or failure to respond to warning signs that actions are illegal.

Three senior Treasury officials, commenting on the Fact Sheet in a blog post, noted that it “dispels certain myths about U.S. supervisory expectations,” and the *Wall Street Journal* linked the publication of the Fact Sheet to recent criticism from International Monetary Fund Managing Director Christine Lagarde that many emerging markets may face systemic disruptions from U.S. banks’ efforts to “de-risk.”<sup>2</sup>

### OCC RELEASES COMPTROLLER HANDBOOK FOR RISK MANAGEMENT

On July 29, 2016, the OCC released a Comptroller’s Handbook booklet, “Corporate and Risk Governance,” to guide OCC examiners in their supervision of national banks and federal savings associations.<sup>3</sup> The booklet discusses a wide

<sup>1</sup> See 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 (Aug. 30, 2016), available [here](#).

<sup>2</sup> See Nathan Sheets, Adam Szubin & Amias Gerety, Complementary Goals – Protecting the Financial System from Abuse and Expanding Access to the Financial System, Treasury Notes (Aug. 30, 2016), available [here](#); Emily Glazer & Aruna Viswanatha, U.S. Defends Its Curbs on Money Laundering, *Wall Street Journal* (Aug. 30, 2016), available [here](#).

<sup>3</sup> See OCC Bulletin 2016-25, New Comptroller’s Handbook Booklet and Rescissions (July 29, 2016), available [here](#).

range of risks faced by national banks and federal savings associations; specific Bank Secrecy Act (“BSA”) and AML guidance includes:

- *CAMELS*. Examiners are to consider a supervised institution’s compliance with its AML obligations in a safety and soundness context when assigning the “management” rating under the agency’s “CAMELS” framework.
- *Director Orientation and Training*. The booklet notes the importance of new directors understanding the BSA/AML regulatory framework, the ramifications of noncompliance and the BSA/AML risk profile of their institution.
- *Beyond Legal Requirements*. Compliance management programs should extend beyond the applicable law (AML laws and regulations included) and contain prudent ethical standards and contractual obligations requiring the board and management to recognize the scope and implications of BSA/AML requirements for the bank.

By expressly tying the effectiveness of a bank’s AML awareness and compliance to its supervisory rating, the OCC is continuing to elevate the importance of AML compliance for both senior management and the board of directors.

### NYDFS CONSENT ORDER WITH MEGA BANK

On August 19, 2016, the NYDFS announced a consent order with Mega Bank requiring, among other measures, the payment of a \$180 million penalty and the installation of an independent monitor.<sup>4</sup> According to the consent order, Mega Bank demonstrated “numerous deficiencies” in BSA/AML compliance, including:

- *CCO and BSA/AML Officer*. The positions of BSA/AML Officer and Chief Compliance Officer (“CCO”) lacked knowledge of BSA/AML and Office of Foreign Asset Control (“OFAC”) requirements and the supervisory expectations for persons holding those positions.
- *Compliance Structure*. The NYDFS criticized Mega Bank’s compliance structure for creating potential conflicts of interest by combining compliance and operational functions. In some instances, such as with the New York branch’s Vice President and Deputy General Manager, who also served as the CCO, these dual roles led to personnel devoting insufficient time to their compliance responsibilities.

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<sup>4</sup> See NYDFS Press Release, DFS Fines Mega Bank \$180 Million For Violating Anti-Money Laundering Laws (Aug. 19, 2016), available [here](#).

- *Transaction Monitoring.* The NYDFS cited a number of issues with Mega Bank's transaction monitoring framework, including (i) an apparent lack of periodic review of the filtering criteria, (ii) no available explanation for the validation process for detected suspicious transactions, and (iii) inadequate documentation (some policies were never translated from Chinese, which left the NYDFS unable to review them).
- *Suspicious Activity with Panama Branches.* Mega Bank operates branches in Panama City and the Colon FTZ. The NYDFS notes that Panama has historically been a high-risk jurisdiction, but Mega Bank failed to treat transactions between its New York and Panama branches with an appropriate level of diligence. The NYDFS states it found evidence of money laundering and other suspicious activity.
- *Customer Due Diligence.* Mega Bank failed to follow its policies and procedures for enhanced due diligence.

This order is one of the first major actions taken by the NYDFS under its recently confirmed Superintendent, Maria Vullo, and is consistent with the department's focus – which predates Ms. Vullo's tenure – on AML issues.<sup>5</sup>

### **FINCEN PROPOSES TO REMOVE AML EXEMPTION FOR BANKS WITH NO FEDERAL FUNCTIONAL REGULATOR, EXPANDS GEOGRAPHIC TARGETING ORDERS**

On August 25, 2016, FinCEN proposed to remove the exemption for banks not subject to regulation by a Federal functional regulator from the AML and customer identification program ("CIP") requirements of the BSA.<sup>6</sup> These banks primarily include state-chartered non-depository trust companies, non-federally insured credit unions, private banks and non-federally insured state banks and savings associations. The comment period for the new proposal expires on October 24, 2016.

Like other banking institutions, these entities would be required to adopt and implement an AML program that includes, at a minimum, (1) internal policies, procedures and controls; (2) designation of an AML compliance officer; (3) an

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<sup>5</sup> One of Superintendent Vullo's first acts in office was to publish a final rule enhancing BSA/AML compliance program requirements, which we discussed in a previous Client Update available [here](#).

<sup>6</sup> See Customer Identification Programs, Anti-Money Laundering Programs, and Beneficial Ownership Requirements for Banks Lacking a Federal Functional Regulator, 81 Fed. Reg. 58425 (Aug. 25, 2016); Interim Final Rule - Anti-Money Laundering Programs for Financial Institutions, 67 Fed. Reg. 21110 (Apr. 29, 2002).

ongoing employee training program; (4) and an independent audit function to test the effectiveness of the program; and (5) effective May 2018, policies and procedures for enhanced and ongoing customer due diligence, including the identification of beneficial owners.<sup>7</sup>

Requiring these banks to adopt AML programs is unlikely to present significant new compliance burdens for many of them. Many are already subject to AML requirements either because they are part of a larger organization with consolidated AML coverage or because they fall under state-mandated AML rules that mirror federal requirements.

In a separate development, last month, FinCEN also expanded the reach of its Geographic Targeting Orders (“GTO”) that temporarily require U.S. title insurance companies to identify the natural persons behind shell companies that pay “all cash” for high-end residential real estate. The expanded GTOs target the metropolitan areas of Los Angeles, San Francisco, San Diego and San Antonio in addition to the previously targeted areas of New York City and Miami.<sup>8</sup>

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We are available to answer any questions you may have regarding these and other recent developments.

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<sup>7</sup> We discussed these enhanced customer due diligence rules in a previous Client Update, available [here](#).

<sup>8</sup> See FinCEN Press Release, FinCEN Expands Reach of Real Estate “Geographic Targeting Orders” Beyond Manhattan and Miami: U.S. Title Insurers Required to Identify High-End Cash Buyers in Six Major Metropolitan Areas (July 27, 2016), available [here](#).