ACHIEVING A SUCCESSFUL AUDIT AFTER A MERGER OR ACQUISITION

Know what is expected for seamless BSA/AML compliance

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I. Executive Summary

Throughout the last 15 years, numerous banks have not survived—whether the failure was caused from being unable to sustain a strong financial balance sheet or simply due to regulatory failure. Since October 1, 2000, the FDIC’s failed bank list notes 539 banks that have failed.\(^1\) Over 100 banks have received enforcement actions through civil money penalties (CMPs) or cease and desist orders (C&D) due to deficiencies in Bank Secrecy Act/anti-money laundering (BSA/AML) programs.\(^2\)

When a bank fails or struggles, it is evident that another financial institution must assume the customers, branches, assets and liabilities of these institutions, making compliance challenging to say the least. At present there is no specific guidance from the regulatory agencies to direct an acquiring financial institution on compliance expectations specific to how and when policies and procedures should be combined to ensure a seamless culture of compliance throughout a merger or acquisition.

Being involved in numerous acquisitions and at least one merger over the past decade, I have learned what I consider “best practices” to ensure a continued culture of BSA/AML compliance by identifying critical processes that auditors and examiners expect to occur simultaneously as soon as the “ink meets the paper” when multiple companies come together to operate as one. My hope in writing this white paper is to share what I have learned with readers so each will be prepared with upfront knowledge in order to proactively incorporate steps throughout a merger or acquisition that will ultimately result in a seamless culture of BSA/AML compliance.

Too many times, BSA officers must work through trial and error to achieve successful audit and exam results. The contents of this paper are intended to provide information that has been successful in hopes that readers will use the guidance to identify, set and achieve goals at the appropriate times during an acquisition or merger process.

The following white paper is based on personal and professional experience, trial and error, and surviving audits and exams after a merger or acquisition.

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\(^1\) [https://www.fdic.gov/bank/individual/failed/banklist.html](https://www.fdic.gov/bank/individual/failed/banklist.html) 2015

II. Regulatory Expectations

As directed in the FFIEC BSA/AML Examination manual, BSA/AML programs are to be risk-based. This leaves much room for a very subjective approach. A risk-based approach is great in the sense that not all banks offer the same products/services; serve the same types of customers, or operate in the same geographic locations. However, a risk-based approach can be challenging when determining how much is enough; especially during a merger or acquisition.³

In one area of the regulation for customer identification, Section 326 of the USA PATRIOT Act does provide specific guidance for mergers and acquisitions stating:

*The final rule codifies and clarifies the ‘transfer exception.’ Under the final rule, the definition of ‘account’ excludes accounts that a bank acquires through an acquisition, merger, purchase of assets, or assumption of liabilities from any third party. Treasury and the Agencies note that the Act provides that the regulations shall require reasonable procedures for ‘verifying the identity of any person seeking to open an account.’ Because these transfers are not initiated by customers, these accounts do not fall within the section 326.9.*

This direct guidance is extremely helpful, saves an acquiring financial institution time and allows them to focus on other areas of elevated risk.⁴ However, in no way should this guidance be a “free-pass” for never “CIP-ing” a customer that was initially obtained through a merger or acquisition. A good rule of thumb is to train staff to review a customer’s CIP record at the time of a transaction, updating any missing information at that time. Certainly another appropriate time would be when a customer opens an additional account with the now combined bank.

In March 2014, during the FDIC’s Atlanta Region conference call, the FDIC spoke about their expectations for mergers and acquisition and provided the following as “considerations:”

- Evaluate BSA/AML/fraud risks of the target institution when considering a merger or acquisition
- BSA review should be part of your due diligence process, similar to loan review
- Develop a plan and timeline to incorporate the other bank’s BSA program into your own program.
- Acknowledge and plan for additional customer due diligence (CDD) and enhanced due diligence after the acquisition (i.e., CIP).⁵

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³ FFIEC BSA/AML Examination Manual 2014
⁵ Bank Secrecy Act and Anti-Money Laundering — FDIC Atlanta Region’s Regulatory Conference Call March 20, 2014
Until that time, the FDIC had not published anything so clear. This guidance has served to be very supportive to ensure the BSA/AML officer/staff is/are included at the appropriate time when considering a merger or acquisition, not “after-the-fact” when executive management seeks to acquire or merge with another financial institution.

The FDIC Supervisory Insights article “Understanding BSA Violations” touches on the “Evolution of the BSA,” noting that the “most sweeping changes in the BSA occurred shortly after the September 11, 2001, terrorist attacks with the passing of the Patriot Act in October 2001.” This law changed many aspects of BSA compliance, including that federal banking agencies consider a bank’s AML record when reviewing bank mergers, acquisitions and other applications for business combinations. This laid out expectations for federal regulatory agencies but not specifically for banks, leaving banks to determine on their own how to prepare for compliance during a merger or acquisition. Unfortunately, nowadays banks must not only look at statutes and regulations to know what to do, they must also review enforcement actions to aid in their evaluation of due diligence, since enforcement actions have become the driving force to understand what regulators are expecting.

Knowing now that there is a high level of expectation, it is time to lay out what has been successful in achieving a seamless culture of compliance when companies converge, and being able to support what has made the convergence so successful. This starts with initial due diligence.

III. Initial Due Diligence

A. Review of Prior Exams and Audits

As with any successful BSA/AML program it is essential to initially assess the products and services, geographic locations, and customers and entities of the financial institution being acquired, or the “target” financial institution. One of the main reasons a merger or acquisition is unsuccessful is poor due diligence. First and foremost, gathering documentation to understand how the acquired financial institution has conducted business is essential. Reviewing prior exams and audits will provide much needed information to support where resources should be dedicated.

6 https://www.fdic.gov/regulations/examinations/supervisory/insights/siwin06/article03_bsa.html 2006
Next it will be critical to access the BSA/AML risk of the target financial institution through a review of its risk assessment. A financial institution’s risk assessment should be the foundation of its BSA/AML compliance program and should be the starting point for due diligence whether the bank was successful or not. This process will identify the impact on the acquiring financial institution’s AML program if any.

**B. Risk Assessment**

Reviewing and analyzing the risk assessment will allow one to develop questions for which to seek further information, validate understanding, and especially to identify higher risk areas, customers, products and services, geographic locations, etc. Once this information has been reviewed, it will be important to communicate findings with other departments or business lines so each will have an understanding of any changes to policies or procedures that will need to be communicated quickly; or in some cases, policies or procedures that may be grandfathered in from the target financial institution which will change existing policies and procedures for the acquiring financial institution (i.e., check cashing for non-customers, selling cashier’s checks to non-customers, etc.). Although not the “norm,” there may be times when the financial institution’s policies and/or procedures would be beneficial to incorporate into the combined companies practices.

The AML department of any financial institution should have a representative that is active on the company’s product development committee or a committee alike. This presence ensures the AML department is kept abreast of new and/or emerging products and services being considered by a financial institution so that risk can be considered PRIOR to final commitment and/or implementation. During a merger or acquisition, the same is true of the AML department to work with other business lines so it will know what products and services will remain, change, be added, etc.

To support that an acquiring financial institution has in fact conducted due diligence, it is very important to document the processes that were followed during that exercise to show all items that were considered, this will be further described in the *Implementation Action Plan — Documentation and Timeframes* section of this paper. Developing a method to document due diligence is an easy way to show an auditor or examiner that all components of the acquired financial institution were reviewed and considered. The document should show a complete picture of the review process which includes the goals and timeframes established from the beginning of the project through the fruition of a company-wide program.

**C. Review of Policies and Procedures**

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9 FFIEC BSA/AML Examination Manual 2014
The initial phase encompasses many steps. Once high-level initial due diligence has been documented, it is time to begin reviewing findings more in depth and establishing a timeline.

The next steps after reviewing the target financial institution’s risk assessment is to review policies and procedures so that the acquiring financial institution has a good understanding of how the target financial institution has said to be complying with laws established by the BSA. During this phase, notation of similarities and differences can prove to be very beneficial and time-efficient when determining if changes are needed. There may be processes that do not have to be changed, need to be changed only minimally, or need to be completely changed. Once identified, the acquiring financial institution can dedicate time and resources to each policy and/or procedure appropriately; knowing that some policies and procedures will need to change or be enhanced and require more attention simply due to their nature (i.e., currency transaction report [CTR] reporting, suspicious activity report [SAR] reporting, CDD, etc.).

D. Identifying Systems

An extremely critical component of the initial due diligence phase is identifying systems the target financial institution has been relying upon for compliance (CTR reporting, SAR reporting, 314a compliance, and others). The acquiring financial institution will need time to plan for system conversion, making it imperative that its understood how compliance will occur until the combined company is operating on one common system if not simultaneously with the final paperwork for the deal. Auditors and examiners alike will expect the same level of compliance and same policies and procedures to be in place as soon as a merger or acquisition occurs regardless of whether or not the combined company operates on one system from inception or not.

It is very vital to identify how regulatory reporting will occur. The expectation is that common customers will be identified immediately and currency transactions between multiple systems will be identified, aggregated and reported for CTRs and SARs. This may create the need for additional resources to assist with developing a process to combine data from multiple systems. Additional resources may be required during this phase to support the extra workload that operating multiple systems may create. The end result must show that cash and other transactions from multiple systems have been considered and filings have occurred.

The acquiring financial institution will also need to consider contract obligations when operating dual systems. Questions such as the following should be asked: How long do we need to keep these systems to ensure continued compliance before system conversion? Are there other areas to consider? How will watch lists be screened? If this responsibility lies within other departments, have these departments been considered? How will their processes occur and continue to occur with the combined company?
IV. Implementation Action Plan — Documentation and Timeframes

A. Documentation of Plan

To show proof of concept, the implementation action plan should be documented. This can easily be done through a simple Excel document that lists each process to review, the priority, category, implementation phase, how the acquiring financial institution performs the current task, how the target financial institution performs the task, which process will survive, how/when it will be implementation and any comments or notes. An example of this due diligence is below.

By documenting this information, the acquiring financial institution will gain a comfort level that no task is being overlooked, considering the integration of people, processes and technology. Examiners and auditors expect an acquiring financial institution to show they have considered all policies and processes in the overall risk assessment of the merger/acquisition deal. This document provides a holistic view which is quick and easy to understand. If the information is documented, one would hope that auditors or examiners would be able to guide the financial institution in another direction if they do not seem right.


B. Revisions of Risk Assessment, Policies, Procedures

During the Documentation of Plan stage, any necessary revisions to the acquiring financial institution’s risk assessment, policies and procedures will need to be made. “The key is to understand the Bank’s risk exposure and develop the necessary policies, procedures, systems, and controls to mitigate the risk.”13 The final risk assessment should demonstrate a complete understanding of the combined company’s overall risk. This may be one risk assessment that combines BSA/AML and the Office of Foreign Assets Control (OFAC) or separate risk assessments for BSA/AML and OFAC.

Policies and procedures may need to be revised during this phase too. Even though the policies and procedures may not become effective at the exact time of the review, this is the stage in which the combined company’s policies and procedures will be determined and revised and/or written to be readily available when needed for implementation.

C. Systems

Any systems that will remain for the combined company should have been identified during the Documentation of Action Plan stage as well. Automated monitoring systems for suspicious activity identification, required reporting (i.e., SARs, CTRs) will need to be ready to function upon system conversion. If there is a lapse of time between the merger/acquisition occurring and systems conversion, be sure to document how monitoring and reporting will be handled. As discussed in the Initial Due Diligence—Identifying Systems section of this paper, the regulatory expectation of the company operating as a combined company for regulatory reporting purposes was detailed. If two systems will remain, the exact process must be documented as to how aggregation and reporting will occur. For example, if two core systems are being relied upon for transaction activity, cash reports from both systems must be combined to identify common customers for CTR aggregation and exemption purposes. This may not be a simple process but should be done. The same goes for suspicious activity reporting. The surviving financial institution would most certainly want to review activity from both AML systems to identify whether the same customer was alerting in both systems and if so, report all the information together in one SAR.

D. Final Program

Once the combined risk assessment, policies and procedures, and systems have been determined, the final program should be easy to create. This may be as simple as a few updates or may entail more time depending on whether the overall risk, policies and procedures, and

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13 Auditing & Updating a $13 Billion Organization’s BSA/AML Risk Assessment by Donna Davidek, CAMS December 30, 2013
systems will undergo extreme changes. Nonetheless, with the due diligence that has been performed, a “road map” has been created that will be easy to follow.

The final program will be the driving force for training. Based on the final program, one will know which business lines will need training immediately and on which policies and procedures, etc.

V. Training

Training will prove to be a great asset to the success of the combined company. The employees that will be retained with the surviving company will not only need to understand any new policies and procedures, they will also need to understand the new culture of the combined company. This may also serve true to existing employees of the surviving company if the overall risk view has changed or changes to policies and procedures that they've come so accustomed to have occurred. Transparency during the integration process is essential to keep people informed, excited and ready to operate as a combined company.14

Timing of the training is also a critical element to ensure a seamless culture of compliance. Prior to opening day of the new company, employees should have a complete understanding of what to expect and how to operate. It may not always be feasible, but face-to-face training is certainly the most beneficial. New employees will be able to put a face with a name when receiving instructor lead training, and they will have the opportunity to ask questions or express concerns. This also allows the employees a comfort level going forward when they have BSA/AML-related questions. Training in this manner strengthens relationships and is very welcoming.

VI. Execution—Operating as “One”

Once training is complete and the company is operating as “one,” monitoring will need to occur to ensure compliance. The policies and procedures that were put into place will need to be reviewed to ensure each are operating as planned.

Samples of CIP, CDD, and OFAC should be obtained to identify any weaknesses. If weaknesses are found, a larger sample should be reviewed to determine if these are occurring by the same employee, branch, customer, etc. This step should point out if additional training is needed

overall or whether the exceptions are isolated. Demonstrating the ability to show the right systems and controls are in place is critical and will be very important to provide during audits and exams because compliance expectations will only continue to “get tougher.”

VII. Conclusion

Ensuring a continued culture of compliance through a merger or acquisition can be very challenging; however, if the right steps are taken from the beginning, a seamless unified culture can be achieved. Taking into consideration at the earliest stages of a merger or acquisition both financial institutions’ exam and audit reports, risk assessments, policies and procedures, and systems used for monitoring, the right decisions can be made at the right times.

Documenting every decision that is made and supporting each will prove to be extremely helpful and will make the process less onerous and more time efficient. Examiners and auditors will see the combined company’s risk assessment completely supported, including its program(s) and the policies and procedures that support the program(s). Examiners and auditors will appreciate the effort that has been put into the overall due diligence and give credit where credit is due.

As noted previously in this document, if a financial institution can physically place information in front of an examiner or auditor, that is the opportune time for the examiner or auditor to bring up any potentially troublesome areas or let the financial institution know they are not on the right path. I have found that examiners and auditors are more than willing to work with financial institutions if they show due diligence and the effort to achieve great results. Supporting the bank’s understanding of its overall risk is the key to a continued, seamless, culture of compliance.


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