BLANKET DE-RISKING OF

MONEY SERVICE BUSINESSES

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Executive Summary

The purpose of this paper is to describe how the current regulatory environment is putting pressure on the banking industry to de-risk their client base, specifically money services businesses (MSB). The de-risking of MSBs often means termination of banking relationships and shutting down services to MSBs. The regulatory bodies of the Financial Crimes Enforcement Network (FinCEN) and the Financial Action Task Force (FATF) are against this blanket de-risking approach for an entire industry. However, I will demonstrate how the process still exists and how it impacts banking institutions and the global financial industry. More importantly I will describe the MSB regulatory environment to demonstrate how MSBs are responsible for implementing compliance programs in accordance with the Bank Secrecy Act (BSA) and the oversight by regulators of this process. The intent is to articulate how regulators need to encourage, through actions and practice, the banks use of FATF's risk-based approach and leveraging existing regulatory oversight of MSBs when evaluating the decision to provide banking services to MSBs.

What is the impact de-risking has on the U.S. and international financial industry? Banks are de-risking MSBs and missing out on revenue opportunities due to regulatory pressure and MSB's inability to support their risk-based approach. Through de-risking, regulatory pressure has also shifted the MSB risk to less sophisticated financial institutions. In addition, regulators are jeopardizing the transparency within the remittance market and failing to address money laundering risks as MSB patrons are going underground.

What are some ramifications from de-risking? The de-risking of MSBs by banks presents challenges to the remittance market, the financial industry and humanity. There are 7 billion individuals globally; of that, around 3 billion have a paying job and around 205 million are unemployed, leaving scores of individuals dependent on others for funds for living.[1] Not only are financial institutions impacting those who rely on remittance funds for food, medical care and education, but they are pushing the remittance market to go underground and lose transparency. Regulatory pressure is influencing banks and board members to apply a one-size-fits-all mentality to MSBs risk level, even those with strong anti-money laundering (AML) programs and good oversight.

What is the solution to de-risking? The solution to de-risking requires cooperation from regulators, banks and MSBs. Regulators need to acknowledge their predisposed impression of MSB risk levels and allow banks to apply their own due diligence and risk-based approach. MSBs need to be informative regarding their AML program and banks need to rely on the regulatory oversight and independent reviews performed on the MSBs. Providing banking services to MSBs requires communication between the MSBs and banks to allow for informed decisions. Regulators need to be supportive of banks who evaluate MSB accounts by applying the requirements of the BSA, based on risk.

What is an MSB? An MSB is a non-bank entity providing mechanisms for people to make payments or to obtain currency or cash in exchange for payment instruments by any means through a financial agency or institution. MSBs may be large sophisticated businesses with global operations or they may be small one-owner storefronts. The services an MSB provides may vary and the management structure

[1]Lisa Evans, "Global Employment: What is the world unemployment rate?" January 25, 2011, www.theguardian.com, accessed July 2015.

may be simple or complex, as well as the overall risk profile. Each MSB has a different structure with branches or agents depending on the global presence of the MSB.

Who are MSB's typical client? MSBs play an important role in providing services to the unbanked and self-banked consumers across the globe. MSBs provide much needed services like check cashing, money transfer, prepaid stored value cards, money orders, traveler's checks and tax preparation to their clients.

How is an MSB regulated? MSBs are regulated by FinCEN and examined by the Internal Revenue Service (IRS). As a regulated entity in the financial industry, MSBs must comply with the BSA. MSBs must implement an effective AML program which is reasonably designed to prevent money laundering and terrorist financing. The MSB AML program must include the four pillars of an AML compliance program. The four pillars are:

1) Designation of a compliance officer for coordinating and monitoring day-to-day compliance;

2) Training for appropriate personnel;

3) Internal controls or policies, procedures designed to ensure ongoing compliance;

4) Independent review to monitor the program.[2] This fourth pillar is performed commensurate with the risk of the institution.

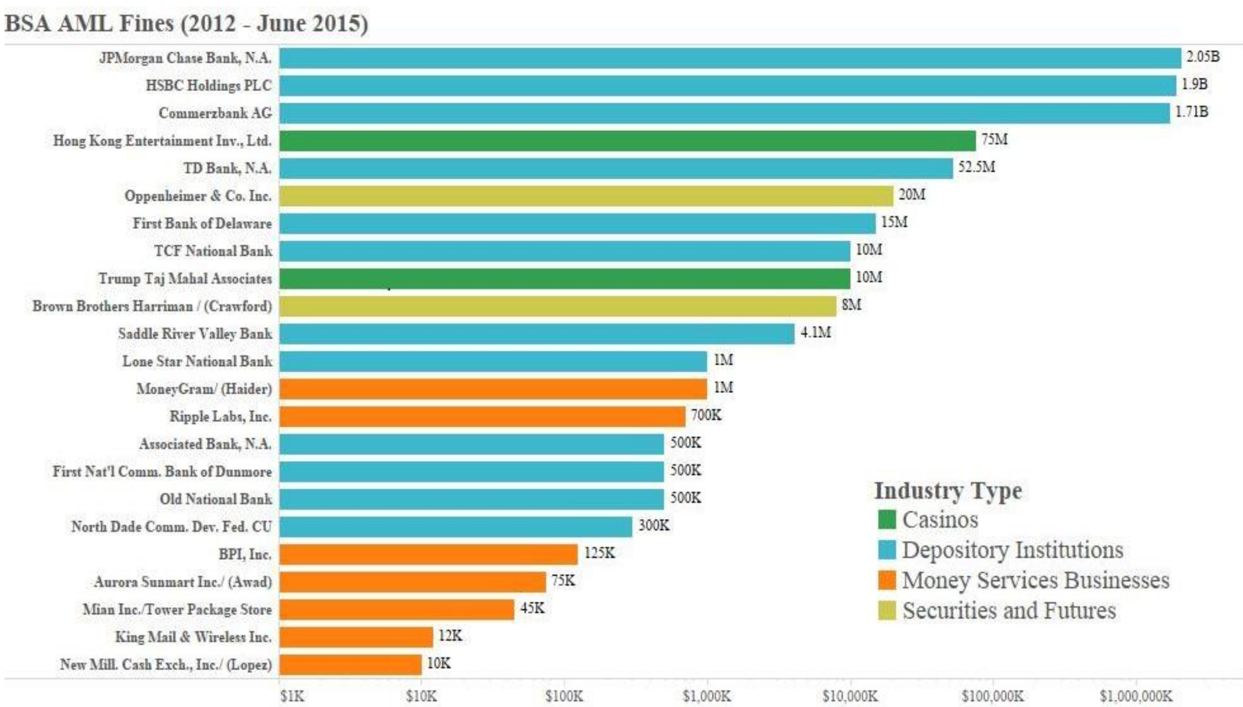
[2] FinCEN, "News Room-Reports & Publications," http://www.fincen.gov/news_room/rp/msb_exam_materials, December 2008, accessed June 2015.

Background

As the pendulum of regulation and risk tolerance swings, the banking environment has responded by wholesale de-risking and no longer providing or offering financial services to entire categories of consumers or businesses, namely the MSB industry.

The regulation environment has strengthened and regulators are placing financial institutions under increased scrutiny. FinCEN issued an advisory in August 2014 highlighting expectations for BSA/AML compliance programs. Expectations include engagement of management, appropriate resources, sharing of information across the business, independent testing of the AML program, periodic updates to the program and ensuring compliance with reporting requirements. In addition to increased scrutiny, the focus of enforcement actions has been applied across a broader range of institutions and officers. Failure by a financial institution to comply with the BSA can result in regulatory sanctions by either the U.S. Treasury Department or other regulators. There are several examples of increased fines and penalties against financial institutions in the news over the past few years (See Figure 1).

Figure 1:



Source: www.bankersonline.com BSA/AML Penalties List and www.finCEN.gov enforcement actions

Enforcement Action Examples:[3,4]

The following examples describe enforcement actions in the news and those noted in Figure 1:

- HSBC Bank USA N.A. (HBUS) received a civil money penalty in the amount of $500 million for violation of the BSA in 2012. FinCEN determined HBUS lacked an effective AML program, failed to perform due diligence on foreign correspondents, and failed to detect and report evidence of money laundering, therefore violating Title 31 of the United States Code, Section 5318. HBUS was fined for inadequate internal controls, failure to conduct adequate independent testing of the AML program, and for insufficient staffing and qualified personnel to monitor day-to-day compliance with the BSA.

- TD Bank N.A. received a Consent Order from the Office of Comptroller of Currency (OCC) in 2013 for $37.5 million from a Civil Money Penalty against TD Bank, N.A. In addition, FinCEN announced a concurrent $37.5 million Civil Money Penalty assessment. The bank was principally charged with failing to file suspicious activity reports (SARs) relating to activity in connection with a $1.2 billion Ponzi scheme from a banking customer/business.

- JP Morgan Chase Bank N.A. received a fine from FinCEN in January 2014 in the amount of $461 million for willfully violating BSA requirements by failing to file suspicious transactions as a result of Bernard L. Madoff's multibillion dollar Ponzi scheme. Bank employees identified suspicious transactions, but they failed to file reports with law enforcement. Other red flags relating to these suspicious transactions and accounts were repeatedly ignored by the bank's AML personnel.

- North Dade Community Development Federal Credit Union received a $300,000 Civil Money Penalty from FinCEN for significant BSA violations in November 2014. North Dade, a credit union with $4 million in assets, worked with a third-party contractor and MSB to provide services to other MSBs in high-risk jurisdictions. North Dade failed to perform due diligence by evaluating the MSB's AML program and associated risks. The credit union failed to monitor or detect suspicious activity from these MSB clients.

Noted within these enforcement actions and civil suits are examples of where the know your customer (KYC) regulation practices were neglected or blatantly disregarded. KYC requirements vary among countries; however, the underlying components include the ability to capture consumer identification (which may include name, address, date of birth, or national ID) in addition to consumer identification, KYC data may also include the source of funds and the countries sending and/or receiving to help identify consumer activity within a known and identifiable pattern. Therefore, if the consumer with an identified KYC profile operates outside of the norm, the activity is noted and perhaps reported or evaluated for potential suspicious activity. In the U.S., KYC regulations do not exist for MSBs. However, the KYC concept is similar to the Customer Identification Program (CIP) where financial institutions need

[3] Paul Hastings, "Key Trends in BSA/AML Compliance: Heightened regulatory expectation as industry growth presents new challenges," April 14, 2015, www.lexology.com, accessed April 2015

[4] FinCEN, "News Room-Enforcement Actions," http://www.fincen.gov/news_room/ea, accessed July 2015.

to verify the identity of individuals wishing to conduct financial transactions with them and is a provision of the USA PATRIOT Act. CIP and KYC are imperative in a strong AML program to identify consumers and match or monitor their financial behavior to evaluate for suspicious activity.

In addition to the KYC regulation failures, failure to monitor transactions for suspicious activity or currency transaction reports (CTRs) was identified in several of the enforcement cases. Banks have been criticized for having accounts but not monitoring or sharing information across accounts. This silo behavior has impacted the knowledge sharing to report appropriately. Most MSBs are transactional; therefore, consumer information is gathered for each transaction. However, the sophistication of the larger MSBs allows the ability to recognize consumers from prior behavior and aggregate consumer activity. This analysis and information helps MSBs report on suspicious behavior and file CTRs appropriately.

The enforcement action examples above depict an overarching failure of various banks to have an AML/CTF program and violated at least one of the four pillars of an AML program. These failures brought about significant fines across the financial industry and enhanced regulatory scrutiny.

FinCEN defines MSBs as entities which deal in foreign exchange, check cashers, money order issuers, money transmitters, providers or sellers of prepaid access cards, and include the U.S. Postal Service.[5] Enforcement actions applied to MSBs more recently highlight heightened regulatory scrutiny for MSBs. Some recent enforcement actions against MSBs are:[6]

- MoneyGram's former chief compliance officer, Thomas E. Haider, was assessed a $1 million Civil Money Penalty by FinCEN for willful violations of the BSA in December 2014. As a compliance officer, Haider had been responsible for the implementation and oversight of the BSA program. MoneyGram had extensive issues related to oversight and due diligence of agents, appropriately disciplining or terminating agent relationships, as well as a failure to file timely SARs. Haider's failure to provide proper guidance and influence management in regards to discipline of agents resulted in the former chief compliance officer obtaining the fine.

- Lee's Snack Shop was assessed a Civil Money Penalty by FinCEN in June 2015 in the amount of $60,000 for willfully violating the BSA and reporting requirements. Lee's Snack Shop was an MSB since 1998. The violations reported by FinCEN include: failure to have written policies and procedures; failure to provide adequate training; failure to conduct independent testing of its compliance program; and failure to file required CTRs.

- King Mail & Wireless Inc. & Ali Al Duais received a $125,000 Civil Money Penalty by FinCEN in 2015 for violating the BSA and reporting and record keeping requests. The MSB failed to monitor, detect and report suspicious activity, failed to retain required customer identification for fund transfers of $3,000 or more, and failed to note red flags with customers. Red flags missed include transactions to high-risk jurisdictions, high-dollar amount sent, frequency of

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[5] FinCEN, "Financial Institutions," http://www.fincen.gov/financial_institutions/msb/defninitions, accessed July 2015.

[6] FinCEN, "News Room-Enforcement Actions," http://www.fincen.gov/news_room/ea, accessed July 2015.

transactions (within a day or month), failure to identify a business reason for sending money, etc. The MSB failed to monitor transactions looking for suspicious activity and currency transaction reports.

- Ripple Labs acted as an MSB by selling virtual currency and received the first civil enforcement action against a virtual currency exchanger in the amount of $700,000 in May 2015 for violating the BSA. Ripple Labs failed to register as an MSB and failed to implement an AML program to protect its products from use by money launderers or terrorist financers. To move forward, Ripple is to engage in remedial steps by complying with fund transfer rules and performing a three-year 'look-back' on customer transactions to evaluate for possible suspicious activity.

As these prior examples depict, some MSBs fail to meet the criteria for BSA reporting requirements. However, as noted in the background enforcement action examples, fines are also occurring at large banks, credit unions, etc., so a one size application of de-risking a financial category like MSBs is not the solution. The money laundering and terrorist financing risk is still not being mitigated and addressed through de-risking. As the MSB category includes check cashers, currency exchangers and money remitters, to categorize all MSBs together to de-risk provides a disservice to bank shareholders and to the spirit of FinCEN's guidance on financial institution oversight.

Problem

Regulatory scrutiny, increased enforcement actions and large monetary penalties assessed on financial institutions have resulted in banks' blanket de-risking of the MSB industry. The act of de-risking or exiting existing client relationships based on their perceived risk is not new; however, the rash application of de-risking MSBs is a short-sighted answer to AML risks.

Extent of the Problem

Terminating client relationships within a business segment or de-risking, as termed today, actually started in 2004 based on a large fine presented to Riggs Bank (now part of PNC Financial Services) for $41 million from specific AML violations.[7] The widespread application of de-risking MSB clientele globally has increased in the last few years. JPMorgan Chase has backed away from many MSB relationships based on the $461 million enforcement act against the institution in 2014. Other large global banks, including Barclays Bank PLC and HSBC Bank, have responded similarly due to Civil Money Penalties incurred or regulatory pressure to remove themselves from the areas with perceived higher risk or as regulators have expressed the MSB sector. Westpac Banking Corp., Australia's second largest lender, was the last big bank in Australia to exit the global remittance business as of March 31, 2015. The Australian global remittance market is a $450 billion dollar industry. Westpac Banking Corp's withdrawal was explained as a way to deal with rising compliance costs to support remitters.[8] The reality is that Westpac is just as concerned with possible reputation damage and the fear of constant regulatory action and, therefore, applied a blanket decision to de-risk MSBs.

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[7] Brett Wolf, "U.S. regulators decry 'derisking' practices; urge wary banks to target anti-laundering responses," Compliance Complete via Thomson Reuters. March 27, 2014, accessed June 2015.

[8] Natalie O'Brien, "Money remitter restrictions: poor and disadvantaged to be hardest hit," www.theland.com, November 16, 2014, accessed June 2015.

Responses from Regulatory Bodies

The MSB sector as a financial services provider is responsible for compliance with the BSA. FinCEN is the agency primarily responsible for administering the BSA. FinCEN Director Jennifer Shasky Calvery made remarks at the *2014 Mid-Atlantic AML Conference* regarding providing banking services to MSBs in response to de-risking by banks. FinCEN followed in November by providing an official statement on the topic. The intent of the statement was to reiterate expectations regarding banking institutions and to ensure banks are seeing the full picture and not indiscriminately terminating MSB accounts. The statement underscores the ability of banks to evaluate on a one-by-one basis the MSB accounts and apply sound judgment when determining to keep, terminate or suspend banking privileges. To quote FinCEN Director Shasky Calvery:

"FinCEN does not support the wholesale termination of MSB accounts without regard to the risks presented or the bank's ability to manage the risk. As noted, MSBs present varying degrees of risk, and not all money services businesses are high-risk."[9]

"FinCEN, as the agency primarily responsible for administering the Bank Secrecy Act, expects banking organizations that open and maintain accounts for MSBs to apply the requirements of the Bank Secrecy Act, as they do with all accountholders, based on risk."[10]

U.S. Assistant Attorney General, Leslie R. Cladwell, spoke at a Treasury Roundtable on Financial Access for MSBs in January 2015. The discussion was tailored towards transparency in the financial industry and responsibilities in terms of providing information to the Criminal Division of the Attorney General to assist in prosecution, etc. The MSB was brought up regarding two cases which involved MSBs, one being the MoneyGram case and the other a case against Belair Payroll Services Inc. Both of these cases demonstrated glaring BSA infractions and willful violations of laws. However, the Assistant Attorney General still stated the following:

"The Criminal Division does not seek to discourage financial institutions from serving money service business, or other lawful industries or businesses."[11]

"We recognize that most money services businesses, even those considered "high risk," are engaged in lawful activity, often providing critical financial services to those who may otherwise be excluded from the formal financial system."[12]

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[9]"FinCEN Statement on Providing Banking Services to Money Services Businesses." November 10, 2014, on FinCEN website, www.FinCEN.gov, accessed June 2015.

[10] Ibid.

[11] Assistant Attorney General Leslie R. Caldwell, speech given at Treasury Roundtable on Financial Access for Money Service Businesses, Washington, D.C., January 13, 2015.

[12]Ibid.

The response from regulators and governing bodies regarding this de-risking paradigm have not only been U.S. focused, as noted above. The United Kingdom's Financial Conduct Authority (FCA) has issued a statement encouraging financial institutions to use an individual approach concerning AML de-risking, as opposed to not providing services to entire categories of customers with higher money laundering risks. They have gone as far as to say banks should adopt a risk-based approach. If rationale does not exist for termination of relationships other issues will arise such as consumer protection issues.

"As a result, we now consider during our AML work whether firms' de-risking strategies give rise to consumer protection and/or competition issues."[13]

The remitter group Australian Remittance and Currency Providers Association (ARCPA) wants banks to reopen accounts with MSBs. The groups have been having candid conversations, but most recently in June 2015 the talks have failed. The ARCPA has noted the impact of this mass de-risking in the country:

"This will lead to loss of livelihoods for remitters, and also the customers they serve will be affected."[14]

How MSBs are Regulated

The MSB sector in the U.S. is not governed by the OCC; however, the reviews and level of compliance with the BSA requirements are just as particular and onerous. Banks may not fully understand or appreciate the level of regulatory scrutiny and oversight the MSB sector has. MSBs are required to be licensed, have reviews performed by governing bodies, and must comply with the stated regulations in the country or state to stay operational. Rather than banks de-risking the MSB relationship, banks should leverage these reviews to better manage the risks presented by various types of MSBs.

To operate as an MSB in the U.S. and in several countries globally (Australia, Malaysia, etc.) requires a license and registration. This process of license and registration often includes providing sound financial information, a visionary plan for the business, information on the owners and a commitment to implement an AML program to thwart money laundering and terrorist financing. MSBs operating in the U.S. and applicable global companies are evaluated by the local regulator and held to their local country AML standards.

MSBs operating within the U.S. register with FinCEN and need to be licensed in the appropriate states the business is offered. Individual states perform reviews of the MSBs based on the risk commensurate with the AML program and the state's examination schedule. The state reviews are extensive and

[13] "Derisking: Banks' management of money-laundering risk – FCA expectations," Financial Conduct Authority (FCA) Press Release April 27, 2015.

[14] Swati Pandey, "Australian remittance firms group says re-opening bank ties unlikely." www.reuters.com June 26, 2015, accessed July 2015.

comprehensive with evaluations of the four pillars of the AML program and detail testing on the sanction screening, transaction monitoring and record keeping reporting requirements.

In the U.S., FinCEN is primarily responsible for administering the BSA and performs reviews of operating MSBs. FinCEN has the authority to identify deficiencies in the BSA/AML applied program at the MSB and note violations of law. In addition, FinCEN may impose significant civil money penalties against the company or owners. FinCEN has delegated authority to the Internal Revenue Service (IRS) to perform reviews called Title 31 of MSBs under the BSA. The IRS reviews evaluate if the MSB has an effective AML program. The review evaluates the four pillars of the AML program in addition to currency reporting requirements and suspicious activity reporting by the MSB.

Impact

Banks Lose Opportunity

Banks are de-risking MSBs in response to regulatory scrutiny and noted enhanced compliance costs associated with managing accounts of MSBs.
Seventy-eight percent of survey respondents (to KPMG's AML Survey) reported increase in their total investment in AML activity with 74 percent also predicting further increase in AML investment over the next three years.[15]

Banks are rationalizing the withdrawal or termination of services to MSBs as a sound financial decision due to compliance costs in monitoring MSBs. They are removing themselves from perceived regulatory pressure and focusing on providing banking services to other industries. In retrospect, compliance costs for banks are going to continue to increase in this regulated environment regardless of the industry they are evaluating. If the banks take the time to apply a risk-based approach to clients, they would soon see all MSBs are not high risk and all food service or retail services are not moderate risk. A one-size-fits-all mentality is not a mindful approach to evaluating risk. Compliance costs continue to rise due to the complex regulatory environment in which banks operate in, the growth in consumer and business products offered and the expansion to a more global market. This rise is not solely due to banking MSBs.

Banks do have the opportunity to make profits from banking these larger MSBs. There is large volume of transactions and dollars flowing through some of these MSBs which banks can capitalize on. A report written by Cognizant on the remittance business noted, "The World Bank estimates the global remittance flow to reach $500 billion globally by the end of 2012."[16]

The banks could look into capitalizing on the remittance market and developing a program to encourage the unbanked and under banked consumers to utilize their banking services or they could leverage the existing MSB relationships and bring shareholder value through banking fees. The Cognizant report states the following: "In today's 'AA' world, where conventional revenue streams are drying up and their revenues and profitability are under pressure, banks must and will take a fresh look at the

[15]KPMG, "Global Anti-Money Laundering Survey 2014", KPMG International, 2014, www.kpmg.com/AML p. 13

[16]Anand Chandramouli, "Remittance Market: Ready and Waiting for Its 'Skype' Moment ," www.cognizant.com November 2012 report, accessed July 2015 p. 1

remittance business."[17] Banks could consider attracting this consumer base; however, the report notes, that "[b]anks are not the preferred choice for retail customers to remit money, due to hefty transaction costs resulting from steep fixed costs." In addition, "banks tend to lag MTOs [money transfer organizations] on a host of other parameters, such as speed, customer service and ease of sending and receiving money, which clients' value highly."[18] Therefore, rather than overhauling the banking business by catering to the unbanked, banks could capitalize by earning fees and interest on transactions from MSBs who manage the customers and transactions.

Countries Challenged to Meet FATF Requirements

The impact of de-risking to the financial market overall is concerning to regulators, both internationally and domestically. FATF relies on a global network of regulatory bodies to promote the effectiveness of the FATF recommendations. These FATF-Style Regional Bodies (FSRBs) assist in conducting peer reviews of countries to ascertain if the country is complying with the FATF recommendations. Failing to meet the requirements could jeopardize the financial community in countries and put additional pressure on regulators (i.e., FinCEN) for compliance with FATF recommendations. FATF is concerned in regards to the recent de-risking as it reallocates the risk in the financial industry to those less capable of managing the risk and decreases transparency of information sharing, both of which go against the goals of the regulators.[19]

Large financial institutions who have participated in blanket de-risking may feel they have removed themselves from the associated risks; however, the financial community is interconnected as demonstrated during the U.S. banking crisis of 2008. These financial institutions are responsible for upholding the FATF recommendations for their country to ensure a risk-based approach becomes the cornerstone to an effective anti-money laundering/counter-terrorist financing (AML/CTF) system where risks are properly managed. Compliance with FATF rules not only means having an effective AML/CTF program but it also means risks are appropriately managed and transparency exists in the global financial market.

Regulators Shift the Risk:

MSBs who are de-risked may choose to partner with smaller banks or local credit union; however, the risks for the small bank or credit union is likely higher as the bank may now be handling risk above their ability to monitor. As noted in the background discussion, North Dade Credit Union was implicated in BSA violations for failure to evaluate the risks associated with banking an MSB. A banking partner needs to evaluate the level of risk present and be confident it has a monitoring program in place to determine whether the risk is appropriately mitigated. Smaller banks have fewer resources, both personnel and systems, to mitigate regulatory risks. The oversight provided is limited and the understanding of the inherent risks may not be present in the smaller banks. Therefore, the credit unions and smaller banks risk regulatory scrutiny for weak oversight.

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[17] Ibid. p.5

[18] Ibid. p.5

[19] Financial Action Task Force,www.fatg.gafi.org/recommendations, FATF Standards 2012

Decrease of Transparency in Remittance Market

One critical component of the BSA consists of the information sharing practices and transparency. FATF also stresses transparency within their recommendations. Financial institutions have been seen as invaluable sources of information for law enforcement. The banks and MSBs are often seen as the front line against fraudsters and money launderers. Banks and MSBs provide value in the CTRs and SARs, which are filed by each party. MSBs often touch a different segment of the consumer population; therefore, if proper monitoring of these services are provided, information can be shared with local law enforcement, etc. If banks shut down the MSBs through termination of banking relationships, the MSB can no longer provide feedback to law enforcement. FATF regulatory bodies and local regulatory organizations including FinCEN are interested in this dynamic behavior and strongly support banks applying a risk-based approach to MSBs rather than blanket de-risking to ensure continued transparency in the remittance network.

Blanket de-risking of MSBs may result in MSBs closing or no longer being available to consumers in certain countries. MSBs often reach the unbanked consumers who are migrants working in foreign countries sending money home to the family. Without the ease and reliability of a MSB, the consumers will often turn to using hawalas. Hawalas are informal value transfer systems which assist in transferring money. Challenges exist within the hawala system when exchanging money. The reliance on the honor system and the physical exchange of money is not documented. The hawala money movement limits transparency of money exchange to law enforcement and regulators increasing the risks of money laundering and terrorist financing within the underground market. Banks are not responsible for this activity; however, regulators, government officials and politicians care tremendously about funds leaving the formal banking system as it jeopardizes the sanctity of the financial institution. Regulators must evaluate how they communicate their concern for oversight of the MSB industry with the banking response of blanket de-risking. The regulator's goal is ensuring the financial market for money remittance is still visible.

Banks are de-risking in response to harsh criticism and regulatory scrutiny from regulators. Banks are losing out on opportunities to serve MSBs and boost shareholder value. This de-risking phenomenon is not addressing regulator's concerns in terms of protecting the financial markets as it moves the money underground. Regulators need to evaluate how they evaluate banks and their risk-based approach ensuring government's transparency and a view of transactional activity globally.

Ramifications

As identified from above, blanket de-risking of MSBs impacts transparency in financial institutions. MSBs provide services to underbanked and unbanked consumers and terminating these relationships impacts many consumers globally and moves funds underground. Consumers who are already in distress have reliance on money transfers and financial remittance. The reality is de-risking affects the global economy and is not only an issue regarding AML. As a Somalia citizen suggested in their country, "Most people literally rely on [remittances] to put food on the table or to pay school fees or medical bills."[20]

As global citizens, regulators need to be more receptive to banks applying a risk-based approach in regards to their clients. Their inability to see the impact of pressuring banks to avoid high-risk industries touches citizens all over the world. MSBs often operate in countries designated as high-risk jurisdictions, countries with cash as the dominant financial instrument, and countries where banking systems have ceased to exist. On the core this operating strategy appears high risk and reason alone for banks to withdraw from the banking relationships with MSBs. However, once you remove the fear of regulatory scrutiny, allow banks to apply their due diligence to MSBs and place more reliance on the oversight regulators have on MSBs, the risk may be manageable. The world is uncertain and has unjust behaviors, but it hurts humanity to abandon consumers in countries where the government has collapsed or the markets are unstable, or where they are experiencing civil war or an uprising. Some of these countries in need have heavy reliance on money remittances to operate and for their gross domestic product. For example, money transfers are estimated to account for 40 percent of Somali's gross domestic product, more than all international aid and foreign investment combined.[21] Other countries are in need of aid and rely on aid organizations receiving funds from money transfer companies. Profit is not the goal of these aid organizations. Their purpose is to provide for the betterment of the individual by providing food, water, health and educational funding to improve the opportunity. To turn away these consumers from the financial system seems immoral.

In addition to impacts on humanity, de-risking presents challenges to the financial industry. The challenges include banks losing out on possible revenue opportunities, MSBs closing and pushing the remittance business underground and regulators losing knowledge necessary to impede money laundering and terrorist financing. The reality is FinCEN and state regulators have been improving their oversight of MSBs since 2005 and through this oversight the AML programs have been improving. Regulators need to acknowledge this growth in the oversight and educate banks on how to apply a risk-based approach to their AML program.

Regulators continue to debate the de-risking topic and they have made clarifying statements, as noted in this report, asking banks to apply a risk-based approach. However, the regulators have not been outright supportive of the banks for banking MSBs as they have only stressed to banks the risks in MSBs. FATF has previously identified certain sectors (i.e., MSBs) at risk for money laundering and terrorist financing. However, it has yet to be proven that the MSB category is more risky than the banking category. As depicted in the earlier graph, more banks have been prosecuted over the last few years than MSBs. The absence of facts and the regulatory pressure has placed banks into this de-risking situation. A more vocal regulatory body which is open to educating banks on the MSB program, the inherent MSB risks and the regulatory oversight of MSBs, should prevail to address the de-risking debate.

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[20]Don Boroughs, "Why Somali grandma and aid workers may be short on cash," www.npr.org, April 22, 2015, accessed June 2015.

[21] Ibid.

Solutions

Addressing the de-risking debate is paramount to the success of many MSBs; however, seeing banks applying caution in the current regulatory environment is understandable due to the regulatory environment and the fear of scrutiny applied by examiners. Regulators need to support banks who provide services to MSBs to ensure transparency and the sanctity of the financial market. As noted previously, the MSB sector is as regulated as other financial industries for compliance with the BSA.

Risk-Based Approach

Banks should be applying a risk-based approach to their due diligence and KYC of MSBs. Banks would benefit by learning the MSB industry, evaluating their relationships and by understanding the risks present before making a decision. A risk-based approach is applied by understanding the entity, the environment, and risks present to rate customer/business partners into different risk classes. Just as all banks are not the same, all MSB companies are not the same and the level of risk and sophistication in regards to the AML compliance program varies. The regulators and banking partners need to become more educated on the MSB risks to ensure a sound decision is made. Applying a risk-based approach is good business and provides rationale for decisions made either to de-risk or to continue partnering with the MSB.

Risk-Based Approach

"By adopting a risk-based approach, competent authorities and MSBs are able to ensure that measures to prevent or mitigate money laundering and terrorist financing are commensurate to the risks identified. This will allow resources to be allocated in the most efficient ways. The principle is that **resources should be directed in accordance with priorities so that the greatest risks receive the highest attention**." *Risk Based Approach: Guidance for Money Services Businesses* (July 2009), at para. 14. www.fatf-gafi.org.

Independent Review

As identified in the background, violations of the BSA by banks and MSBs have continued. This has regulators and shareholders concerned with the failures and understanding how these translate to their own bank or MSB. One of the pillars of the AML program is the independent review. Often the independent review of an MSB is performed by internal or external audit. It is the job of the auditor to ensure the program is reviewed and issues are identified. Auditors must perform comprehensive reviews which are timely to provide feedback to the business on the program.

The banks and regulators need to understand reviews are being done on MSBs by qualified auditors. Regulators and banks can and should evaluate the internal or external audit functions to place reliance on the work performed and the ability of the audit function to communicate gaps to the business. The auditor's training, experience, certification, and level of independence and reporting should all be considered when evaluating the qualifications of an auditor.

Audit reviews for MSBs focus on the regulatory requirements and on the pillars of the AML compliance and are typically comprehensive. Highlights of the types of items reviewed are noted here:

Designated Compliance Officer – Auditors should evaluate the background, expertise and knowledge of regulations of the assigned BSA compliance officer. In addition to the individual's qualifications, the roles, responsibilities, authority and management oversight of the AML program should be evaluated. Beyond the compliance officer it is important to understand the governance program and the communication, delegation and ownership of tasks completed for the AML program.

Training – Auditors should evaluate the training program, including the content of the training and to whom training is deployed. As a standard, employees at the MSB should receive training on their role in the AML program. Therefore, if the individual is performing suspicious activity reviews, they should be provided basic AML training and specialized training to ensure they are knowledgeable of the risks and the regulatory requirements. In addition to the employees, audit evaluates training delivered to board members. Board member training informs them of the regulatory requirements, how the company meets these requirements and the risk associated with the program. In this manner, the board can be supportive or ask questions of decisions in regards to the AML program. In addition, the board will be informed of the AML program, so they can apply an appropriate risk appetite in regards to products, consumers, geographies, etc.

Internal Controls – The internal controls pillar is broad and encompasses the policies, procedures and processes designed to detect, prevent, limit and control money laundering and terrorist financing risks. The bulk of the audit work performed resides under the internal controls pillar. Critical areas reviewed by audit include the following: verification of customer identity, monitoring transactions, filing of required reports, and agent oversight.

- Verification of Customer Identity – One of the areas of concern regarding MSBs is the nature of the transactions and the identity of the consumer, as noted in some countries as KYC. "Seventy percent of respondents (to KPMG's AML survey) stated that they had received a regulatory visit which focused on KYC."[22] Audit is charged with evaluating how the MSB meets the regulatory requirements in terms of consumer identification and KYC.

> *"Sixty percent of respondents (from KPMG's annual AML survey) reported transaction monitoring as the largest investment in anti-money laundering controls." Global Anti-Money Laundering survey, KPMG International, 2014*

- Monitoring Transactions – Critical to law enforcement and to the health of the financial industry is monitoring transactions for suspicious behavior or for regulatory reporting. Auditors typically review the process and procedures for transaction monitoring, which includes identification, research and reporting. The extent of review performed considers the volume of transactions and overall risk profile of the MSB. In addition to monitoring the corporate MSB, audit may evaluate how transactions are monitored at the agent level. Auditors should evaluate the model

[22]KPMG, "Global Anti-Money Laundering Survey 2014", KPMG International, 2014, www.kpmg.com/AML p. 25

used and thresholds applied to ensure it is operating as designed and generating transactions requiring review.

- Filing of Required Reports and Record Retention – The MSB AML program must meet regulatory requirements and ensure all appropriate records are retained. One component of these regulatory requirements is timely filing of SARs and CTRs. Auditors evaluate the process to ensure timely and accurate reporting.

- Agent Oversight – Depending on the agent model deployed there are several lines of defense in regards to evaluating agent behavior and agent activity. The first line of defense (using audit terminology) is the agent's AML program and how the agent operates to ensure compliance with the BSA. The agent's second line of defense would be their independent reviews conducted on their AML program. The third line of defense is the Master MSB who performs risk-based reviews of agents. These reviews evaluate the agent's customer base, the level of expertise the agent has, how the agent stays informed and trained on AML, how the agent evaluates and reports suspicious activity, and how the agent has implemented an AML compliant program. These Master MSB reviews help identify red flags and areas for follow-up. The auditor of the Master MSB may also review agents or review the agent oversight program, which AML compliance has implemented. Lastly, as noted in the background, MSBs are licensed entities and, as such, may receive Title 31 reviews by the IRS. These Title 31 reviews are to evaluate the AML program at the agent site to ensure the four pillars are representative and operating. The rationale is there are several lines of defense and levels of review which can be leveraged to help understand the control environment at agent locations.

Banks need to leverage the oversight of MSBs by regulatory bodies and by the independent reviews as noted above to support their risk-based approach. Banks considering a risk-based approach should analyze the MSBs in regards to the type of AML program they have in place, the levels of regulations which they are responsive to and the quality of review performed by the internal or external audit departments.

Banks Due Diligence and KYC

To support a risk-based approach, banks should perform a review of the MSBs AML program. Banks should consider the following items when conducting their review of the AML program:

1. Obtain an overview of the AML program, including recent changes in the program, long-term projects or compliance spending.
2. Obtain a list of AML management, their experience, background, and credentials as well as understand the governance around the AML program for approvals and changes.
3. Obtain an understanding of the products and geographies and agent base of the MSB.
4. Evaluate the independent review or interview the audit team to understand the scope, coverage, areas of concern or findings identified, reporting structure and independence.

5. Perform external research on the MSB for enforcement actions, civil money penalties, or other negative news related to the MSB or MSB agents.

MSBs need to be supportive of the banks requests to understand the AML program and their desire to meet and interview appropriate personnel behind the AML program. If banks obtained this level of support and communication, the banks would be able to make informed decisions in regards to banking MSBs.

Conclusion

In conclusion, regulators want to thwart money laundering which is not accomplished through de-risking, as transparency is lost when funds go underground through closure of MSB relationships. Banks are de-risking MSBs as a response to regulatory scrutiny and from a poor understanding of the regulations and reviews performed of MSBs. Regulators need to rely on existing laws and global regulations which speak to performing due diligence and stringent monitoring of high-risk clients as part of a risk-based approach. Banks need to leverage the same laws and global regulations when evaluating MSBs to capitalize on banking this industry.

Banks should recognize MSBs not only carry the risk, but they are managing the risk by implementing AML programs. If banks leveraged the regulatory oversight and independent reviews in their due diligence, they would come to understand large sophisticated MSBs operating today are well suited to monitor the money remittance business.

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