

2018 Bank Regulator Panel

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Pages 4-11, 41

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Pages 12-24, 42

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Pages 25-26

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Agenda

- **Banking Marijuana and Related Businesses**
- **Risk Assessment**
- **Independent Testing Tips and Best Practice
MSB's Hot Topics**
- **Beneficial Ownership**

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Banking Marijuana and Marijuana Related Businesses

Banking Marijuana and Marijuana Related Businesses

The History of Cannabis

- 1) Medicinal Usage
- 2) Recreational
- 3) Hemp

Prohibition

- a) Harry Anslinger, Federal Bureau of Narcotics
- b) Marijuana Tax Act
- c) Controlled Substances Act
 - Tricky Dick
- d) Recent Executive Branch
 - Clinton, Bush, Obama and Trump

Risk Assessment – Regulatory Guidelines

The State Movement

- a) Late 70's and Early 80's
- b) CA Proposition 215
- c) Current State Environment 2018

Regulatory Environment

- a) Cole Memo
- b) FinCEN FIN-2014-G001 BSA Expectations Regarding MRB's
- c) CA Department of Business Oversight
 - Position, Exam Findings, Enforcement Efforts

Examination Considerations – MRB Program Governance

- Does the bank have adequate board-approved policies and procedures in place as to how to handle marijuana accounts and monitor for red flags?
- Has the Board established appropriate risk-based pricing standards for MRB deposit and loan accounts?
- Has the Board set appropriate limits to this program? (i.e. type of licensees [producer, processor, and/or retailer] accepted, number of accounts accepted, total amount allowed to be deposited, amount and types of loans, etc.)
- Does management have a contingency plan which includes an exit from the business should there be a change in the policies and forbearances from the Federal and State governments?

Examination Considerations – MRB Program Governance

continued

- Is there a comprehensive risk assessment of the business line?
- Has the bank considered and addressed the practicalities of cash management, including the facility's capacity and security issues associated with handling greater amounts of cash than with other merchants?
- Does employee BSA training include sufficient detail on marijuana-related BSA risks and is the coverage commensurate with the bank's involvement in the industry?
- Does the bank have the staffing resources necessary to perform sufficient due diligence and ongoing monitoring on the MRB accounts, particularly given the size, nature, and risk inherent in the individual customers?

Examination Considerations – MRB Program Governance

continued

Lending

- Does the independent loan review appropriately test adherence to the bank's policy on lending to MRBs?
- Under what circumstances do the provisions in the loan and collateral documents contain requirements that the financial institution can accelerate the loan terms and call the balance due and payable?
 - I.e. MRB loses its license, runs counter to the Cole Memo requirements, or engages in activity that triggers red flags listed in the FinCEN guidance, etc.
- Does the ALLL methodology consider the inherent credit risks associated with MRB borrowers?

Examination Considerations – MRB Program Governance

continued

- Does the bank take steps to prevent the furtherance of any violation of the Cole Memo, including notice to the customer to halt the offending activity or evict a violating tenant?
- Did the bank perform a legal review of applicable federal and state laws, including seizure of property and forfeiture/subordination of collateral?

Examination Consideration – Regulatory Reporting

- Has management considered participation in 314(b) – Voluntary Information Sharing. If so, have policies and procedures, and processes been developed?
- Does the bank's BSA Policy prohibit the exemption of MRB customers for currency transaction reports (CTR) filing purposes?
- Is the bank filing CTRs on MRB customers in accordance with existing regulations and with the same thresholds?
- Is the bank filing SARs on MRB customers in accordance with the 2014 FinCEN guidance?
- Does the content of marijuana-related SARs include all of the contents as required by the 2014 FinCEN guidance?

Risk Assessments

Risk Assessments – *Basic Regulatory Guidelines*

BSA Exam Manual – “A well-defined risk assessment assists in identifying the bank’s BSA/AML risk profile. Understanding the risk profile enables the bank to apply appropriate risk management processes to the BSA/AML compliance program to mitigate risk”

- What does this really mean?
- What am I required to do?
- What makes a good risk assessment and should it be worth investing some time in?
- What have you seen that has worked and hasn’t worked?

Risk Assessments - *Minimum Regulatory Expectations when Developing a Risk Assessment*

FFIEC BSA/AML Examination Manual ○ Appendix J - *“Banks and examiners may use the following matrix to formulate summary conclusions. Prior to using this matrix, they should complete the identification and quantification steps detailed in the BSA/AML Risk Assessment Overview section at page 18 of this manual.”*

- *Page 18 - “The development of the BSA/AML risk assessment generally involves two steps: first, identify the specific risk categories (i.e., products, services, customers, entities, transactions, and geographic locations) unique to the bank; and second, conduct a more detailed analysis of the data identified to better assess the risk within these categories.”*

Risk Assessments – *Smaller Banks (with lower risk)*

A risk assessment would:

- Identify Inherent Risks for: Clients, Products/Services, Entities, Transactions, and Geographies
- Use supporting data that is applicable to the bank's size, complexity and risk profile
- Be utilized to develop a program that adequately addresses said risk profile (Refer to Appendix I of BSA Exam Manual)
- Be updated every 12-18 months, but more frequent measures may be warranted based on underlying risks or significant events
- Be reviewed for reasonableness by Audit

Risk Assessments - *Larger Banks (or banks with higher risk)*

A risk assessment would include:

- Inherent risks for: Clients, Products/Services, Entities, Transactions, and Geographies
- Data utilization to support the identification of risk in the above categories will typically be robust in nature
- Ongoing utilization as a tool to develop a program that adequately addresses said risk profile (Refer to Appendix I of BSA Exam Manual)
- Application to how these risks and controls impact the bank's business lines, operational areas, and related legal entities
- An annual update, but more frequent measures may be warranted based on underlying risks or significant events
- A review for reasonableness by Audit

Risk Assessments – *Why?*

Why should I invest time in a quality Risk Assessment?

- Being confident in knowing, more specifically or concretely, what is going on at the bank to:
 - Identify Risk
 - Manage/Mitigate Risk
- Avoid significant regulatory criticism or enforcement action
 - Under-identified or unidentified risk
- CMPs or fines tend to involve either willful acts or willful blindness.
 - The latter can be combatted with an appropriate risk assessment and mitigating factors built from that (i.e. controls, training, staffing, technology, etc.).

Risk Assessments – *How Step 1*

How (not the traditional ‘How’ info from regulators):

Step 1 is making friends with the people in the bank who can get you Data.

Identify what you have access to and what you want...if you find that there is missing key data, that can be a potential red flag of:

- CDD/EDD and Client Risk Rating processes, and/or Suspicious Activity Monitoring processes perhaps not being designed appropriately; or
- Unorganized, behind-the-scenes data management or data structures that aren't designed to help business lines use info that the bank is already gathering

Risk Assessments – *How Step 2*

Step 2 is determining if your data is comprehensive and accurate, and can you expand your reach?

- Data integrity is critical to ensure a risk assessment is supportable.
- Always pushing data management personnel/contacts by asking questions can be helpful to show them what you need.
 - Conversely, it allows them to show what they can provide.
- This translation may be beneficial for both parties for more than just a BSA Risk Assessment – it could lead to new vehicles for on-going data use

Risk Assessments – *How Step 3*

Step 3 is gathering your key data in a format that makes sense to you

For clients – NAICS or nature of business? HR, MR, and LR? Tenure? Categorical HR clients? Niche Clients? Exception/Prohibited Clients? Auto HR clients?

For transactions – transaction types and volumes? HR, MR, LR types and volumes? Transactions by NAICS/Occupation? Transactions to/from geographies? Largest transaction types by client, branch, business line?

For geographies – Out of market clients? International clients? Geography of Transactions (Domestic/Int'l)? Domestic HR Geographies? HR Country Lists/Tools?

Risk Assessments – *How Steps 4 and 5*

Step 4 is taking this supporting data and putting into a usable and reasonable format for what your bank is trying to accomplish (i.e. ID risk and build controls).

- May be the Appendix J matrix; May be a narrative; may be a blend of narrative, spreadsheet, matrix, and graphs; etc.

Step 5 is taking this material and putting it into a readable and meaningful format for the Board or a Committee thereof.

- Bringing forward previously unknown or under-identified risks; gaps in internal controls; opportunities to expand risk; confirmation of risks; etc.
- Highlighting significant changes or speaking to how strategic plans may impact a significant area of risk.

Risk Assessments – *Common Challenges*

- A clear methodology or plan that fits the bank's specific needs
- Clean Data
- Data that tells the story
- Data that tells a story within a story
- Multiple Years of consistent implementation
- Incorporate your controls – don't forget to heavily leverage audit and exam results

Risk Assessments - *Commonalities for challenges*

- Fitting a templated methodology without tailoring to the bank
- Not using Data
- Using Incomplete or inaccurate data
- Not considering critical controls with more weight
- Not considering Audit or Examination results for controls

Risk Assessments – *Anecdotal Experiences*

The quality of a risk assessment and the use of data to create a truly meaningful product is NOT exclusive to large banks.

- The best risk assessment methodology and product that I've observed was at a bank holding company with numerous non-bank subsidiaries and an \$18 billion dollar bank.
- The second best risk assessment methodology and product that I've observed was at a bank with under \$100 million in total assets.
- The risk assessment with the most flaws that I've observed was at a bank holding company with numerous nonbank subsidiaries and a bank with well over \$50 billion in total assets.

Darlene James, OCC

Independent Testing and Money Services Businesses

Independent Testing Tips

Independent Testing Best Practice

MSB's Hot Topics

The content of this presentation does not reflect the views or opinions of the Office of Currency Comptroller.

FinCEN Customer Due Diligence Rule: Understanding the Final Rule

FinCEN Customer Due Diligence Rule: Understanding the Final Rule

May 2016, FinCEN published a final rule that will require financial institutions to collect beneficial ownership information from legal entities at account opening beginning May 11, 2018.

- The Final Rule does not impose a categorical, retroactive requirement on collecting beneficial ownership information on accounts opened prior to May 11, 2018.
- Verification of identity of the beneficial owners should be in accordance with risk-based procedures and contain the elements currently required under the Customer Identification Rule.
- The financial institution may comply either by obtaining the required information on the standard certification form template FinCEN provided in Appendix A of the Final Rule. However, the Final Rule also permits financial institutions to obtain the information by other means, provided that such means include the certification of the natural person opening the account that is required by the standard certification.
- Financial institutions may rely on the beneficial ownership information supplied by the customer, provided that the institution has no knowledge of facts that would reasonably call into question the reliability of the information.

Benefits of the Rule

For Law Enforcement

- Transparency is less attractive to criminals.
- Providing inaccurate information demonstrates unlawful intent.
- Generates leads to identify additional evidence or co-conspirators.

For Financial Institutions (FIs)

- Improves FI's ability to assess and mitigate risk and comply with existing requirement, including the BSA and related authorities

For Tax Compliance

- Facilitates tax reporting, investigations and compliance.

Broader three-part strategy by Treasury Dept. to enhance financial transparency of legal entities.

Four Key Elements of Customer Due Diligence

There are four key elements of Customer Due Diligence:

- I. Customer Identification and Verification
- II. Beneficial ownership identification and verification

} **Current CIP**

} **NEW!** 31
CFR 1010.230

Appropriate risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:

- III. Understanding the nature and purpose of customer relationships to develop a customer risk profile; and
- IV. Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk-basis, to maintain and update customer information

**Amends BSA
"5th Pillar"**

} Viewed as restating existing expectations [31 CFR 1020.210]

I. Customer Identification and Verification

Existing requirement under Customer Identification Program (“CIP”) requirements [31 CFR 103.121].

Name

Date of birth

Address

Identification number

- (i) For a U.S. person, a taxpayer identification number; or
- (ii) For a non-U.S. person, one or more of the following: a taxpayer identification number; passport number and country of issuance; alien identification card number; or number and country of issuance of any other government-issued document evidencing nationality or residence and bearing a photograph or similar.

II. Beneficial Ownership Identification and Verification

- i. Must identify and verify the identity of beneficial owners of all legal entity customers (other than those excluded) for each new account at the time the new account is opened (other than accounts that are exempted).
- ii. Verification of identity of the beneficial owners should contain the elements required for verification under CIP, but FIs may rely on copies of IDs provided by the person opening the account.
- iii. FinCEN provided an optional Certification Form in Appendix A of the Final Rule. FIs may choose to comply by using the sample Certification Form, using the institution's own forms, or any other means that complies with the substantive requirements of this obligation.
- iv. May rely on beneficial ownership identification supplied by the customer, provided FI has no knowledge of facts that would reasonably call into question the reliability of the information.

IV. Ongoing Monitoring

- i. Customer information includes beneficial ownership information.
- ii. All accounts must be monitored on a risk-based approach (not just those subject to the final rule).
- iii. Updates to beneficial ownership should be event-driven as part of normal monitoring, not as a categorical requirement on a continuous or periodic basis. Applies to all legal entity customers, including existing customers.
- iv. FinCEN acknowledges: change in beneficial ownership is unlikely to be identified through transaction monitoring.

Who is the Beneficial Owner?

Ownership Prong

- i. Individual (persons, not entities) that own directly or indirectly 25% or more of equity interest of a legal entity customer.
- ii. FinCEN “does not expect FIs or customers to undertake analyses to determine whether an individual is a beneficial owner under the definition.”
- iii. Not obligated to determine or inquire if ownership has been structured to avoid tripping the 25% level, but SAR may be appropriate if you determine the owners did.
- iv. If no one meets the 25% ownership level, no beneficial owner needs to be identified under the ownership prong.
- v. Trustee is considered “owner” if trust owns 25% or more of equity interest.

Who is the Beneficial Owner?

continued

Control Prong:

One person with significant responsibility to control, manage, or direct the company.

Managerial control, not administrative control. Not just the first 'titled' individual available.

Even if no one meets the 25% ownership prong, you must always identify one beneficial owner under the control prong.

Certain legal entity customers are subject only to the control prong of the beneficial ownership requirement:

Charities and Nonprofits

Non-excluded pooled investment vehicles (i.e. non-US mutual funds, hedge funds, private equity funds)

Screening of Beneficial Owners

OFAC

Q. Are financial institutions required to comply with the OFAC regulations with respect to beneficial ownership information?

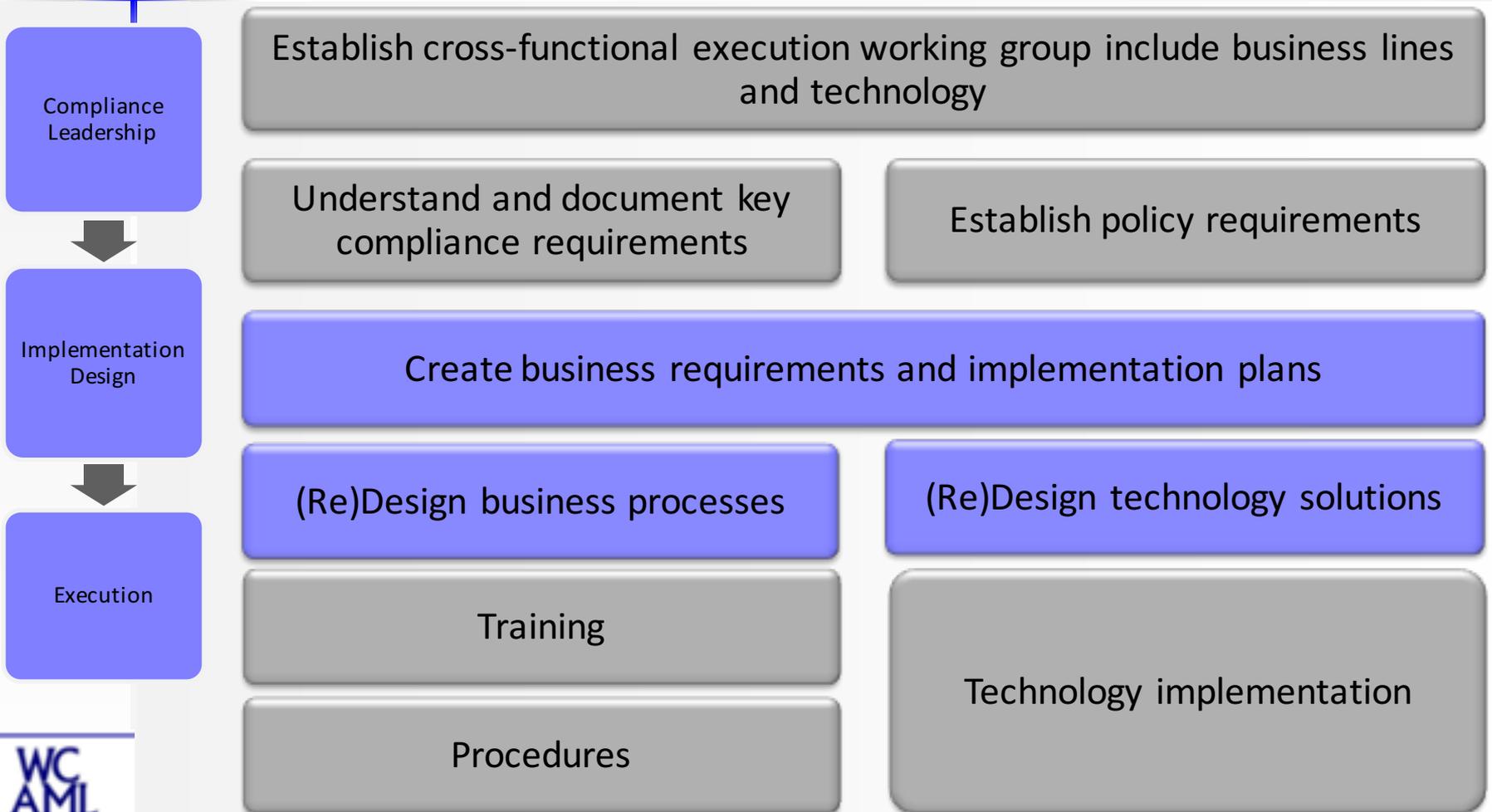
A. Yes, requirement to block property and interests owned more than 50% by an SDN so FIs generally should scan.

314(a)

Q. Do FIs now have additional obligations under Section 314(a) Information Sharing for beneficial ownership information?

A. No, the regulation implementing section 314(a) does not require the reporting of beneficial ownership information associated with an account or transaction matching a named subject in a 314(a) request. As such, FinCEN does not expect this final rule to impose additional requirements under 314(a).

Implementation Approach Example



Regulatory Examination Expectations: Post - May 11, 2018

Regulators will:

Examination Procedures for the CDD Final Rule that are currently being finalized by Regulators and should be issued in the coming weeks.

Key Takeaways

Beneficial Ownership

The Rules Provide a Floor—not a Ceiling. While regulators expect all financial institutions to comply with the new minimum requirements set forth in the rules, organizations can opt to apply higher beneficial owner standards, and in cases of high risk, primary federal regulators may expect such higher standards.

The Rules Are Not Retroactive. Financial institutions are not obligated to identify beneficial owners for accounts existing prior to the compliance deadline. However, in the course of monitoring existing accounts, if the institution learns information about beneficial owners of a customer that may be relevant to assessing or reevaluating risk, then the beneficial owner information should be collected and their identities should be verified at that time.

There Will Always Be a “Controlling” Individual. There are two prongs to the beneficial ownership requirements. First, the customer needs to identify any owners of 25% or more of the equity interests of the legal entity. There may be no owners that meet this threshold. Second, the customer must identify a single individual with “significant responsibility to control, manage, or direct a legal entity customer,” which may or may not be one of the owners. The customer must always identify a control person under this prong, regardless of whether any 25% owners are identified.

Key Takeaways

Beneficial Ownership

Use of the Certification Form Is Optional. The rules include a “Certification Regarding Beneficial Owners of Legal Entity Customers” for collecting beneficial ownership information from customers. Use of this form is not mandatory, nor does it provide a safe harbor. Institutions may collect the required information by whatever means they choose, as long as the individual completing the form certifies, to the best of his/her knowledge, the accuracy of the information.

Institutions Need to Verify the Individual’s Identity, Not Status. Financial institutions do not need to independently verify that the individuals named as beneficial owners are actual beneficial owners of the entity. The institution can rely on the customer’s identification of these individuals, provided the institution has no knowledge of facts that would reasonably call into question the names the customer gave. However, the institution does need to verify the identities of the individuals the customer name

Key Takeaways

Marijuana and Marijuana Related Businesses

a) Best Practices for Banking MRBs

- Basic BSA tenets...KYC/CDD/EDD/SAM
- Know your customers and their customers
- Follow the Cash
- No Exceptions
- De-risking and

b) Resources

- Weedmaps
- State and/or Local Authority (CA Bureau of Cannabis Control)
- MJ Business Daily

c) Models

- Safe Harbor Private Banking – Partner Colorado CU

Key Takeaways

Risk Assessments

The Risk Assessment process is one of the most critical internal control functions to protect a bank from regulatory criticisms, citations for violations of law, and enforcement actions.

Ensuring a Risk Assessment utilizes appropriate data is a crucial component to ensuring the conclusions are sound and well-supported by facts.

FAQs

Thank You