

Federal Bank Secrecy Act Issues for Mobile Payment Systems

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Andrew J. Lorentz, Partner
Washington, D.C. Office

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The BSA from 30,000 Feet

The BSA from 30,000 Feet

- Intent of the BSA is to **abate money laundering**
- Major Provisions
 - 3 R's: Registration, Record-Keeping and Reporting
 - Requires Anti-Money Laundering (“AML”) programs – the “Four Pillars”
 - Criminalizes money laundering
- BSA Timeline
 - Enacted in 1970
 - Money laundering criminalized in 1986
 - Major expansion in 2001 under USA PATRIOT Act

The BSA from 30,000 Feet

Application of the BSA

- Applies to “financial institutions”
- Defined in FinCEN regs as:
 - Banks and other depository institutions
 - Money Service Businesses (“MSBs”)
- Other financial institutions
 - Brokers or dealers in securities
 - Casinos and card clubs with revenues > \$1 M

The BSA from 30,000 Feet

The (Many!) BSA/AML Regulators

- **FinCEN**
 - BSA administrator, promulgates regs; reviews SARs; exam manual for MSBs
 - **IRS**
 - Examines AML processes of MSBs; reviews CTRs
 - **FFIEC – Federal Financial Institutions Examination Council**
 - Federal Reserve, OCC, FDIC, NCUA, CFPB, State Liaison Committee
 - Creates BSA/AML Examination Manual for banks
 - **Federal Banking Agencies**
 - Bank chartering: OCC and NCUA
 - Insurance: FDIC and NCUA
 - Examine AML processes of banks, credit unions and S&Ls
 - **OFAC – Office of Foreign Asset Control**
 - Not BSA, but same FFIEC exam manual and similar exam procedures
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The BSA from 30,000 Feet

BSA Reports

- **CTR** - Currency Transaction Report
 - Filed for each deposit, withdrawal, exchange of currency, or other payment or transfer, by, through or to a financial institution, which involves a transaction in currency \geq \$10,000 in same business day
 - \$10,000 in 1970 \rightarrow \$59,000 in 2012 dollars
 - FinCEN Form 104 for banks and MSBs
- **SAR** - Suspicious Activity Report
 - Filed with FinCEN within 30 days of detection of activity
 - Required if transaction has no apparent business purpose or is not the sort that customer is expected to engage (KYC!); or derived from illegal funds or designed to hide origin of funds
 - Judgment call - suspicious activity varies by context
 - Confidentiality required – reg (Jan. 2011) and advisory (Mar. 2012) clarify scope

The BSA from 30,000 Feet

BSA Reports (continued)

- **CMIR** - Report of Int'l Transportation of Currency or Monetary Instruments
 - Applies to any person who physically ships, transports, or mails currency or other monetary instruments into or out of US; \geq \$10,000
 - FinCEN Form 105; file w/Bureau of Customs & Border Protection
 - Pending FinCEN rulemaking
- **MIL** — Monetary Instrument Log
 - Log of cash purchases of monetary instruments (money orders, traveler's checks, etc.) between \$3k - \$10k inclusive
 - Kept on record at financial institution and maintained for 5 years
 - Must be produced at request of examiners

The BSA from 30,000 Feet

BSA Reports (continued)

- **FBAR** - Foreign Bank Account Report
 - Applies to any person with bank account, securities, or financial account in foreign country with value \geq \$10,000 at any point during year
 - Annual filing with Dept. of Treasury
- **DOEP** - Designation of Exempt Person
 - Filed biennially to designate exempt customer for CTRs
 - For banks only

The BSA from 30,000 Feet

The “Four Pillars” of AML Compliance

- Internal Controls: policies, procedures and controls reasonably designed to assure compliance
- Designated compliance officer
- Ongoing employee training program
- Independent Review - audit function to monitor and test programs

The BSA from 30,000 Feet

Penalties for BSA Violations

- Criminal - 31 U.S.C. § 5322
 - Willful violations: fine \leq \$250,000 and/or prison \leq 5 years
 - Pattern of illegal activity: fine \leq \$500,000 and/or prison \leq 10 years
- Civil - 31 U.S.C. § 5321
 - Willful violations: fine of not more than the greater of the amount of the transaction (not to exceed \$100,000) or \$25,000
 - Failure to file a report: fine \leq \$10,000
 - Negligent violations: fine \leq \$500
 - Pattern of negligent violations: fine \leq \$50,000
 - Civil penalties may be cumulative with criminal penalties
 - Individuals can be removed from banking - 12 U.S.C. § 1818(e)(2)
- Failure to register/obtain license as Money Transmitter
 - Fine \leq \$5,000 per day – 31 U.S.C. § 5330
 - Prison \leq 5 years – 18 U.S.C. § 1960

The BSA from 30,000 Feet

Penalties for Money Laundering

- Laundering of Monetary Instruments - 18 U.S.C. § 1956
 - Illegal to engage in transaction with proceeds from specified unlawful activities (“SUAs”)
 - Requires knowledge and specific intent
 - Prison \leq 20 years; fine \leq \$500,000
- Engaging in Monetary Transactions with Property Derived from SUAs - 18 U.S.C. § 1957
 - prohibits spending \geq \$10,000 derived from SUA regardless of any attempt to disguise
 - no specific intent required
 - Prison \leq 10 years; fine \leq \$250,000

ABCs of the BSA for MSBs

The BSA for MSBs

	Depository Institutions	Money Transmitters	Agents of Money Transmitter*	Providers of Prepaid Access	Sellers of Prepaid Access
Registration	X	X		X	
Records	X	X	X	X	X
Reports					
SARs	X	X	X	X	X
CTRs	X	X	X	X	X
CMIRs	X	X	X	X	X
Others	X				
AML Program	X	X	X	X	X

* Principals and agents may allocate responsibility but both are responsible for compliance.

The BSA for MSBs

MSBs in mobile payments

- Money transmitters and their agents
- Providers of prepaid access
- Sellers of prepaid access
- Other MSBs
 - Currency dealers/exchangers
 - Check cashers
 - Issuers/sellers of traveler's checks or money orders;
 - U.S. Postal Service
- Exclusions: banks, securities dealers, < \$1000/day, natural person + infrequent + not-for-profit

The BSA for MSBs

Money Transmitter - defined

- How do I become a money transmitter?
 - By accepting currency, funds or other value that substitutes as currency, and
 - Transmitting currency, funds or other value that substitutes as currency to another location or person by any means
- Any person who engages as a business in the transfer of funds is a money transmitter *regardless of the amount transmitted*
- Facts and circumstances determine whether an entity's business causes it to be a money transmitter
- Exclusions:
 - Persons who transmit funds integral to *bona fide* sale of goods/services
 - Providers of communications or network access services

The BSA for MSBs

Money Transmitter – BSA Requirements

- Registration
 - Required with FinCEN (Form 107); renewal every 2 years
 - Failure to register can result in fine \leq \$5,000 per day and/or up to 5 years in prison
- Record-Keeping
 - Registration form, estimate of business volume, information regarding ownership/control of the business, and a list of agents; kept at U.S. location for 5 years and updated annually
 - Money transfer records \geq \$3,000
 - MIL for cash sales of money orders or traveler's checks \$3k - \$10k
 - Currency exchange records $>$ \$1,000

The BSA for MSBs

Money Transmitter – BSA Requirements (cont'd)

- Reporting
 - Must file SARs - \$2,000 threshold
 - Must file CTRs and CMIRs
- AML Program
 - Four Pillars required
 - Must be reasonably designed to prevent money transmitter from being used to facilitate money laundering or terrorism financing
 - Must be commensurate with the risks posed by the location, size, nature and volume of the financial services provided

The BSA for MSBs

Agent of Money Transmitter

- Agents play a critical role in getting cash into any mobile payment system (consider m-Pesa, others abroad)

- Transaction Flow:

Sender → Agent → Money TX → Receiving Agent → Recipient

- Typical agents are established retail businesses
 - Grocery stores, truck stops, check cashers, pharmacy stores, travel agents, supermarkets, etc. – carrier storefront?
- Agents paid commission on fees paid to money TX
- Money TX agent is itself an MSB for BSA purposes

The BSA for MSBs

Agent of Money Transmitter (continued)

- Principal and agent may contractually allocate compliance responsibility between themselves
- But both are independently responsible for compliance (contrast those subject to “federal functional regulator”)
- Registration
 - Not required if only agent of a money transmitter
- Record-Keeping and Reporting
 - Requirements same as for money transmitters, but principals may maintain centralized records for agents
- AML Program: all MSBs must have one

The BSA for MSBs

Provider of Prepaid Access is either:

- “the participant within a prepaid program that agrees to serve as the principal conduit for access to information from its fellow program participants”
 - Program participants must determine a single participant within the program to serve as provider of prepaid access.
- Or, in the absence of registration, “the provider of prepaid access is the person with principal oversight and control over the prepaid program.”
 - The person who exercises “principal oversight and control” is a matter of facts and circumstances, as determined by FinCEN.
- Exclusions: closed loop < \$2,000 per day, government assistance programs, flexible health spending programs, employee benefits programs, < \$1,000 (if

The BSA for MSBs

Provider of Prepaid Access – BSA Requirements

- Registration
 - Required with FinCEN
- Record-Keeping
 - Must maintain prepaid transaction record
- Reporting
 - Must file SARs, CTRs and CMIRs
- AML Program
 - Must be reasonably designed to prevent money laundering and commensurate with the risks posed by the location, size, nature and volume of the financial services provided

The BSA for MSBs

Seller of Prepaid Access - defined

- “Any person that receives funds or the value of funds in exchange for an initial loading or subsequent loading of prepaid access if that person:
 - Sells prepaid access offered under a prepaid program that can be used before verification of customer identification; or
 - Sells prepaid access (including closed loop prepaid access) to funds that exceed \$10,000 to any person during any one day, and has not implemented policies and procedures reasonably adapted to prevent such a sale”

The BSA for MSBs

Seller of Prepaid Access – BSA Requirements

- Registration not required
- Record-Keeping
 - Must collect, verify and retain information regarding purchasers of prepaid access
 - Impact on retailer and POS experience?
- Reporting
 - Must file SARs, CTRs and CMIRs
- AML Program
 - Reasonably designed to prevent money laundering and commensurate with the risks posed

The BSA for MSBs

	Banks	MSBs
BSA/AML Obligations	Subject to all R's and pillars	“BSA lite” for some obligations
Exam Manuals	439 pages	159 pages
“Reliance Provisions”	May use a “reliance provision” by contract with an FI subject to “federal functional regulator”	Rely at your own risk!

Impact on Customer Acquisition

Customer Acquisition

- Customer acquisition in mobile payment solutions often implicate bank or MSB customer verification obligations (if not both)
- For banks and MSBs, including money transmitters and prepaid providers/sellers, “verification” of customer identities required upon opening or establishing an account

Customer Acquisition

- An important component of a bank's AML Program is the Customer Identification Program (CIP) for new account openings
 - Must enable the bank to “form a reasonable belief that it knows the true identity of each customer”
 - FFIEC exam manual recommends that bank subsidiaries implement a CIP for “safety and soundness and protection from reputational risks”

Customer Acquisition

- **CIP “account” opening procedures**
 - Account: “Formal banking relationship established to provide or engage in services....”
 - Does not include transactions for which a formal banking relationship is not established, eg, check cashing, funds transfer, sale of check/money order
- Applies to a “customer,” defined as a person or entity that actually receives banking services
 - But not one that has an existing account with the bank if there is a “reasonable belief that [the bank] knows the true identity of the person”

Customer Acquisition

- Requires bank obtain, at a minimum:
 - Name
 - Date of birth (for an individual)
 - Address
 - Identification number (e.g., taxpayer ID; for non-US persons: passport number, alien identification card number, other government-issued document)
- Requires bank to verify the identity of the customer within a “reasonable time” after account opening
 - Documentary vs. Non-documentary methods

Customer Acquisition

- Verification using documents
 - For individual: unexpired government-issued identification evidencing nationality or residence, with photograph or similar safeguard (eg, driver's license, passport)
 - For non-individual: documents showing existence of entity (eg, articles of incorporation, business license, partnership agreement, trust agreement)

Customer Acquisition

- Verification through non-documentary methods
 - Contacting customer
 - Independently verifying identity by comparing customer-provided information with information obtained from consumer reporting agency, public database, or other source
 - Checking references with other financial institutions
 - Obtaining a financial statement
- Non-documentary procedures must address account openings where documents are not obtained or customer does not appear in person

Customer Acquisition

- **MSB verification requirements**
 - Providers/sellers of prepaid access must:
 - Establish procedures to “verify the identity of a person who obtains prepaid access under a prepaid program” and
 - “Obtain identifying information concerning such a person, including name, date of birth, address, and identification number”
 - NOTE: Information collected is same as bank CIP

Customer Acquisition

- Sellers of prepaid access must also
 - Establish procedures to “verify the identity of a person who obtains prepaid access to funds that exceed \$10,000 during any one day” and
 - “Obtain identifying information concerning such a person, including name, date of birth, address, and identification number”
 - NOTE: This additional seller obligation applies even if not a “prepaid access program”

Customer Acquisition

Summary of Verification Reqts	Must obtain identifying information when...
Bank	Opening an “account” for a “customer”
Provider of Prepaid Access	A “person” “obtains prepaid access under a prepaid program”
Seller of Prepaid Access	(1) A “person” “obtains prepaid access under a prepaid program,” or (2) A “person” “obtains prepaid access to funds that exceed \$10,000 during any one day”

Customer Acquisition

- **The mobile environment presents certain challenges regarding customer acquisition and verification**
- “Obtaining” information may be difficult in a mobile environment
 - Small form factor may introduce an inefficient or awkward registration process
 - Interface may not be optimized for mobile
 - Increased risk of abandoned transactions

Customer Acquisition

- “Verifying” a person’s identification generally requires non-documentary verification, if possible
 - If not, then two options:
 - (1) reject the transaction, or
 - (2) rely on back-end verification based on documents
 - Unclear whether prepaid verification may occur within a “reasonable time” after establishing a prepaid account but before allowing access to prepaid funds (compare with bank CIP rules)

Customer Acquisition

- **Possible solutions:** Utilize preexisting relationships in mobile environment to perform real-time verification.
 - **Direct carrier billing**
 - Facebook recently announced partnership with carriers to streamline purchase of Facebook credits through carrier bills
 - “Cramming” is an inherent risk
 - FCC’s new cramming rules (landline) permit blocking of third-party charges, require itemized billing; FCC to monitor wireless cramming
 - FTC recent motion in US District Court seeks \$52.6 million in wireless cramming charges

Customer Acquisition

- **Verification by carrier customer accounts**
- Payfone's "Mobile Authentication" leverages customer's existing relationship with mobile carriers.



Customer Acquisition

- **Prepaid accounts with mobile carriers**
- BOKU Accounts permit users to deposit money into “prepaid” accounts powered by credit card networks, maintained by mobile carriers



Customer Acquisition

- **Mobile transactions also limited by display capabilities, but agencies are taking note**
- **FTC**
 - 2000 Dot Com Disclosures does not address mobile
 - 2007 Staff Report, “Beyond Voice: Mapping the Mobile Marketplace”
 - May 30, 2012 workshop to discuss revisions to Dot Com Disclosures to illustrate how to provide clear and conspicuous online and mobile disclosures

Customer Acquisition

- CFPB
 - New foreign remittance transfer rules under Regulation E require pre- and post-transaction disclosures
 - Remittances performed through mobile apps and SMS are exempt from certain disclosure requirements, including:
 - Disclosures must be retainable
 - In writing requirement for pre-transaction disclosures (may be presented via app or SMS)
 - Disclosure formatting guidelines

BSA/AML Enforcement

Notable BSA/AML Enforcement

- Citibank NA (April 2012)
 - Cease and desist order for general weaknesses in BSA/AML programs; no fines imposed at this time.
- “Operation Adam Bomb” (April 2012)
 - Investigation by federal, state and international law enforcement leading to the arrest of creators, operators of a secret online narcotics marketplace in 34 countries, including the US
 - Narcotics operation permitted anonymous sale and purchase of controlled substances through encrypted on-line marketplaces.
 - Marketplace included storefront, order forms, online forums, and customer service, and accepted Western Union, Pecunix, PayPal, I-Golder, and cash.

Notable BSA/AML Enforcement

- Libertad Bank, Austin, TX (Oct. 2011)
 - Consent order requiring bank to implement compliance management and oversight programs; correct violations of FTC Act, RESPA, EFTA; monitor and assess third-party risk; furnish progress reports
- Sigue Corporation (Jan. 2008)
 - Failed to create procedures to identify suspicious transactions; undercover agents able to transfer funds represented to company as drug proceeds
 - Deferred prosecution agreement required company to forfeit \$15 million

Other BSA/AML Enforcement

Entity	Violations	Penalty
Ocean Bank (2011)	Operating without, for example, proper director oversight, management supervision, internal controls to ensure compliance, or effective CIP	\$10.9 million CMP C&D
Pacific Nat'l Bank (2011)	Failure to implement, for example, effective risk assessment program, SAR monitoring and reporting, audits, inadequate BSA staffing	\$7 million CMP
Zions First Nat'l Bank (2011)	Failure to monitor new product initiatives (RDC), wire activity, SAR processes, customer due diligence with respect to foreign businesses	\$8 million CMP
Royal Bank of Scotland (2010)	Stripped information from fund transfers to avoid OFAC compliance	\$500 million forfeiture
Wachovia Bank (NC) (2010)	Failure to, for example, monitor foreign transactions, RDC products, or travelers checks, report SARs in timely manner	\$110 million forfeiture \$50 million CMP C&D
Pamrapo Savings Bank (2010)	Conspired to conceal customer identities and suspicious activities, failure to report SARs, willful failure to maintain AML program, comply with BSA obligations	\$5 million forfeiture \$1 million CMP

Non-Bank BSA/AML Enforcement

Entity	Violations	Penalty
Lower Sioux Indian Community (2011)	Casino committed extensive violations of AML program and reporting requirements, material deficiencies in AML program	\$250,000 CMP
Victor Kaganov (2011)	Operated an independent money transmitter business in personal residence, pled guilty in federal court to DOJ charge for operating an unlicensed MT business	\$25,000 CMP Imprisonment
Omar and Mahamed Sufi (2011)	Operated an unregistered MSB service as part of grocery store business, accepting cash and food stamps for MSB services, pled guilty in federal court to food stamp fraud and operating unlicensed MT business	\$40,000 CMP Sentenced to five years and restitution to USDA for food stamp fraud
Pinnacle Capital Markets (2010)	Securities broker-dealer failed to implement proper AML program, internal controls, collect information per CIP, SAR reporting	\$50,000 CMP

From Bankers Online, <http://www.bankersonline.com/security/bsapenaltylist.html>

Current Topics and Resources

Current Topics

- CMIR Pending Rule (76 Fed. Reg. 64049, Oct. 17, 2011)
 - FinCEN proposal to include tangible prepaid access devices as reportable monetary instruments
- Beneficial ownership (77 Fed. Reg. 13046, March 5, 2012)
 - FinCEN proposal to require financial institutions to identify the real or beneficial ownership of accountholders
- Balancing compliance with financial inclusion
 - Dodd-Frank, Title XII, “Improving Access to Mainstream Financial Institutions”
 - Encourage use of traditional banking products among the non-banked and underbanked – but verification can be difficult among this population

Resources

- BSA Resources
 - FFIEC BSA/AML Examination Manual (certain sections updated 2010)
 - http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm
 - FinCEN MSB Guidance (online)
 - http://www.fincen.gov/financial_institutions/msb/guidance.html
 - BSA Requirements for MSBs (online)
 - http://www.fincen.gov/financial_institutions/msb/msbrequirements.html
 - FinCEN MSB Exam Manual (2008)
 - http://www.fincen.gov/news_room/rp/files/MSB_Exam_Manual.pdf
 - FAQ: MSB AML Program Review (2006)
 - http://www.fincen.gov/statutes_regs/guidance/pdf/Guidance_MSBIndependentAudits9-21.pdf
 - FAQ: Prepaid Access Rule (2011)
 - http://www.fincen.gov/news_room/nr/pdf/20111102.pdf

Resources

- Other resources
 - FFIEC Exam Manual
 - http://www.ffiec.gov/bsa_aml_infobase/pages_manual/manual_online.htm
 - FFIEC 2005 Authentication Guidance
 - http://www.ffiec.gov/pdf/authentication_guidance.pdf
 - FFIEC 2011 Authentication Guidance
 - [http://www.ffiec.gov/pdf/Auth-ITS-Final%206-22-11%20\(FFIEC%20Formatted\).pdf](http://www.ffiec.gov/pdf/Auth-ITS-Final%206-22-11%20(FFIEC%20Formatted).pdf)
 - FinCEN Administrative Letter Rulings
 - http://www.fincen.gov/statutes_regs/rulings/

Questions?

Andrew Lorentz, Partner

202.973.4232

andrewlorentz@dwt.com

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