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FinCEN's Proposed AML/CFT Program Rule Potentially Heralds a Change in Approach

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On June 28, 2024, the US Department of the Treasury's Financial Crimes Enforcement Network (FinCEN) announced long-anticipated proposed rules on anti-money laundering and countering the financing of terrorism (AML/CFT) program effectiveness; this announcement was followed on July 19, 2024, with parallel proposed rulemakings by the Office of the Comptroller of the Currency, the Federal Reserve System, the Federal Deposit Insurance Corporation and the National Credit Union Administration.[1] Promulgated under the Anti-Money Laundering Act of 2020, the rulemakings' ostensible objective is to improve the efficacy of the country's AML regime as a whole by directing banks' efforts toward filing Suspicious Activity Reports (SARs) that are "highly useful"[2] in criminal, tax, national security and regulatory investigations; reducing "de-risking" and defensive SAR-filing; increasing the use of innovation; and reducing the amount of resources banks must spend on lower-value tasks. These are all laudable goals, but if the Proposed Rules are implemented as currently written, these goals may remain elusive. FinCEN states that it does not intend its Proposed Rules to "impose additional costs or burdens"[3] beyond discrete new requirements. But in adding an "effectiveness"[4] component to AML programs defined in part by an expectation that AML programs should also "prevent" financial crime, there is a risk that the Proposed Rules will substantially increase the compliance burdens on financial institutions and lead to increased enforcement activity. Financial institutions may wish to participate in FinCEN's comment process for

[1] *See* Interagency Statement on the Issuance of the AML/CFT Program Notices of Proposed Rulemaking (July 19, 2024) *available at* https://www.occ.gov/news-issuances/news-releases/2024/nr-ia-2024-82a.pdf (last accessed July 22, 2024).
[2] FinCEN Proposed Rule: Anti-Money Laundering and Countering the Financing of Terrorism Programs (July 3, 2024) *available at* https://www.federalregister.gov/documents/2024/07/03/2024-14414/anti-money-laundering-and-countering-the-financing-of-terrorism-programs (last accessed July 22, 2024) (hereinafter FinCEN Proposed AML/CFT Program Rule).
[3] *Id.*
[4] *Id.*

the Proposed Rules, which ends September 3, 2024, to provide feedback on potential unexpected costs and risks associated with the Notice of Proposed Rulemaking (NPRM) as drafted.

I. Brief Summary of Notice of Proposed Rulemaking

On June 28, 2024, FinCEN issued an NPRM, later mirrored by the other agencies, meant to "strengthen and modernize"[5] the AML/CFT programs of financial institutions subject to the Bank Secrecy Act (BSA). The Proposed Rules implement key provisions of the Anti-Money Laundering Act of 2020 (AML Act), which was the most significant revision to the BSA since the USA PATRIOT Act in 2001 and sought to improve the national AML/CFT regime. The Proposed Rules formalize certain new specific requirements for financial institutions and codifies new FinCEN commitments, as well.

The biggest change is that financial institutions must now have programs that are "effective" in addition to being risk-based and reasonably designed. The Proposed Rules also emphasize the expectation that the AML/CFT regime will "safeguard" the financial system by "preventing" the flow of illicit funds.[6] This new emphasis on prevention, rather than mere detection and reporting of suspicious activity, could raise supervision and enforcement agencies' expectations for private industry participants.

Other notable changes include the following:

- requiring financial institutions to formally include the label "CFT" in the titles (and substance) of AML programs, which should now become AML/*CFT* programs;
- exhorting financial institutions to consider and evaluate "innovative approaches" to meet their AML/CFT compliance obligations;
- encouraging public-private feedback loops, including through increased participation in processes created by the AML Act, such as:
  - the FinCEN Exchange;
  - FinCEN Domestic Liaisons; and
  - FinCEN's formal sharing of threat pattern and trend information;
- formalizing the requirement for financial institutions to incorporate the AML/CFT priorities FinCEN has begun publishing, which FinCEN must reevaluate at least every four years, into their AML/CFT programs;
- formally requiring financial institutions to conduct a risk assessment that:
  - considers FinCEN's priorities;

[5] FinCEN, *FinCEN Issues Proposed Rule to Strengthen and Modernize Financial Institutions' AML/CFT Programs* (June 28, 2024) *available at* https://www.fincen.gov/news/news-releases/fincen-issues-proposed-rule-strengthen-and-modernize-financial-institutions (last accessed July 22, 2024).
[6] FinCEN Proposed AML/CFT Program Rule.

- evaluates the money laundering/financing of terror risks presented by its business activities, products, services, distribution channels, customers, intermediaries, geographic locations and regulatory filed reports; and
- is updated both periodically and based on appropriate triggers;

- requiring financial institutions to secure approval of the board of directors or equivalent governing body for the AML program and to make a copy available to FinCEN upon request;[7] and
- requiring that financial institutions:
  - appoint US-based persons accessible by US regulators to oversee and implement the AML/CFT programs; and
  - name a head of AML/CFT (i.e., adding the CFT title to what is currently the BSA officer role) who is appropriately qualified, approved and overseen by the board of directors or equivalent body.

II. Origins of the "Effectiveness" Requirement

FinCEN's codification of the "effectiveness" prong is likely an attempt to respond to long-standing industry concerns that financial institutions expend significant resources complying with BSA requirements that do not produce high-value insights to law enforcement and national security agencies, as mandated by the BSA itself (e.g., analyzing indicia of low-dollar structuring evasion near the $10,000 limit). The industry has sought greater flexibility to use technology to meet compliance goals, arguing that new systems, if permitted by FinCEN, could help financial institutions to achieve more "effective" outcomes in a more resource-efficient manner. For example, in June 2019, the Bank Secrecy Act Advisory Group, a forum comprising government and industry representatives, created a working group to improve the effectiveness and efficiency of AML measures. The working group ultimately recommended "refocus[ing] the national AML regime to place greater emphasis on providing information with a high degree of usefulness to government authorities based on national AML priorities, in order to promote effective outputs over auditable processes and to ensure clearer standards for measuring effectiveness in evaluating AML programs."[8] These recommendations, alongside congressional guidance in the AML Act of 2020, are influences that shaped the hopeful aims in the present Proposed Rules.

[7] This rule previously applied only to banks lacking a federal functional regulator; the new rule effectively merges rules for banks with and without a federal functional regulator.
[8] FinCEN Proposed Rule: Anti-Money Laundering Program Effectiveness (Sept. 17, 2020), *available at* https://www.federalregister.gov/documents/2020/09/17/2020-20527/anti-money-laundering-program-effectiveness (last accessed July 22, 2023).

III. Potential Challenges With the Current Proposed Rules

The Proposed Rules mean to grant the industry permission to pursue industry-requested goals of innovation, financial inclusion and information-sharing, all without intending to substantially increase administrative burden. These aims may prove difficult to achieve, however, as currently drafted. This is because the Proposed Rules add the effectiveness requirement to preexisting commitments, and even codify that financial institutions' programs are now expected to *prevent*[9] rather than simply detect and report suspicious behavior.

One significant risk to financial institutions of an effectiveness requirement is that a regulator may find that—no matter how reasonably designed a program was, and no matter how many SARs the financial institution filed—if the financial institution's AML/CFT program failed to *prevent* the flow of illicit funds, it was not effective. The filing of Continuing Activity SARs, which are required under certain circumstances, without exiting a relationship may, for example, become evidence that a financial institution failed to prevent transactions involving illicit funds.

While the Proposed Rules also seek to encourage financial institutions to use new technology in AML/CFT program processes, they do not provide safe harbors or assurances to financial institutions to make those investments. The Treasury Department should outline a clear framework to incentivize financial institutions to experiment with and then adopt novel technological approaches to AML compliance—with appropriate governance frameworks.

The Proposed Rules similarly outline a goal of financial inclusion without providing a clear pathway to address the dynamics that have created the "de-risking" phenomenon. It seeks to offer financial institutions "flexibility" to serve customers in line with their unique risk profiles, stating, "An effective, risk-based, and reasonably designed AML/CFT program may enable . . . the extension of financial services to appropriately identified and risk-managed non-profit organizations . . . and other individuals or companies that have been historically subject to barriers in accessing or maintaining financial services."[10] FinCEN invites comment on how technology can "mitigate de-risking and encourage lower cost access to financial services and activities across communities and borders."[11] The Financial Action Task Force (FATF) published a report focused on the unintended negative consequences that stemmed from implementation of similar FATF standards. These consequences included de-risking, financial exclusion, undue targeting of nonprofit organizations and even curtailment of human rights.[12] The Proposed Rules would benefit from greater specificity on the core dynamics that led to de-risking, and would be rendered more effective by an

[9] FinCEN Proposed AML/CFT Program Rule.
[10] *Id.*
[11] *Id.*
[12] *See* FATF, *High-Level Synopsis of the Stocktake of the Unintended Consequences of the FATF Standards* (Oct. 27, 2021) *available at* https://www.fatf-gafi.org/content/dam/fatf-gafi/reports/Unintended-Consequences.pdf.coredownload.inline.pdf (last accessed July 19, 2023).

explanation of how financial institutions can avoid de-risking while also working to "prevent" illicit financial activity, as the NPRM appears to require.

In finalizing any rules, FinCEN would be wise to mirror the way in which the effectiveness component that has been required of AML programs for money service businesses (MSBs) has been implemented for more than a decade now. That regulation requires that each MSB "develop, implement, and maintain an *effective* anti-money laundering program,"[13] just as financial institutions will now have to do. But the MSB regulation in that instance defined an effective AML program to be "one that is *reasonably designed* to prevent the money services business from being used to facilitate money laundering and the financing of terrorist activities."[14] Based on the enforcement history of this provision since 2011, it is generally perceived within the industry that the addition of the effectiveness requirement has not created a significantly different enforcement regime from those that prevail for other financial institution types. But if FinCEN and other regulators do not adopt a similar approach with respect to finalization and enforcement of the Proposed Rules, industry participants could see FinCEN's AML/CFT program rule as adding significant new burdens.

We encourage financial institutions to consider actively participating in the comment process, which ends September 3, 2024, to ensure industry perspectives are taken into account.

Contributors

Michael J. Leotta
PARTNER

michael.leotta@wilmerhale.com
+1 202 663 6526

Zachary Goldman
PARTNER

zachary.goldman@wilmerhale.com
+1 212 295 6309

[13] 31 CFR § 1022.210(a) (emphasis added).
[14] *Id.* (emphasis added).

David M. Cook
SPECIAL COUNSEL

david.cook@wilmerhale.com
+1 202 663 6109

Monika R. Weisman
ASSOCIATE

monika.weisman@wilmerhale.com
+1 202 663 6152

Sarah Manney
SUMMER ASSOCIATE

sarah.manney@wilmerhale.com
+1 (0)20 7872 1000