EXECUTIVE SUMMARY

Anti–money laundering (AML) regulations are constantly evolving, integrating new guidelines and controls to detect, report and address any suspicious activity. In May 2018, the Financial Crimes Enforcement Network (FinCEN) Customer Due Diligence Requirements for Financial Institutions (CDD) rule and beneficial ownership requirements became effective, amending Bank Secrecy Act (BSA) guidelines to enhance financial transparency and further counteract potential money laundering. These new requirements presented several new challenges for banks and credit unions, including confusion about guidance, training and technology concerns.

RSM’s second Anti–Money Laundering Survey took place in late 2018, and the results have been summarized in this report to help financial institutions benchmark CDD rule and beneficial ownership efforts against their peers. Our survey profiles AML departments of U.S.–based commercial banks and credit unions between $500 million and $50 billion in assets. The survey analyzes overall beneficial ownership program management, development and structure.

While certain requirements of the rule are uniform for all covered financial institutions, other elements of the rule are risk–based. The survey included questions to identify areas where approaches are consistent or diverge significantly.

The survey detailed several key trends related to beneficial ownership compliance, including:

**Guidance concerns** — Beneficial ownership guidance updates were late in arriving, delaying many institutions’ development of compliance plans or causing last minute changes to processes.

**Training issues** — Training front–line staff on the rule and the importance of the new requirements presented a significant challenge for many financial institutions.

**Third–party technology complications** — Technology is a critical element for compliance, but delayed guidance and rollout of updates by system vendors limited the testing and training of systems and solutions prior to the effective date of the rule.
Cost increases — The new CDD rule and beneficial ownership requirements have resulted in a significant rise in costs for education and training on the new guidance, and for technology changes.

Program design — The survey results identified several trends in program design and implementation:

- The majority of respondents adopted the minimum beneficial ownership threshold of 25 percent while a small percentage implemented or kept in place more conservative thresholds
- Use of and spending on technology and process automation correlated positively with asset size
- Institutions that implemented the rule in full or in part prior to May 11, 2018, expressed higher confidence in the strength of compliance with the rule

Our survey data provides key insight into the compliance efforts and concerns of over 200 financial institutions nationwide. This data provides insights into the challenges and approaches to compliance with the CDD rule from a broad spectrum of banks and credit unions.

PROFILE OF PARTICIPANTS

236 TOTAL PARTICIPANTS

ASSET SIZE

49% $500M–$1B
47% $1B–$10B
4% $10B–$50B

87% COMMERCIAL BANKS
13% CREDIT UNIONS
Confidence in compliance functions

Our survey indicates that respondents appear confident in the overall effectiveness of their BSA compliance activities, especially internal control procedures and independent testing. In fact, 99 percent of banks and 100 percent of credit unions were either “very confident” or “mostly confident” in the effectiveness of internal controls; however, 90 percent of banks and only 74 percent of credit unions were completely or mostly confident with their compliance with the CDD rule.

Figure 1. Confidence in BSA compliance activities

In addition, 78 percent of all institutions—80 percent of banks and 66 percent of credit unions—were confident in their efficiency of managing compliance of the rule. However, only 69 percent of banks and 60 percent of financial institutions felt confident in the performance of their front-line units and staff.

Figure 2. Confidence in management of compliance

While overall confidence in compliance in implementing the CDD rule is high, institutions that fully implemented changes prior to the May 11, 2018, effective date had the highest levels of “completely confident” and the lowest levels of “somewhat confident” responses related to their compliance with the rule.

“Implementing the rule in part or in full prior to the effective date provided institutions the ability to stress test the program to identify processes that were inefficient, ineffective or required additional training,” said RSM director Chris Dick. “It also provided an opportunity to educate customers on the requirements of the rule, since there was no public outreach by government agencies beyond the financial services industry.”

Confusion over last-minute changes

Survey respondents indicated the delayed issuance of updated guidance for implementing the CDD rule and beneficial ownership requirements was a significant source of confusion. Long-awaited updates to FAQs were not issued until April 2018 and updated examination procedures for the CDD rule were not released until the effective date of the rule, May 11, 2018.

Certain updates to the guidance, particularly related to requirements for automatically renewing loans and time deposits, forced many financial institutions to make last-minute changes to their programs. Furthermore, the temporary suspension of requirements related to loan and time deposit renewals created uncertainty until the requirement was permanently suspended later in 2018.

While institutions experienced a disconnect with FinCEN with regard to guidance, 91 percent of respondents still saw the organization as “very helpful” or “somewhat helpful” in designing beneficial ownership procedures. Eighty-two percent of respondents also found state, regional and national banking associations as helpful when developing compliance processes.

Survey data shows that institutions that acted proactively and made changes to align with the CDD rule early had a higher level of confidence in their compliance efforts.

“Just as important as managing the compliance rule is managing regulators’ expectations,” said RSM partner Patricio Perez.

Survey respondents indicated the delayed issuance of updated guidance for implementing the CDD rule and beneficial ownership requirements was a significant source of confusion. Long-awaited updates to FAQs were not issued until April 2018 and updated examination procedures for the CDD rule were not released until the effective date of the rule, May 11, 2018.

Certain updates to the guidance, particularly related to requirements for automatically renewing loans and time deposits, forced many financial institutions to make last-minute changes to their programs. Furthermore, the temporary suspension of requirements related to loan and time deposit renewals created uncertainty until the requirement was permanently suspended later in 2018.

While institutions experienced a disconnect with FinCEN with regard to guidance, 91 percent of respondents still saw the organization as “very helpful” or “somewhat helpful” in designing beneficial ownership procedures. Eighty-two percent of respondents also found state, regional and national banking associations as helpful when developing compliance processes.

FinCEN and regulators received the highest dissatisfaction ratings in our survey: 5 percent of respondents found FinCEN counterproductive when designing processes and 7 percent stated that regulators were counterproductive. Financial institutions were frustrated that regulators were unable to share information with institutions, but in many cases, regulators were in the same situation—awaiting new guidance from FinCEN and updates to the Federal Financial Institutions Examination Council (FFIEC) BSA examination manual.
Training concerns

Survey respondents consistently indicated that training front-line staff was the greatest challenge to complying with the CDD rule. The timing of guidance is seen as a factor, as well as general push back from staff and customers about new processes and responsibilities.

In our survey, exactly half of institutions rated training as “very challenging” or “mostly challenging” when implementing the rule. Other significant concerns from respondents involve the implementation or modification of systems for beneficial owner data at 37 percent and the creation of a process to acquire information from new customers at 36 percent.

Beneficial ownership training is a significant issue within banks, but an even larger concern within credit unions. Among survey respondents, 48 percent of banks found training of front-line staff as “very challenging” or “mostly challenging,” compared to 62 percent of credit unions.

Third-party systems issues

Financial institutions also indicated delays from technology vendors as a significant issue. As a result, financial institutions had limited time to test and validate offerings designed to address the CDD rule and beneficial ownership before the rule went into effect. This situation appears to have contributed to some apprehension from banks and credit unions about the effectiveness of their technology solutions.

Technology is a key element for regulatory compliance efforts, but only 73 percent of banks and 80 percent of credit union respondents were either “very confident” or “mostly confident” in their technology used to manage compliance with the rule. Given these results, institutions likely have room for improvement with technology solutions and can likely benefit from regularly evaluating solutions and vendors.

In addition, implementing or modifying systems for beneficial owner data was the second greatest challenge when developing a compliance plan, behind only training of front-line staff. Our survey found that 37 percent of institutions found implementing or modifying systems either “mostly challenging” or “very challenging,” compared to only 18 percent that see it as “not at all challenging.”
Compliance-related costs

Not surprisingly, financial institutions have seen a fairly significant rise in costs in an effort to comply with the new regulations. New compliance demands typically require new investments, including people costs, technology changes and education on new guidelines.

Banks in our survey reported a 15.7 percent increase in costs due to the development of responses to the beneficial ownership rule. However, larger banks had higher spend increases related to the rule than smaller banks. Survey respondents from $1 billion to $10 billion in assets reported a 19.9 percent increase in spending, while institutions between $500 million and $1 billion in assets had an average of an 11.8 percent growth in spending.

“Organizations were not surprised by the increase in related expenses and many budgeted for the increase in 2017,” commented Perez.

Perez finds that the result of new rules and regulatory requirements is a heightened level of associated costs. “The rise in talent costs, technological tools and training due to regulatory changes should be followed by an expectation of efficiencies created from a well-trained staff,” said Perez. “Such efficiencies should also come from better use of technology as tools are customized for the institution’s risk profile and customer base.”

Training was the most significant cost increase for survey respondents, representing an 8 percent jump in spending—9.9 percent for banks with $1 billion to $10 billion in assets and 6.6 percent for banks with between $500 million and $1 billion in assets. Beyond training, our respondents also required cost increases for software and operating systems (5.6 percent), personnel (4.7 percent) and compliance consulting (3.5 percent).

Figure 6. Increase in costs associated with compliance
PROGRAM DESIGN

The survey included a series of questions designed to gather information on approaches financial institutions took to implement various risk-based elements of the CDD rule.

Ownership threshold: 92 percent of respondents are using the 25 percent ownership threshold for all customers, while 5 percent are using a lower threshold for higher-risk customers and 4 percent are using a lower threshold for all customers. Regulatory expectations were cited as the reason for the lower threshold for 10 percent of respondents with thresholds below 25 percent, while existing standards accounted for 30 percent and internal decisions accounted for 65 percent.

Triggers for beneficial ownership updates: The survey asked respondents to indicate changes in customer information that triggered updates to beneficial ownership information. Four triggers were by far the most common:

98% 1. Opening of new account, which is a mandatory trigger in the rule
82% 2. Change in customer name
81% 3. Change in account signers
73% 4. Change in customer taxpayer identification number (TIN)

Beneficial owner verification and certification: Most institutions verify a beneficial owner’s identity via a copy of a photo ID; a third of respondents overall also use a third-party search tool; however, 88 percent of banks between $10 billion and $50 billion reported relying on third-party search tools. One form is typically used for all customers and updates, although banks are more likely to use shorter forms, where customers certify previously collected information is still current for updates to existing information.

Methods used to verify beneficial owners’ identity

92% Copy of photo ID
34% Third-party search tool
15% Internet search
11% Other

Certification forms used

83% One form for all customers and updates
11% Shorter forms for updates to existing information
8% Expanded forms for higher-risk customers

Figure 7. Ownership threshold triggers
RISK PROFILE UPDATES

Other program changes: The CDD rule prompted additional changes to compliance programs including the addition of periodic customer due diligence reviews and increased frequency of reviews, automation of customer risk rating, and consideration of the complexity of the customer’s ownership structure in the risk profile.

Periodic review frequency correlates positively to customer risk rating, with larger institutions more likely to review customers of all risk ratings more than annually.

**Figure 8. Modifications to program due to CDD rule**

- Periodic review processes where there were none
- Customer risk rating process
- Assessing the complexity of ownership structure
- Automated customer risk rating process
- Increased frequency of CDD/EDD reviews and/or risk rating calculations
- **Other**

**Figure 9. Risk profile update frequency**

<table>
<thead>
<tr>
<th></th>
<th>Banks with $500M–$1B in assets</th>
<th>Banks with $1B–$10B in assets</th>
<th>Banks with $10B–$50B in assets</th>
<th>Credit unions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>HIGH-RISK CUSTOMERS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than annually</td>
<td>61%</td>
<td>50%</td>
<td>63%</td>
<td>33%</td>
</tr>
<tr>
<td>Annually</td>
<td>22%</td>
<td>33%</td>
<td>25%</td>
<td>30%</td>
</tr>
<tr>
<td>Less than annually</td>
<td>16%</td>
<td>16%</td>
<td>13%</td>
<td>30%</td>
</tr>
<tr>
<td><strong>MEDIUM-RISK CUSTOMERS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than annually</td>
<td>38%</td>
<td>29%</td>
<td>38%</td>
<td>14%</td>
</tr>
<tr>
<td>Annually</td>
<td>27%</td>
<td>28%</td>
<td>13%</td>
<td>28%</td>
</tr>
<tr>
<td>Less than annually</td>
<td>33%</td>
<td>43%</td>
<td>50%</td>
<td>45%</td>
</tr>
<tr>
<td><strong>LOW-RISK CUSTOMERS</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>More than annually</td>
<td>19%</td>
<td>21%</td>
<td>38%</td>
<td>13%</td>
</tr>
<tr>
<td>Annually</td>
<td>20%</td>
<td>18%</td>
<td>0%</td>
<td>13%</td>
</tr>
<tr>
<td>Less than annually</td>
<td>58%</td>
<td>59%</td>
<td>63%</td>
<td>60%</td>
</tr>
</tbody>
</table>
THE FUTURE OF COMPLIANCE

The survey results show that, overall, financial institutions have confidence in their compliance with the CDD rule while facing challenges particularly around training, implementation of new systems or changes to existing technologies. Just over a third of respondents had completed a regulatory examination that included coverage of compliance with the CDD rule, and the coming year will provide a clearer picture of both regulatory expectations related to the rule and the degree to which financial institutions are meeting those expectations.

Financial institutions will also need to focus on the sustainability of their compliance programs. Front-line training should be an ongoing focus in light of the concerns expressed in the survey and the higher levels of turnover typically experienced with branch staff. Institutions will also need to ensure they maintain sufficient staffing levels to keep up with the additional workload resulting from the rule and manage regulatory expectations.

The survey also reflects the ongoing trend of financial institutions seeking to gain efficiencies through new systems and process automation. Sustainability of these solutions depends on training, testing, and validation of data quality and system performance.
ACKNOWLEDGMENTS

Survey methodology
The RSM Anti–Money Laundering Survey was conducted by Minneapolis–based Barlow Research, an independent marketing research company specializing in the financial services industry. Survey results are based on the responses of 236 qualified respondents drawn from a stratified random sample from U.S.–based commercial banks with assets from $500 million to $50 billion (according to the FDIC).

In addition to the institutional asset-size requirements, participation in the study was limited to senior–level officers and managers responsible for oversight of the BSA program at their respective institutions. A paper–based invitation was distributed and respondents had the option to complete the survey via mail (37 percent) or online (63 percent) between Nov. 5 and Dec. 24, 2018. Data was weighted by asset size to be representative of the total population of domestic banks in the determined asset range.

Individual responses to the survey are confidential and accessible only by RSM and Barlow Research. Survey data will be shared with third parties only in aggregate form or through RSM articles, white papers and presentations.

For more information
Rob Farling, Director, RSM US LLP
rob.farling@rsmus.com, +1 212 372 1421

Chris Dick, Director, RSM US LLP
chris.dick@rsmus.com, +1 617 241 2767

For more information

© 2019 RSM US LLP. All Rights Reserved.