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BANKING INDUSTRY UPDATES

NYLIB
NEW YORK LEAGUE OF INDEPENDENT BANKERS

NYLIB Kicks Off 2019 with Spring Meeting

On Thursday, April 11, 2019, the New York League of Independent Bankers ("NYLIB") held its Spring Meeting, featuring two distinguished speakers. The evening began as the new president of NYLIB, Ms. Casey Christopher, [1] introduced herself. Ms. Christopher provided her vision for NYLIB to grow both as a think tank for community bankers to share experiences and ideas, and as an advocacy force for local, independent financial institutions.

Following the introduction, NYLIB presented its first speaker of the evening, Mr. Diego Zuluaga, [2] who serves as a policy analyst at the Cato Institute's Center for Monetary and Financial Alternatives. Mr. Zuluaga spoke about his perspective of the impact of financial regulations on small versus large banks and echoed the concerns shared by many NYLIB members. He also provided statistics regarding the amount of regulation across various financial sectors over the years and highlighted the biggest regulatory event in recent history, the Dodd-Frank Act. Mr. Zuluaga concluded his speech with his view of the motivations for financial regulations, as well as the regulatory impact to financial institutions in 2018.

Subsequently, Mr. Douglas Bloom, [3] the Head of Cybersecurity and North American Privacy Law at Morgan Stanley, spoke at length about emerging cybersecurity issues for banks and other financial institutions. Mr. Bloom shared his knowledge of recent trends in cybersecurity and brought his myriad of experience as a former cybersecurity and privacy consultant and federal prosecutor to answer questions from the audience. He also addressed the regulatory burdens the rise in cybersecurity attacks have created on financial institutions.

Overall, the Spring Meeting kicked off a promising year for NYLIB, with members and attendees networking and actively participating in discussions with the new president of the organization and the two keynote speakers. NYLIB would like to offer special thanks to Mr. Zuluaga and Mr. Bloom for appearing as guests and providing their insights on issues faced by the banking community.

Marijuana Banking:
The Prospects for Legal Protection

By Contributing Author, John W. Vardaman, [4]
General Counsel of Hypur

As New York considers legalizing the recreational use of marijuana, Congress is taking steps to address the issue of marijuana banking. Regardless of one's views about the merits of marijuana legalization, this should come as welcome news to the New York financial industry. With 33 states and counting that have legalized some form of marijuana, financial institutions can ill-afford to ignore the legal, regulatory, and policy realities surrounding marijuana banking.

On March 28, the House Financial Services Committee voted overwhelmingly to approve the Secure and Fair Enforcement ("SAFE") Banking Act, [5] which would for the first time provide a level of legal protection for financial institutions serving marijuana-related businesses ("MRBs"). The heart of the problem is that so long as marijuana remains illegal at the federal level, all proceeds derived from marijuana-related commerce are considered criminal proceeds for purposes of federal anti-money laundering and Bank Secrecy Act ("AML/BSA") laws, even in states where marijuana has been legalized. The result is a multi-billion industry that continues to operate primarily in cash due to a scarcity of legitimate banking and payment options.

The SAFE Banking Act is not the federal government's first attempt to expand banking access to the marijuana industry. In 2014, the Treasury Department's Financial Crimes Enforcement Network ("FinCEN") issued guidance to financial institutions for how to permissibly bank MRBs consistent with their AML/BSA obligations. [6] (The Department of Justice concurrently issued similar guidance to federal prosecutors, but that document was rescinded last year by then Attorney General Jeff Sessions.) [7] The message of the FinCEN

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guidance is that so long as financial institutions and their MRB customers comply with the FinCEN guidance and relevant state law, they will not face regulatory or criminal sanction solely for serving MRBs. FinCEN also established a Suspicious Activity Report (SAR) regime exclusively for financial institutions serving MRBs.

Five years after it was issued, the FinCEN guidance has to be considered a qualified success in bringing some measure of banking access to the marijuana industry. FinCEN releases quarterly results about Marijuana SAR reporting, the most of recent of which revealed that nearly five hundred financial institutions have filed some form of a Marijuana SAR.[8] While not all those institutions are actively and openly accepting MRB customers – anecdotally that figure is less than 50 – it does reflect a functional system offering some banking relief to the marijuana industry.

The inherent limitation of the FinCEN guidance, however, is that it is policy prescription to a legal problem. For the vast majority of financial institutions, even an effectively "hands off" federal policy is insufficient protection to take on MRB accounts so long as marijuana remains federally illegal. The result is that the demand for MRB banking continues to outstrip supply, leaving much of the marijuana industry frozen out of the U.S. financial system.

The SAFE Banking Act attempts to remedy this problem in a number of ways. First and foremost, it removes the threat of regulatory or criminal sanction against financial institutions and their officers, directors, and employees "solely" for providing financial services to MRBs and ancillary businesses. It addresses the AML/BSA problem by exempting marijuana-generated proceeds from the definition of "criminal proceeds" from federal money laundering laws. The bill retains the FinCEN SAR reporting regime, and requires the Federal Financial Institutions Examination Council to develop uniform guidance and examination procedures for financial institutions serving MRBs. The bill has garnered broad support among the financial industry, including the American Bankers Association, the Credit Union National Association, and the Independent Community Bankers of America.

While the SAFE Banking Act is expected to comfortably pass the full House, its fate will be decided in the Republican-controlled Senate. Many Republicans continue to oppose any form of marijuana legislation and may be reluctant to support a measure that would enable the industry to continue to expand. Others may attempt to expand the scope of the SAFE Banking Act to prevent improper regulatory interference against banking relationships in general, not just the marijuana industry. The goal would be to prevent a repeat of DOJ's controversial Operation Choke Point during which federal regulators targeted the bank accounts of certain politically disfavored industries.[9]

Whatever form eventually emerges, the primary mission of the SAFE Banking Act is unique if not historic – to provide legal protection for banks to serve a federally illegal industry. Whether that ultimately proves to be a bridge too far for this Congress remains to be seen. But the fact that it is a viable possibility is testament to the ever growing influence of, and support for, the U.S. marijuana industry.

FinCEN Director Encourages Innovation and Resource Sharing for BSA Compliance

On February 4, 2019, FinCEN Director Kenneth A. Blanco delivered his remarks at the SIFMA Anti-Money Laundering & Financial Crimes Conference.[10] Mr. Blanco reiterated FinCEN's dedication to streamlining BSA compliance through innovation and information sharing.

Last December, the regulatory agencies had issued a Joint Statement on Innovative Efforts to Combat Money Laundering and Terrorist Financing.[11] In that Statement, the Board of Governors of the Federal Reserve System ("FRB"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration ("NCUA"), the Office of the Comptroller of the Currency ("OCC"), and FinCEN encouraged financial institutions to pursue innovative approaches to combating money laundering, such as experimenting with artificial intelligence and digital identity technologies. The agencies assured banks that pilot programs "in and of themselves should not subject banks to supervisory criticism even if the pilot programs ultimately prove unsuccessful." However, while testing innovative pilot programs, banks are expected to otherwise maintain effective AML/BSA compliance programs.

These regulatory efforts acknowledge the burden and cost of AML/BSA compliance and aim to offer a solution that would aid financial institutions in reducing that cost.

These efforts are designed to encourage innovation that may in the long run provide more cost-effective solutions to BSA compliance. To that end, FinCEN indicated that it would consider requests for exceptive relief under 31 C.F.R. § 1010.970 to facilitate the testing and potential use of new technologies and other innovations. Each of the banking and credit union agencies will also establish projects or offices that "will work to support the implementation of responsible innovation and new technology in the financial system."

The agencies also issued a separate joint statement in October of last year that allowed banks to enter into collaborative arrangements "suitable for banks with a community focus, less complex operations, and lower-risk profiles for money laundering or terrorist financing."[12] This would allow banks to pool human, technology, and other resources to reduce BSA compliance costs. Individual banks, however, must still ensure that the collaborate efforts are sufficient to address the risk profile of the particular bank and that adequate third-party due diligence is performance on the collaborative arrangement.

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OCC Fintech Charter in Limbo

Since the OCC first announced its intentions to offer special purpose national bank charters to Fintech companies ("Fintech Charters") in December 2016,[13] there has been a slew of legal controversy surrounding the OCC's authority to grant such charters. In 2017, the Conference of State Banking Supervisors ("CSBS") and the New York State Department of Financial Services ("DFS") brought suit challenging the OCC's authority to issue such special purpose national bank charters to Fintech companies that do not take deposits. Subsequently, both lawsuits were dismissed without prejudice, as the District Courts in New York and D.C. deemed the matter not ripe for adjudication.[14] The main factual basis for the dismissal was that the new Comptroller, Joseph Otting, had yet to make a definitive statement with respect to Fintech Charters.

This changed in July 2018, when the OCC announced that it will begin accepting national bank charter applications from Fintech companies.[15] Following that announcement, both the CSBS and the DFS renewed their lawsuits challenging the OCC's authority to grant such charters under the National Bank Act.[16] The OCC then again filed motions to dismiss both complaints, arguing, among others, that the matter is still not ripe for adjudication as the OCC has not approved any charter applications and that the OCC's interpretation of its own authority under the National Bank Act is entitled to deference.[17] Of note, the OCC pointed out that no Fintech company has even applied for the charter. In opposition, the CSBS and DFS argued that the matter is ripe for adjudication as the OCC's announcement to accept applications created an imminent threat that the OCC will preempt state law and regulatory authority by granting the charters to non-deposit accepting Fintech companies.[18] In addition, both the CSBS and DFS challenged the OCC's legal and constitutional authority to grant charters to companies that do not take deposits, arguing that such action would fall outside of the OCC's authority to govern institutions that engage in the "business of banking" under the National Bank Act.

If the OCC continues on its path to consider and grant Fintech Charters, the courts will be compelled to address the substantive legal issue of whether the OCC can grant such charters to non-deposit accepting companies. Given the uncertainty of these pending lawsuits, however, Fintech companies may be reluctant to apply for the charters in the first place. While the parties have filed their motion papers, it remains to be seen when and how the courts will decide on these issues.

Developments Regarding the Fifth Pillar

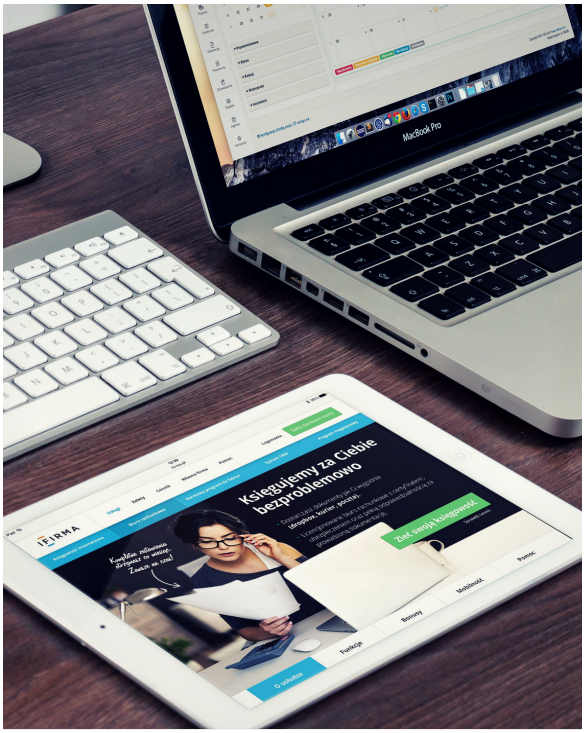
FinCEN's new "fifth pillar" requirement[19] became effective on May 11 of last year and had initially raised some concerns with its implementation. Previously, the four pillars were 1) policies and procedures, 2) a designated compliance officer, 3) employee training, and 4) independent testing.[20] The new beneficial ownership rule added customer due diligence as a fifth pillar and imposed certain minimum requirements for establishing the beneficial owners of legal entity customers.

The new rule requires financial institutions to establish policies and procedures to collect information verifying the beneficial owners of legal entities at the time a new account is opened.[21] FinCEN initially issued a FAQs guidance indicating that "each time a loan is renewed or a certificate of deposit is rolled over, the bank establishes another formal banking relationship and a new account is established."[22] This created concerns for banks and credit unions that expect a large volume of CD rollovers, many of which had been done on an automated basis.

While FinCEN's exceptive relief in 2018 has significantly reduced the regulatory burden of this rule, financial institutions must remain vigilant in implementing the new requirements going forward and be cognizant of any ongoing regulatory guidance for this relatively new rule.

Following objections from financial institutions, FinCEN first granted a 90-day limited exceptive relief for financial products and services that automatically roll over or renew and were established prior to the new rule's effective date of May 11, 2018.[23] That relief was extended for another 30 days in August.[24] Finally, on September 7, 2018, after meeting with various representatives from financial institutions and trade associations, FinCEN issued a ruling that exempted rollovers and renewals of CDs, loans, commercial lines of credit, and safety deposit box rentals from the beneficial ownership requirements.[25] This exception only applies to rollover, renewal, modification or extensions of the types of accounts listed and did not apply to the initial opening of any such accounts on or after May 11, 2018.

For all other legal entity customers, financial institutions are still required to obtain information relating to 1) each individual who owns, directly or indirectly, 25% or more of equity, and 2) an individual with significant responsibility to control, manage, or direct the legal entity.[26] While FinCEN's exceptive relief in 2018 has significantly reduced the regulatory burden of this rule, financial institutions must remain vigilant in implementing the new requirements going forward and be cognizant of any ongoing regulatory guidance for this relatively new rule.



CRA Reform May be Completed Within Next Year

Last year, the OCC issued an advance notice of proposed rulemaking to reform the Community Reinvestment Act[27] ("CRA"). The notice sought input on modernizing the implementation of the CRA and invited comments that would modify and streamline the existing CRA performance tests, establish a metric-based framework, redefine communities and assessment areas, and expand CRA-qualifying activities. Following the OCC's lead, Lael Brainard, one of the members of the FRB, indicated that her agency will fully participate in the OCC's request for comments and anticipates working with the OCC and FDIC on a joint proposal to revise CRA regulations.[28]

Just last month, Ms. Brainard signaled that the FRB was considering making adjustments to the assessment area definition to expand the area in which a bank would receive CRA consideration for community development activities.[29] She also addressed comments from banks and community organizations "to create a separate, comprehensive community development test to evaluate community development loans and qualified investments through a similar lens, possibility along with community development services." Ms. Brainard noted the high number of organizations that have responded to the OCC's request for comments and attended the FRB's outreach meetings, and encouraged interested parties to continue the dialogue with regulators.

On April 3, 2019, both the Chairwoman of the FDIC, Jelena McWilliams, and the Comptroller of the OCC, Joseph Otting, signaled that revisions to the CRA regulations could be completed by next year.[30] Both regulators seemed optimistic that a streamlined interagency reform could be achieved, which would allow banks more certainty on how loans and investments will count toward their CRA performance and account for technical developments, such as online banking, in determining a bank's assessment area.

Footnotes

1 Ms. Christopher is a seasoned banker with over 10 years of experience in the financial sector. She is a Vice President and Business Development Officer at CenterState Bank and manages a portfolio of over 200 bank customers across multiple states, specializing in SWIFT, domestic and international online clearing, asset-liability management services, and syndicated national credits and derivatives. She is an active member of the Florida Bankers Association, New Jersey Bankers Association, Financial Women's Association of NY, Financial Managers Society of NY/NJ, and the Junior League of Bergen County.

2 Mr. Zuluaga specializes in financial technology and consumer credit. Prior to joining the Cato Institute, he was the Head of Financial Services and Tech Policy at the Institute of Economic Affairs in London. He was also a former lecturer in economics at the University of Buckingham. Mr. Zuluaga has authored numerous publications on topics involving finance and regulation. His work has been featured in the Times, Newsweek, and the Daily Telegraph.

3 Mr. Bloom is responsible for Morgan Stanley's cybersecurity and North American privacy legal matters. He is also an Adjunct Professor of Law at Fordham University, where he teaches a course on computer crimes. Prior to joining Morgan Stanley, Mr. Bloom was a director in PwC's Cybersecurity & Privacy, Financial Crimes and Forensics practices. Mr. Bloom also served as a federal prosecutor in the U.S. Attorney's Office for the Southern District of New York, where he investigated and prosecuted national security cyber offenses.

4 Mr. Vardaman is the General Counsel of Hypur, a banking compliance company that works with banks to service the marijuana industry. He has had extensive experience working in the federal government on issues concerning money laundering, the Bank Secrecy Act, and other financial crimes. He has previously served as Assistant Deputy Chief in the Asset Forfeiture and Money Laundering Section of the Department of Justice and as Special Assistant to the General Counsel at the Department of Treasury. Mr. Vardaman can be reached at jvardaman@hypur.com.

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Footnotes

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