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Federal Financial Regulators Encourage Innovative Efforts to Combat Money Laundering and Terrorist Financing

Overview: Late last year, five federal banking agencies—the OCC, the Federal Reserve Board, the FDIC, the NCUA, and FinCEN (the "Agencies")—issued a joint statement (the "Statement") encouraging innovation by banks[1] in meeting their Bank Secrecy Act/anti-money laundering ("BSA/AML") obligations. The announcement follows a series of other regulatory developments from 2018 that focused on supporting new approaches to the financial system, such as, for instance, another joint statement on banks sharing BSA/AML resources, a request for comment on innovative ways to move toward a faster payment system, and a major report on creating a regulatory environment that encourages financial innovation and emerging technologies.

This Statement promotes innovation in BSA/AML programs by describing potential positive aspects and minimizing potential drawbacks. Importantly, the Statement specifies the Agencies are neutral as to *how* a bank uses (or does not use) innovation to maintain an effective BSA/AML program—indeed, they do not advocate a particular compliance method or technology. Rather, the Agencies commit to generally supporting attempts at innovation, while also assuring banks they will not face penalties or criticisms for choosing not to pursue innovative BSA/AML strategies. Either way, banks are still expected to comply with BSA/AML obligations, regardless of whether they employ innovative techniques to do so.

BSA/AML Innovation Explained

The Statement recognizes private sector innovation as a promising tool for banks to more effectively combat money laundering, terrorist financing, and other illicit financial activity. Whether such innovation occurs by developing entirely new technologies or simply new ways to use existing tools, it could help banks protect against illicit financial activity while maximizing their compliance resources at the same time.

For instance, banks could enhance identification of suspicious activity through internal financial intelligence units that detect "complex and strategic illicit finance vulnerabilities and threats." The Statement also mentions artificial intelligence and digital identity technologies as potentially effective tools to augment existing transaction monitoring systems. The Agencies encourage banks to consider these and other innovative methods when determining how to comply with BSA/AML obligations.

Pilot Programs

The Agencies focus a substantial portion of the Statement on how banks can use pilot programs to experiment with innovation. Pilot programs can be implemented in conjunction with existing BSA/AML processes, so that banks can test and evaluate the effectiveness of new methods while ensuring they maintain compliance with BSA/AML obligations.

While the Agencies may provide feedback regarding a bank's pilot program, they will not punish banks based solely on the fact that a pilot program is unsuccessful or exposes gaps in existing processes. For instance, imagine a bank implements a pilot program to test an artificial intelligence-based monitoring system, and the new system identifies suspicious activity missed by the bank's existing BSA/AML program. The Agencies will not use that fact to automatically find the bank's existing processes inadequate or deficient. Instead, the existing processes will be evaluated "independent of the results of the pilot program." Using innovation will not lead to heightened regulatory expectations.

Again, it is critical that a bank maintain effective BSA/AML compliance, even throughout the development and implementation of a pilot program. The Statement says that, before replacing or enhancing existing BSA/AML processes with innovation from a pilot program, bank management should formally evaluate whether such innovation is sufficiently developed and tested. The Statement provides the following factors that banks should consider in such an evaluation: information security issues; third-party risk management; and compliance with other applicable laws and regulations (e.g., those related to customer notifications and privacy). In addition, management should consult with the bank's regulator about the evaluation.

Engaging with the Private Sector

The Agencies highlight their willingness to confer with bank management on innovative BSA/AML pilot programs, particularly at the early stages of development. There are many reasons banks should engage with the Agencies, such as: to improve regulator understanding of a new approach; as a means to discuss compliance and risk management expectations; and because it can provide an opportunity for the Agencies to clarify supervisory expectations.

Pilot programs are just one way the Agencies are exploring how to encourage innovation. For instance, additional approaches by FinCEN include: its Bank Secrecy Act Advisory Group; its policy to consider requests for exceptions from certain BSA obligations to facilitate innovation; and a new initiative aimed at identifying opportunities and challenges of BSA/AML-related innovation, which will include outreach to financial institutions, technology providers, and other relevant actors.

FinCEN is not the only agency committed to innovation—indeed, each of the others have or will establish projects or offices to facilitate responsible innovation and new technology in the financial system. These projects and offices are intended to improve Agency responses to innovation and new technology by helping them understand related risks and encouraging discussion of regulatory principles, processes, and expectations.

Outlook: Overall, the Statement seeks to encourage innovation in BSA/AML compliance programs by highlighting its positive sides—e.g., increased effectiveness—while minimizing potential negatives—e.g., increased regulatory expectations. The Statement concludes with an appeal for industry feedback on "how the Agencies can best support innovative efforts through explanations of, or updates to, supervisory processes, regulations, and guidance." Written feedback can be electronically submitted to FinCEN at FRC@fincen.gov.

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