

# 6 Steps

## for Community Banks to Succeed with Money Services Businesses

BY KATHLYN L. FARRELL, CRCM

By any estimation, the U.S. market for providing bank services to money service businesses (MSBs) is huge. As of October 1, 2005, when Financial Crimes Enforcement Network (FinCEN) updated its MSB list, there were 28,256 MSBs listed. However, by most reported accounts, banking institutions continue to exit the business of banking MSBs due to the regulatory risks involved in this industry. On March 30, 2005, the federal banking regulators issued a joint statement that generally set forth their expectations for MSB accounts. On April 26, the agencies issued a joint guidance for providing banking services to MSBs operating in the United States. Both of these issuances were meant, in part, to allay the fears of financial institutions that all MSB accounts have too much compliance risk for a bank to effectively maintain them. Although many banks have decided to stop taking MSB accounts, some community banks have found the risks of banking MSBs to be manageable and have actively marketed their MSB account services.

Banking MSBs has its advantages. MSB accounts have a high volume of transactions and therefore are good fee income producers. In the current environment, MSB customers are very loyal to their existing bank relationships. Well-run MSBs also make good credit customers. Banks that can become familiar with the risks surrounding these accounts and learn to manage them properly often find that they have solid and profitable bank relationships.

Community bankers generally feel comfortable managing the more traditional risks attached to these accounts, such as the credit and operational risks. When only these risks are in the picture, most bankers would consider MSB accounts to be good ones. The more recent focus on the regulatory risks of MSB accounts, particularly the Bank Secrecy Act (BSA)/anti-money laundering (AML) risks, has caused some bankers to conclude that these accounts

are not worth the trouble. Regulatory risks can be harder to quantify and they do change over time. However, there are steps that community banks can take to manage these risks when opening and servicing MSB accounts. Some of these elements in successful community bank MSB programs are similar to those stated in the April 2005 interagency guidance.

### *Step One:* **Assess the Program Risk**

It is important to decide what types of MSBs a bank can effectively serve, and choosing the bank's MSB market should be a part of the overall BSA/AML risk assessment. For example, a bank that decides it can service only low-risk MSBs should concentrate its resources in marketing to that group.

CHECKS  
CASHED

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ATM

Money Orders  
Payment  
Transfer



Money  
Orders

29¢

We have  
ATM  
service



**“In my experience a company that operates as an MSB will have the internal controls, software, and other systems in place to control the AML risk.”**  
 —David Gragg  
 Gateway Executive  
 Vice President

In most cases small-town banks have their markets chosen for them. These bankers will be knowledgeable about all MSBs in town, whether they are check-cashing outlets or local grocery stores. In many cases it is difficult for the bank to close out the account of the town grocery store, so even if the grocery store cashes checks, the bank may feel obligated to continue providing banking services to the store. Even in situations like this one, the bank can take steps to manage its BSA/AML risk.

In urban areas, banks can choose the types of MSBs they want to service. Gateway National Bank, a \$236 million bank located in the Dallas area, decided in 2004 to market to MSBs after determining these companies were underserved in southeast Dallas communities. The bank targeted companies that were core MSBs—those that provide MSB services exclusively—rather than companies that provide these services incidentally to their other businesses, such as grocery stores that sell money orders. According to Gateway Executive Vice President David Gragg, the bank believes MSBs that are solely in the business to provide MSB services often pose less regulatory risk than those offering the services incidentally to their other businesses. “In my experience a company that operates as an MSB will have the internal controls, software, and other systems in place to control the AML risk. A small convenience store that also cashes checks is much less likely to spend resources on AML compliance.”

In other situations banks may find that the local grocery store, which cashes fewer checks, offers less risk than a check-casher. The bank’s location and the amount of resources the bank allocates to its MSB program will determine the bank’s target market.

Part of the process of structuring an MSB program is developing an MSB policy. The bank’s MSB program should influence its BSA policy, but an MSB policy should include the types of MSB accounts the bank will accept, what due diligence will be required of them, and how the accounts will be monitored.

### *Step Two:* **Know Your Customer**

The next step in managing MSB risk, and one that is outlined in the regulatory guidance, is to conduct appropriate due diligence on any potential MSB customer. The guidance provides some examples of items to include, such as confirming the MSB’s FinCEN filing and state license, if required. Community banks that open MSB accounts may go further in the due diligence process.

Gateway National Bank has a special MSB customer application required of all potential customers. This application requires standard identification information and also asks the potential customer for information on the types and amounts of products sold (including volume of checks cashed), insurance policies held by type and amount, types of software used, copies of AML programs, Customer

Identification Program (CIP) requirements, Office of Foreign Assets Control (OFAC) processes, training policy, and employee screening processes. Gateway also requires that the MSB complete a credit application because the bank will often make available balances that are uncollected.

Southwestern National Bank is a \$187 million community bank in Houston with a diverse customer base and many MSB accounts. The bank conducts extensive due diligence on MSBs prior to opening accounts. According to Senior Vice President Joy Langston, the bank also requires the following at the beginning of a relationship with an MSB:

- Conduct a site visit. The account officer visits the location of the MSB and takes photos of the location, which will be included in the MSB’s file.
- Obtain copies of the MSB’s business formation documentation such as certificates of incorporation, partnership, or assumed name certificate.
- Obtain information on the individual owners of the company.
- Obtain copies of any agency agreements with other MSBs such as traveler’s check and money order issuers.
- Obtain a copy of the FinCEN filing.
- Request copies of the previous year’s tax return or financial statement.
- Determine the MSB’s primary lines of business and target customer base.
- Request copies of the MSB’s AML policy and program.
- Determine if the MSB has procedures to check government lists, such as the OFAC Specially Designated Nationals (SDN) list.
- Determine the MSB’s expected transactional profiles, especially cash withdrawals and deposits.

Gragg says that when Gateway conducts a site visit, it also notes how much security the MSB has in place, as well as how organized the business appears. He requires three years of tax returns for the company and the principal owners, as well as three months of prior bank statements. The purpose of the information is to assess the financial stability of the MSB and determine how well it managed its past banking relationships.

### *Step Three:* **Conduct a BSA/AML Risk Assessment of the MSB**

After the due diligence information is received, the bank can assess the BSA/AML risk likely to be associated with the account. Some MSBs will be low risk for BSA/AML compli-

## Risk Matrix for MSB Accounts

	1 (Low)	2 (Medium)	3 (High)	Rating
<b>Routine transactions</b>	\$100 - \$500	\$100 - \$1,000	\$100 - \$3,000+	
<b>Customers</b>	Neighborhood residents	Mixture of area and transient	Primarily transient	
<b>Service offered</b>	Single service, e.g., check cashing or sales	Multiple services, but no money transmission	Money transmission and/or server services	
<b>Checks cashed (if applicable)</b>	Local payroll or U.S. Treasury checks only for individuals	All types of checks, only for individuals	All types of checks for individual and entities	
<b>Funds transfers (if applicable)</b>	Domestic only	Some domestic and some international, but no high-risk jurisdictions	International includes high-risk jurisdictions	
<b>Checks/money orders (if applicable)</b>	For domestic bill payments	Some domestic and some international, but not high-risk jurisdictions	Destinations include high-risk jurisdictions	
<b>Currencies handled</b>	No currencies from current High-risk jurisdictions	Very small amounts of currencies from current high-risk jurisdictions	Significant amount of currencies from current high-risk jurisdictions	
<b>Ownership</b>	Publicly traded company listed on a major exchange	Corporation or LLC	Partnership or sole proprietorship	
<b>Offices</b>	Single location or agent only	Multiple locations within the United States	Multiple locations including outside the United States	
<b>Customer's location (includes branches)</b>	Not located in a HIFCA or HIDTA, nor are its customers	Either the NBFIs or its customers are located in a HIFCA or HIDTA	Both the NBFIs and its customers are located in a HIFCA or HIDTA	
<b>Revenues produced by financial activities</b>	Incidental to the overall business, e.g., less than 10 percent	Significant to the business, e.g., greater than 10 percent, but less than 50 percent of gross	Very significant to the business, e.g., greater than 50 percent of gross revenues	
<b>Established business</b>	Five+ years	One to five years	Less than one year	
<b>Length of relationship</b>	Five+ years	One to five years	Less than one year	
			<b>Total divide by 13 = rating</b>	

ance. MSBs that have good BSA/AML programs themselves will have good customer identification programs, as well as file currency transaction reports (CTRs) and suspicious activities reports (SARs) when required. MSBs with weaker programs could be low risk if they have few transactions. For example, a grocery store in a small town may qualify as an MSB but may cash very few checks and usually to the same group of people. While the store may not have a very structured BSA/AML program, its type of transactions might make it low risk for BSA/AML compliance.

Southwestern National Bank uses a BSA/AML risk matrix to risk-rate its MSB customers. This matrix was devel-

oped by Attilio F. Galli, chief credit officer of the bank, from one he used in a previous position. The risk matrix uses 13 factors that are applied to the potential MSB customer (see Risk Matrix for MSB Accounts). The account officer completes the risk assessment, which determines whether the bank will open the account and how much monitoring it will require. The risk assessment, along with all due diligence documentation and the photos of the MSB's place of business are organized in a separate file maintained on each relationship. The MSB's eventual risk rating will also determine the amount of the CD the bank requires for collateral for the MSB account.

## Account agreements can help a bank to manage all types of risks associated with the MSB's account operations.

### *Step Four:* **Communicate Your Expectations**

It is important to make sure that the MSB knows exactly what is expected of it after the account is opened. All risks will be better controlled if all parties are clear as to what will be required during the life of the account. Gateway National Bank uses several methods to communicate its expectations. It has a standard welcome letter as well as a disclosure that sets forth the bank's standards for continuing to operate the account. The bank also has an AML handbook it provides to the MSB upon account opening.

Community banks may choose to define the responsibilities of the MSB with a special account agreement. While some banks use a less formal letter agreement in addition to the bank's own deposit account agreement, others have a very structured, formal contract with MSB customers. Account agreements can help a bank to manage all types of risks associated with the MSB's account operations. Terms of an account agreement for a check casher, for example, may include

- the types of checks the bank will accept
- account pricing
- liability for cash in transit and returned checks
- special deposit requirements, such as separating large checks from smaller ones, using special deposit slips, or prohibiting cash withdrawals through the drive-through facility
- special rules for accepting Treasury checks
- required collateral for the account or CDs to be held to guarantee payment for returned checks
- requirement for the customer to register with all appropriate state and federal government authorities and to keep the registrations current through the life of the account
- requirement that the customer have an AML program
- requirement that the customer obtain an independent AML audit annually

The benefit of a separate agreement, even an informal letter agreement, is that the customer will have a clear idea of what is expected throughout the life of the account and surprises are avoided.

### *Step Five:* **Price Services Commensurate with the Risk**

MSB accounts are often subject to the bank's account analysis system, which takes into account all hard dollar costs, including such things as interest on uncollected funds, fees for checks deposited and paid, and returned items. However, the regulatory risk of operating an MSB account must be taken into consideration when pricing is formulated. Independence Bank, a \$100 million community bank in Houston, implements a flat fee for MSB accounts simply in consideration of the regulatory risk involved in banking the MSB. Each tier of the flat fee schedule depends upon the average balance of the account during the month. The bank charges a minimum of \$250 per month for the lowest tier and \$1,000 for the highest. Gateway National Bank also charges a minimum flat fee to all MSB customers. Depending upon the account activity, additional fees may be incurred, primarily to offset the bank's expense in monitoring the account for unusual activity.

### *Step Six:* **Monitor the Account Activity**

Effectively managing the AML risk in an MSB program requires account monitoring that includes both a daily review of deposits and less frequent reviews of overall account activity.

Deposits should be reviewed daily to make certain the MSB conforms to its agreement for depositing checks. The bank should review the types and amounts of checks. Examining checks will also allow the bank to see if the MSB is following its stated procedures when cashing checks.

This daily review is also important for detecting suspicious activity. For example, a common bank requirement for MSB accounts is to prohibit the deposit of third-party checks. A check casher generally cashes a check for the payee of the check. If the check is not cashed by the payee, there is more risk involved. If, for example, a check casher deposits large numbers of third-party checks, he could be purchasing them from other, unregistered check cashers.

Another example of unusual activity is the deposit of unused money orders in large amounts. Depositing money orders into the MSB's own account can indicate kiting. A review of the daily deposits will detect such unusual activity and is an essential element in monitoring the MSB's business operations.

The account should be reviewed on a more comprehensive level as well, especially if the account has been designated as high risk for BSA/AML. Monthly or quarterly reviews can reveal unusual fluctuations of deposits, the amount of uncollected funds in the account, the number of NSF's,

and the number of times the account is on the kite suspect report. The bank should watch for other activity involving the account to make sure it is within the bounds of normal business operations. Excessive wire transfers or ACH activity that cannot be explained or foreign transactions when none were expected would warrant further review. For BSA/AML review purposes a sample of statements and items posting on the account should be examined in consecutive months to determine trends on the account.

All account reviews and monitoring activity should be documented in a form that is easily maintained and retrieved. Checklists that are signed or initialed and summaries of findings in memo format are common forms of documentation.

Banks may require the MSB to obtain an annual BSA/AML independent audit. Because the MSB is subject to a BSA independent audit requirement, it is reasonable to expect that the bank could obtain a copy. Audits should set forth the scope of the review as well as enumerate any problems discovered. The audit should draw a specific conclusion as to the MSB's risk for BSA/AML compliance, and the bank should use the audit as confirmation of the strength of this compliance.

As the BSA/AML regulatory environment continues to change, so too will effective MSB compliance risk management. As both the regulatory agencies and community bankers respond to the interagency examination procedures

issued in June 2005, best practice for MSB compliance will continue to emerge. By clearly identifying, quantifying, documenting, and monitoring the risks associated with MSB accounts, community bankers should be able to satisfactorily manage the compliance risk and continue to serve this segment of the financial services industry. **BC**

#### ABOUT THE AUTHOR

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