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New BSA Order Brings Welcome Flexibility For Banks

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On Sept. 28, 2018, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corp., the National Credit Union Administration, and the Office of the Comptroller of the Currency(collectively, the federal banking agencies, or FBAs), with the concurrence of the U.S. Department of the Treasury's Financial Crimes Enforcement Network, issued an interagency order exempting premium finance accounts from the requirements of the customer identification program rules imposed by the Bank Secrecy Act. The exemption applies to banks and their subsidiaries subject to the FBAs' jurisdiction that offer loans to commercial customers (i.e., corporations, partnerships, sole proprietorships and trusts) to facilitate purchases of property and casualty insurance policies (herein referred to as premium finance loans or premium finance lending). The FBAs based their exemption on FinCEN's conclusion that certain structural aspects of such loans make them a low risk for money laundering or terrorist financing, and also on their own conclusion that such lending did not present a safety or soundness issue.

The structural aspects of these loans that make them low risk include: (1) the fact that loan proceeds typically are remitted to the insurance company directly or through a broker or agent, and not to the borrower; (2) property and casualty insurance policies have no investment value; and (3) borrowers cannot use these accounts to purchase other merchandise, deposit or withdraw cash, write checks, or transfer funds. The FBAs found no safety and soundness issue because: (1) in the event of default by the borrower, the insurance company is legally obligated to return unearned premiums to the lender; and (2) most bank-affiliated lenders will finance premiums only for insurance issued by creditworthy insurers.

The order builds on FinCEN's previous determination, in its 2016 customer due diligence rule, to exempt premium finance accounts from the requirement to collect beneficial ownership information on legal entity customers, based on the low money laundering risk associated with such lending. The continued

application of CIP requirements to banks and bank-affiliated premium finance companies for such accounts, despite FinCEN's finding of negligible money laundering risk, put these companies at a competitive disadvantage against non-bank-affiliated premium finance lenders, which are not subject to regulation under the BSA. In particular, such entities are not required to obtain and verify customer identifying information such as Social Security numbers, allowing them to process loan requests more quickly and less intrusively. This led a consortium of bank-affiliated premium finance lenders to petition FinCEN and the FBAs for a change in the rules to harmonize its approach to this issue across both CIP and beneficial ownership rules.

Although it took these agencies more than two years to respond to this request with an exemption, it shows a welcome and thoughtful flexibility in the administration of the BSA and related AML rules that could provide a useful model in other contexts. It also appears to represent only the second time that a categorical exemption to CIP rules has been granted. (FinCEN previously granted an exemption for certain state address confidentiality programs).

Practical Considerations

The exemption will allow financial institutions to concentrate more AML resources on products and services posing a greater BSA/AML risk to their institution. However, the exemption applies only to CIP requirements, and banks must continue to comply with various other BSA obligations for premium finance accounts, including the requirement to file suspicious activity reports. Accordingly, although the obligations will be easier to meet than for typical accounts, banks should continue to provide, in their AML programs, for the collection of basic information as needed to establish a customer risk profile and understand the nature and purpose of such accounts, and to update customer information on a risk basis, so as to allow them to file SARs or take other action when necessary. Automated commercial diligence services likely will be helpful in this regard.

In reaching its decision, the FBAs relied upon both FinCEN's guidance on the CIP rules and the in-depth description of the premium finance loan industry from the consortium of bank-affiliated premium finance lenders. The FBAs granted the exemption pursuant to 31 CFR 1020.220(b), which gives the "appropriate Federal functional regulator, with the concurrence of the Secretary [of the Treasury, whose authority has been delegated to FinCEN]" the authority, by "order or regulation," to "exempt any bank or type of account from the requirements" of the CIP rule. This is noteworthy, because a separate provision of the BSA, 31 C.F.R. § 1010.970, appears to give FinCEN the authority to grant such an exemption to this rule or any other BSA rule unilaterally. It suggests that, for any future proposed exemption to CIP requirements, FinCEN is likely to seek to act in concert with the FBAs. This likely means a longer waiting period to obtain a decision on any additional proposed exemptions, but ensures uniform treatment across these agencies.

The agencies also made clear that their decision rested on FinCEN's long track record of finding low money laundering risk associated with such transactions — first in a 2005 rule excluding property and casualty insurance from AML regulation based on low money laundering risk, and then in its exclusion of premium financing for such policies in the 2016 customer due diligence rule. This suggests that the

exemption granted for premium finance lenders is not likely to lead to substantial numbers of similar exemptions in other contexts. Finally, the FBAs concluded the order by noting that the FBAs could revoke the CIP exemption should the manner in which premium finance lending operates or the risks of money laundering and terrorist financing associated with the premium finance loan industry change.

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