



Dangerous Riptide Threatens Financial Institutions

A riptide or rip current is caused after waves coming in from the ocean hit the beach. The receding water is referred to as a backwash, causing a rip current on the surface. The bigger the waves, the more dangerous the riptide becomes to swimmers. In a strong riptide, swimmers are at greater risk of being caught in the backwash. The ultimate consequence is drowning. Riptides occur on the surface and swimmers trapped in them have a chance to survive by relaxing and swimming across the current, parallel to the shoreline.

Unfortunately, the natural tendency is to swim against the current directly toward shore. This places the swimmer at higher risk of tiring and drowning, which could be avoided had the swimmer swam across the current and out of the riptide. More harrowing is an undertow. Undertows are currents along the bottom of the backwash. They pull their victims down beneath the surface. A strong undercurrent can knock a swimmer down and drag that individual out to sea on the bottom of the ocean. This makes the risk of drowning far greater.

What is the relevance of this information to financial institutions?

Many financial institutions are currently treading water in an ocean of economic uncertainty. They are having enough trouble staying afloat without having to worry about riptides, or worse yet undercurrents. Regrettably, the waves hitting the banks attempting to stay afloat are growing larger and more violent making it more difficult for those institutions to tread water. Consequently, the resulting riptides and undercurrents are gaining momentum and becoming extremely dangerous.

As the financial crisis has worsened over the last six months, many thousands of bank employees have lost their jobs. As this situation continues to grow bleaker, the layoffs will continue. In addition to the alarming number of layoffs, financial institutions have had to slash budgets dramatically. These overwhelming resource reductions are placing financial institutions at greater risk for falling prey to dangerous riptides or worse, a fatal undertow.

Although financial institutions are being forced to downsize staff and budget because of the losses they are sustaining, it does not relieve them of their Bank Secrecy Act (BSA) compliance and reporting obligations. Many of the people being let go from financial institutions are compliance professionals. The loss of talent and experience, coupled with likely diminished compliance functionality, could well be the next crippling blow causing one or more financial institutions to drown due to a catastrophic compliance breakdown.



The BSA requires financial institutions to establish and maintain a robust anti-money laundering (AML) program. An AML program has four mandatory requirements:

1. Development of internal policies, procedures and controls
2. Designation of a Compliance Officer
3. Ongoing employee training programs
4. Independent audit function to test programs

Essentially, financial institutions must have the ability to assess and mitigate risk. They must have the ability to monitor their systems for risk and to establish controls to ensure they meet all BSA reporting requirements, the most important of which are suspicious activity reporting and know your customer policies and procedures. The loss of highly qualified compliance professionals and the potential of decreased monitoring make it extremely challenging for financial institutions to adequately meet their reporting requirements. In many institutions, compliance professionals are not considered revenue generators, only cost centers. Therefore, a mindset could easily exist among senior business executives that compliance professionals are more expendable. This rationale is pervasive in the industry and incredibly flawed.

Compliance professionals may not be revenue generators. However, given the opportunity to perform and meet their obligations, they are revenue savers and/or loss preventers. If financial institution business executives follow their natural instinct and opine to cut compliance professionals because they are merely considered cost centers, then they will find themselves swimming against the riptide and will be more likely to drown in unnecessary business risk.

In today's monetary crisis, many financial institutions are taking responsible steps to reduce unnecessary overhead. There are a number of internal institutional redundancies, where reductions are justified. This is particularly true where fraud, security and/or AML programs overlap by virtue of having been stove piped or having been duplicated as the result of mergers or acquisitions, resulting in redundant functions. In those instances, compliance resource reductions are generally more justifiable. However, compliance staff reductions must be assessed for the potential risk of inability to adequately meet BSA reporting and monitoring requirements.

The two elements of the AML program mandatory requirements that are most susceptible to budget cuts are training and internal controls. Training budgets have probably been sliced to the bone, as one of the easiest places to cut. How can compliance professionals continue to learn about the nuances of money laundering, emerging trends, and to adequately understand terrorist financing, if they do not receive appropriate training? Likewise, internal controls and monitoring capabilities have likely been reduced to more minimal levels. Any reduction in controls and/or monitoring capabilities place financial



institutions at greater risk of vulnerability. How much compliance risk are these institutions willing to accept in order to meet budget reduction demands?

A troubling reality exists. Budget cuts have not escaped the attention of fraudsters, money launderers, and most problematic, terrorist financiers. The best of these bad guys know how to identify systemic weaknesses and exploit them for their nefarious purposes. They must be salivating at the opportunity in front of them.

In spite of the massive problems the financial crisis is causing financial institutions, there are two questions they better come to terms with:

1. How far are they willing to cut their compliance programs and risk non-compliance with BSA reporting requirements?
2. Do they have a belief that the regulators will give them a pass from BSA reporting requirements because of the perilous position they are already in?

Before answering these questions, financial institutions should come to the realization that they could be swept up in a dangerous riptide or undertow. Will they swim across the tide and reach safety or will they swim against the tide and drown. It will be interesting to see the choices they make as this unprecedented financial crisis plays out.

By Dennis M. Lormel

2/24/2009