

15th Annual International Anti-Money Laundering Conference

March 15-17, 2010 | The Westin Diplomat | Hollywood, Florida

IAT COVERAGE/ACH CDD

By: Deborah Thoren-Peden
Partner, Pillsbury Winthrop
Thoren@pillsburylaw.com
213-488-7320

This is not intended as legal advice

EXAMPLES OF IAT COVERAGE:

- Covers payment transactions that start as wires or interbank transfers from abroad and converted to ACH entries by a US FI
- Book entries involving a foreign customer if the foreign financial agency creates an ACH credit entry to send the funds to the Receiver at the Receiver's US bank
- A foreign recipient (even using US bank routing # and account) where there is an offshore bank that credits a foreign account for the recipient
- In general, if there is a foreign currency exchange and an ACH transaction in the US it is likely an IAT
- Unlike BSA "Funds Transfer Rule" IAT triggers at \$.01

OFFSHORE PROCESSING:

- IAT does not apply to transactions that involve data received or processed offshore, where:
 - the processing entry is not a party to the transaction, and
 - such processing is incidental to and does not alter the terms of the transaction
- in these cases the offshore party does not have a direct financial stake in the transactions through an account relationship or settlement obligation
 - e.g., consolidated corporate treasury dept or contracted third-party data processors

SWIFT COVER PAYMENTS:

- Similar obligations
- Effective November, 2009

IAT IMPACT:

- Material system changes
- Affirmative obligation to ID covered transactions as IAT
 - both as ODFI and RDFI
 - bank should determine if its Originators originate IAT transactions
 - if Correspondent Bank for IAT - need to identify as such on addenda record
- Wire room and ACH need to coordinate/talk to each other
- More info to analyze for AML and OFAC purposes

IAT IMPACT (Continued)

- More possible OFAC matches
 - higher # of IATs than expected
- Ongoing education of customers/agents
- AML/OFAC policies, procedures, training should incorporate IAT
- No one exempt - no way to "opt out"
- Government agencies conducting transactions can be covered too

INTERNATIONAL ACH IS EXPANDING:

- 37 countries by year end
 - Specific contractual responsibilities
- Emerging payments/payment systems
 - Sometimes IAT identification harder
- Speed, safety, cost

ACH AML RISK

- ACH originally designed to handle high volume of low-\$ domestic transfers
- Automation means fewer opportunities for human review
- IAT intended to help ID OFAC transactions
- Adequacy of systems to manage ACH, management's ability, effectiveness of monitoring and reporting

ACH AML RISK - TPSPs:

- Third Party Service Providers (TPSP) - an entity other than an Originator, ODFI or RDFI that performs functions on their behalf.
 - Some independent TPSP contract w/ independent sales orgs (ISOs) or other 3rd-party payment processors
 - Can be multiple layers between the ODFI and Originator
 - ODFI may authorize a TPSP to send ACH files directly to an ACH Operator, effectively bypassing the ODFI.
 - Higher risk where neither TPSP nor ODFI performs due diligence on the companies for which they originate payments
 - Need to Id IATs

DUE DILIGENCE ON TPSs:

- NACHA requires a Third Party Sender with an agreement with ODFI to establish ID of each originator
 - Must use commercially reasonable methods, warrant the originators comply, and warrant it assumes the liabilities of ODFI
- ODFI should conduct due diligence, establish exposure limits and employ monitoring procedures to ensure the TPS and its clients do not create undue risk

NACHA – DIRECT ACCESS REGISTRATION

- Required for all ODFIs for debit entries (but not ODFI credit entries)
- June 18, 2010
- Registration – either no Direct Access Participants or provide required info about each DAP
- Direct Access – where Originator, 3rd Party Sender or 3rd Party Service Provider transmits credit or debit entries directly to ACH Operator using an ODFI's routing # and settlement account
 - Bank must know its ACH customers where it allows direct access

DIRECT ACCESS REGISTRATION -

- Not required for an ODFI that:
 - transmits files using another participating DFI's routing # and settlement account (correspondent relationships) or
 - TPSP that transmits ACH file solely on behalf of ODFI where TPSP has no direct agt with Originator and is not itself an Originator

Registration Includes:

- Depository FI's name and contact info
- 3rd party or originator's name, contact info and TIN
- # of originators transmitting thru a 3rd party that is a DAP
- DFI's routing #s provided for such use by a DAP
- Statement of whether DFI's Board or Board level committee has approved the direct access relationship
- Probably not atty-client privileged

Reporting Requirements:

- Quarterly reporting requirements
 - Origination (dollars and volume of transactions by Standard Entry Class code)
 - Entries returned (dollars and volume by return reason code and SEC)
 - Rate of return by origination, volume, SEC and reason return code
- New relationship must be registered as established
- Significant changes must be updated

DIRECT ACCESS DUE DILIGENCE:

- Each ODFI with DAPs must mitigate risks by:
 - appropriate underwriting, managing and monitoring its relationship
 - utilizing ACH operator tools that track volume and exceptions
 - ODFI is responsible for its customer and the entities the introduce to the ACH network

NACHA BOARD RECOMMENDATIONS FOR DIRECT ACCESS RELATIONSHIPS:

- Board level approval to ensure this type of ACH activity is w/in bank's risk parameters
- KYC- originators and 3rd parties, to ensure direct access is appropriate for the customer
 - understand type of business
 - know the types of ACH transactions being originated
 - review financial statements (3 years) for creditworthiness
 - obtain and review ratings from a credit service co and the Better Business Bureau

NACHA BOARD RECOMMENDATIONS:

- Approve new business introduced by originators and 3rd parties with direct access only AFTER conducting review
- Do a risk-based review of new originators supported by a 3rd party with direct access to manage risks related to changes in volume or character of transactions
- Ensure bank agts with originators and 3rd parties address all appropriate ACH rules
- Monitor origination and return volume and act appropriately if unusual activity
- Follow banking agency guidance on 3rd party relationships

CUSTOMER DUE DILIGENCE:

- Some ODFIs and RDFIs rely on each other to perform adequate due diligence on their customer
 - But all parties must have a strong CDD program for regular ACH customers
 - Adequate and effective CD policies/procedures/processes are critical to id unusual transactions
- Restrict or Refuse ACH service to originators engaged in questionable activities/fail to comply
- AML/BSA exams look at ACH in more depth
- IAT information