

BOARD BRIEFS

Navigating the Compliance Maze: Challenges Facing Community Banks with the Bank Secrecy Act

by Chris Couch, Phelps Dunbar

Community banks play a vital role in local economies, providing personalized financial services to individuals and small businesses. However, amidst their commitment to customer service and community engagement, these institutions face an array of regulatory challenges, with compliance with the Bank Secrecy Act (BSA) being one of the most prominent. The BSA, enacted in 1970, aims to safeguard the financial system from illicit activities by requiring financial institutions to establish anti-money laundering (AML) programs and report suspicious transactions. While the BSA serves a critical purpose, its complex requirements present significant challenges for community banks.

Regulatory Complexity

One of the primary challenges community banks encounter with BSA compliance is the sheer complexity of BSA/AML compliance. The BSA and its accompanying regulations have evolved over the years, becoming increasingly intricate. The five chief elements of an AML compliance program (the Five Pillars) – designating a BSA officer, performing risk assessments, building internal controls and policies, monitoring and auditing the program, and customer due diligence – are easily understood in plain language. Navigating the regulations implementing the BSA, however, requires a deep understanding of AML principles, transaction monitoring, customer due diligence, and reporting requirements. For community banks with limited resources and personnel, interpreting and implementing these regulations can be daunting.

The Rise of A.I. Regulations

On March 31, 2021, the U.S. Department of the Treasury released a notice outlining the use of A.I. by financial institutions and the appropriate protocols for managing the technology to follow laws and regulations and protect consumers. These guidelines were the first in a series of regulations, followed by requirements for making credit decisions based on complex algorithms and quality control standards for automated valuation models, which were released in June 2023.

Resource Constraints

Just as resource constraints may impair a community bank's ability to wade through the complexity of BSA regulations, these constraints may impair a bank's ability to satisfy each of the Five Pillars. Unlike larger financial institutions with dedicated compliance departments and substantial budgets, community banks often have limited resources at their disposal. Hiring compliance experts and investing in sophisticated AML technology may strain their financial resources. Consequently, community banks must strike a delicate balance in fulfilling regulatory obligations and managing operational realities (Pillar Two), often relying on manual processes and existing staff to handle compliance tasks, rather than leaning into technology that may mitigate risk more effectively.

Technological Challenges

In today's digital age, technological advancements have revolutionized the banking industry. While these innovations offer numerous benefits, they also present challenges for community banks in terms of BSA compliance. Implementing robust AML software and systems (Pillar Three) capable of detecting suspicious activities requires substantial investment. Moreover, integrating new technology into existing infrastructure and training personnel on its use and administration can be complex and time-consuming. Community banks must carefully evaluate their technological capabilities and marry them effectively to the organization's product set and the capabilities of its human resources.

Evolving Threat Landscape

Evolutions in technology and product sets, overlaid with an evolving threat landscape, pose a perpetual challenge for community banks in combating financial crime and fulfilling BSA requirements. Money launderers and other illicit actors continually adapt their tactics to evade detection, making it challenging for banks to stay ahead of emerging risks. Community banks must remain vigilant, regularly monitoring and updating their AML policies and procedures to address new risks effectively. This necessitates regular and periodic

monitoring and auditing of internal controls, and ongoing training and education for staff members to recognize suspicious activities and report them promptly (Pillar Four).

Knowing Your Ever-Changing Customer Base

While products, technologies and threats evolve rapidly, the base and risk profiles of community banks typically evolve somewhat slowly. That said, for any BSA/AML program to be effective, the bank should establish customer profiles based on the institution's risk appetite and typical customers, and evaluate new and existing customers to determine the appropriate customer profile for each. Due diligence, enhanced due diligence and – for entities – beneficial ownership data are critical to knowing your customers (Pillar Five) and spotting behavior that may indicate illegal activity.

Enhanced Scrutiny and Enforcement

Tight BSA/AML compliance is of increasing importance, as regulatory agencies in recent years have intensified their focus on BSA. Financial institutions, including community banks, frequently face enhanced scrutiny and costly enforcement actions. The growing regulatory expectations and enforcement

measures have placed additional pressure on community banks to strengthen their AML programs and enhance compliance controls. Failing to meet regulatory standards can result in severe penalties, reputational damage, and loss of customer trust, underscoring the importance of prioritizing BSA compliance efforts.

Compliance with the BSA remains a significant challenge for community banks, requiring a comprehensive understanding of regulatory requirements, strategic allocation of resources, technological investment, and ongoing vigilance against financial crime. Despite these challenges, community banks play a crucial role in safeguarding the integrity of the financial system and fostering trust within their communities. By addressing the obstacles associated with BSA compliance head-on and adopting a proactive approach to satisfying the Five Pillars and regulatory requirements, community banks can navigate the BSA landscape effectively while fulfilling their mission of serving local customers and supporting economic growth.

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