**DIVISION OF BANKING**
1601 N. Harrison Avenue, Suite 1, Pierre, SD 57501
605-773-3421

**MEMORANDUM**

NUMBER: 11-001

DATE: August 15, 2018

TO: SOUTH DAKOTA MONEY LENDERS

FROM: BRET AFDAHL, Director

RE: FEDERAL POLICIES REQUIRED FOR NON-BANK FINANCIAL INSTITUTIONS

Pursuant to 31 USC 5312 and 16 CFR 313 a loan or finance company is defined as a financial institution. These federal laws and regulations govern what information must be collected from borrowers. Additionally, they establish federal requirement for non-bank financial institutions. These requirements include:

1. Developing an Anti-Money Laundering (AML) Policy;
2. Performing Office of Foreign Assets Control (OFAC) checks;
3. Completing Suspicious Activity Reports (SARs);
4. Implementing a Customer Identification Program (CIP); and,
5. Ensuring privacy of Consumer Financial Information.

Attached is a summary of the Federal Regulations for your information. All Money Lenders licensed in South Dakota are required to have policies established to ensure they meet the Federal requirements. During license renewals, Money Lenders will be required to submit updated policies annually to the South Dakota Division of Banking (Division) for review. Failure to submit the policies can be grounds for denial of an application.

If you would like additional information regarding these federal requirements, or if you have any questions, please do not hesitate to contact the Division 605-773-3421.

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## BSA for Money Lenders

Bank Secrecy Act (BSA), codified in Title 31, has undergone several revisions, most recently through amendments introduced by the Patriot Act, and it places affirmative obligations on financial institutions to implement anti-money laundering policies that prevent the flow of illicit funds through those institutions. Financial institutions are also required to report large cash transactions, as well as any suspicious transactions—information critical for law enforcement to prosecute criminal actors and forfeit criminal proceeds.

31 U.S. Code (USC) § 5312 defines a loan or finance company as a financial institution. http://uscode.house.gov/view.xhtml?path=/prelim@title31/subtitle4/chapter53/subchapter2&edition=prelim

## Suspicious Activity Reports (SARs)

Financial institutions and businesses are required to report the financial activities of their customers and clients. These reports, called SARs, are filed secretly with the Financial Crimes Enforcement Network, or FinCEN. FinCEN processes these reports and forwards the information to the appropriate law enforcement agency for further investigation and inquiry. In many cases the information contained in a SAR can initiate a criminal investigation into the underlying suspicious transaction or contribute to an existing criminal investigation.

FinCEN https://www.fincen.gov/

## Office of Foreign Assets Control (OFAC)

The OFAC of the US Department of the Treasury administers and enforces economic and trade sanctions based on US foreign policy and national security goals against targeted foreign countries and regimes, terrorists, international narcotics traffickers, those engaged in activities related to the proliferation of weapons of mass destruction, and other threats to the national security, foreign policy or economy of the United States.

All financial institutions are required to comply with the OFAC regulations there are no exceptions. OFAC violations have serious consequences. Persons not complying with OFAC-administered sanctions are liable for significant penalties, even if their action was inadvertent or uninformed.

Penalties include:

- **Civil penalties:** $250,000 or twice the amount of each underlying transaction up to $1,075,000 per violation
- **Criminal penalties:** $50,000 to $10,000,000 fine; 10-30 years in prison
- **Publication of penalty:** OFAC publishes the names of companies that have been penalized

OFAC Search List https://sanctionssearch.ofac.treas.gov/

**Anti-Money Laundering Program (AML)**

Money laundering is the process of making illegally-gained proceeds (i.e. "dirty money") appear legal (i.e. "clean"). Typically, it involves three steps: placement, layering and integration. First, the illegitimate funds are furtively introduced into the legitimate financial system. Then, the money is moved around to create confusion, sometimes by wiring or transferring through numerous accounts. Finally, it is integrated into the financial system through additional transactions until the "dirty money" appears "clean." Money laundering can facilitate crimes such as drug trafficking and terrorism and can adversely impact the global economy.

**Five Pillars of Program Requirement**

For an effective BSA/ AML Program, financial institutions need to implement the five pillars. Every BSA program must adhere to the following:

*Internal Controls* – Financial institutions are required to have approved policies, procedures and processes for all aspects of BSA/AML. However, since a BSA program is based on risk, this will not look the same for every financial institution.

*Independent Testing* – Independent testing refers to your auditors: either internal or third party. The key here is "independent," which means the party reports directly to the board, a designated committee, or a member of the board. The auditing party should not report to the President or BSA Officer. The audit will address the overall adequacy and effectiveness of the program (policies, procedures, etc.), the risk assessment (thoroughness, adequacy), reporting and record keeping requirements (SARs, CTRs, the five-year retention rule), transaction monitoring (whether manual or automated), training, and so on.

*Designated BSA Officer* – Every institution must have a designated BSA Officer. This individual must have the necessary experience to carry out the role. In many cases, this means appointing a higher-level individual – someone with a comprehensive understanding of BSA who can confidently speak to examiners about all areas of the program. He or she has to have authority and resources in order to make decisions and do the job effectively. This includes adequate and competent BSA staff.

*Training* – Training is arguably the largest pillar. The BSA Officer is responsible for training the whole enterprise of the institution on BSA: the board, lenders, front line, etc. Training needs to be customized to each audience. As part of the customization process, make sure staff knows how BSA applies to their role. Furthermore, staff should be trained in a timely manner. It is critical that training is supported by the executive team and that its importance is instilled from the top (the board) down.

*Customer Due Diligence (CDD) Requirements* – The institution must implement risk-based procedures for conducting ongoing customer due diligence, to include, but not be limited to:

> Understanding the nature and purpose of customer relationships for the purpose of developing a customer risk profile; and
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> Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information.

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# Customer Identification Program (CIP) Information for Money Lenders

The federal law regarding the CIP is found in 31 United States Code (USC) § 5318. The federal code requires financial institutions to verify the identity of individuals wishing to conduct financial transactions with them and is a provision of the USA PATRIOT Act.

http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title31-section5318&num=0&edition=prelim

Some key points include:

- The CIP should be appropriate for the size and type of your business;
- An effective CIP is a matter of safety and soundness and protection from reputational risks;
- The CIP is intended to know the reasonable belief that it knows the true identity of each customer; and,
- The CIP rule applies to a "customer" (individual, corporation, partnership, trust, estate, or any entity recognized as a legal person.

Customer information required includes:

- Name, DOB, Address, Identification number;
- Sufficient information to form reasonable belief the institution knows the true identity of the customer; and,
- Verify the customers nationality or residence and bear a photograph (Driver's License or Passport).

For a "person" other than an individual (corporation, partnership, or trust) the institution should obtain documents showing legal existence of the entity such as:

- Certified articles of incorporation; and,
- Unexpired government issued business license, partnership agreement, or a trust instrument.

Here are some helpful links regarding the CIP (Customer Identification Program) portion of the USA PATRIOT Act.
https://www.fincen.gov/resources/statutes-regulations/usa-patriot-act

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# Privacy of Consumer Financial Information

The federal law regarding the Privacy of Consumer Financial Information is found in 16 Code of Federal Regulation (CFR) § 313. The federal code governs the treatment of nonpublic information about consumers by financial institutions. Financial institutions include mortgage lenders, ‘‘pay day’’ lenders, finance companies, mortgage brokers, account servicers, check cashers, wire transferors, travel agencies operated in connection with financial services, collection agencies, credit counselors and other financial advisors, tax preparation firms, non-federally insured credit unions, and investment advisors that are not required to register with the Securities and Exchange Commission (16 CFR 313.1).

https://www.govinfo.gov/content/pkg/CFR-2018-title16-vol1/pdf/CFR-2018-title16-vol1-part313.pdf

**Requirements**
Financial institutions are required to provide clear and conspicuous notices that accurately reflects your privacy policy and practices. Additionally, this privacy statement must be provided annually.

**Include**
Financial Institutions must include each of the following items of information that applies to you or to the consumers to whom you send your privacy notice, in addition to any other information you wish to provide:

1. The categories of nonpublic personal information that you collect;
2. The categories of nonpublic personal information that you disclose;
3. The categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information;
4. The categories of nonpublic personal information about your former customers that you disclose and the categories of affiliates and nonaffiliated third parties to whom you disclose nonpublic personal information about your former customers;
5. If you disclose nonpublic personal information to a nonaffiliated third party, a separate statement of the categories of information you disclose and the categories of third parties with whom you have contracted;
6. An explanation of the consumer’s right under to opt out of the disclosure of nonpublic personal information to nonaffiliated third parties, including the method(s) by which the consumer may exercise that right at that time;
7. Any disclosures that you make under section the Fair Credit Reporting Act;
8. Your policies and practices with respect to protecting the confidentiality and security of nonpublic personal information; and,
9. Any disclosure that you make to third parties for your everyday business purposes, such as to process transactions, maintain account(s), respond to court orders and legal investigations, or report to credit bureaus.

Use of the model privacy form in appendix A 16 CFR 313, consistent with the instructions in appendix A, constitutes compliance with the notice content requirements, although use of the model privacy form is not required.

**Opt Out Option**
Financial Institutions must provide a clear and conspicuous notice to each of your consumers that accurately explains the right to opt out. The notice must state:

- That you disclose or reserve the right to disclose nonpublic personal information about your consumer to a nonaffiliated third party;
- That the consumer has the right to opt out of that disclosure; and,
- A reasonable means by which the consumer may exercise the opt out right.

**Delivery Methods**
You must provide any privacy notices and opt out notices, that each consumer can reasonably be expected to receive actual notice in writing or, if the consumer agrees, electronically.

- Hand-deliver a printed copy of the notice to the consumer;
- Mail a printed copy of the notice to the last known address of the consumer;
- For the consumer who conducts transactions electronically, clearly and conspicuously post the notice on the electronic site and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining a product or service; and,
- For an isolated transaction with the consumer, such as an ATM transaction, post the notice on the ATM screen and require the consumer to acknowledge receipt of the notice as a necessary step to obtaining the product or service.

**Prohibitions**
Financial institutions must not, directly or through an affiliate, disclose, other than to a consumer reporting agency, an account number or similar form of access number or access code for a consumer's credit card account, deposit account, or transaction account to any nonaffiliated third party for use in telemarketing, direct mail marketing, or other marketing through electronic mail to the consumer.

Additionally, financial institutions may not, directly or through any affiliate, disclose any nonpublic personal information about a consumer to a nonaffiliated third party unless: (i) You have provided to the consumer an initial notice; (ii) You have provided to the consumer an opt out notice; (iii) You have given the consumer a reasonable opportunity, before you disclose the information to the nonaffiliated third party, to opt out of the disclosure; and (iv) The consumer does not opt out.

**Relations to Other Federal and State Laws**
This Federal requirement does not modify, limit, or supersede the operation of the Fair Credit Reporting Act. This Federal requirement shall not be construed as superseding, altering, or affecting any statute, regulation, order, or interpretation in effect in any State, except to the extent that such State statute, regulation, order, or interpretation is inconsistent with the provisions of this part, and then only to the extent of the inconsistency.

State statutes, regulations, orders, or interpretations is not inconsistent with the provisions of this part if the protection such statutes, regulations, orders, or interpretations affords any consumer is greater than the protection provided under this federal regulation.