

COMPLIANCEWATCH

YOUR EYES AND EARS IN WASHINGTON, D.C. • MAY 2011 • ISSUE 26

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What does the Pacific National Bank settlement mean to financial institutions?

Bob Pasley

Just recently, on March 23, 2011, the OCC and FinCEN issued a \$7 million civil money penalty (CMP) against the Pacific National Bank, Miami, Florida. In connection with this case, the first question is what gave rise to such a relatively large CMP against a bank which, as of year end, had total assets of only \$355 million and, for 2010, had a negative net income of \$300,000.

Background

A little history can explain a lot. A number of years ago, the OCC concluded that the bank had failed to establish and maintain procedures reasonably designed to ensure and monitor its compliance with the Bank Secrecy Act (BSA) (in violation of 31 U.S.C. § 5311, et seq.); had violated the regulation pertaining to Suspicious Activity Reporting requirements (12 C.F.R. § 21.11); and had violated the regulations requiring a BSA compliance program (12 C.F.R. § 21.21). As a result, the OCC required the bank to enter into a "Consent Order" on December 16, 2005. Among the things required of the bank by the Order were the following:

- An adequate system of BSA internal controls;
- Enhanced policies and procedures for monitoring transactions that pose a greater than normal risk for BSA compliance;
- Procedures for opening new accounts;
- Procedures for identifying and reporting suspicious activity, especially large and unusual cash transactions and wire transfers;
- Procedures to review foreign correspondent bank accounts;
- Appropriate thresholds for monitoring;
- Annual review of all high-risk accounts;
- Sufficient BSA personnel;
- Adequate BSA audits; and
- Adequate BSA training.

Less than a year later, on 7/14/06, FinCEN sent a formal written warning to the bank stating that the bank's BSA and SAR procedures were potentially deficient.

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K.Y.A. KNOW YOUR ACRONYMS

GAO General Accountability Office
UAT User Acceptance Testing
SIC Standard Industrial Classification
C&D Cease and Desist Order





- Failure to conduct adequate enhanced due diligence when appropriate;
- Failure to comply with Suspicious Activity Reporting requirements by not identifying, monitoring and reporting suspicious activity;
- Failure to have adequate policies and procedures concerning foreign correspondent bank accounts; and
- Failure to monitor:
 - Failure to recognize the risk inherent in foreign correspondent bank accounts and to adequately monitor transactions in light of that risk;
 - Restricting the monitoring of foreign correspondent accounts to those accounts with transactions greater than \$50,000 a day (in seeming direct violation of the 2005 order);
 - Failure to effectively identify and monitor all accounts owned by one customer; and
 - Failure to aggregate and monitor wire activity, some of which were conducted through sundry accounts.

The concluding remark by Acting Comptroller of the Currency Walsh with regard to this case was: "Banks must devote appropriate resources commensurate with their risk profile and must take prompt and necessary steps to comply with the OCC enforcement actions to ensure compliance with the Bank Secrecy Act and the USA PATRIOT Act."

This advice needs to be taken to heart in order to potentially avoid being the next Pacific National Bank.

Lessons learned

Some of the lessons to be learned from this case include the following:

- Comply with BSA;
- Have the best BSA program possible;
- Have good and complete BSA policies and procedures that the Board of Directors and senior staff buy-in to and actively support;
- Retain adequate and competent BSA staff;
- Respond to warnings from the regulators: take them seriously and comply with regulatory directives, suggestions and advice fully and on a timely basis (unless there is a sound basis for not doing so and you discuss the issue thoroughly with the regulators);
- Comply even more assiduously with formal administrative actions (failure to do so is simply crazy);
- Conduct a comprehensive risk assessment of your money laundering and terrorism financing risks (if you do not think that you have any, check again);
- Periodically update your policies, procedures and risk assessments;
- Retain outside consultants to review your BSA program; and
- Don't spare the expense: if you spend the money upfront, you may well avoid having to pay exorbitant penalties that could have been better spent on your BSA program.



Robert S. Pasley spent 30 years with the OCC as an attorney and then as an Assistant Director in the Enforcement and Compliance Division of the OCC's Law Department. He worked for FinCEN and then for Bank of America as a Senior Vice President. He is currently a consultant and attorney in the areas of anti-money laundering and bank regulatory compliance. Email bob@pasleyconsulting.net.



Benefits of Outsourcing Compliance Work and ... **A Few Words of Caution**

MARY THORSON

You've discovered a way to:

Get access to specialized compliance skills and services;

Concentrate more on your core business and economize your in-house efforts to support compliance requirements; and

Develop resources to stay ahead of or even with the regulatory tide.

You must be dreaming ... or you may be using outsourcing as a compliance tool.

Over the past 25 years, the financial services industry has experienced swings of deep and far-reaching regulatory changes. Although very large or complex organizations may have some unique compliance recordkeeping and reporting requirements, the vast majority of banks, non-bank financial institutions and other financial service providers shoulder a full repertoire of sophisticated regulatory requirements, nearly oblivious to their size, geographical location, business targets or complexity of products and services. Costs associated with full-time compliance staff employment and benefits have strained organizational resources supporting non-core business functions, such as compliance program management and operation.

As a take on the old Gerber television advertisement, “compliance is our business.....our ONLY business,” Ascella Compliance dedicates its core business to providing such outsourced compliance support and we observe key benefits for our clients’ time and time again.

Compliance outsourcing provides you with access to specialized skills and reduces the need for internal commitment of specialists. These benefits remain the key reasons why many financial services companies opt for some form of compliance outsourcing. By outsourcing, you can take advantage of expert and skilled services of compliance professionals that you would not be able to justify as full-time employees. Just taking Ascella Compliance as an example, the experience level of our staff averages 25 years directly managing compliance requirements in the industry and from perspectives blended among financial institutions, money services businesses, regulatory agencies and consultancies.

Breadth and depth of experience are important points to consider, too – 25 years in the same organization filling the same role is a vastly different experience than being on teams among different organizations in different roles in the industry. There are reasons why, histori-

cally, there have been migrations of regulators to for-profit financial concerns and vice versa. Cross-pollination brings perspective of the “sister” organizations of the industry to the table. Outsourcing compliance services is based on that concept without the long-term obligation to your organization to add costly full-time staff. Consider, too, that your consultants have opportunities to bring a quiver of arrows that represent experiences among numerous organizations like yours or that have already fought the compliance battle that you are now beginning. You benefit from the provider’s expertise in solving problems for a variety of clients with similar requirements.

A small- to medium-sized business can contain the costs of access to specialized compliance professionals, benefit from a broad and deep base of experience and select from a “menu” of services, choosing only those that make sense when fitted with the available in-house resources. Organizations can pick and choose among outsourced

loan requirements, outsourcing allows you to leverage the specific experience needed to balance the knowledge base.

Consider that, regardless of size or complexity, the technical requirements for financial service providers lay out on a pretty level playing field. That’s a good thing from the standpoint of competition and fair business practices; however, a level playing field also holds smaller organizations to standards that stretch the capabilities and bandwidth of their more-limited human resources. Although they can adapt the measurement of some requirements to the organization’s profile, regulators are forced, too, to measure many legal and regulatory requirements by the strict letter and spirit of the rule. So, even if your organization only has one or two transactions of a particular type during an evaluation period, all the policies, procedures, disclosures and training that are required of organizations for which those transactions are a core product apply to your smaller universe. Voila! The “cost” of compliance.

Ask anyone who has made a career in financial services what the top challenges are to successful compliance management and, inevitably, among the top responses you will find “changes in regulatory requirements.”

services to fill gaps or to provide better coverage to high-risk processes. It’s not uncommon for an organization to be “unbalanced” in its organic expertise among compliance disciplines. Whether your staff leans toward anti-money laundering experience or consumer

Ask anyone who has made a career in financial services what the top challenges are to successful compliance management and, inevitably, among the top responses you will find “changes in regulatory requirements.” Think about the profile of your compli-



ance outsourcing provider. Not only can and should they employ the most recent compliance requirements in the work that you have engaged them to perform, but you can benefit from ensuring an element of your agreement with them includes a provision for keeping you or key members of your staff in the know.

Relationship-building is another key benefit of outsourcing with compliance professionals. By engaging highly-experienced professionals, you also have the opportunity to facilitate links to regulators, other beneficial service providers and industry leaders. Years ago, management courses focused on the concept of the "sphere of influence." One's workplace sphere of influence was the span of effective relationships he/she built and maintained among colleagues, management, direct reports and business partners. Outsourcing has the potential to exponentially expand your sphere of influence beyond mainstream internal and external contacts.

One last benefit is the independence of the consultant. You are likely to get some unique feedback regarding the completeness and cohesiveness of

your compliance program and posture from a third party who is not a part of or subject to organizational chain-of-command dynamics. This benefit is priceless.

After all is said and done, any organization can benefit from professional compliance services. Any services performed by a third party for your organization, though, need to be managed. Here are some key components to successfully partnering with outsourced compliance service providers:

- Review thoroughly the qualifications and experience of the consultants who will work with your organization. Schedule a call to experience how effectively the communication flows.
- Make sure you understand the scope of the work that will be done – a review of the Bank Secrecy Act can be very high-level or "in the weeds." Discuss what your organization needs.
- Encourage your staff to be responsive to requests for review materials. Timeliness of deliverables is critical to

project completion within estimated timeframes and can mitigate the need for costly additional hours.

- Encourage your staff to be forthcoming in discussions with your consultants. Disclosure about procedures and records, even when they may not be pristine, is paramount for the consultant to help resolve challenges. When you are paying someone to help you, it is not a good time to play "hide the ball!"

In the evolution of the financial services industry, most organizations have found that their internal resources cannot meet every purpose – either due to bandwidth, expertise or a combination of both. Consider how compliance outsourcing, when surgically tailored to meet the needs of your organization, can raise the level of compliance success and relieve internal resources to be applied to your core business. Ascella Compliance welcomes the opportunity to discuss your compliance challenges with you to find your solution.



*Mary Thorson, SVP, Ascella Compliance, has over 25 years of experience in regulatory compliance management, review and training. She has previously held positions such as Managing Examiner for the Federal Reserve System; Director and Deputy Chief Compliance Officer for E*TRADE Financial; Director for Corporate Compliance at First Data Corporation and Director of AML Compliance for National Accounts at Western Union. As Principal and Director of Fortner, Bayens, Levkulich & Co., P.C., a Denver-based consulting firm, Mary created and managed a highly successful program of professional compliance consulting services for financial institution clients including, but not limited to, the Bank Secrecy Act and related anti-money laundering laws and regulations, loans, deposits, operations, funds transfers/wires, privacy and sale of non-FDIC insured deposit products on bank premises.*

Who Are SARs Written For?

By Dennis M. Lormel

Bank Secrecy Act (BSA) reporting requirements are written in black and white. However, their application is gray, not black and white, and their interpretation can be subjective. These dynamics go directly to the heart of a confusing and frustrating question. Who do financial institutions write suspicious activity reports (SARs) for, law enforcement or regulators?

The purpose of SARs is to report known, or suspected, violations of law or suspicious activity observed by financial institutions subject to BSA regulations. In many instances, SARs have been instrumental in enabling law enforcement to initiate or supplement major money laundering or terrorist financing investigations and other criminal cases. SARs make a difference and are valuable investigative tools. Without question, law enforcement is the direct beneficiary of SARs. Hence, SARs should be written for law enforcement.

Unfortunately, many financial institution compliance professionals responsible for submitting SARs will tell you that they prepare SARs to satisfy their regulators. Most of these compliance professionals understand that SARs should be written

for law enforcement, according to law enforcement's specifications. However, they have been criticized or fear repercussions from their regulators if they don't write the SARs in accordance with the regulator's preferences. Many times, the regulatory opinion differs from the law enforcement opinion on how a SAR should be written by a financial institution. This is where the gray area of application and the subjectivity of interpretation conflict with practicality, and the black and white of regulations.

What complicates the situation is that the biggest BSA compliance breakdown is the failure to file SARs or adequate SARs. There is a clear need for regulatory oversight of the SAR process. Quality control is extremely important. Regulators play a pivotal role in ensuring that financial institutions comply with BSA reporting requirements and maintain an effective and efficient SAR process. Regulatory oversight of the SAR process is an essential component of consistent meaningful SARs being prepared by financial institutions for law enforcement's benefit.

Regulators must realize that SARs are not written for them. They are written for law enforcement. In that regard, there needs to be national and local consensus between law enforcement, regulators, financial institutions and FinCEN that SARs are written specifically for law enforcement's use. This is where the challenge of the gray area and subjectivity factor must be broken down in favor of practical application to better benefit law enforcement.

A strong and visible public-private partnership between the regulators, law enforcement, financial institutions and FinCEN is needed in order to accomplish this. There has to be communication, cooperation and coordination among all stakeholders in the SAR process. A consensus on a meaningful and consistent SAR process to better support law enforcement is in our best interest. Good SARs make an important difference to law enforcement's ability to make strong prosecutable cases. Strong prosecutable cases safeguard our economy and national security.



Dennis Lormel, Senior Advisor, retired from the Federal Bureau of Investigation (FBI) in December 2003, following over 30 years of government service, almost 28 years as a Special Agent in the FBI. During his distinguished career, Mr. Lormel amassed extensive major case experience as a street agent, supervisor and senior executive, particularly in complex, document- and labor-intensive financial-related investigative matters.

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B.S.A. CORNER

Bald, Short & Active!

GREGORY D. BENSON

I just read where Colombian soldiers seized a 99 foot long fully submersible submarine that was to be used to transport drugs to Mexico. (Estimates are that the sub could have held eight tons of drugs.) Colombian officials estimated the sub took six to eight months to build and cost about \$2 million. This would have been one of the first fully submersible subs in the Colombian drug cartel's arsenal. Over the last decade, Colombia law enforcement has seized over thirty (30) semi-submersible vessels (i.e., those that have to be above water part of the time and are easier to spot). I have been told over the years by a good friend down in Southern Florida that many banks in his neck of the woods offer submarine financing and I always chuckled. Maybe the laugh is on me now.

Since our economy is showing signs of recovery, is mortgage fraud a thing of the past? "Not so fast, my friend," the pet phrase of ESPN's College GameDay Analyst Lee Corso, comes to mind. Here in Virginia a local real estate agent has been arrested on charges that she defrauded lenders of \$50 million. According to court documents, Diane H. Frederick Atari fraudulently fixed her clients' credit scores, inflated their incomes on financial records, falsified her clients' employment records and, in some cases, deposited some of her own money into clients' accounts to inflate their balances. She is alleged to have earned more than \$1 million in fees and commissions from the scheme. If convicted of all twelve felony charges, she could be doing 280 years. A piece of cake, right? According to the Mortgage Bankers Association, there are 4.5 million homes here in the United States in some stage of foreclosure. Some experts are predicting another 1.5 million may be added in 2011. If your bank has foreclosed on any mortgages in the last two to three years, I would recommend that you look at those loans to see if there is any indication of unusual or suspicious activity. It would be a big mistake if the regulators found unusual or suspicious activity on a number of your foreclosed mortgage loans and they were not reported on a SAR. Just a word to the wise.

Bad Karma? The new Consumer Financial Protection Bureau is moving into the old Office of Thrift Supervision Headquarters space in Washington, D.C. Hopefully Elizabeth Warren can remain independent and not be like the OTS who seemed to cower to its biggest thrift institutions (e.g., Washington Mutual).

Welcome to the latest edition of BSA Corner. This new column has a reason behind its name and I'll share it with you... I am sure a number of you are familiar with Tony Kornheiser, sportscaster for ESPN and host of "Pardon the Interruption." Tony's roots go back to his days at The Washington Post as a sports columnist. Throughout my banking career, I have contributed articles to various publications and I thought if Tony could write a column, so could I. I have entitled my column, **B.S.A. Corner ("Bald, Short and Active")**, which I think describes me and is a tribute to Tony and his book ("Bald as I Want to Be").

With all the turmoil around the world, now would be a great time for all BSA officers to spend some quality time in your wire transfer department. A quick examination of wire transfer activity to the countries in the news – like Egypt, Libya, and Tunisia – might turn up some activity worth a more detailed review. Another word to the wise.

All check cashers and their banks should be carefully watching the Palm Beach, Florida case involving Wachovia Bank, FHA All Day.Com and Swifty's Market. Wachovia Bank has been sued by a court-appointed receiver for FHA All Day.COM, a defunct loan modification company. The lawsuit states that FHA All Day.Com received cashier's checks from homeowners seeking modification of their loans. These checks were sent as an upfront fee. FHA All Day.Com cashed the checks at Swifty's Market (FinCEN MSB Registration website contains a listing for Sabat Brothers, Inc. DBA Swifty Market Grill & Deli, Boca Raton, Florida). Swifty's Market then deposited those checks into their Wachovia Bank account to clear the checks. The lawsuit contends that Wachovia never questioned the checks, never alerted the homeowners and never reported any unusual or suspicious activity to the proper authorities. The lawsuit claims that Wachovia did not pay attention to the many "red flags" related to Swifty's Market account – the market's need for large sums of currency, the massive number of cashier's checks being deposited into Swifty's Market account and its lack of oversight of a high-risk business – a check casher. The lawsuit also names Swifty Market and its principal, Charly Sabat. In an unrelated mortgage scheme, Jason Vitulano, CEO in FHA All Day.COM, was sentenced to five years in jail in August 2010. The Secret Service seized his assets which included a Rolls Royce Phantom, Lamborghini, Ferrari and 42-foot Fountain racing boat. Boys and their toys – racing boats and subs – when will they grow up?



Gregory D. Benson, Principal, Ascella Compliance, has over 30 years of financial service industry experience at commercial banks, savings and loans, private consulting and trade association work, with special emphasis on compliance and security issues.

*He is the former SVP, Sr. Compliance and BSA Officer of \$650M asset NOVA Bank; VP and Chief Compliance Officer of \$1.5B Burke and Herbert Bank and Trust Company; and Director, Compliance & Security at E*TRADE Financial. Mr. Benson served on the U.S. Treasury's Financial Crimes Enforcement Network's Bank Secrecy Act Advisory Group for five years.*



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- > The subscription fee includes **one hour per month of free compliance consulting** with Ascella staff.
- > This comes out to 12 hours of compliance consulting for just the subscription fee of \$100-200 a year- a **savings of over \$2,000 a year in consulting costs!**
- > Our staff members will answer your questions about compliance and provide advice and recommendations about changes in regulations, best practices, BSA/AML, licensing and so much more.

To subscribe, contact us at: compliancewatch@mfi-corp.com.

Contact Us

Corporate Headquarters

Ascella Compliance
1090 Vermont Avenue, N.W.,
Suite 1250
Washington, D.C. 20005

Tel: 202.503.1075
Fax: 202.682.9710

Mary Thorson, SVP
Ascella Compliance
Tel: 804.739.2403
mary.thorson@mfi-corp.com

On the web at

www.ascellacompliance.com

Si desea más información
en español escríbanos a:
kris.welch@mfi-corp.com

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Ascella Compliance fosters market growth, stability and social development within North America and developing countries by providing superior innovative and holistic compliance services to financial institutions, in particular, those with a focus on financial innovation. Ascella Compliance is a department of Microfinance International Corporation, whose mission is to enable clients to offer competitive and innovative financial services.

Clients look to Ascella Compliance for assistance with complex regulatory, safety and soundness and internal control matters. We provide a diverse range of services to help financial institutions

establish and maintain strong compliance programs, improved transaction monitoring, proper internal control programs, and compliance with financial services laws and regulations and licensing requirements. We also advise our clients on designing new business models and structuring transactions in a way that ensures compliance with U.S. and state regulatory requirements. In order to meet the needs of our customers offering money remittance and wire transfer services, we offer a proprietary transaction settlement platform which includes a real-time anti-money laundering/OFAC compliance monitoring system.

Our Team



Mary Thorson, SVP, has over 25 years of experience in regulatory compliance management, review and training across the regulatory field, brokerage and MSB arena and consulting. She has served as Managing Examiner for the Federal Reserve System. She was previously the Director for Corporate

Compliance at First Data Corp and Director of AML Compliance for National Accounts at Western Union. She holds a Bachelor's Degree in Human Resources Administration from St. Leo College.



Dennis Lormel, Senior Advisor, retired from the Federal Bureau of Investigation (FBI), following over 30 years of government service, including almost 28 years as a Special Agent in the FBI. He has amassed extensive major case experience, particularly in complex, document and labor intensive financial related investigative matters. Immediately following the terrorist attacks of September 2001, Mr. Lormel established and directed the FBI's comprehensive terrorist financing initiative.



Connie Fenchel, Senior Advisor, has of 33 years of experience in regulatory compliance, financial crimes and customs violations in government and private sector. Ms. Fenchel served as the Deputy Director, Operations and the Executive Assistant Director of Law Enforcement Policy for FinCEN. She led FinCEN's effort to administer AML provisions of BSA more effectively and efficiently. Ms. Fenchel holds a Masters Degree in Management from National Louis University and a Bachelors Degree in Criminal Justice from the University of South Florida.



Robert S. Pasley, Senior Advisor, spent 30 years at the OCC, where he was an attorney and then an Assistant Director of the Enforcement and Compliance Division. He is an expert in the area of AML and financial regulatory and enforcement matters. After retiring from the OCC, he worked for FinCEN and was a Senior Vice President at the Bank of America. More recently, he has been a consultant for the IMF, American Express and ABA.



Elliott C. McEntee, Senior Advisor, is a member of the Company's Board of Directors and retired as President and CEO, NACHA that oversees the operations of the ACH Network and develops its operating rules. He has also served for 20 years with the Federal Reserve System including 15 years as its Associate Director for Payment Services and Policies on the staff of the Board of Governors. He graduated from San Jose State University with a Bachelor of Science degree in Industrial Relations and was a member of the U.S. Air Force.



Paul Allan Schott, Senior Advisor, has had a distinguished 30 year career in financial services, having served as Chief Counsel of the Office of the Comptroller of the Currency, Assistant General Counsel for Banking and Finance at the U.S. Treasury Department, and Senior Attorney at the Board of Governors of the Federal Reserve System.



Kris Welch, CRCM, CAMS, VP, has worked over 25 years in the financial industry, in compliance and regulatory risk assessment, branch management, and real estate appraisal. She established, coordinated and maintained an effective compliance program for two financial institutions, which resulted in improving their regulatory ratings from unsatisfactory to satisfactory. She has experience with both banks and MSBs.



Gregory D. Benson, AVP, has over 30 years of financial service industry experience at commercial banks, savings and loans, MSBs, private consulting and trade associations, with special emphasis on compliance and security issues. Mr. Benson served on the U.S. Treasury's Financial Crimes Enforcement Network's Bank Secrecy Act Advisory Group for five years.



Jill Emerson, AVP, has worked in BSA/AML and other areas of regulatory compliance in the financial services industry for more than 20 years with three different banking institutions. She has also served as a Consumer Affairs Examiner for the Federal Reserve Bank of Kansas City. She has created and maintained BSA/AML programs, provided BSA/AML training, conducted independent reviews of large financial institutions and MSBs and overseen and administered automated monitoring software programs.



Melissa Henry, AVP, has over 22 years experience in the financial industry She has developed and maintained compliance monitoring programs and testing and implementation for appropriate enhancements to the programs. She administered an effective compliance program for a growing financial institution, including establishing new branch locations, providing guidance to the management on mitigation and reviewing internal policies, operational standards, controls and procedures.



Wendy Knutson, AVP brings extensive experience in state/territorial money transmitter and check/money order sales licensing. She served as Senior Compliance Analyst for First Data Corporation, leading a team responsible for the licensing requirements of Integrated Payment Systems. Ms. Knutson holds a BA in Political Science from the University of Houston and a paralegal certificate from the Denver Paralegal Institute.



Rodney Esch, Business Development Advisor, is focused on strategy, planning, risk management and governance for his client companies. For thirty years, he has led large and small organizations in public and private company settings providing services to financial institution and commercial clients. His leadership has achieved results with increased revenue and operational efficiencies. He is past President and General Manager of Integrated Payment Systems. Mr. Esch received his BS Accounting degree from the University of Northern Colorado.