Practical Suggestions and Tips for an Effective BSA/AML Compliance Function

Enterprise-Wide Risk Assessments as a Roadmap To Efficient BSA / AML Compliance

May 23, 2011
Agenda

- Importance of Enterprise-Wide BSA / AML Risk Assessments
- US Regulatory Guidance & International Standards
- Commonly Cited Weaknesses
- Linking Risk Assessment Results to AML Operational Strategies
- Key Attributes for Success
  - Ownership
  - Inputs into the risk assessment process (risk factors)
  - Review / refresh process
  - Sustainability
Importance of Enterprise-Wide BSA / AML Risk Assessments

- Compliance expectation of US operation in a Global enterprise
- Central focus of regulatory examinations
- Anchors the entire AML risk management framework
  - Enables an institution to apply risk management processes to its BSA / AML compliance program
  - Meets the BSA / AML compliance program needs of the local enterprise reflecting the institution’s global standards
  - Allows flexibility and adaptability as businesses, markets, customer types change
- Facilitates the allocation of compliance resources
- Sound business practice
The revised Federal Financial Institutions Examinations Council (FFIEC) Bank Secrecy Act / Anti-Money Laundering (BSA / AML) Examination Manual recommends that:

- Institutions should not only assess risk within individual business lines, but also on a consolidated basis across all activities and legal entities.

- BSA / AML risk assessment should be an ongoing process, and not just a one-time exercise.

- Institutions should reassess their BSA / AML risks at least every 12 to 18 months.

- Risk assessments should also be revisited more frequently if and when there are material changes in the facts and circumstances of the underlying businesses.

- Institutions structure their BSA / AML compliance program to adequately address its risk profile (as determined by the risk assessment).
International Standards

- Financial Action Task Force (FATF)
  - “Guidance on the Risk-Based Approach to Combating Money Laundering and Terrorist Financing – High Level Principles and Procedures” (June 2007)

- Basel Committee on Banking Supervision
  - “Compliance and the Compliance Function in Banks” (April 2005)

- The Wolfsberg Group
  - “Guidance on a Risk-Based Approach for Managing Money Laundering Risks”

- The United Kingdom Joint Money Laundering Steering Group (JMLSG)
  - “Prevention of Money Laundering / Combating the Financing of Terrorism” (December 2009)
Commonly Cited Weaknesses

- Risk assessments were not performed / documented
- Risk assessments did not incorporate all lines of business or entities
- Risk assessments were not consistently performed globally
- Assessments did not consider all major risk categories
- Policies did not specify frequency of updates / reassessments
- Lack of methodology for assigning risk levels to customers
- Policies and procedures (e.g., CDD / EDD, transaction monitoring) procedures are not commensurate with the institution’s BSA / AML risk profile
Practical Suggestions and Tips for an Effective BSA/AML Compliance Function

Linking the Risk Assessment to AML Operational Strategies

- A formal process that considers all elements, stakeholders, inherent risk, and residual risk within a documented, defensible and maintainable form.

- Build the AML program to have linkage and connectivity to the risk assessment. Focus on risk and improvement areas, and avoiding a “turnkey” overcontrolling of program elements.

- Reporting is key to managing operational risk, regulatory need, and to influencing future risk assessments.

Formally Linking Risk Scores to Practices

Executive Sponsorship / Advocacy

Risk Assessment
- Formalized, Documented Process

Program Development & Execution
- Policies
- Procedures
- Control Design
- Technology Enablement Evaluation
- Resource Evaluation
- Differentiate Training
- CDD & EDD
- Ongoing Transaction Monitoring

Risk Reporting
- Escalation
- Evaluation
- SAR Report
- Internal Metrics

Program Monitoring

Ernst & Young
Quality In Everything We Do
Key Attributes for Success

- Executive sponsorship; approval by appropriate committees
- Active participation from key stakeholders
- Identification of relevant risk categories / factors
- Upfront dialogue with business (new products, businesses, etc.)
- Refresh of risk assessments – timely and responsive to changes
- Comprehensive in terms of depth and breadth
- Applied consistently throughout the enterprise
- Sustainable and ongoing across all business lines
- Risk philosophy and risk assessment methodology are clearly described and documented
Ownership of the AML Risk Assessment Process

- Ownership of the process
  - Compliance, Line of Business, Legal, Audit, Operations

- Inputs into the process (by risk type)
  - Line of business risk
  - Customer risk
  - Product risk
  - Transaction risk
  - Geographic risk
Customer Risk Factors

- Type of customer
- Products used
- Primary location
- Citizenship or incorporation
- Source of income or wealth
- Location of transactions
- Prior enforcement actions
- PEP or watch list status
- Length of relationship
Trigger Events for a Refresh /Review

- **Examination Findings**
  - Internal Audit, External Audit, Regulatory Exam

- **Significant Changes to Business:**
  - Acquisition, New Line of Business, New Market/Geography, Product Launch

- **Customer Activity:**
  - New customer activity, SAR filing against customer, Law enforcement request against a customer, change in customer’s geographic location,
Sustainability

- Tools
- Complexity of risk scoring model
  - The more complex, the more likely the rating will reflect customer’s overall risk
  - However, the more difficult it may be to determine risk rating on an on-going basis (addition of new products, new markets, etc)
Appendix
Primary Risk Assessment Factors

- Client / Customer Types
- Geographies/ Jurisdiction
- Products and Services
- Distribution Channels
- Funds Flow
- Transaction Documentation
- Terms of Settlement or Delivery
Secondary Risk Assessment Factors

- Suspicious Activity Reports (SARs) Filed
- 314(a) and 314(b) Referrals
- Subpoena Volume
- OFAC Blocking and Rejecting Activity
## Sample Inherent Risk Framework

<table>
<thead>
<tr>
<th>Client Types</th>
<th>High</th>
<th>Medium</th>
<th>Low</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Arms Manufacturers</td>
<td>• Building Construction / General Contractors</td>
<td>• Utilities</td>
<td></td>
</tr>
<tr>
<td>• Travel Agencies</td>
<td>• Waste and Metal Recycling</td>
<td>• Agricultural Production</td>
<td></td>
</tr>
<tr>
<td>• Dealers in Precious Stones / Metals / Jewels</td>
<td>• Insurance Agencies</td>
<td>• Oil and Gas Extraction</td>
<td></td>
</tr>
<tr>
<td>• Import / Export Companies</td>
<td>• Loan and Finance Companies</td>
<td>• Government / Public Administration Agencies</td>
<td></td>
</tr>
<tr>
<td>• Pawn Brokers</td>
<td>• Returning Customers</td>
<td>• Publicly Traded Corporations</td>
<td></td>
</tr>
<tr>
<td>• Private Investment Companies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Bearer Share Corporations</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Senior Foreign Political Figures</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Geographies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Countries or jurisdictions designated as primary concerns for money laundering</td>
<td>• Jurisdiction of concern</td>
<td>• Jurisdiction monitored</td>
<td></td>
</tr>
<tr>
<td>• Countries recognized as state sponsors of terrorism</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Offshore Financial Centers</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Countries with high perceptions of political corruption</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Major drug transit or producing countries</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Product / Service Offerings</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Correspondent Accounts</td>
<td>• American Depositary Receipts (ADRs)</td>
<td>• US Treasuries</td>
<td></td>
</tr>
<tr>
<td>• Electronic Banking</td>
<td>• Commodity Derivatives</td>
<td>• Corporate Bonds</td>
<td></td>
</tr>
<tr>
<td>• Private Banking</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Distribution Channels</td>
<td>• Online account opening</td>
<td>• Third party distributors</td>
<td>• Referrals from affiliates</td>
</tr>
<tr>
<td>Funds Flow</td>
<td>• Acceptance of physical currency or monetary instruments</td>
<td>• Frequent transfers to / from accounts at other institutions</td>
<td>• Proprietary trading</td>
</tr>
</tbody>
</table>

Practical Suggestions and Tips for an Effective BSA/AML Compliance Function
Quality of Risk Management / Mitigating Factors

- Organizational Structure and Tone
- IT Infrastructure & Transaction Monitoring / Surveillance Capabilities
- LOB-Specific AML Policies & Procedures
- Global Standards & Local Enterprise
- Employee Training / Awareness
- Results of Prior Internal and External Assessments
## Determining Residual Risk (with sample matrix)

Inherent Risk – Quality of Risk Management = Residual Risk

<table>
<thead>
<tr>
<th>RESIDUAL RISK MATRIX</th>
<th>Quality of Risk Management</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Satisfactory</td>
</tr>
<tr>
<td>Inherent Risk</td>
<td></td>
</tr>
<tr>
<td>High</td>
<td>M</td>
</tr>
<tr>
<td>Medium</td>
<td>L</td>
</tr>
<tr>
<td>Low</td>
<td>L</td>
</tr>
</tbody>
</table>
### Sample Reporting of Risk Assessment Results

<table>
<thead>
<tr>
<th>Service (Line of Business)</th>
<th>Client Types</th>
<th>Geographies</th>
<th>Product Types and Features</th>
<th>Distribution Channel</th>
<th>Funds Flow (In/Out)</th>
<th>Transaction Documentation and Terms of Settlement or Delivery</th>
<th>SARs Filed</th>
<th>314(a) and 314(b) Referrals</th>
<th>Subpoena Volume</th>
<th>OFAC Blocking or Rejecting Activity</th>
<th>Inherent Risk</th>
<th>Organizational Structure</th>
<th>IT Infrastructure and Transaction Monitoring Capabilities</th>
<th>Employee Training/Awareness</th>
<th>Results of Prior Internal and External Assessments</th>
<th>Residual Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>FX Trading</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit Trading</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Debt Syndication</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>IRG Trading</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Securitization</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EMK Prop Trading</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Origination and Distribution</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Karen Modena
Principal
Anti-Money Laundering
Ernst & Young LLP
5 Times Square
New York NY 10036-6530
phone - (212) 773-7959
fax - (866) 491-7963
email - Katherine.Modena@ey.com