Anti-Money Laundering: 2015 Update

July 15, 2015

Anti-Money Laundering: 2015 Update

- Welcome
- The presentation will begin promptly at noon EDT.

- Audio:
  - There is not an option to listen via your computer.
  - Audio conferencing (toll-free): +1 877 275 2967
    Audio conferencing (toll/international): +1 512 900 2166
    Participant code: 58750287

- To view the webinar, you must join via the unique URL provided in your confirmation email.
  - If you have technical issues, please contact WebEx technical support at +1 800 508 8758.

Housekeeping

- All phones will automatically be muted upon your entrance to the meeting. Please also place your phone on mute if that feature is available to you.

- An email will be sent within 48 hours with a link to a recording of the webinar, presentation handouts, and topic-related thought leadership.

- Please submit questions or comments through the Q&A function at the right side of your screen.

- Questions will be addressed throughout the presentation and as time permits at the end of the presentation. We are committed to getting back to everyone about any questions we cannot get to during the presentation.

Housekeeping (continued)

- CPE credit
  - ➤ Log in individually to the WebEx session.
  - ➤ Successfully complete at least three polling questions.
  - ➤ To answer the polling questions, select your response by clicking on the corresponding radio button. You'll have approximately 20-30 seconds to answer each question.
  - ➤ Remain online for at least 50 minutes.

- No CPE credit
  - ➤ Join only the conference call.
  - ➤ Fail to successfully complete at least three polling questions.
  - ➤ View a recording of this session (CPE is awarded only for live sessions).
  - ➤ Remain online for less than 50 minutes.

Housekeeping (continued)

Upon completion of this program, you will receive:

- Evaluations
  - Your feedback is important.

- CPE Certificate of Completion
  - It will be emailed within two to three weeks of your passing this program.

Anti-Money Laundering: 2015 Update

July 15, 2015

Learning Objectives

After this session, you should be able to:

Identify the current trends in anti-money laundering (AML) regulatory supervision and the areas of intensified regulatory expectations. Takeaways include being better able to:

1. Review and inventory the current trends in AML regulatory supervision

2. Discuss the operational impact of regulatory guidance

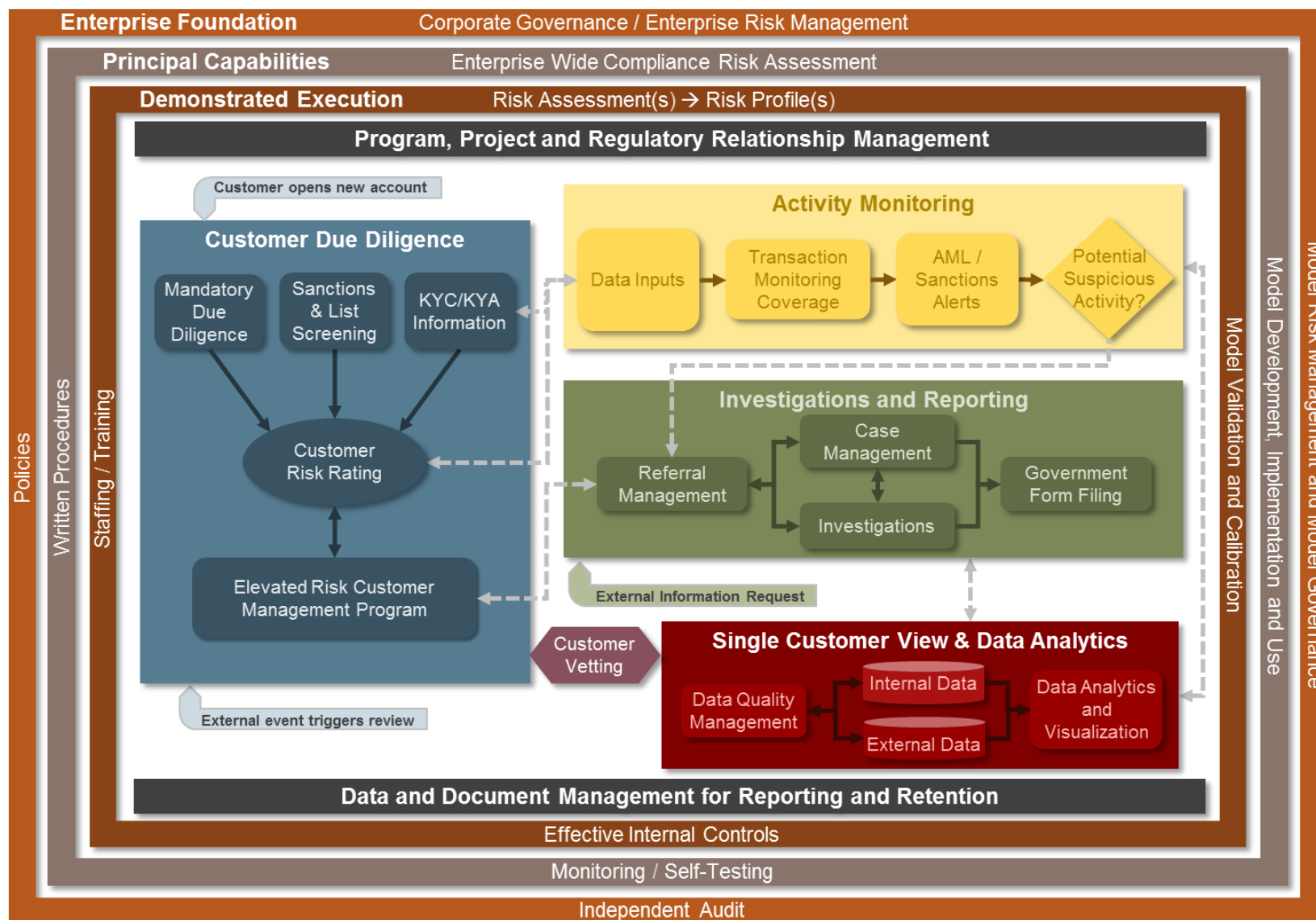3. Explore alternatives for meeting regulatory expectations, including the use of technology and tools

Agenda

A   OVERVIEW OF 2015 REGULATORY LANDSCAPE

B   REVIEW CURRENT AML TRENDS AND AREAS OF FOCUS

C   QUESTIONS

Overview of 2015 Regulatory Landscape

- Derisking
  - Nonbank
  - Virtual currency
  - Foreign correspondent banks

- Consent orders
  - Resources consumed
  - Performance expectations for exit from consent order

- Sanctions/Bribery
  - FIFA
  - Hastert

- Third line of defense
  - What Key Risk Indicators (KRIs) and Key Performance Indicators (KRIs) (alert volume, SARs, etc.) should drive targeted audit projects?

- Focus on model tuning and optimization initiatives
  - Need for data analytics and other empirical support for tuning and optimization decisions
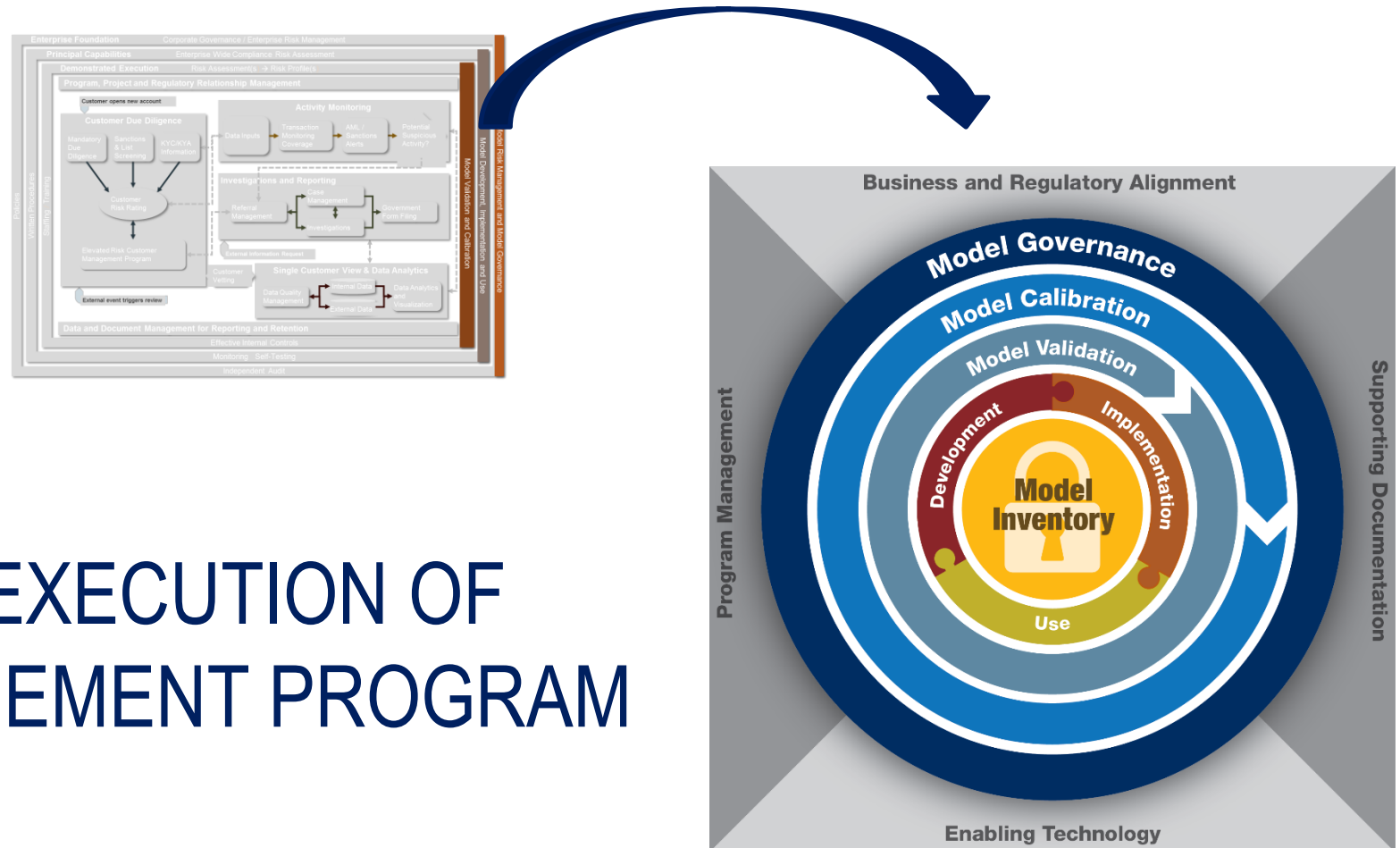
Current AML Trends and Areas of Focus

1 Governance and execution of model risk management program

2 Calibration of customer due diligence models

3 Management of sanctions risk

4 Evolving expectations for nonbank service providers

5 Building and maintaining a sustainable AML program

1

GOVERNANCE AND EXECUTION OF MODEL RISK MANAGEMENT PROGRAM
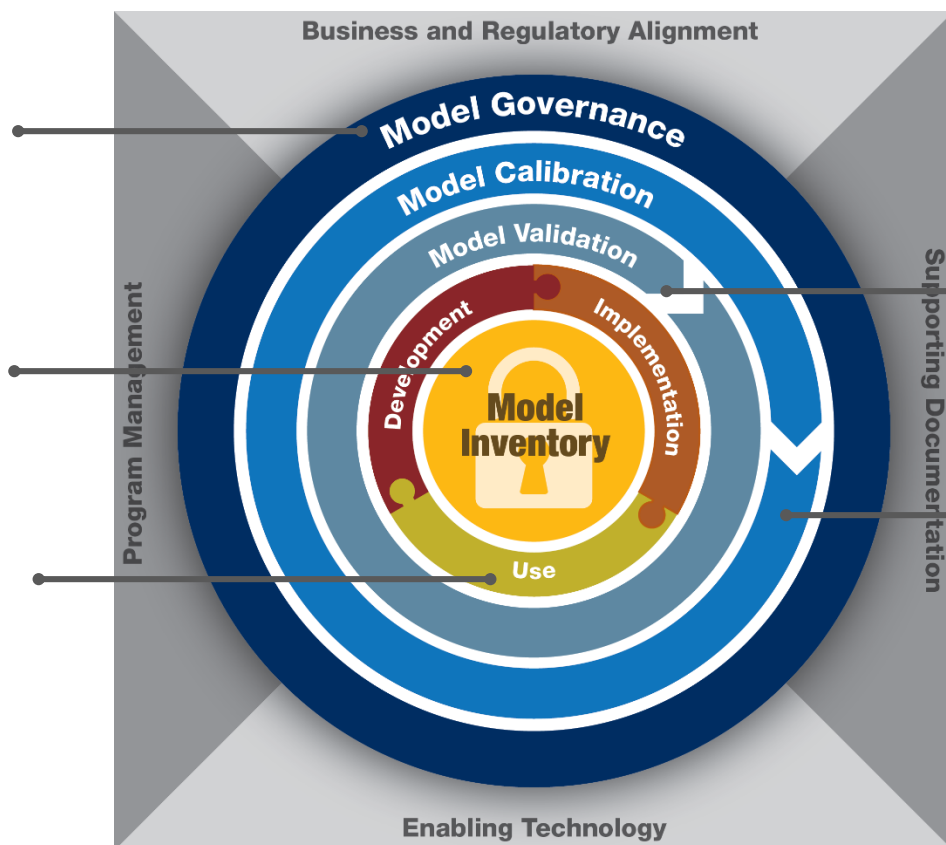
Polling Question 1

- How would you describe the current level of regulatory oversight on AML model risk management?

    a) Experienced targeted examinations that are highly focused on aspects of AML model risk management, such as calibration, validation, or governance

    b) Regulatory agencies pushing my organization to start to build processes and controls over model risk management

    c) No perceived pressure on model risk management at this time

    d) Unsure/don't know

Model Risk Management Operating Framework

Prevailing internal controls are required to govern the model life cycle with the bank's board of directors providing oversight.

Model inventory provides a central repository to store all of the information related to various models.

Model requirements, design, implementation plan, business purpose, and use need to be clearly documented and executed according to sound practices.

Model validation is essential to verify the accuracy and effectiveness against a standard model or any available benchmarks.

A prescriptive calibration methodology and model analysis are necessary to optimize the overall efficiency of the models.

Model Risk Management Themes and Perspectives

- Increasing focus and number of examiner comments connected with AML model risk management concepts

- Continued focus on enhancement or replacement of AML technology

- Renewed focus on all models relied upon for AML compliance

- Continued resource management challenges

- Industry looking to maintain smarter and more efficient model risk management processes that drive value while remaining compliant
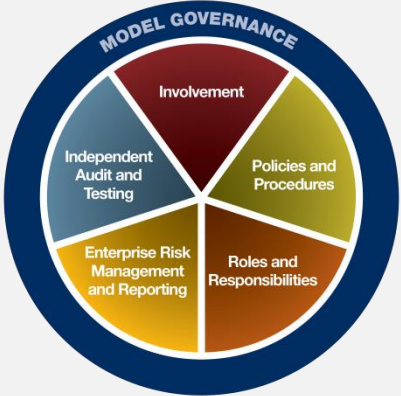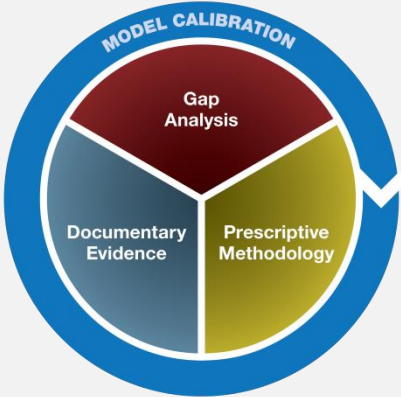
Model Risk Management Challenges

Model Component	Challenges	Strategies
Model Inventory 	✓ **Model inventory and model determination** ✓ **Transparent view of model risks across model stakeholders**	✓ **Standardized model definition approach and methodology** ✓ **Defined and granular model risk assessment**
Model Validation 	✓ **Lack of comprehensive testing plan and strategy** ✓ **Validation of model output and decisions** ✓ **Assessment of model sustainability vs. point in time**	✓ **Alignment of validation scope to model risk assessment** ✓ **Testing design and operational effectiveness of model controls**

16

Model Risk Assessment

	Model Risks	**Model Controls**		**Output**
Risk #1	Model is not aligned to identify typologies of money laundering consistent with the unique risk profile of the organization.	A robust coverage assessment is performed periodically to asses the coverage of detection rules deployed within the system.	**Residual Risk**	✓ **Transparent view of model risks across model stakeholders** ✓ **Robust assessment of granular model risks as opposed to aggregate view** ✓ **Risk-based validation review plan aligned to residual model risks** ✓ **Focus of resources and attention to pockets of high residual risk** ✓ **Senior management, board, and regulatory reporting**
Risk #2	Model assumptions and limitations are unknown or inaccurate resulting in failure to identify suspicious and unusual activity.	Model assumptions and limitations have been documented and impact to transaction monitoring systems assessed.		
Risk #3	Data lacks accuracy and completeness from source systems to the transaction monitoring system.	Data quality assessments verify data provided to transaction monitoring system is accurate and complete.		
Risk #4	Poor business decisions are applied based on model output.	Model output (alerts) are subject to supervisory quality review.		

Model Risk Management Challenges

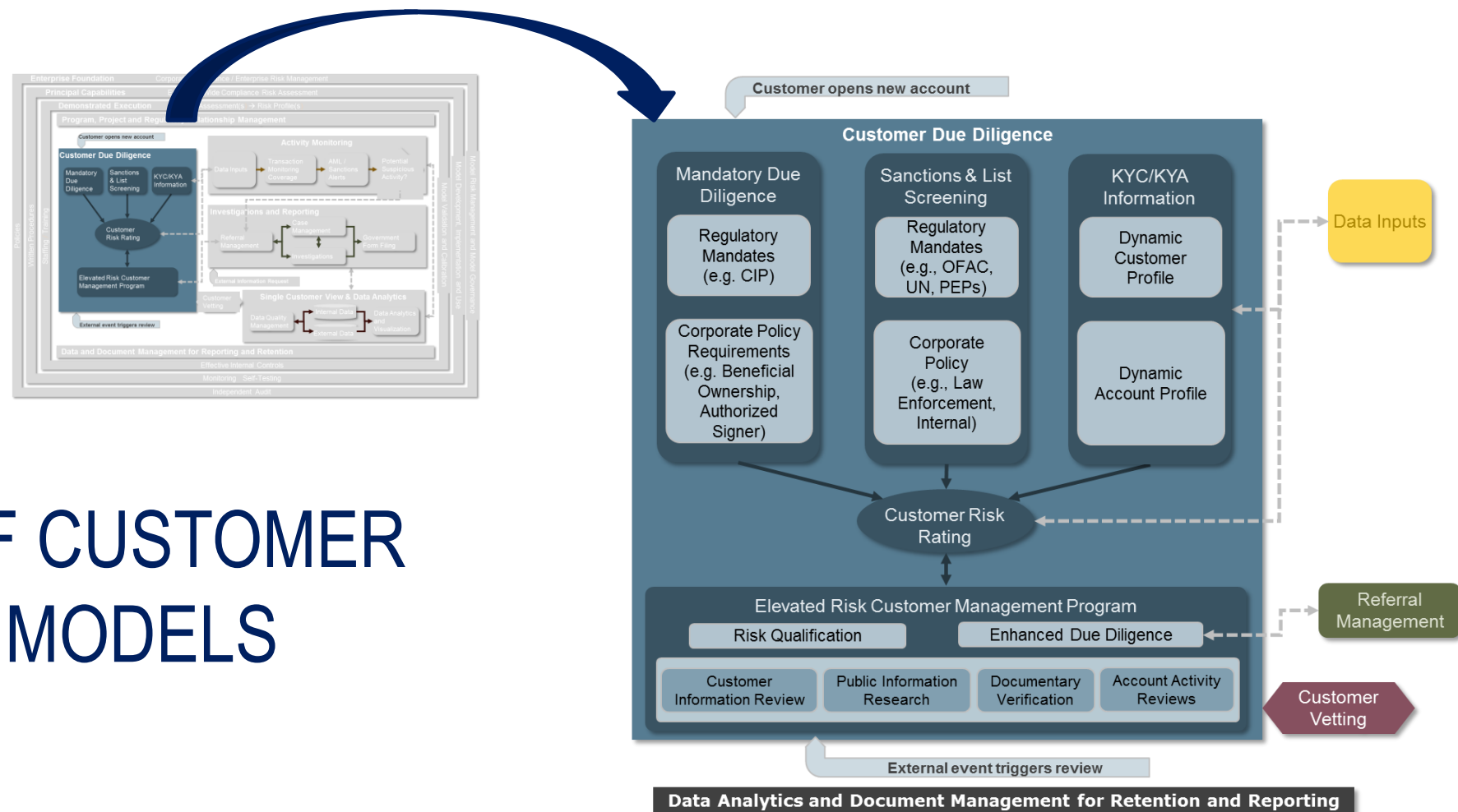| Model Component	Challenges	Strategies
Model Governance	✓ **Maintenance of documentation standards** ✓ **Driving consistency across model risk management tasks and efforts**	✓ **Deploying enabling MRM technology to manage requirements and workflow**
Model Calibration	✓ **Sound and statistically valid processes to calibrate AML models over time** ✓ **Defining and managing "triggering" events, analytics, and reporting**	✓ **Embedding culture of data and analytics** ✓ **Defined event-based calibration triggers**

Model Triggering Event Examples

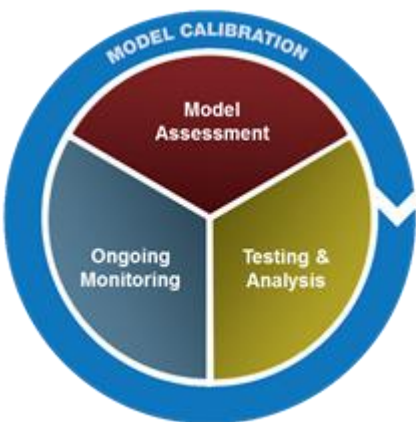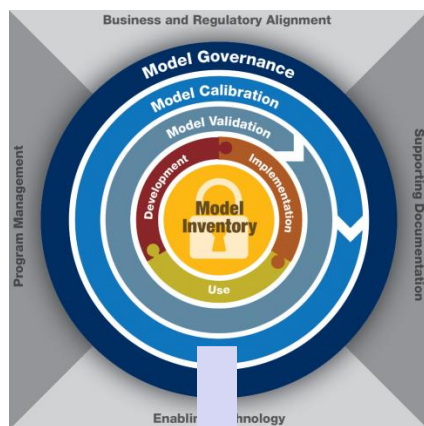| Event	Metric	Response	Party
Low Alert Return	✓ <1% Effectiveness Yield	✓ Production Tuning – Above the Line	✓ Alert Team
High Alert Return	✓ >10% SAR Yield	✓ Production Tuning – Below the Line	✓ Alert Team
New Product	✓ Introduction of New Product	✓ Gap Assessment/Risk Assessment/Baseline Tuning	✓ AML Program Office/FIU
Acquisition	✓ >5% Growth in Deposits	✓ Gap Assessment/Risk Assessment/Tuning/Validation	✓ AML Program Office/FIU/ Validation Team
Change in AML Typology	✓ Ad Hoc – as Identified	✓ Gap Assessment/Tuning	✓ AML Program Office/FIU
Transaction Volume Cash	✓ >1 Standard Deviation Change	✓ Production Tuning	✓ Alert Team

Examples for illustrative purposes only

2

CALIBRATION OF CUSTOMER DUE DILIGENCE MODELS

Polling Question 2

- How would you categorize your customer risk model calibration processes?

  a) We leverage data analytics on new and existing customers to drive continual (for example, monthly, quarterly) calibration efforts.

  b) We have risk-based events as part of our model risk management program that identify when calibration is considered (for example, for new markets or products and services introductions).

  c) We calibrate when we receive specific feedback from either auditors or regulatory agencies.

  d) We have not calibrated since model implementation.

  e) Unsure/don't know

Customer Due Diligence Model Calibration Themes and Perspectives

Expectations

- Above-the-line and below-the-line testing

- Consistently applied methods and decision-making

- Advanced statistical and analytic techniques

- Ongoing process of review and enhancement

- Oversight, approvals, and appropriate change control
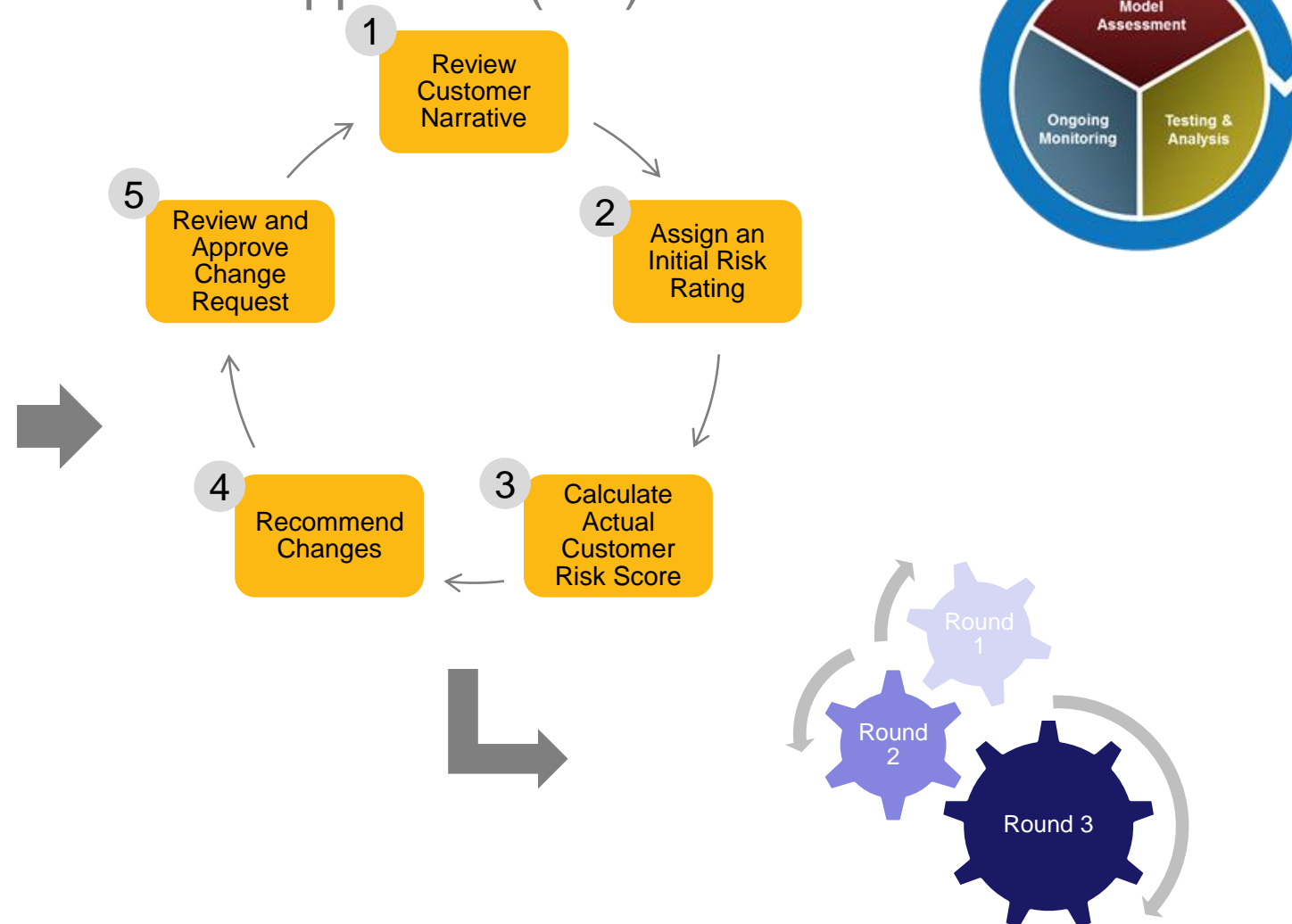
- Documented audit trail of results

Common Challenges

- Use of prescriptive methodology to execute calibration
  - Mature surveillance calibration models

- Review of all system parameters
  - Large number of CDD source data systems
  - Multiple CDD systems for data capture and risk rating

- Qualified resources for model ownership and model governance

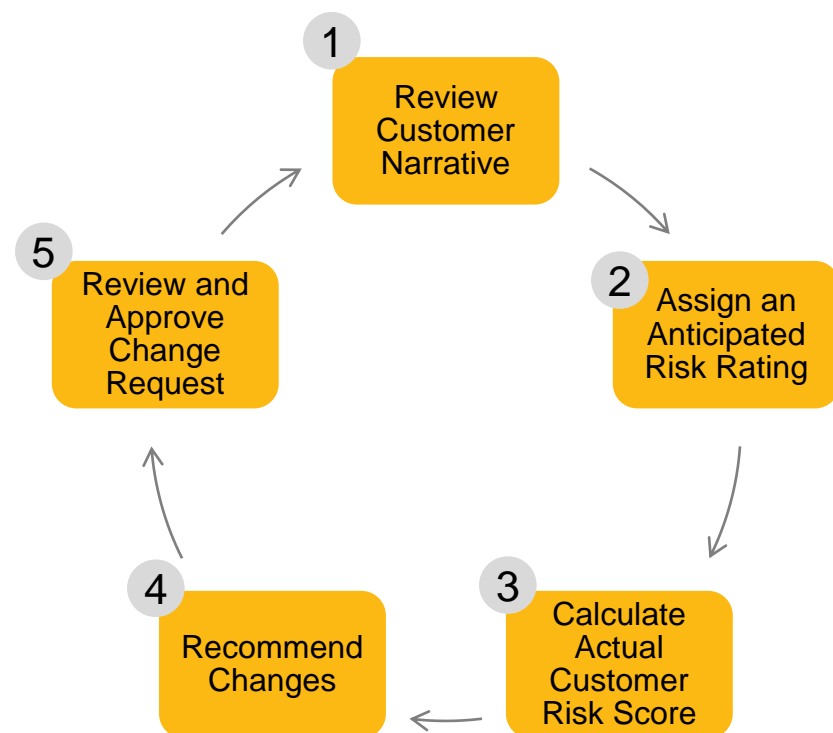- Availability and use of enabling technology to support calibration efforts

Customer Due Diligence Model Calibration Approach (1/2)
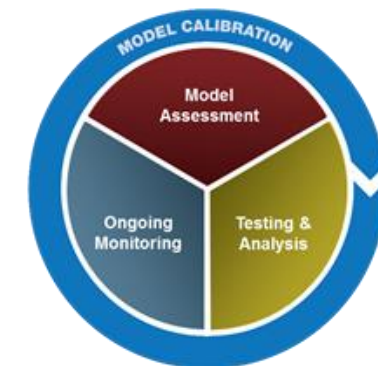
Success Criteria

- Follow a structured process using existing customer profiles to test the proposed risk factors and scores.

- Use a representative sample of complete and accurate data.

- Include all high-risk categories in the sample of customer profiles.

- Use multi-round calibration approach to determine if scoring adjustments had the desired effect, which also includes identifying any potential unintended scoring issues.

- Obtain management review of and sign off on proposed adjustments (based on the calibration results).

1. Review Customer Narrative
2. Assign an Initial Risk Rating
3. Calculate Actual Customer Risk Score
4. Recommend Changes
5. Review and Approve Change Request

MODEL CALIBRATION
- Model Assessment
- Testing & Analysis
- Ongoing Monitoring

Round 1
Round 2
Round 3

Customer Due Diligence Model Calibration Approach (2/2)

1 Review Customer Narrative

2 Assign an Anticipated Risk Rating

3 Calculate Actual Customer Risk Score

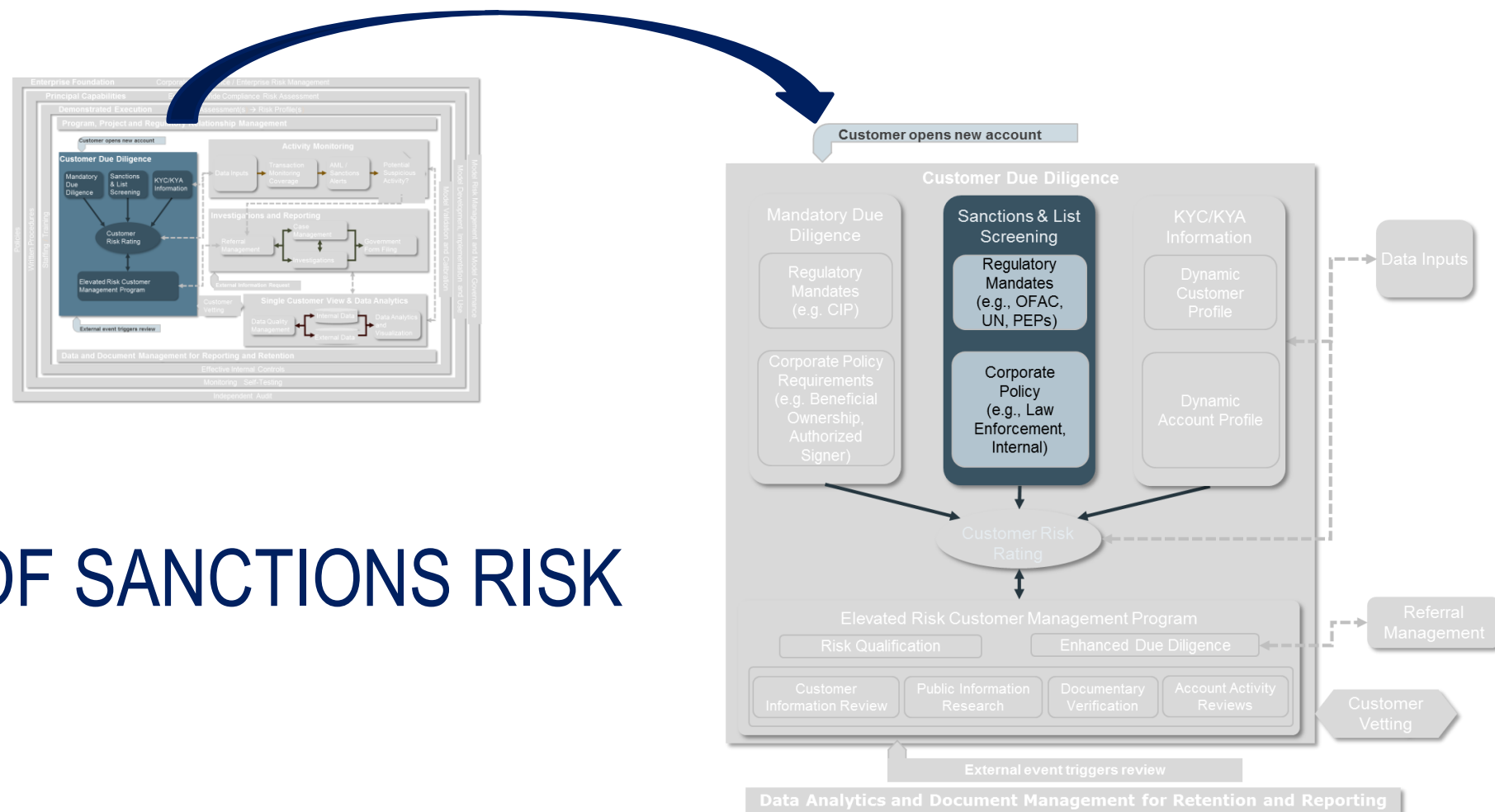**4** Recommend Changes

5 Review and Approve Change Request

1 Describes the customer and his or her related attributes (what activity she or he engages in or expects to engage in, and other related information which will allow the bank to determine what the customer's anticipated risk rating should be.

2 Describes the anticipated risk rating of the customer. (low, moderate, high).

3 Compares anticipated to actual results. Any discrepancies and possible explanations are noted and documented.

4 Describes the actual risk scores and risk level attributed to the customer based on the answers in the profile. The specifics of what contributes to the risk total are documented.

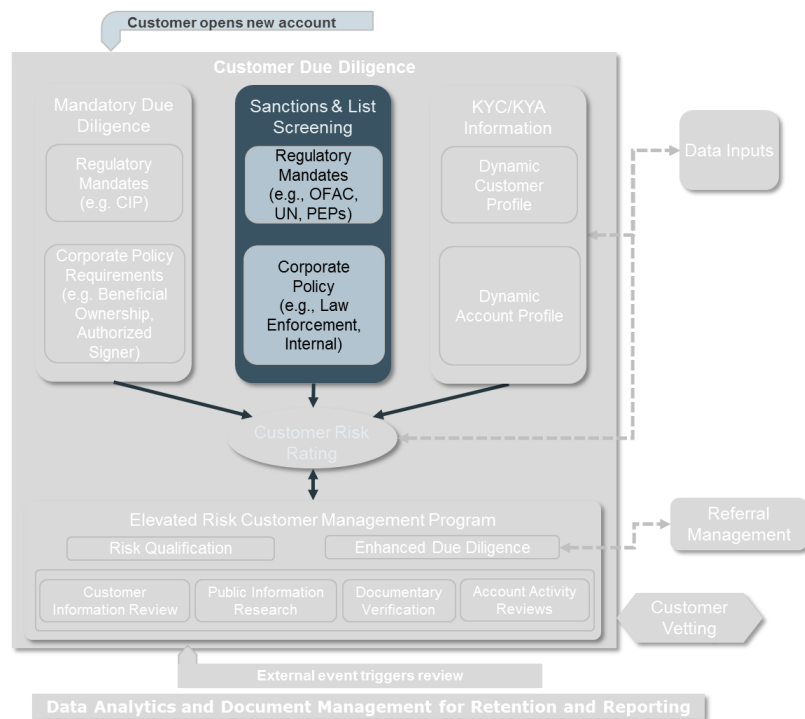**5** Documented management approval of model change.

3

MANAGEMENT OF SANCTIONS RISK

Polling Question 3

- How would you describe the current level of regulatory oversight on your sanctions compliance program?

    a) Targeted examinations that are highly focused on aspects of sanctions compliance, such as matching algorithm tuning/optimization or data quality, are conducted.

    b) Sanctions capabilities are reviewed as part of my AML exam, but there is not a particular focus.

    c) Sanctions compliance is, generally, not reviewed at my institution.

    d) Unsure/don't know

Sanctions Compliance Themes and Perspectives

Expectations

- Accuracy and completeness of data are critical to program effectiveness.

- Alert-generation threshold settings and other settings affecting alert generation should be supported by sound data analysis.

- Threshold models should be reviewed using a risk-based approach on schedule with other high-risk models.

- Governance of alert-disposition processes must be tested.

Organizational Impact

- Significant data quality assessment and remediation initiatives are undertaken as part of corporate AML enhancement initiatives, model risk management program, or as a result of audit findings/MRAs.

- Technology matching algorithm threshold settings are increasingly governed under firm model risk management framework.

- Application of quality control processes is increasingly used within the sanctions operations team.

- Higher-complexity sanctions programs are developing stronger relationships with analytics functions.

27

4

EVOLVING EXPECATIONS FOR NONBANK SERVICE PROVIDERS

Polling Question 4

- How would you best describe your organization in relation to nonbank financial institutions (NBFI):

  a) My organization is a bank and continues to actively bank nonbank financial institutions.

  b) My organization is a bank and has actively exited nonbank financial institution accounts or sought service charges to maintain such accounts.

  c) My organization is a nonbank financial institution, and the retention of (a) bank account(s) is an ongoing struggle.

  d) My organization is a nonbank financial institution, and I typically have no issues in the retention of my banking relationships.

  e) My organization has no relationship to nonbank financial institutions.

  f) Unsure/don't know

NBFI Themes and Perspectives

- Increasing trends in banks exiting NBFI relationships

- OCC "Statement on Risk Management" (OCC Bulletin 2014-58)

- FinCEN Statement on Providing Banking Services to Money Services Businesses (20141110)- November 2014

- Significant investments in new and innovative payment and FinTech companies

- Increasing competition between banks and the FinTech industry

  - Domestic and international payments

  - Innovative technology platforms

  - Crowdfunding and lending

  - Wealth management

  - Digital currencies

Bank and NBFI Challenges

	Banks	NBFIs
Business Opportunity	✓ Increasing business opportunities in the form of NBFI relationships (accounts and partnerships)	✓ Bank relationships are often the lifeline of business plans and strategies.
Resources	✓ Maintenance of resources and infrastructure to support effective AML monitoring and risk mitigation strategies	✓ Maintenance of an AML program that aligns to increasing regulatory and banking partner expectations
Technology	✓ Define, obtain, and monitor critical data associated with NBFI relationships	✓ Maintenance of effective AML technology
Due Diligence	✓ Vetting potential risks associated with NBFIs and their respective customers	✓ Responding to increasing due diligence requirements

Crowe Horwath.

Bank Strategies

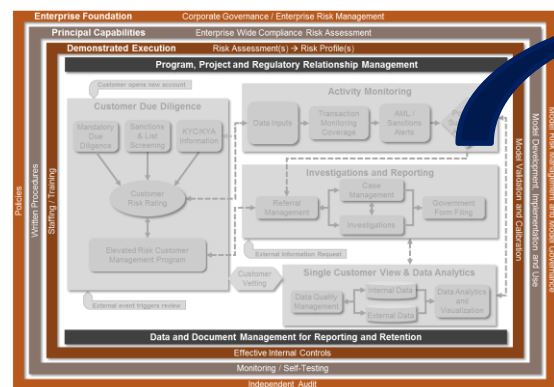|	Challenge	Strategies
Business Opportunity	✓ Increasing business opportunities in the form of NBFI relationships (accounts and partnerships)	✓ Define risk appetite and tolerance statements ✓ Challenge and vet NBFI partnerships and value each party is receiving
Resources	✓ Maintenance of resources and infrastructure to support effective AML monitoring and risk mitigation strategies	✓ Assess NBFI profitability and fee structure ✓ Mobilize internal and external due diligence teams and efforts
Technology	✓ Define, obtain, and monitor critical data associated with NBFI relationships	✓ Define data requirements to support ongoing transaction monitoring and mobilize infrastructure to support
Due Diligence	✓ Vetting potential risks associated with NBFIs and their respective customers	✓ Consider advancements in NBFI risk assessment methodology and process ✓ Seek collection or assessment of NBFI consumer/customer base and other critical metrics ✓ Build and foster ongoing communication and relationships

NBFI Strategies

	Challenge	Strategies
Business Opportunity	✓ Bank relationships are often the lifeline of business plans and strategies.	✓ Consider well-documented and transparent AML risk assessment, business plan, and growth strategies.
Resources	✓ Maintenance of an AML program that aligns to increasing regulatory and banking partner expectations	✓ Adherence to AML laws and implementing regulations regardless of requirements ✓ Replicating industry and regulatory standards expected of banks (for example, model risk management, customer/consumer risk-based due diligence)
Technology	✓ Maintenance of effective AML technology	✓ Consider the availability and format of your data and how it can be shared with your banking partners.
Due Diligence	✓ Responding to increasing due diligence requirements	✓ Seek audit and assurance documents which will aid in your bank's due diligence efforts (for example, SOC reports, qualified audits). ✓ Maintain and share ongoing self-testing programs. ✓ Build and foster ongoing communication and relationships.

5
BUILDING AND MAINTAINING A SUSTAINABLE AML PROGRAM

Sustainability

Considerations

Strategy	✓ **AML needs to understand strategic direction and vision of the organization.** ✓ **Business opportunities consistently evaluated with at-risk customer segments** ✓ **Identifying and communicating advancements in regulatory expectations**
Culture	✓ **Understanding and developing a culture of AML compliance (rewarding and penalizing, as appropriate)** ✓ **Communication of AML risks across the organization (across the lines of defense)**
Organization	✓ **Maintenance of deep AML specialization and supporting infrastructure** ✓ **Roles and accountability clearly defined across the lines of defense**
Change Management	✓ **Handling of business-as-usual processes in regulatory response environment** ✓ **Prescriptive and continuous event response ("mobilized for change")** ✓ **Mobilizing for advancements in financial services technology**

Questions?

For more information, contact:

John Epperson

Direct +1 630 575 4220

john.epperson@crowehorwath.com

Ralph Wright

Direct +1 630 586 5203

ralph.wright@crowehorwath.com