Testing Your AML and Sanctions Compliance Program via Quality Assurance (QA) Reviews

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Discussion Topics

- Defining Compliance Testing / QA Reviews
- Regulatory Drivers
- QA Life Cycle
- Key Considerations for Building a QA Function
- Organizational Partnership
- Q & A
Three-Layered Defense Model

1st Line of Defense
Business Line Procedures & Controls

Your Financial Institution

2nd Line of Defense
Compliance Testing or QA Reviews

3rd Line of Defense
Independent Testing (Internal Audit)
Compliance Testing vs Internal Audit Testing

• Types of testing
  ✓ Compliance separately validates the outcome of the application of controls (second layer of defense)
  ✓ Internal Audit not only tests the outcome, but also validates that procedures are appropriately designed and being adhered to (third layer of defense)

• Escalation of the same issues
  ✓ Sometimes over three dimensions (e.g., Compliance, Internal Audit, Regulatory Agency)

• Friction caused by varying results
Regulatory Expectations

QA reviews of AML programs have come under increasingly greater scrutiny from regulators. Specifically, regulators expect that a strong QA program:

- is risk based and sufficient in scope and frequency
- is sufficiently budgeted in terms of hours and optimal staffing levels
- contains testing procedures that have been tailored to the unique risks of an organization
- has workpapers that are adequately documented and that have clear linkages between risk assessments and work plans
- includes sufficient transaction testing
- contains proper follow-up of prior findings/remediation plans
- is executed by competent individuals (individuals who are sufficiently trained, certified in the subject matter and possess the necessary experience)

Regulators typically ask for bios/credentials of the QA team
Federal Reserve Guidance

- SR 08-8 published on October 16, 2008
- Requires banking organizations to:
  - Implement a firmwide approach to compliance risk management and oversight.
  - Ensure the independence of compliance staff.
  - Implement robust compliance monitoring and testing.
  - Assign responsibilities regarding compliance risk management and oversight to boards of directors and senior management.
FINRA Rules

• Rule 3130
  – Requires a firm to designate a chief compliance officer (CCO).
  – CCO must certify that the firm “has in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures …”
  – CEO must conduct one or more meetings with the CCO in the preceding 12 months to discuss such processes.

• Rule 3110
  – Requires a firm to supervise the activities of each registered representative, registered principal, and other associated person.
QA Life Cycle
Methodology

MACQUARIE

ANTI-MONEY LAUNDERING & SANCTIONS QUALITY ASSURANCE PROGRAM

MACQUARIE – U.S.
PROGRAM OWNER: MACQUARIE COMPLIANCE AMERICAS
VERSION 1.0
APRIL 2011

EXPLORING THE ROLE OF AUDIT TO IMPROVE YOUR INSTITUTION’S AML PROGRAM
June 28, 2012 – New York
Risk Assessment Factors

Inherent Risk Factors
- Customers / Entities
- Geographies
- Products and Services
- Distribution Channels
- Funds Flow
- New Business and/or New Product Development

Controls & Mitigating Risk Factors
- Organizational Structure and Tone
- Policies and Procedures
- IT Infrastructure
- Employee Training / Awareness
- Results of Prior Regulatory Examinations, Internal Audits, and QA Reviews
- AML-Related Projects / Initiatives Currently Being Undertaken
Sample Risk Assessment Dashboards
## Sample Work Plan

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<td>Globec User Acceptance Testing (UAT)</td>
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<td>Validation of IAD / Regulatory Corrective Actions</td>
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</tbody>
</table>

**Legend**

- Milestone
- Not Started
- On Schedule
- In Progress
- Behind
- Complete
# Testing Procedures

### Index

- Customer Identification Program
- Customer Due Diligence
- Transaction Monitoring / Account Surveillance
- Suspicious Activity Reporting
- Foreign Bank & Financial Accounts Reporting
- Funds Transfers
- Office of Foreign Assets Control
- Documentation & Recordkeeping
- Vendor Management

## Customer Identification Program

<table>
<thead>
<tr>
<th>Step</th>
<th>Customer Identification Program</th>
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<tbody>
<tr>
<td>Overview</td>
<td>As of October 1, 2008, all covered financial institutions and their operating subsidiaries must have a written Customer Identification Program (CIP). Section 326 of the USA PATRIOT Act requires a financial institution to implement a written CIP that is appropriate for its size and type of business and that includes certain minimum requirements. The CIP must be incorporated into the institution’s BSA/AML compliance program, which is subject to approval by the institution’s board of directors. The CIP is intended to enable the institution to form a reasonable belief that it knows the true identity of each customer. The CIP must include account opening procedures that specify the identifying information that will be obtained from each customer. It must also include reasonable and practical risk-based procedures for verifying the identity of each customer.</td>
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</table>
| 1 | Determine whether the Business Group/Legal Entity has implemented Customer Identification Program (CIP) to verify so that the identity of all new/prospective customers can be verified (USA PATRIOT Act Section 326). At a minimum, the CIP should require the following information to be collected for all new customers before an account is opened (81CFR 101.121(b)(2)(i)):  
  i. Full Name  
  ii. Date of Birth (for individuals)  
  iii. Address (home/business address, not a mailing address or P.O. Box)  
  iv. Social Security Number (for individuals) or Tax Identification Number (for corporations)  
  Note: The following relationships are exempted from CIP requirements:  
  i. Accounts acquired by Macquarie via an acquisition, merger, purchase of assets, or assumption of liabilities;  
  ii. Accounts opened for the purpose of participating in an employee benefit plan established under the Employee Retirement Income Security Act of 1974 (“ERISA”);  
  iii. Dealings in connection with Macquarie’s own operations or premises (e.g., a relationship with Macquarie’s technology provider);  
  iv. Accounts for financial institutions that are regulated by a federal (U.S.) functional regulator. Such institutions include broker-dealers, banks, mutual funds, publicly traded companies, governmental agencies, and ERISA accounts;  
  v. Banks and other depository institutions that are regulated by a state (or federal) regulator in the U.S.; | Reviewer/ Date | Reference |

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Typical Testing Areas

- Employee Training
- Customer Identification Program (CIP)
- Customer Due Diligence (CDD) / Enhanced Due Diligence (EDD)
- Transaction Monitoring / Account Surveillance
- Suspicious Activity Reporting
- Currency Monitoring and Transaction Reporting
- Purchase and Sale of Monetary Instruments
- Foreign Correspondent Accounts
- Funds Transfers
- Information Sharing
- Special Measures
- Office of Foreign Assets Control (OFAC)
- Documentation and Recordkeeping
- Vendor Management
Conducting Effective QA Reviews

QA reviews should never be “box checking” exercises; specific skills necessary to ensure quality of execution include:

- Knowledge of regulatory expectations – both those required by law and seen in practice.
- Understanding of evolving regulations.
- Knowledge of market leading AML software solutions and how they work.
- Understanding of the “red flags” unique to the business being audited.
- Ability to distinguish between regulatory violations and industry best practices.
- Appropriate, robust workpapers that are commonly reviewed by regulators upon request.
Sample Report

Quality Assurance ("QA") Review
January 2012

Americas AML & Sanctions Compliance

1 Executive Summary

1.1 Purpose and Overview

We have conducted our QA review of the processing, access for the Mercantile Bank Ltd. (MBL) Houston representative (rep) office. The primary objective of this review was to ensure that new and prospective counterparties were processed in accordance with the policies of the Bank Secrecy Act (BSA), as amended by the USA PATRIOT Act, and Mercantile’s policy requirements.

Specifically, the review included testing of files and other supporting documentation to determine whether counterparties were appropriately identified, verified, and subjected to risk-based due diligence and screening measures.

1.2 Scope and Sample

The QA review covered the period from January 14 through June 29 of 2011. During the review period, a total of 36 accounts were opened for by the Houston rep office. The reviewer examined a sample of 16 accounts (44%) for detailed testing.

1.3 Summary of Testing Results

Our testing procedures include the following exceptions:

- Of the 36 accounts, the names of the Ultimate Beneficial Owners (UBOs) were not collected against lists available or suspected to be related to transportation (e.g., CIP and other sanctions lists).
- The coverage of the counterparty’s business and its international activity was not consistently documented, as required by the Bank's BSA/AML Policy.
- It should be noted that the above mentioned documentation was not always recorded. Additionally, CIP, alternative customer due diligence processes (e.g., SARs) and financial transactions were not consistently documented in the Americas region and the system does not capture and record all data and information required by policy.

Out of the 16 accounts, 14 were fully compliant (fully compliant, no exceptions noted).

2 Detailed Observations and Recommendations

<table>
<thead>
<tr>
<th>Attribute Tested</th>
<th>Assessment</th>
<th>Observation(s)</th>
<th>Recommendation(s)</th>
<th>Details / Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>The identifying information for prospective counterparties (e.g., name, address, TIN) was collected prior to account opening.</td>
<td>G</td>
<td>No exceptions noted</td>
<td>N/A</td>
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<tr>
<td>The identities of potential counterparties were verified via acceptable methods</td>
<td>G</td>
<td>No exceptions noted</td>
<td>N/A</td>
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<tr>
<td>Counterparty were provided sufficient notice that the firm would not open the account.</td>
<td>G</td>
<td>No exceptions noted</td>
<td>N/A</td>
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</table>

Legend:
- G: Fully Compliant. No exceptions were noted during testing.
- A: Partially compliant. Testing exceptions were noted and certain improvements are necessary. These improvements can be addressed in the normal course of business.
- R: Not compliant. Several significant testing exceptions were noted requiring management's immediate attention. Full remediation may be required.
Key Considerations for Building a QA Function

- Qualified, skilled, and experienced team.
- Certified Anti-Money Laundering Specialist (CAMS) professionals.
- Prioritization of coverage by risk.
- Adequate time allocated to planning / preparing for the audit.
- Transparent process / timely escalation of issues.
- Robust workpapers.
- Appropriate / tailored reporting and issue tracking.

Organizational partnership.
Questions ?
Speaker Bio

Vasilios P. Chrisos, CAMS
Office: +1 212 231 0705
Email: vasilios.chrisos@macquarie.com

Vasilios is the Americas Anti-Money Laundering (AML) and Economic Sanctions Director for Macquarie, Australia’s largest investment bank. He is responsible for managing the company’s AML and sanctions programs across all business groups and legal entities in North and South America. This includes coordinating the completion of risk assessments, developing and implementing policies and procedures, ensuring employees receive periodic AML training, acting as an adviser to stakeholders regarding AML/CTF and sanctions matters, managing investigations, as appropriate, ensuring Suspicious Activity Reports are prepared and filed timely, performing compliance testing, participating in the new business / product approval process, and chairing various AML Working Groups across the region.

Prior to joining Macquarie, Vasilios helped lead Ernst & Young’s AML advisory practice by managing projects / initiatives at large, complex institutions. He assisted and advised financial services institutions in developing comprehensive AML risk assessment frameworks, identifying inherent money laundering vulnerabilities, establishing customer risk ranking protocols, designing AML compliance programs, implementing policies, procedures, and controls, creating AML governance structures, establishing Enhanced Due Diligence (EDD) protocols, and developing transaction monitoring capabilities. Vasilios has worked with financial institutions that were either undergoing or facing regulatory enforcement actions and advised them on the construction of action plans and communication strategies with regulators, including regular updates on the progress of remediation efforts.

Vasilios is a Certified Anti-Money Laundering Specialist (CAMS). He currently serves as the Co-Chair of the ACAMS New York Chapter and is also involved with several ACAMS initiatives, including: the global Chapter Steering Committee and Education, Securities Industry, and Audit task forces.