Regulatory Update & Analysis
Revised FFIEC BSA/AML Examination Manual and Current Trends
May 12, 2015
Agenda

- Introduction
  - Dan Tira, CAMS, Senior Manager – AML/Regulatory Compliance
  - Chris Kopp, CAMS, Senior Associate – AML/Regulatory Compliance

- Regulatory Landscape

- 2014 FFIEC BSA/AML Examination Manual Updates

- Current Regulatory Environment

- Model Risk Management

- Wrap-Up
Regulatory Landscape

- Regulators’ expectations for strong and effective compliance management programs continue to increase, particularly in the area of Anti-Money Laundering (AML) and Bank Secrecy Act (BSA) compliance.
- We continue to see covered financial institutions of all types faced with regulatory actions, consent orders, and penalties tied to their AML and BSA programs with increasing emphasis on areas including:
  - Enterprise-wide Program Coverage
  - Suspicious Activity Identification, Monitoring, and Reporting
  - Customer Due Diligence, Customer Risk Rating, and Enhanced Due Diligence
  - OFAC and Sanctions Screening
  - Model Risk Management
- More institutions of every size are implementing and enhancing systems to support AML compliance functions and examiners are increasingly understanding each of these systems’ strengths and weaknesses.
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Overview

- Released on November 26, 2014

- Several Revisions and Updates
  - Suspicious Activity Reporting
  - Currency Transaction Reporting
  - Foreign Correspondent Accounts
  - FBAR and CMIR Reporting
  - ACH and IAT Monitoring
  - Prepaid Access
  - Third-Party Payment Processors
  - Embassy and Foreign Mission Relationships
  - NBFI Relationships
  - Independent Testing
Suspicious Activity Reporting ("SAR")

New SAR Form
- Electronic BSA Suspicious Activity Report ("BSAR")
  - Replaced Form TD.F 90-22.47
  - Mandatory as of April 1, 2013
  - Includes additional "critical" fields and data elements
  - Appendix T of the Manual provides additional information and requirements with respect to the BSA E-Filing System.

SARs on Continuing Activity
- 120 calendar days subsequent to initial or previous SAR Filing

SAR Confidentiality
- SAR Disclosure
- Joint Filing

SAR Sharing
- Head Offices and Controlling Companies
Currency Transaction Reporting ("CTR")

New CTR Form
- Electronic BSA Currency Transaction Report ("BCTR")
- Replaced FinCEN CTR Form 104
- Mandatory as of April 1, 2013
- Includes additional "critical" fields and data elements
- Appendix T of the Manual provides additional information and requirements with respect to the BSA E-Filing System

Common Ownership
- Not operating separately/independently
- Commingled funds

CTR Exemptions
- Designating exempt customers
- Ineligible business activities
- E-Filing requirements
Foreign Correspondent Account Recordkeeping and Reporting

Iran Sanctions
- Includes requirements of the 2010 Comprehensive Iran Sanctions, Accountability, and Divestment Act (“CISADA”)
- Authorizes the use of sanctions
  - Payable Through Accounts
  - Foreign Correspondent Accounts

Reporting Requirements
Upon receiving written requests from FinCEN, Bank’s must disclose:
- Correspondent accounts for Iranian-linked financial institutions designated under the International Emergency Economic Powers Act (“IEEPA”)
- Funds transfers processed in the preceding 90 days on behalf of:
  - Iranian-linked financial institutions
  - Iran’s Islamic Revolutionary Guard Corps ("IRGC")
- Notices, Timeframes, and Reporting Requirements
Foreign Correspondent Accounts

Risk Assessment
- Understand varying levels of risk
- Customer risk rating factors should include:
  - Sound understanding of strategic profile
  - Size
  - Geographic locations and reach
  - Products
  - Services
  - Markets served

Due Diligence and Risk Management
- Emphasizes the use of the following references:
  - The Clearing House Association, LLC
  - The Wolfsberg Group
  - Section 311 of the USA PATRIOT Act
- Foreign Correspondent Banks should have:
  - Acceptable AML compliance program
  - Robust suspicious activity monitoring processes
  - Increasing expectations
  - Above and beyond collection of policies and Wolfsberg questionnaires
International Reporting

International Transportation of Currency or Monetary Instruments Reporting ("CMIR") and Bulk Shipments of Currency

- Clarifies and delineates roles involved in the cash shipment and delivery process, irrespective of the medium of transportation.
  - Common carrier
  - Shipper
  - Consignee
  - Originator
  - Recipient
- References FIN-1988-R002 and FIN-2014-G002, where postal service or common carriers are involved

Monitoring and Due Diligence

- Shipping customer’s expected volumes
- Geographic footprint
- Customer base
- Activity that generates the cash
- CTR Reporting

Foreign Bank and Financial Accounts Reporting ("FBAR")

- Mandatory electronic filing
- Replaced form TD F 90-22.1
- Filing for signature authority over account but no financial interest
  - Deadline extended to June 30, 2015 (FinCEN Notice 2012-1)
Automated Clearing House ("ACH") Transactions

International ACH Transactions ("IATs")
- NACHA modifications
- Gateway
  - A financial institution, ACH operator, or ODFI ("Originating Depository Financial Institution") that acts as an entry or exit point to or from the United States
- Banks must classify and identify IATs
  - Inbound IAT with ‘further credit to’
  - Foreign Originator
- Transaction monitoring implications
  - Key fields
Prepaid Access

Risk Assessment
- Reclassified Electronic Cash as “Prepaid Access”
- Incorporated Prepaid Access Rule
- Risk Assessment must cover:
  - Prepaid access program
  - Card program features and usage
  - Third parties to the prepaid card program
  - Risk mitigating strategies such as transaction monitoring and third party due diligence

Monitoring and Due Diligence
- CDD Program must identify third parties involved in prepaid access program
- Due Diligence must include a review of:
  - AML Compliance Program
  - Compliance Culture
  - Monitoring Capabilities
  - AML and OFAC
  - System Integrity
- Monitoring should cover all transactions processed through the Bank

Contractual Agreements
- Should include:
  - Roles and responsibilities
  - Products and services
  - Program features
- At a minimum roles and responsibilities should outline:
  - AML/BSA/OFAC requirements
  - Customer base
  - Due diligence processes
  - Network obligations
  - Monitoring processes
Third-Party Payment Processors ("TPPPs")

**Mitigating Controls**
- Review of policies, procedures, and processes
- Ensure that no law enforcement actions exist
- Periodically review that processor is fulfilling contractual obligations
- Understand expected activities and volumes

**Transaction Monitoring**
- Monitor for red flags:
  - Insufficient funds/unauthorized returns
  - Remotely Created Checks
  - ACH Transactions
  - Return rates
  - Attempts to evade NACHA limitations or return thresholds
  - Significant deviations from expected activity volumes
Embassy, Foreign Consulate, and Foreign Mission Accounts

Due Diligence and Monitoring

- Updated to address interagency guidance issued in March 2011
- Now includes Foreign Missions
- Apply stratified customer risk rating standards to foreign embassies, consulates, and missions
- Understand and monitor expected business activities
- Understand account purpose
Nonbank Financial Institutions ("NBFIs") and Money Services Businesses ("MSBs")

Prepaid Access
- Defined provider registration
- Covered prepaid products
- Due diligence and monitoring

Virtual Currency
- Due diligence and monitoring
  - Virtual Currency Administrators
  - Exchangers
- State based licensing

Foreign MSBs
- Due diligence and monitoring
- Foreign located persons conducting MSB activity
  - Registration

MSB Due Diligence
- Robust processes must be in place to identify, risk rate, and monitor
- Review of MSB customer’s due diligence standards
  - Third-party servicers
  - Paying agents
Independent Testing

Independence
- Internal or External
  - Qualified
  - Independent of AML function

AML Audit Reporting
- Audit findings and recommendations must be:
  - Reported to the Board of Directors or Designated Committee

Sufficiency of Audit
- Audit coverage
- Critical evaluation/challenge
- Jurisdictional privacy laws
Current Regulatory Environment
The Unique Alternative to the Big Four®

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<table>
<thead>
<tr>
<th>Company</th>
<th># of Enforcement Actions</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>JPMorganChase</td>
<td>6</td>
<td>$2B in combined penalties for “willful” BSA violations related to the Madoff settlement levied by Federal prosecutors, the OCC and FinCEN 5 OCC and 1 FRB Enforcement Actions required enhancement of all “4 Pillars” of the AML program and execution of a SAR look-back</td>
</tr>
<tr>
<td>HSBC</td>
<td>6</td>
<td>$1.9B deferred prosecution for failure to comply with a 2010 cease &amp; desist order addressing BSA violations $500M civil penalty &amp; 2 OCC Enforcement Actions related to internal controls for customer due diligence, suspicious activity monitoring procedures, testing, training, and execution of a SAR look-back $165M civil penalty and 4 FRB Enforcement Actions for willfully failing to establish and maintain an effective AML program and due diligence for foreign correspondent accounts.</td>
</tr>
<tr>
<td>Wells Fargo</td>
<td>2</td>
<td>$50M civil penalty &amp; 2 OCC Enforcement Actions relating to internal controls for customer due diligence, procedures for monitoring suspicious activity, independent testing, training, and execution of a SAR look-back $37.5M FinCen and $37.5M OCC civil penalties (and 1 Enforcement Action) for failure to detect and adequately report suspicious activities in a timely manner</td>
</tr>
<tr>
<td>TD Bank</td>
<td>1</td>
<td>$37.5M FinCen and $37.5M OCC civil penalties (and 1 Enforcement Action) for failure to detect and adequately report suspicious activities in a timely manner 3 OCC Enforcement Actions for SAR &amp; CTR reporting and CTR reporting, internal controls, risk rating, transaction sampling and auditing.</td>
</tr>
<tr>
<td>PNC</td>
<td>3</td>
<td>1 OCC Enforcement Action for failure to adopt and implement a compliance program that adequately covers the required program elements. Inadequate controls, testing, due diligence and SAR filing</td>
</tr>
<tr>
<td>Citigroup</td>
<td>1</td>
<td>1 FRB Enforcement Action which delayed its $3.7B purchase of Hudson City Bancorp because of inadequate money laundering controls, CDD, and transaction monitoring.</td>
</tr>
<tr>
<td>MetBank</td>
<td>1</td>
<td>$165M civil penalty and 4 FRB Enforcement Actions related to CDD, suspicious activity reporting and independent testing</td>
</tr>
<tr>
<td>TCF Bank</td>
<td>2</td>
<td>2 FRB Enforcement Actions related to deficiencies found in initiating, tracking, documenting, reconciling, and auditing SARS and in EDD and risk assessments</td>
</tr>
<tr>
<td>BNY Mellon</td>
<td>2</td>
<td>$10M civil penalty and 2 OCC Enforcement Actions related to CDD, suspicious activity reporting and independent testing</td>
</tr>
</tbody>
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*Banking holding companies as of 9/12/2001 to 12/31/2013: https://www.ffiec.gov/nicpubweb/nicweb/top50form.aspx
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## Regulatory Themes (1/2)

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<thead>
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<th>Component</th>
<th>Consent Order / Focus Areas</th>
<th>Remediation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Due Diligence and Enhanced Due Diligence</td>
<td>• Collection of Appropriate Due Diligence &lt;br&gt;• All-inclusive Risk Scoring Models &lt;br&gt;• Enterprise-Wide Customer View &lt;br&gt;• Model Risk</td>
<td>• Enhancing CDD/EDD Processes and Software &lt;br&gt;• De-Risking (MSBs, TPPP, Prepaid, FCBs) &lt;br&gt;• Due Diligence Reviews &lt;br&gt;• Model Validation</td>
</tr>
<tr>
<td>BSA/AML/OFAC Risk Assessment</td>
<td>• Enterprise-Wide Risk Assessments &lt;br&gt;• Quantitative and Qualitative Attributes &lt;br&gt;• Product/Service/Customer Coverage</td>
<td>• Executing Expanded Risk Assessments</td>
</tr>
<tr>
<td>Staffing and Qualifications</td>
<td>• Reviewing Staffing Levels/Qualifications &lt;br&gt;• Organizational Structure</td>
<td>• CAMS Certifications &lt;br&gt;• Capacity Planning &lt;br&gt;• Supplementing with Qualified Consultants</td>
</tr>
<tr>
<td>Independent Testing</td>
<td>• Focused Transactional Testing &lt;br&gt;• Audit Risk Assessment &lt;br&gt;• AML Auditor Qualifications &lt;br&gt;• Authority and Independence &lt;br&gt;• Tracking and Reporting Remediation Efforts &lt;br&gt;• Timely Remediation of Audit Recommendations</td>
<td>• Derivation of Sample Size &lt;br&gt;• Targeted Samples &lt;br&gt;• Self Testing &lt;br&gt;• Usage of Data Analytics to Drive Samples &lt;br&gt;• Continuous Audit Risk Assessment &lt;br&gt;• AML Auditor Qualifications</td>
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## Regulatory Themes (2/2)

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<td>SAR Monitoring</td>
<td>• Coverage of Monitoring Scenarios</td>
<td>• Performing Coverage Assessments</td>
</tr>
<tr>
<td></td>
<td>• Timeliness of Investigations and SARs</td>
<td>• Implementing New Monitoring Platforms</td>
</tr>
<tr>
<td></td>
<td>• Increased Scrutiny of Monitoring Software</td>
<td>• Increasing Staffing</td>
</tr>
<tr>
<td></td>
<td>• Model Risk Management</td>
<td>• Development of MRM Program</td>
</tr>
<tr>
<td>Sanctions Screening</td>
<td>• Screening Avoidance (&quot;Wire Stripping&quot;)</td>
<td>• Data Validation of Sanctions Feeds</td>
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<tr>
<td></td>
<td>• US Dollar Clearing Services for Sudan, Iran, Cuban parties</td>
<td>• Reviewing Sanctions Procedures</td>
</tr>
<tr>
<td></td>
<td>• Systemic Issues and Management Complicity</td>
<td>• Continuous Training</td>
</tr>
<tr>
<td></td>
<td>• Jurisdictional Sanctions</td>
<td>• Self-Testing and Internal Monitoring</td>
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<tr>
<td></td>
<td>• Syria/Iranian Related Sanctions - Executive Order 13608</td>
<td></td>
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<tr>
<td></td>
<td>• Foreign Sanctions Evaders (&quot;FSE&quot;) List</td>
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<td></td>
<td>• Ukraine/Russia Related Sanctions - Executive Orders 13660, 13661, &amp; 13662</td>
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<tr>
<td></td>
<td>• Sectoral Sanctions Identifications (&quot;SSI&quot;) List - E.O. 13662</td>
<td></td>
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<td></td>
<td>• New Cuban Regulations - Update to 31 CFR Part 515</td>
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Model Risk Management
AML Model Risk Management Themes

- Regulators consider most AML systems to be models which are subject to the expectations of the Supervisory Guidance.

- Regulatory agencies have shifted quantitative resources and attention to assessing how institutions model their AML systems to meet regulatory requirements.

- There is continued regulatory focus on the utilization of a prescriptive approach to model risk management, as well as the establishment and maintenance of supporting documentation evidencing that systems are functioning as intended.

- Many organizations are approaching AML model risk management as an exercise of compliance rather than incorporating the concepts of a risk based model risk management program.
Model Risk Management Framework

The rings of the Crowe AML Model Risk Management Framework capture the core requirements of the supervisory guidance and expand on key principles.

- Appropriate management oversight, policies and procedures, and approval processes are necessary for managing AML model risk.

- Models relied upon for AML compliance should be identified and categorized by risk level.

- As new AML models are developed and implemented, the appropriate documentation around requirements, design, planning, etc. must be captured.

- AML models must be validated to verify accuracy and effectiveness and confirm the model was designed and implemented in accordance with its requirements.

- Targeted exam teams and examiner focus on AML system calibration is driving a lot of pressure on financial institutions.
## MRM Challenges and Hot Topics

<table>
<thead>
<tr>
<th>MRM Component</th>
<th>Challenges / Focus Areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model Inventory</td>
<td>- Model definition&lt;br&gt;- Model identification&lt;br&gt;- Model risk assessment</td>
</tr>
<tr>
<td>Model Development, Implementation, and Use</td>
<td>- Model development documentation&lt;br&gt;- Maintenance of supporting model configuration</td>
</tr>
<tr>
<td>Model Validation</td>
<td>- Model specific expertise&lt;br&gt;- Validation frequency&lt;br&gt;- Scope and depth and breadth of validation approach</td>
</tr>
<tr>
<td>Model Calibration</td>
<td>- Prescriptive and statistically valid approach to calibrate model performance</td>
</tr>
<tr>
<td>Model Governance</td>
<td>- Enterprise MRM policies and procedures&lt;br&gt;- Role of internal audit&lt;br&gt;- Defining and monitoring model performance and risk indicators overtime&lt;br&gt;- Alignment across three lines of defense</td>
</tr>
<tr>
<td>Model Foundation</td>
<td>- Enabling technology&lt;br&gt;- Adherence to documentation standards</td>
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</table>
Types of AML Models

For AML, the types of AML Models which Model Risk Management can be applied typically includes:

- **Transaction Monitoring Systems**
- **Customer Risk Scoring Models**
- **OFAC, Sanctions and Watch List Filtering Systems**
- **CTR Aggregation**
- **“Any other analytical/quantitative model”**
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Model Risk Management Trends

How would you describe the level of regulatory oversight of model risk management at your organization?

- Experienced targeted examinations that are highly focused on aspects of model risk management.
- Regulatory agencies are pushing our organization to start to build processes and controls over model risk management.
- No perceived pressure to support model risk management.

Asset 1: (30+ Billion)
Asset 2: (10-30 Billion)
Asset 3: (3-10 Billion)
Asset 4: (Less than 3 Billion)
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Model Validation

Conceptual Design
Evaluating the conceptual design and capabilities of the pertinent business processes to include business and regulatory alignment and developmental evidence

System Validation
Validating that the systems are properly designed to execute on the model with specific focus on system functionality and limitations and data integration and mapping processes

Data Validation
Validating that accurate and complete information is captured by a system to execute the Models

Process Validation
Ensure the adequate design and ongoing sustainability surrounding the processes and administration of the system and Model
Conceptual Design Validation

Evaluating the conceptual design and capabilities of the pertinent business processes to include business and regulatory alignment and developmental evidence. Key activities include:

- Assess whether model aligned with both the business and regulatory environment, including whether identified risks are appropriately managed and mitigated within the design of a model
- Assessing developmental evidence support the reasonableness of the model’s logic

<table>
<thead>
<tr>
<th>Assessed Risk</th>
<th>Example Activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>High</td>
<td>▪ Robust mapping of AML risks to model settings</td>
</tr>
<tr>
<td></td>
<td>▪ Test validity of assumptions</td>
</tr>
<tr>
<td>Moderate</td>
<td>▪ Challenge appropriateness of model assumptions and logic, including consistency with market practices</td>
</tr>
<tr>
<td>Low</td>
<td>▪ Assess controls and processes governing model development and secondary review processes</td>
</tr>
</tbody>
</table>
System Validation

Validating that the systems are properly designed to execute on the model with specific focus on system functionality and limitations and data integration and mapping processes. Key activities include:

- Assess known limitations of a system which may affect the desired reporting or results of an AML model.
- Assess the data mapping and integration processes from source systems to the AML Model
- Evaluate the design and effectiveness of the threshold setting processes

<table>
<thead>
<tr>
<th>Assessed Risk</th>
<th>Example Activities</th>
</tr>
</thead>
</table>
| High          | ▪ Recreating model output in parallel environment  
▪ Robust analytics of model output |
| Moderate      | ▪ Assessing and critically challenging data mapping and system configuration documentation |
| Low           | ▪ Leverage and challenge self-testing results |
Data Validation

Validating that accurate and complete information is captured by a system to execute the model. Key activities include:

- Assessing and testing the accuracy, integrity, and completeness of data within the model
- Determining whether business rules are being applied correctly
- Determining whether the output from the model is generating complete and accurate results

<table>
<thead>
<tr>
<th>Assessed Risk</th>
<th>Example Activities</th>
</tr>
</thead>
</table>
| High          | • Independent reconciliation of source data to AML model  
                • Recreation of model results |
| Moderate      | • Sample field mapping between core systems and models  
                • Risk based throughput and back testing |
| Low           | • Assessment of system balancing controls and processes  
                • Evaluating and confirming self-testing results |
Process Validation

Ensure the adequate design and ongoing sustainability surrounding the processes and administration of the Model

- Determining whether policies and procedures articulate roles, responsibilities, and standard processes in the administration of an AML model
- Assessing the management, workflow, and documentation standards governing the handling of model output
- Assessing controls governing changes to model logic or assumptions

<table>
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<th>Example Activities</th>
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</thead>
<tbody>
<tr>
<td>High</td>
<td>Rigorously test model output, management decisioning, change control</td>
</tr>
<tr>
<td>Moderate</td>
<td>Challenge and test operational effectiveness of established model procedures</td>
</tr>
<tr>
<td>Low</td>
<td>Evaluate design effectiveness of established model policies, procedures, and processes</td>
</tr>
</tbody>
</table>
Transaction Monitoring Model (Example)

Scope of Coverage
- Objective and quantifiable testing approach
- Complete and accurate data
- Determination if transactional activity is properly utilized for ongoing monitoring
- Identify gaps and limitations
- Ensure that system is functioning as intended

Common Errors
Evaluation of Conceptual Design
- Coverage Gaps

System Validation
- Model Optimization
- Importing/Periodic Balancing Procedures
- System Limitations
- Transaction Code Management and Mapping

Data Validation
- Transaction Based Interface Testing

Process Validation
- User Management Controls
- Quality Control Procedures
- Management Reporting and Governance
Wrap-Up

- Perform an Audit Program coverage assessment
- Regulatory expectations continue to increase
- Apply risk-based model validation concepts
- Increased pressure across the three lines of defense
  - Model Owner (1st Line)
  - Model Validation Department (2nd Line)
  - Internal Audit (3rd Line)

“One of my highest priorities since becoming Comptroller in 2012 has been to strengthen the OCC’s oversight of BSA/AML compliance in the banks we supervise. We have modified our examination procedures so that BSA deficiencies receive proper emphasis in our evaluation of each bank’s overall safety and soundness.”

Remarks by Thomas J. Curry
Before the Institute of International Bankers
March 2, 2015
Questions

- Dan Tira, Senior Manager Regulatory Compliance

- Chris Kopp, Senior Associate Regulatory Compliance

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