How to Deliver Value Through The Three Lines of Defense
What We Do and How We Go About Doing It
Three lines of defense. Where Compliance fits in as an independent risk function.

<table>
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<tr>
<th>First Line</th>
<th>Line of Business</th>
<th>Front line business <strong>owns risk</strong></th>
<th>First line compliance program to <strong>manage risk</strong> (“1b”)</th>
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<td>Second Line</td>
<td>Independent Risk</td>
<td>Risk management • Market • Credit, etc.</td>
<td>Other risk management • AML • Compliance • Finance</td>
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<td>Third Line</td>
<td>Internal Audit</td>
<td>Independent assurance</td>
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- OCC Heightened Standards
Ann Marie Wright
Managing Director
Head, Compliance & Supervision
BMO Capital Markets
A Strong Risk Culture is Anchored in the Three Lines of Defense

Operating Groups

Risk Management and Corporate Areas

Corporate Audit
1st Line of Defense

- Owning, measuring, and managing, all risks for their specific area of responsibility

- Identifying, monitoring, quantifying and reporting risks and capital demand arising from their operating activities and initiatives

- Setting appropriate internal control structures and implementation of compliance monitoring

- Escalating and/or rectifying and deficiencies identified

Ultimate Accountability for Managing All Risks
2nd Line of Defense

- Establishes policies and standards, operating procedures, and practices to support effective risk management
- Provides governance and authority to provide effective challenge of the businesses
- Provides independent assessment of risk-taking activities
- Proactively involved in all risk decisions and activities
3rd Line of Defense

- Monitor and evaluate Compliance Program and compliance with applicable laws and regulations
- Address adequacy of AML risk assessment
- Determine adherence to AML policies and procedures
- Perform transaction testing (emphasis in high-risk operations)
- Assess training adequacy
- Support senior management and the Board in protecting the bank’s reputation

Provides Independent Assurance on the Effectiveness of Controls
The AML Reporting Officer (AMLRO)

Provide guidance, oversight, and support to the Operating Groups in order to ensure Compliance with the AML program requirements and broader legislative and regulatory requirements as they relate to AML.

- Ensure well designed policies and procedures
- Ensure controls are designed, and implemented and aligned to Regulatory requirements
- Test compliance controls
- Identify, assess the severity of, reporting and overseeing remediation of Compliance issues
- Formulate action plans to remediate compliance and remediation issues
- Monitor the resolution of compliance issue action plans
- Change management and support the implementation of new regulations and monitoring processes
- Delivering education initiatives and maintain training manuals and related tools

The AMLRO has Personal Accountability
Benefits of the AMLRO Role

1. Subject Matter Expert

2. Provides Independent Effective Challenge to the Operating Group

3. Maintains a holistic view of the customer activity across the organization

4. Has the authority to stop transactions
Jeffrey Houde
Director, US AML Audit
Audit’s Objective

Ensure management designed and is operating appropriate risk-based controls to effectively manage risk and comply with statutory requirements.
1. Independent testing of 1st and 2nd lines of defense

2. Risk-based coverage – high risk annual and non-high risk bi-annual

3. Critical assessment of control design

4. Detailed testing of operating effectiveness
2\textsuperscript{nd} line of defense – Three primary audits, all annual
   1. Transaction monitoring & investigations
   2. Risk assessment, oversight & governance
   3. OFAC compliance program

1\textsuperscript{st} line of defense – Mix of vertical unit & horizontal function audits
   - Annual
     1. High risk lines of business & legal entities (LE/LOBs)
     2. Key centralized support functions
   - Bi-annual
     1. Non-high risk LE/LOBs and support functions
Keys to Audit’s Success

1. Support of Board of Directors & senior leadership

2. Independence

3. Close alignment to key stakeholders (line of business & regulators)

4. Maintaining appropriate stature in the organization to effect change

5. Effective challenge
1. LOB executive buy-in / compliance culture

2. Clear accountability, roles and responsibilities

3. Staffing – quantity and quality

4. Proactive and consistent investment in non-revenue generating processes

5. Monitoring and issue management
Pitfalls – 2nd Line of Defense

1. Demonstrating effective oversight, including effective challenge

2. Maintaining appropriate stature in the organization to effect change

3. Managing large scale, cross functional initiatives

4. Communication of emerging risks and changing regulatory expectations across functions

5. Delivering efficient compliance solutions
1. Efficient, timely and appropriate information sharing

2. “White space” and/or duplicative functions

3. Unified regulatory interaction model

4. Lack of alignment in reporting

5. Competing agendas