



BSA Coalition Anti-Money Laundering Conference

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Welcome



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Customer Due Diligence – Risk-Based Approach

Megan Hodge – CCO – RBC Bank

Dan Soto – CCO – Ally Financial

Agenda

- **Risk Based Approach**
- **Customer Risk Scoring**
- **Enhanced Due Diligence**
- **Case Studies**
- **Evolution of a CRS Model**
- **Other Considerations in a Dodd-Frank World**

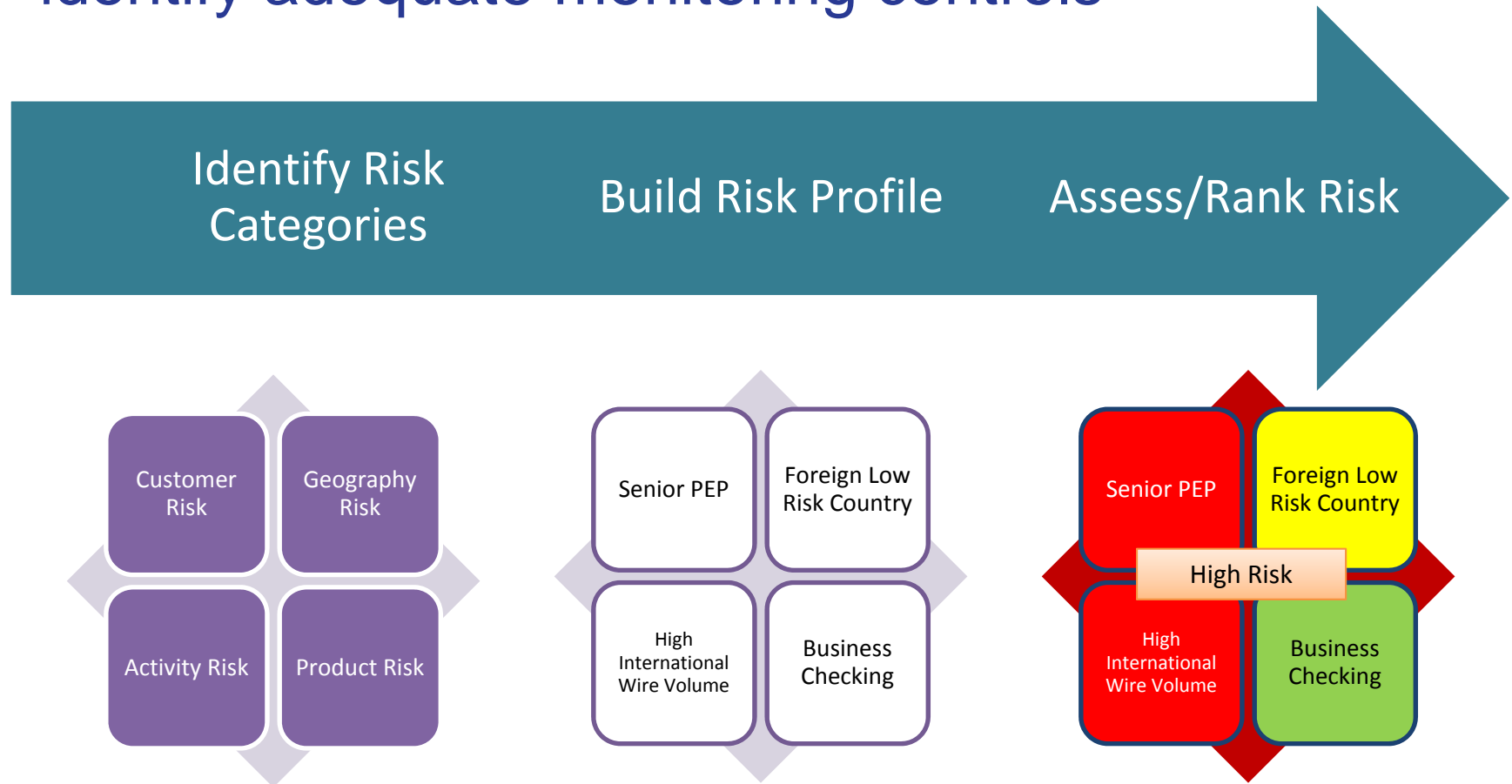
Overview

Institutions should have a Risk Based Approach to managing AML

- **The level of Due Diligence depends on the Money Laundering (ML) or Terrorist Financing (TF) risk posed**
- **Customer risk should be rated, monitored and managed**
- **Institutions can mitigate their own risk exposure through the risk-based approach and risk exposure**
- **Risk Scoring also enables institutions to develop benchmarks and risk rating parameters**

Customer Risk Scoring

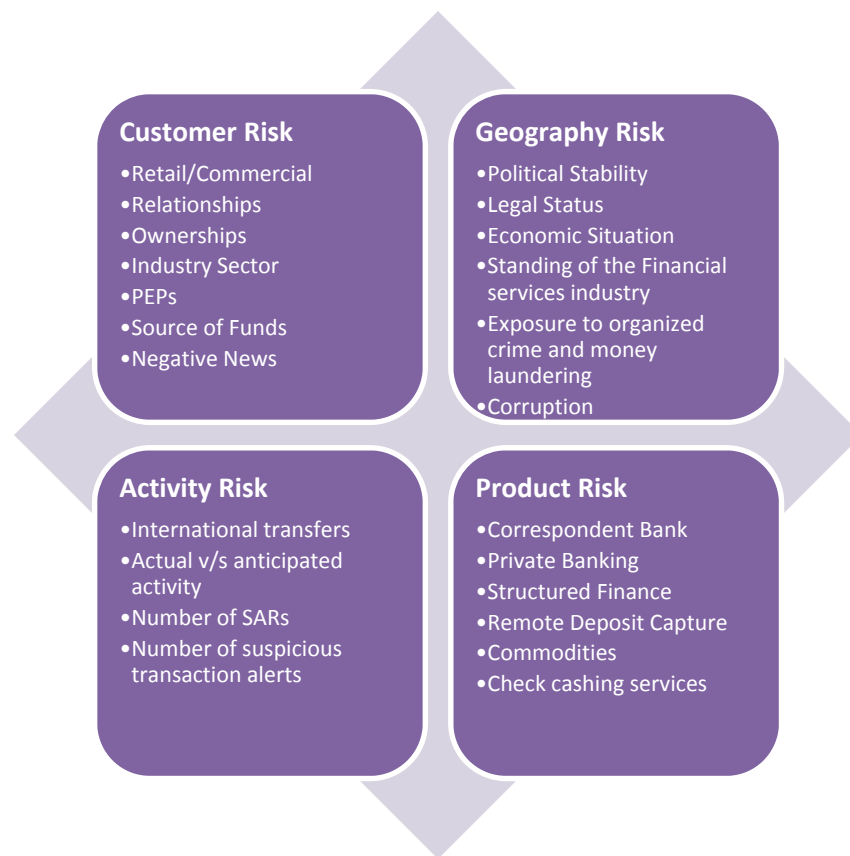
ML/TF Risk should be assessed in order to identify adequate monitoring controls



Risk Category

Risk category should be identified based on the business tenants

- **Risk categories and factors should be identified based on the risk posed by:**
 - **The products/services offered**
 - **The customer base to which these services are offered**
 - **The geographic locations of the customer base or business region**
 - **The transaction activity of the customer**



Risk Scoring

Risk Score is assigned based on ML/TF risk posed by each factor

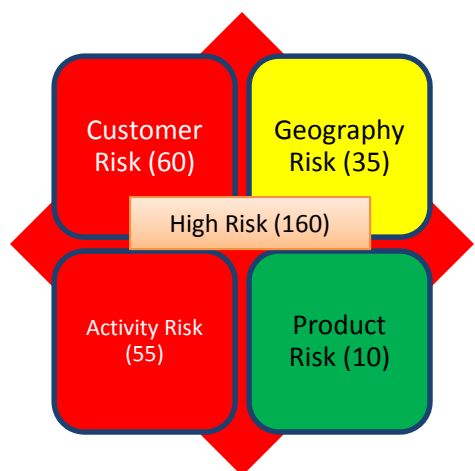
	Low	Medium	High	Very High
Customer Risk	Green	Yellow	Red	Dark Red
Geography Risk	Green	Yellow	Red	Dark Red
Product Risk	Green	Yellow	Red	Dark Red
Activity Risk	Green	Yellow	Red	Dark Red

Risk Grade	Description
0<...<_20	No concerns in this particular area; little negative impact if not managed
20<...<_40	There are some concerns and/or historic issues; could be absorbed in the normal course of business
40<...<_60	Certain identified risks; could become significant if not managed
60<...<_80	Significant risks; could be harmful if not managed properly

Risk Scoring Example (Customer Risk)

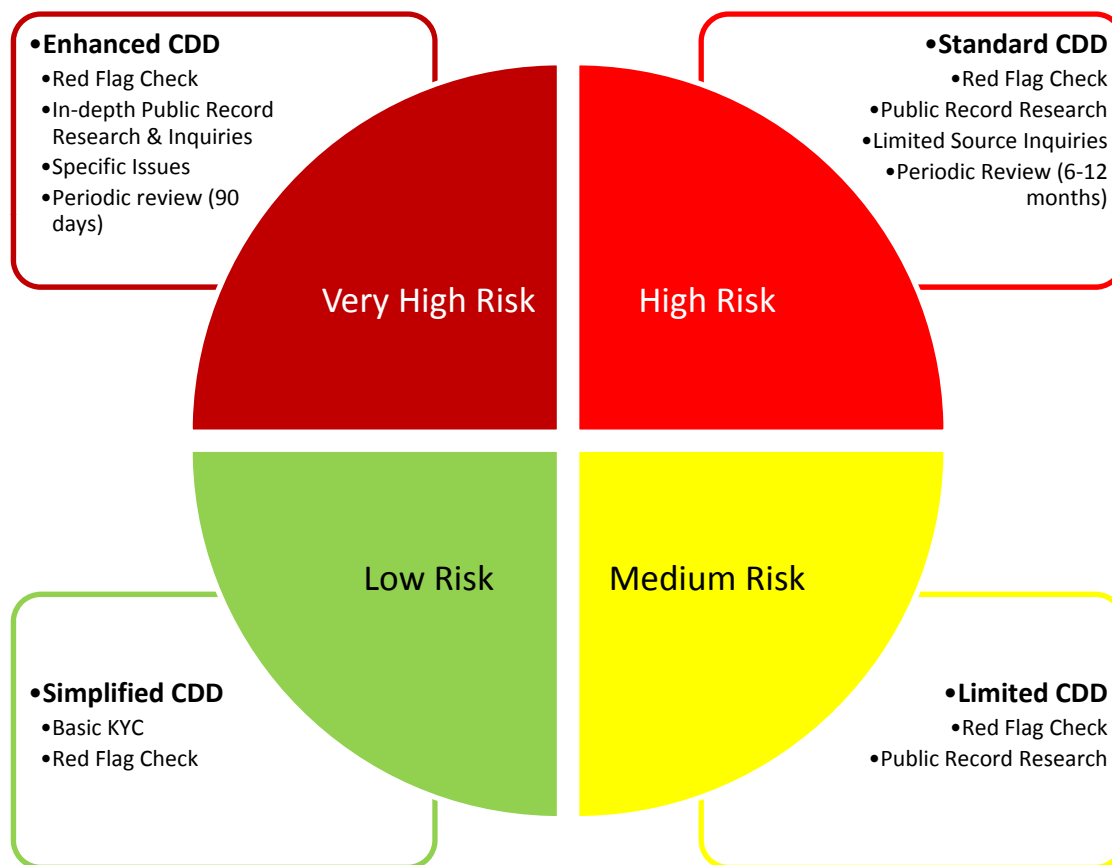
Risk Scoring Example (Overall Risk)

Risk Monitor	
Ownership	38.50
Political Link	68.00
Business Link	67.00
Management	58.00
Reputation	49.00
Total	60.00
Public Profile	High



Customer Due Diligence

Level of due diligence depends on the ML/TF risk posed



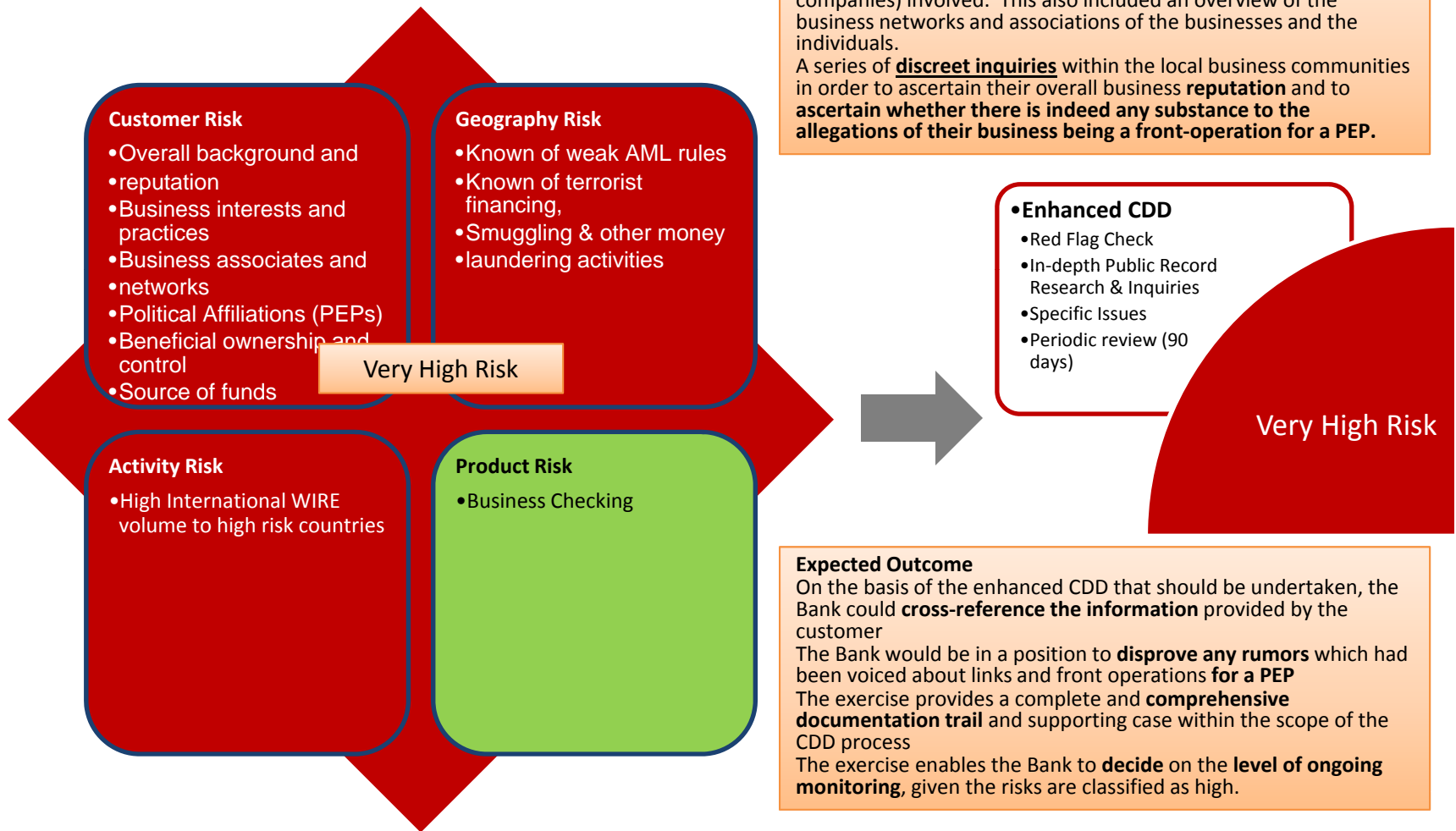
Case Study – Background

Cayman Island Construction Company

- A small size internet bank received an application for opening a business account
- From KYC information collected at account opening it was found that applicant is a Construction company incorporated in Cayman Island but with a US address
- The country into which the funds will flow are the Ivory Coast and East of Europe countries as majority of company's projects are in these locations
- The sector in which the transaction is due to take place is the construction sector and therefore, from FFIEC guidance, inherently a high money laundering risk.
- It is unclear whether the directors and shareholders of the company are the beneficial owners.
- Rumors have been identified in the public record suggesting that the two businessmen and the company are linked to a PEP and that the foreign correspondent bank involved in the transaction is a pocket bank of the same PEP.

Case Study

Customer Risk Scoring



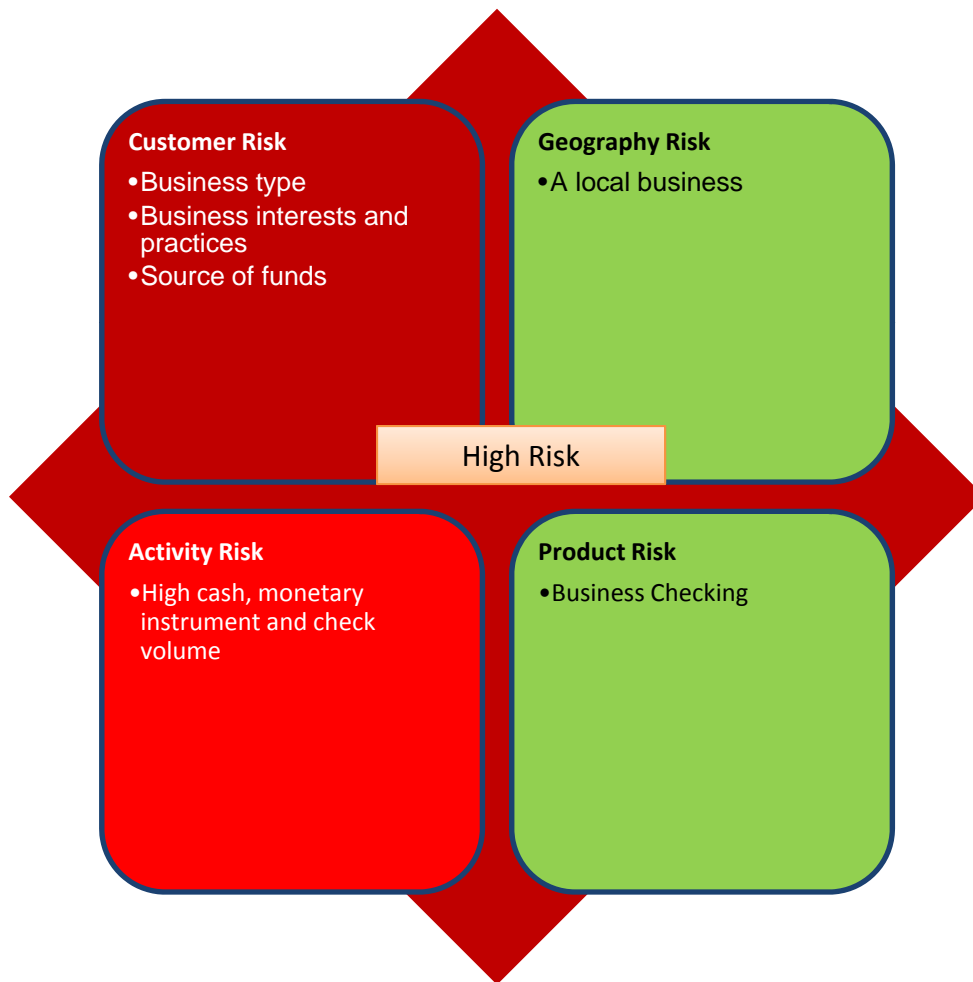
Case Study – Background

Local Money Service Business

- **A local Money Service Business (MSB) applied for business account (mom and pop grocery store)**
- **Initial examination found that this MSB also offered check cashing services including monetary instruments**
- **This MSB had limited identification requirements for it's customers**

Case Study

Customer Risk Scoring



The scope of research
 Involve **public record research** into all parties (beneficial owners, key employee) involved.
Inquiries within the local business communities in order to ascertain their overall business **reputation**
Inquiries to know their customer base and business practices and record keeping

Standard CDD

- Red Flag Check
- Public Record Research
- Limited Source Inquiries
- Periodic Review (6-12 months)

High Risk

Expected Outcome
 On the basis of the Standard CDD that should be undertaken, the Bank could **cross-reference the information** provided by the customer
 The Bank would be in a position to **prove source and beneficiary of funds/transactions**
 The exercise provides a complete and **comprehensive documentation trail** and supporting case within the scope of the CDD process
 The exercise enables the Bank to **decide on the level of ongoing monitoring**, given the risks are classified as high.

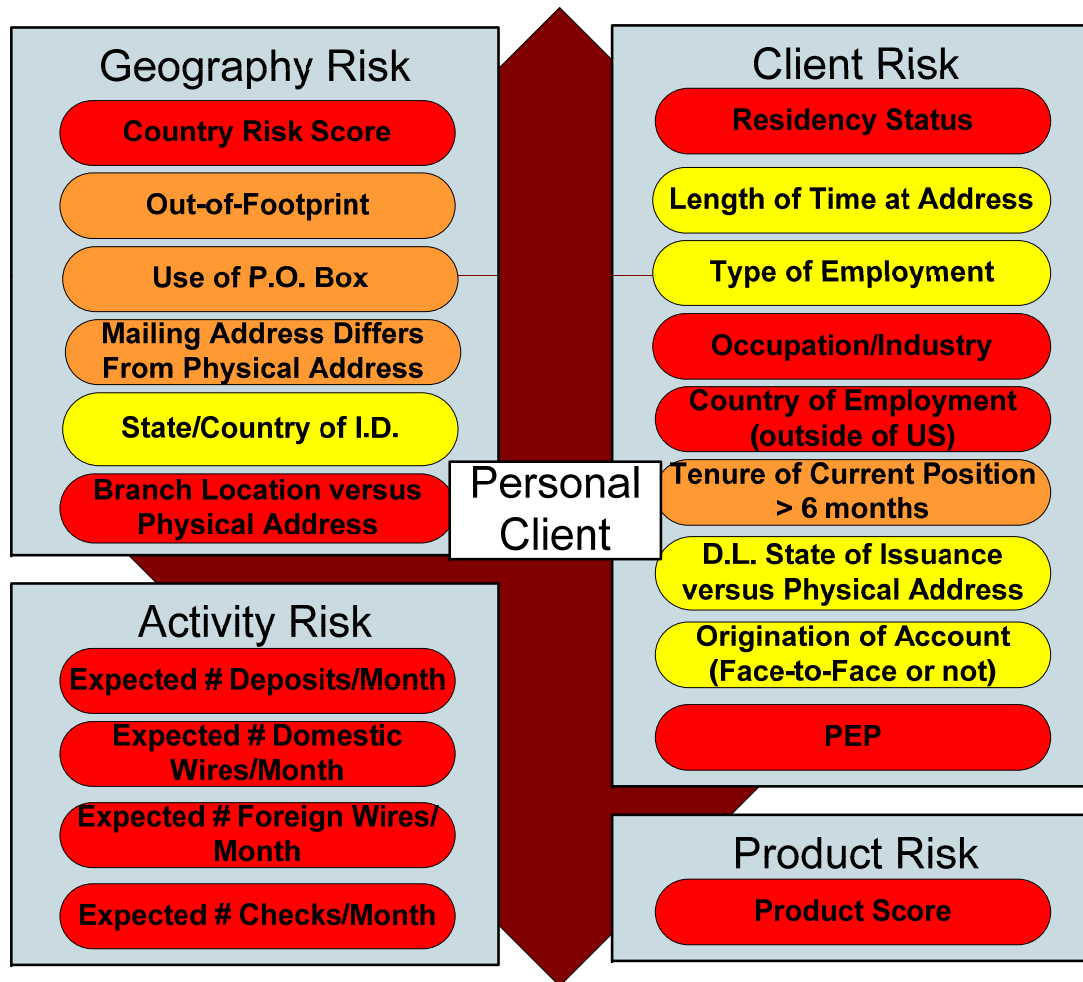
Evolution of a CRS Process

A Brief Timeline of Change

- **2005: implemented initial Client Risk Scoring (CRS) Process**
 - CRS system separate from, but connected to, account-opening platform
- **2006-2008: changing technology, better understanding of CRS results**
 - Bank migrated to new account-opening platform
 - Improvements to CRS methodology based on analysis of clients which scored high risk
- **2009: decision to make radical change to CRS methodology and system**

CRS Methodology

2005 Model: Personal Client



Challenges with Model:

- **Complex model – requires significant programming effort**
- **High number of rejects due to missing data elements**
- **High number of Canadian clients identified who were otherwise low risk**
- **Clients scored only once**
- **Identification requires multiple high risk factors before being considered for EDD**
- **Overly complex model given level of risk that overall Bank and clients posed**

Fine-Tuning the CRS Model:

An Evolutionary Process

Factors that Led up to Analysis:

- **CRS model had strict data requirements which created complexities in an automated, multi-data input environment (client could not be scored without all data, created “defects”)**
- **Complexity of business rules and costs associated with implementation or changes within CRS model or any systems connected to model**
- **Desire to add/remove criteria as needed to ensure the appropriate clients are submitted Enhanced Due Diligence**
- **Data showed that the majority of higher risk customers identified by the CRS application were Canadians with checking accounts**
- **Desire to improve the quality of referrals with greater focus on individuals and businesses who differ from the “typical” customer**

Fine-Tuning the CRS Model:

An Evolutionary Process

Objectives of the Analysis:

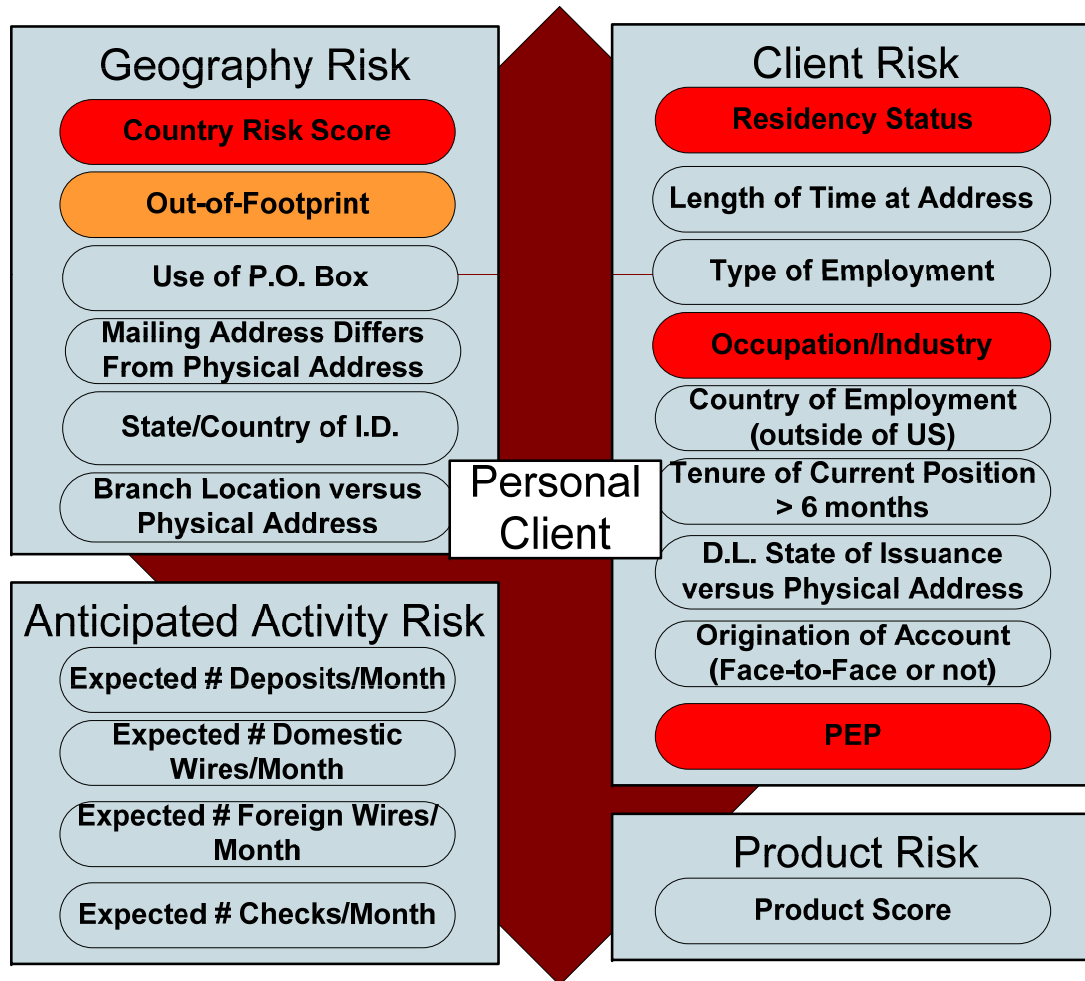
- Simplify the model to reduce the likelihood of “defects” and support a more sustainable technology support process
- Continue to identify clients we believed were higher risk
- Reduce the volume of lower-risk clients that scored as high risk (the “so what?” factor)
- *NOT* an exercise in reducing volume

Analysis Criteria:

- Ability of each risk factor to distinguish risk (stratification of client responses)
- Likelihood that individual risk factor resulted in the client being rated high-risk overall
- Individual factors which generate high degree of false positives (unintended identification of high-risk clients)

CRS Methodology

2010 Model: Personal Client



Benefits of Model:

- Simple scoring methodology using data elements generally captured by all source systems
- Reduces impact on branch personnel to follow-up on missing scoring
- Clients continuously scored
- Reduction in maintenance costs
- Resulted in higher ratio of clients being appropriately referred for EDD

Comparison of Results

Three Years in Review

2008 CRS Results

11,051 New Clients
Deemed Higher Risk
(7% of the total clients
risk scored)

1 SAR filed

3 Clients Demarketed

2009 CRS Results

13,488 New Clients
Deemed Higher Risk
(9% of the total clients
risk-scored)

222 Clients Subject to
Level 2 EDD

1 SAR filed

2 Clients Demarketed

2010 CRS Results

16,724 New and
Existing Clients
Deemed Higher Risk

197 Clients Subject to
Level 2 EDD

2 SARs filed

9 Clients Demarketed

Other Considerations

AML in a Dodd-Frank World

- **Be wary of detracting resources and management attention from your BSA program**
- **Continue to take a risk-based approach to drive areas of focus**
- **Ensure that BSA/AML concerns are considered during new product development**
- **Don't forget about Fraud-related SAR obligations, especially when the bank is not at risk for taking a loss**