WELCOME
The AML Risk Conundrum
What Does AML Risk *Really* Mean?

BSA Coalition Training Event
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Opening Remarks:

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What does AML risk REALLY mean?

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The views and opinions expressed here are those of the speakers. They do not represent an official position of the Federal Reserve Bank of Richmond or the Federal Reserve System.
Panel Objectives

• List and understand the challenges of implementing and documenting risk-based BSA/AML compliance programs

• Describe or implement ways to improve communication across business lines within your organizations

• Develop communication strategies with law enforcement and your regulators to ensure understanding of BSA/AML risk at your organization

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Welcome and Introduction of Speakers
The Definition of Risk - The Conundrum
The Challenges of Risk-Based Compliance Programs
Risk Assessment Considerations
Best Practices for Communicating Risk
Conclusions
Question and Answer Session
Closing Remarks

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Varner, Lisa/Melinda Lytle
Lisa Varner, Debra D’Arrigo
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Varner/Lytle/D’Arrigo
Varner/Lytle/D’Arrigo
Tucker, Amanda
The Definition of Risk
- The Conundrum
A technical definition of AML risk:

The risk to the institution of
• regulatory sanctions
• fines
• penalties or
• losses
resulting from the facilitation of money laundering or terrorist financing
A regulator’s perspective of AML risk:

- Managing risks is fundamental to banking
- Failure to establish a risk management structure is considered unsafe and unsound
What is risk?

“Exposure to the chance of loss, or injury, or dangerous hazardous chance.”
The components of risk evaluation:

Threats
Vulnerabilities
Consequences
What are threats?

A person or group or object or activity that has potential to cause harm
Criminals, terrorist groups, their facilitators and their funds

Identifying threats is where understanding risk begins
What are Vulnerabilities?

Those things that can be exploited by the threat or support or facilitate the activity

Evaluate vulnerabilities distinct from threats by focusing on those factors that present weaknesses in your AML systems and controls.

Also focus on certain features of your products/services that make them attractive for AML purposes
What are Consequences?

Impact or harm financial crimes can cause
Risks to the financial system
Risks to your institution
Impacts your community, your business environment and your reputation
So, what’s the conundrum?

AML Program definition of “risk based” is
• Very broad, inherently subjective in nature
• Risk is a function of three factors: Threat, Vulnerability, & Consequences
• Making judgments and everyone defines risk differently: Regulators, Law Enforcement, LOB, Management and Board
• Misunderstanding may lead to faulty controls or risk mitigants
• Mitigants can be difficult to “operationalize”
• Make sure to bridge the gap and require robust onboarding
The Challenges of Risk-Based Compliance Programs
Common Challenges of Risk-Based Compliance Programs

- Deciding the best way to measure and monitor risk in your institution
- Getting your partners on the same page about risk
- Implementing controls
- Communicating risk effectively -
  - to your regulators,
  - your business partners and law enforcement
Challenges of Risk-Based Compliance Programs

Small Bank Perspective

• How do we get to “risk-based” if we don’t understand our risk?

• AML risk can be viewed from multiple perspectives and sources
  - Reputational, operational
  - Products, customers, geography

• Proactively engage our business lines, our regulators, and our local law enforcement
Challenges of Risk-Based Compliance Programs

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Business line challenges
- Getting the LOB to understand AML risk

Regulatory challenges
- Getting regulators on board with your AML risk evaluation
- Ask for their input

Law enforcement challenges
- Getting the right LE officer/agent who will provide information to help build your risk profile

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Challenges of Risk-Based Compliance Programs

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• Defining how to measure, monitor, control and ultimately report on risk
  - Systems used, tools, defining roles and responsibilities
  - Scope and timing of reporting, policies and procedures

• Aligning with internal and external constituents on a common definition of risk
  - Ensuring a mutual understanding exists about the quantity of risk exposure

• Implementing commensurate controls to mitigate risk
  - Systemic or manual
  - Detective vs. preventive

• Communicating risk effectively to management, auditors, regulators and law enforcement
Risk Assessment Considerations

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Risk Assessment Considerations

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Working with your business lines
- Resources might be limited
- Methods to evaluate risk
  - Utilization of the FFIEC BSA/AML Examination Manual
    - expanded sections and regulatory communications
  - Periodic meetings to gather and discuss those identified risks
    - BSA Action Team discussions
  - Assess risk separately or together – ML/TF
  - Looking at trends – Key Risk Indicators
Risk Assessment Considerations

Small Bank Perspective

- Preparing your written risk assessment
- Identifying specific risk categories, i.e. products, services, customers, entities, transactions and geographic locations
- Analysis, controls and risk rating
- Keeping your risk assessment updated
The risk assessment provides a perfect opportunity to clearly define the inherent risks to be managed throughout the program.

Risk Assessment Considerations

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Inherent Risk

- Customers
- Products
- Services
- Transactions
- Channels
- Geographies
- Other Qualitative Factors
- Emerging
- Economic Sanctions

What does AML risk REALLY mean?
Risk Assessment Considerations
Large Bank Perspective

The risk assessment also provides context about the controls in place to mitigate the risk

What does AML risk REALLY mean?

Internal Controls

| Pillar 1 - Designated Chief AML and Sanctions Officer |
| Pillar 2 - Independent Testing and Oversight |
| Pillar 3 - Training |
| Pillar 4 - Internal Controls, further defined as: |

- • Policies and Procedures
- • Customer Identification Program (CIP)
- • Customer Due Diligence (CDD)
- • Enhanced Due Diligence (EDD)
- • Politically Exposed Persons (PEP)
- • Risk-Based Approach (RBA)
- • MIS / Reporting
- • Record Keeping and Retention
- • Suspicious Activity Report (SAR) Filing
- • Transaction Monitoring
- • Regulatory Specific
- • Sanctions Monitoring

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Risk Assessment Considerations
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The risk assessment measures risk and assesses controls to arrive at a residual risk rating
Risk Assessment Considerations

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Results of the risk assessment should be documented in a formal report. Elements to consider when utilizing the report as a tool to communicate risk:

- Broad distribution to all key stakeholders
- Report should tell the “risk story” of the organization
- Align with the functional organization but also consider legal entity nuances
Risk Assessment Considerations

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Key elements of a comprehensive risk assessment

- Identifies areas of heightened risk
- Covers all risks (products, services, customers, entities, transactions, channels, geographies)
- Considers forward-looking/emerging risks
- Uses a formulaic approach to derive results
- Aggregates and prioritizes risks
- Provides enhanced risk reporting
What does AML risk REALLY mean?

Best Practices for Communicating Risk
Best Practices for Communicating Risk

Small Bank Perspective

With business lines:

- Should be shared and communicated with all business lines across the bank as well as board of directors, management, and appropriate staff.
- Organizational awareness, knowledge and understanding.
- Document in a concise and organized manner.
- Importance of front line staff.
Best Practices for Communicating Risk

Small Bank Perspective

With law enforcement:

- Key in the fight against money laundering and terrorist financing
- Identifies significant relationships, patterns and trends
- Can help your institution protect itself
Best Practices for Communicating Risk

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With regulators:

- Risk assessment is shared during the examination - recommendations from examiners are considered for incorporation into the assessment.
- Ongoing communication of key risk issues through quarterly calls.
- “One-off” phone calls with regulator about significant AML risk events.
All aspects of the compliance management program can be leveraged to implement, document and communicate risk-based AML programs to ensure risks are well understood and managed within the risk tolerance of the organization.
Best Practices for Communicating Risk
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Governance, Risk Management, and Compliance (GRC) systems can be leveraged to communicate risk.

- GRC systems can provide comprehensive documentation of risks and requirements
  - Inventory of all laws & regulations (risks) to manage
  - Associate applicable risks to business areas
  - Demonstrate control coverage
  - GRC typically forms a basis for compliance monitoring and testing
Best Practices for Communicating Risk
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Policy and Procedures (P&Ps) are another way to communicate risk.

• Enterprise P&Ps provide Program-level guidance
• Businesses should implement subordinate procedures
  - Clear articulation of roles and responsibilities
  - Delineate risk takers vs. risk managers
  - End-to-end coverage (onboarding through the account life cycle)
Best Practices for Communicating Risk
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Management Information Systems (MIS) can facilitate management’s ability to effectively measure, monitor, control and report on risk.

• Technology strategy should be prioritized to cover top risks and ensure:
  - Consistent and accurate customer data collection occurs
  - Data is available for use in downstream AML processes
  - Meaningful management reporting can be produced
Best Practices for Communicating Risk

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Reporting is a critical communication mechanism used to reach a broad group of constituents with a consistent message.

- Key elements of successful reporting
  - Audience is defined
  - Level, extent and frequency of reporting is tailored to the audience
  - Key Risk Indicators and Key Performance Indicators included
  - Signal early warnings of adverse trends
  - Overall state of compliance is reflected
Best Practices for Communicating Risk

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Other Program components can be leveraged for communicating risk.

- Board and Senior Management oversight/escalation channels
- Auditors, regulators and law enforcement
  - Audit – Proactive engagement
  - Regulators – Routine meetings; shared reporting; offer deep dive reviews; communicate organizational changes or material risk issues and controls breakdowns promptly
  - Law enforcement – FIU should have clear communication channels/established Points of Contact
- Compliance Monitoring and Testing plans
Best Practices for Communicating Risk

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Training is a required Program pillar and is a key component to ensuring there is a mutual understanding of risk and controls.

- Key elements of an effective Training program:
  - Scope should be enterprise wide to include all personnel whose duties require knowledge of the BSA/AML requirements, including new hires
  - Content is tailored to the specific responsibilities of each area and target audience
  - Examples of money laundering activity and red flags are included
  - Attendance is documented and retained

What does AML risk REALLY mean?
Conclusions
How do you solve for the Conundrum?

- Strengthen relationships with business lines, regulators and law enforcement
- Understand risk through the risk assessment process
- Communication
- Education and training
How do you solve for the Conundrum?
Here’s your action list

- Ensure a clear definition and a mutual understanding of risk throughout the bank
- Implement controls
- Educate business lines, regulators and law enforcement about AML risk throughout the risk assessment process
- Ensure mutual understanding of BSA/AML risk between your bank, regulators and law enforcement
What does AML risk REALLY mean?

Questions?
Closing Remarks