

REGULATORY HOT TOPICS FOR INTERNAL AUDITORS: *EVALUATING THE USE OF AML TECHNOLOGY*

Shaheen Dil – MANAGING DIRECTOR, PROTIVITI

John Atkinson – DIRECTOR, PROTIVITI

Carl Hatfield – DIRECTOR, PROTIVITI

Chetan Shah – ASSOCIATE DIRECTOR, PROTIVITI

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Today's Presenters

Shaheen Dil, Managing Director, Model Risk and Capital Management, Protiviti



Shaheen Dil is a managing director of Protiviti, responsible for the Model Risk practice as well as Capital Management activities. She has 25 years of experience in all aspect of risk management—domestic and international. This includes Basel qualification and compliance, enterprise-wide risk governance and reporting, risk modeling and model validation, credit approvals and credit portfolio management. Prior to joining Protiviti, she was an Executive Vice President at PNC Financial Services Group, where she held various leadership positions, including Head of Risk Analytics, Leader of the Basel Implementation Program, Head of Model Validation, Chief Performance Officer, and Head of Credit Portfolio Management. Before that, Shaheen worked at Mellon Bank, initially as an Economist and then as a Senior Credit Approval Officer. Shaheen was selected as one of 2011's "Top Women in Retail and Finance" by Women of Color Magazine.

John Atkinson, Director, Regulatory Risk Consulting, Protiviti



John Atkinson is a Director with Protiviti in the firm's Regulatory Risk Consulting practice, and he works with financial institution clients on regulatory and risk management issues, with a focus on anti-money laundering. John joined Protiviti in June 2008 after a 30-year career at the Federal Reserve Bank of Atlanta, serving nearly 20 years as an assistant vice president in the Division of Supervision and Regulation. In this capacity, he had oversight responsibilities at the officer level for numerous bank supervision functions, including anti-money laundering, consumer compliance, international bank supervision, bank holding company and large bank supervision, and enforcement. John served as the Atlanta Fed's AML subject matter expert for over 20 years and has been a regular speaker at professional conferences and events for industry, regulatory, and law enforcement groups.

Today's Presenters

Carl Hatfield, Director, Regulatory Risk Consulting, Protiviti



Carl Hatfield is a Director in Protiviti's Regulatory Risk Consulting practice with a focus on the financial services industry. Carl has been working with AML technologies and other risk management disciplines for most of his career. He has experience with validating AML technologies, performing system requirements analysis, identifying gaps in transaction monitoring rules, testing AML applications and reviewing data integrity controls for AML application technologies. In addition, he has led projects to assess the current state of compliance technology solutions and develop prioritized roadmaps to improve technology environments.

Chetan Shah, Associate Director, Regulatory Risk Consulting, Protiviti



Chetan Shah is an Associate Director of Protiviti. He has more than 16 years of experience in Financial Services Technology and has an extensive Financial Data Analytics experience using various statistical techniques and related software and a deep AML business and technology implementation experience with large financial institutions. Chetan has led various independent AML model validation projects with primary focus on analyzing and validating the various data sources and suspicious activity scenarios/thresholds deployed by the bank. Additionally Chetan has successfully executed suspicious transaction monitoring projects for major bank's correspondent banking and retail line of business primarily focusing on identification of relevant monitoring scenarios, independently validating the logic of chosen scenarios and performing PMO level activities.

Agenda



The Current Regulatory Environment

Selecting the Right System

Ongoing Maintenance

Case Study

The Role of Internal Audit

Q&A

THE CURRENT REGULATORY ENVIRONMENT

Excerpt from a Recent Enforcement Action

Within one hundred eighty days (180) days of this Order, the Bank shall fully install, test, and activate a new wire transaction monitoring system. In implementing the new system, the Bank shall use a satisfactory approach to validating the system commensurate with the Bank's BSA/AML risk.

Indicators of Ineffective Monitoring

- Your institution is buried in alerts, but files few SARs.
- Your institution has a very high SAR / Alert ratio.
- More SARs come from business line referrals than from system-generated alerts.
- A high percentage of alerted customers were previously investigated for similar activity and deemed not suspicious.
- Certain transaction types never seem to generate alerts.
- Your institution has had to implement a number of manual workarounds to its monitoring regime.
- Your regulators have identified suspicious activity that you did not report.

What's the Root Cause of These Problems?



Poorly selected,
inadequately installed
and calibrated, and/or
improperly tested
software.

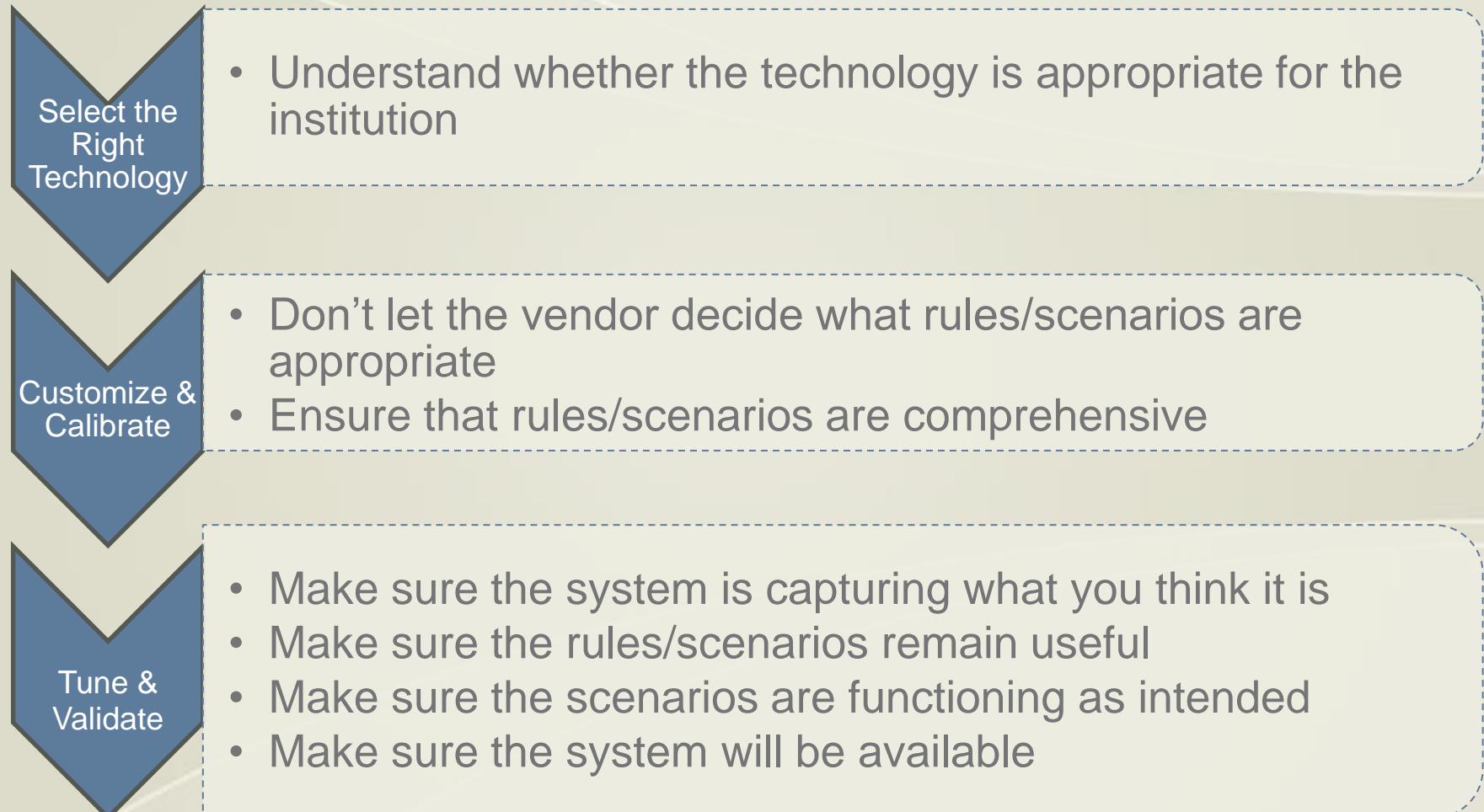
Polling Question #1

Which of the following are potential indicators of a flawed monitoring process? (Select all that apply)

- a) Lots of alerts and no SARs
- b) Nearly every alert results in a SAR
- c) No alerts are generated on international wires
- d) Significant manual workarounds are necessary
- e) None of the above

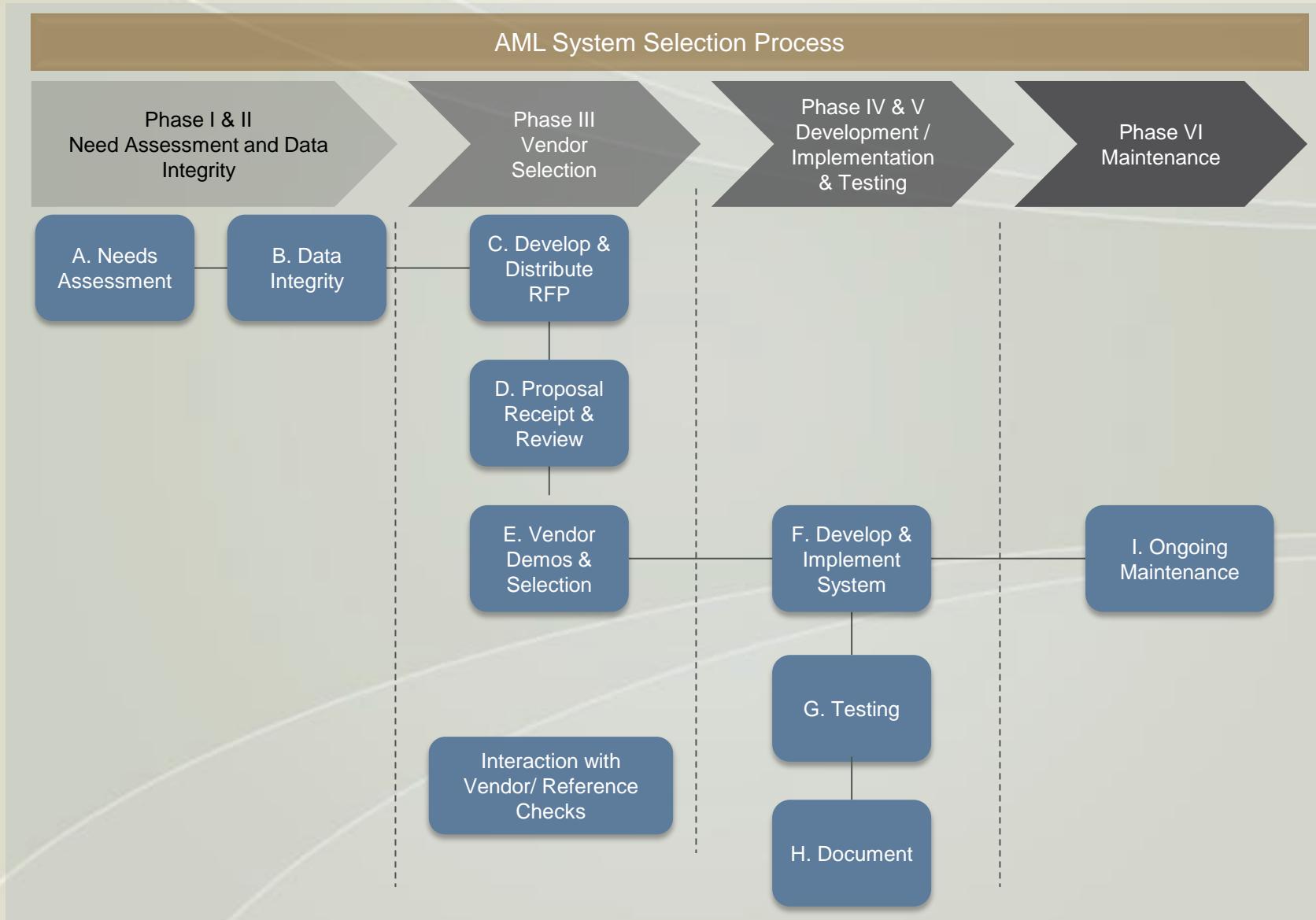


What Do the Regulators Expect?



SELECTING THE RIGHT SYSTEM

AML System Selection Process



Polling Question #2

It's appropriate to use the vendor-selected scenarios in place of customized scenarios in a newly implemented system.

a) True

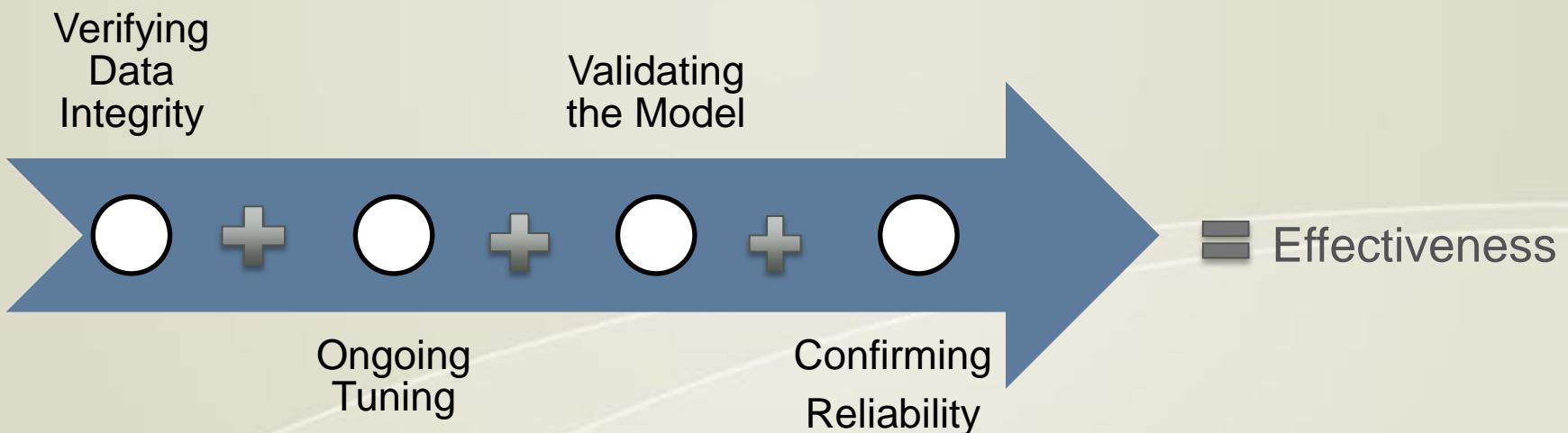
b) False



Ongoing Maintenance

Ongoing Maintenance

Ongoing maintenance requires periodic validation of the effectiveness of the AML monitoring technology. This is a four-stage process, which requires several different skill sets.



Verifying Data Integrity

- Understanding the data flows from transaction and customer systems to the transaction monitoring system.
- Confirming that intended products/transactions are included in the monitoring system.
- Documenting and testing data exclusions.
- Mapping the institution's transaction codes to the transaction monitoring system's transaction codes.
- Testing Information Technology process controls that are in place to detect data errors.

Skill Sets Required: Data analysis and IT controls

Ongoing Tuning

- Documented Threshold Tuning Methodology.
- Availability of data related to Alerts, Cases and SARs filed.
- Above- and below-threshold value testing approach.
- Pseudo investigation cycle before applying threshold values into production environment.
- Documentation of findings and reasoning behind increasing / decreasing threshold values.

Skill Set Required: Understanding of products, related AML risks and information technology

Polling Question #3

Once thresholds are determined, it is unlikely they will need to be changed.

a) True

b) False



Model Validation

- Ensure scenario definitions are implemented accurately
 - by writing separate queries in SAS to check results
- Determine appropriateness of existing scenario thresholds by using cluster analysis and standard deviation methods
- Use historical performance of Alerts, Cases and SARs to tune and benchmark existing thresholds
- For customer risk rating scenarios, tune and assess assigned risk scores
- Transfer knowledge to client by sharing independent data queries and statistical algorithms

Skill Set Required: Quantitative analysis

Confirming Reliability

- Transaction monitoring systems are included in the institution's business continuity and disaster recovery planning
- System recovery times are aligned with the compliance team's expectations.
- Outsource technology solutions have appropriate disaster service level agreements.
- Manual workarounds are planned in the event the transaction monitoring system is not restored for an extended period of time.

Skill Set Required: Business continuity/disaster recovery

Polling Question #4

Which of the following are elements of an effective ongoing maintenance process? (Select all that apply)

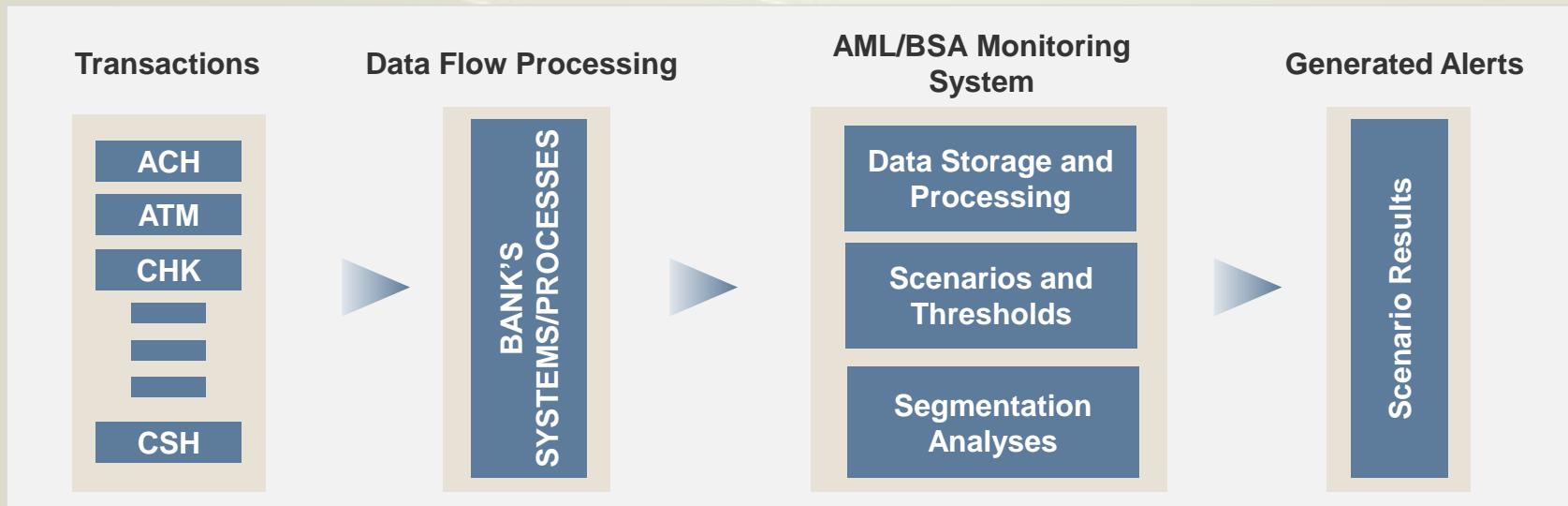
- a) Validating data integrity
- b) Ongoing tuning
- c) Validating the model
- d) Confirming reliability
- e) None of the above



CASE STUDY

Case Study: AML System Validation for a Regional Bank

Transaction Monitoring System Configuration



Typical Transaction Monitoring System Configuration

1. Customer / Account / Transaction Data extraction and loading processes.
2. Deployed Scenarios residing in the monitoring system.
3. Scenario execute at set threshold levels.
4. Segmentation Analyses to identify Thresholds.
5. Risk Rate Customers and Assign Scores
6. Scenario results are the “Alerts” that need to be investigated

WHAT IS INTERNAL AUDIT'S ROLE?

The Role of Internal Audit

AML Technology
Implementations

- Monitoring the implementation:
 - ✓ Are the institution's standard project management practices being used to manage the implementation?
 - ✓ Are the right stakeholders involved in the project?
 - ✓ What process was used to select scenarios and determine threshold settings?
 - ✓ Is the test strategy appropriate?
 - ✓ Is there adequate system documentation?

Verifying Data
Integrity

- Performing transaction walkthroughs.
- Comparing data between source data systems and the transaction monitoring system.
- Testing IT process controls related to data processing and change management.

The Role of Internal Audit

Ongoing Tuning

- Reviewing artifacts created as part of threshold tuning exercise.
 - ✓ Software Code (scripts).
 - ✓ Observed results (alerts and their corresponding threshold values).
 - ✓ Pseudo investigation results.
 - ✓ Evidence of application of threshold values into production environment.

Model Validation

- Internal Audit ensures Validation covers all requirements of OCC Guidance 2011-12 and FRB SR 11-7
 - ✓ Validation is performed by objective, independent, skilled personnel
 - ✓ Validation documentation includes assessment of model risk governance, model development, performance testing, and change controls
 - ✓ An effective challenge process is evident.

The Role of Internal Audit

Confirming Reliability

- Reviewing recovery time capabilities for transaction monitoring systems.
- Reviewing the compliance process' business continuity plans.
- Confirming the disaster recovery and business continuity plans have been appropriately tested.

Polling Question #5

What are the potential challenges involved in auditing the use of AML technology? (Select all that apply)

- a) Insufficient skill sets
- b) Lack of documentation to support system design/changes
- c) Overreliance on a vendor or a few key personnel
- d) Difficult to document an effective challenge process



Q & A



Resources

Refer to Protiviti's website for more resources related to AML Technology

www.protiviti.com/AML		
Validating Suspicious Transaction Monitoring Systems - Combining AML Expertise and Data Analytics	Point of View	Link
Enhance AML Transaction Monitoring Scenarios by Leveraging Customer Segmentation	Point of View	Link
Implementing AML Transaction Monitoring Systems: Critical Considerations	Point of View	Link
Protiviti's Guide to U.S. Anti-Money Laundering Requirements: Frequently Asked Questions, Fifth Edition	Resource Guide	Link

***Also look for our quarterly Compliance Corner on the IIA's FSA Times site
www.theiia.org/fsa***

THANK YOU!