Managing BSA/AML Compliance Risk

Presentation at the Breakfast Meeting
Co-Hosted by ABANA and the American Bar Association’s Middle East Committee

May 12, 2015
I. U.S. Regulatory Expectations

II. Key Elements of an Effective AML Program

III. Meeting Increasing Regulatory Expectations
I. U.S. Regulatory Expectations
Money Laundering Continues to Undermine the Financial System

Money laundering is an illegal activity, so estimates of scope are, by their very nature, approximate. However:

- **Criminal proceeds are thought to have equaled 3.0 - 3.6% of global GDP** in 2012, including:
  - $692 billion from counterfeiting and piracy
  - $411 billion from illegal drug proceeds
  - $240 billion from human trafficking
  - $162 billion from smuggling
  - $140 billion from illegal gambling

- **Approximately 76% of criminal proceeds are laundered** through the financial system—but **less than 1% are seized**

*Source: United Nations Office on Drugs and Crime (UNODC), 2011*
Regulators Are Publically Announcing Their Rising Expectations

“The Federal Reserve places great importance on ensuring that the institutions we supervise comply with the BSA and U.S. economic sanctions…and in the last five years has issued 113 enforcement actions relating to BSA and OFAC compliance, including 25 public cease and desist orders and written agreements…and assessed hundreds of millions of dollars in penalties…We will continue these efforts…to ensure a coordinated response to the threat posed by illicit financing to the U.S. financial system.”

Jerome H. Powell, Governor of the Federal Reserve Board March 7, 2013

“Without a commitment from the highest levels of bank management to maintain strong programs, ensure a culture of compliance, and support the BSA/AML officers…it’s more than likely that BSA/AML programs will not be effective and will result in an enforcement action.”

Thomas J. Curry, Comptroller of the Currency March 17, 2014

Lanny Breuer, formerly the Assistant Attorney General for the Criminal Division of the Department of Justice, signaled that the government would prosecute bankers who “abdicated their roles as responsible gatekeepers to the American banking system.”

Lanny Breuer, Former Assistant Attorney General Department of Defense, October 19, 2010
The U.S. has imposed almost $19 billion in AML and sanctions-related fines since 2007.

Source: U.S. Department of the Treasury, New York Department of Financial Services, Wall Street Journal
Enforcement Actions Address Banks’ AML Compliance Programs

Nearly all of the 122 public AML-related enforcement actions issued in the U.S. from 2012 to 2014 cited weak governance, oversight, and compliance culture.

Elements Cited in 2012-2014 U.S. AML Enforcement Actions

- Related to AML risk assessments: 80
- Related to customer due diligence: 91
- Related to transaction monitoring systems: 102
- Related to independent testing/audit: 95
- Related to training program: 70

Sources: Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve, Federal Deposit Insurance Corporation

© 2015 Promontory Financial Group, LLC. All rights reserved.
AML activity can have an adverse impact that extends beyond financial penalties and enforcement actions to include reputational, legal, operational, and regulatory risks.

Criminal Prosecution

- Loss of Clients
- Decline in Market Value
- Liability in Private Litigation
- Loss of Banking Licenses
- New Product Restrictions
- Loss of Upstream Correspondent Relationships
- Forced Retirement of Senior Executives
- Secondary Sanctions from other Regulatory Entities
- Downgraded Regulatory – “Management” Rating
- High Remediation Costs

“A company's size will never be a shield from prosecution or penalty.”

– Attorney General Eric Holder, Weekly Address, May 5, 2014
II. Key Elements of An Effective AML Compliance Program
The Board, Management and Three Lines of Defense Play Key Roles

**1ST LINE OF DEFENSE**
*Individual lines of business*
- Own the AML risk
- Understand and manage client risks
- Manage AML risks on a day-to-day basis
- Promote a compliance culture
- Escalate unusual activities and concerns to AML Compliance

**2ND LINE OF DEFENSE**
*AML Compliance*
- Assesses AML risk enterprise-wide
- Provides governance and oversight of AML risk
- Develops reports for the board and senior management
- Investigates, analyzes and reports suspicious activities
- Monitors and tests AML processes

**3RD LINE OF DEFENSE**
*Internal Audit Testing*
- Independently tests the effectiveness of the AML Program
- Tests the adequacy of systems, staffing and technology that support the AML Program
- Develops reports for the board and senior management

“The risk governance framework and the three lines of defense are intended to ensure that the bank has an effective system to identify, measure, monitor, and control risk-taking and standards of behavior.”

Thomas J. Curry, Comptroller of the Currency, November 21, 2014
Effective AML Programs Must Be Rigorous and Comprehensive

<table>
<thead>
<tr>
<th>Oversight, Governance, and Reporting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Assessment</td>
</tr>
<tr>
<td>KYC Program, Ongoing Customer Due Diligence, and Name Screening</td>
</tr>
<tr>
<td>Transaction Monitoring and SAR/CTR Filing</td>
</tr>
<tr>
<td>Data Analytics and Tools/Effective Systems/Data Quality</td>
</tr>
<tr>
<td>Policies and Procedures</td>
</tr>
<tr>
<td>Controls for Managing Sanctions and Terrorist Financing Risk</td>
</tr>
<tr>
<td>AML Head and Resourcing</td>
</tr>
<tr>
<td>Human Resources and Training</td>
</tr>
<tr>
<td>Quality Assurance, Compliance Monitoring and Testing</td>
</tr>
<tr>
<td>Independent Testing</td>
</tr>
</tbody>
</table>

© 2015 Promontory Financial Group, LLC. All rights reserved.
III. Meeting Increasing Regulatory Expectations
### Stay Ahead Of The Curve By Enhancing Core Components of the AML Program

<table>
<thead>
<tr>
<th>Component</th>
<th>Action Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Risk Assessment</strong></td>
<td>Conduct an annual risk assessment</td>
</tr>
<tr>
<td><strong>Change Management</strong></td>
<td>Develop robust early-warning systems to identify and incorporate changes in regulatory expectations and best practices</td>
</tr>
<tr>
<td><strong>Training</strong></td>
<td>Continuously improve training to strengthen culture, awareness, and controls</td>
</tr>
<tr>
<td><strong>Reporting</strong></td>
<td>Provide insightful reports for senior management and the board, including roll-ups from AML audit reports, regulatory exams and enforcement actions</td>
</tr>
<tr>
<td><strong>Escalation Mechanisms</strong></td>
<td>Establish and follow procedures for promptly escalating AML compliance-related issues to the board, senior management, and regulators as appropriate</td>
</tr>
<tr>
<td><strong>Technological Support</strong></td>
<td>Use technology to supplement human judgment not replace it</td>
</tr>
<tr>
<td><strong>Minimize AML Risk</strong></td>
<td>De-risk the business where AML risk is too high</td>
</tr>
<tr>
<td><strong>Remedial Action</strong></td>
<td>Take remedial action, as appropriate and as needed</td>
</tr>
</tbody>
</table>

What’s good today won’t be good enough tomorrow.

Leading banks are continuously improving their practices.

What’s good today won’t be good enough tomorrow.

Leading banks are continuously improving their practices.