



ADI Adviser

Considerations When Performing Anti-Money Laundering Risk Assessments

Risk Assessment is the new mantra in anti-money laundering (AML) compliance programs. As varied as one financial institution is from another, so will their AML risk assessment be varied. The variation, however, will be in the depth and breadth of the assessment and largely due to the variation in business activities across institutions. AML risk assessments, however, should begin by considering certain fundamental elements.

These include but are not necessarily limited to:

- Legal and organizational structure of the institution
- Geographies and Operating markets – both foreign and domestic
- Regulatory framework, intensity and scrutiny within the operating markets
- Counterparties that may be used to facilitate transactions
- Customer base characteristics
- Scope of customer relationships
- Products and services offered

- Anticipated activity types and levels by customer and account type
- Customer duration or dormancy
- Method of product or service delivery or acceptance

These elements then become part of your quantitative and qualitative assessment of AML risk and controls. Consideration of these elements can be very limited in scope for less complex financial institutions or span many different areas in highly complicated institutions. Further, as the complexity of the institution grows the extent of risk is likely to be far greater.

Legal and Organizational Structure

Consideration of the legal and organizational structure of the institution is an essential first step in preparing an effective, comprehensive AML risk assessment. Large organizations with many different markets, subsidiaries, functional areas, or business lines present higher levels of AML risk. Each may have different types of controls to address that risk. Each area will need to be assessed, both for its individual risk as well as its effect on the aggregate risk assessment for the institution.

Geographies and Operating Markets

The areas served by your institution can present varying degrees of risk and they do so for different reasons. Institutions that operate in a confined, well defined, market present a lower level of risk than an institution that operates on a global basis. It is possible to know your customer very well in a smaller institution operating in a well defined market. The level of risk is heightened greatly as the market area expands. Larger institutions, invariably, have less contact with, or ability to interact personally with their customers. Additionally, if the institution operates in or accepts accounts and transactions from areas designated as High Risk Money Laundering and Related Financial Crimes Areas, HIFCAs, additional scrutiny may be warranted.

There is a much greater necessity to have formalized processes to gather, understand and utilize information about your customer in a larger institution. Smaller institutions can effectively rely on personal, informal one-

on-one contact. Institutions operating in foreign territories have an even higher level of inherent risk. Not only are the legal and regulatory frameworks different, there is a vast array of cultural differences to be considered.

Each institution should continuously analyze its accounts and the activity in those accounts based on their source geographies and the types of transactions that occur across geographies.

Regulatory Framework

Every institution needs to consider the regulatory framework within each of its operating markets. This is not only important to ensure compliance with applicable local or host country laws and regulations, but also to understand the level of regulatory scrutiny that may be applied to counterparties. Lack of regulatory framework or scrutiny may be indicative of a heightened risk level for transactions or beneficiaries involving those markets.

Counterparties

When an institution establishes relationships with others in order to facilitate transactions or establish customer relationships, there is an increase in the level of risk. An institution can, perhaps unwittingly, assume a level of risk through its counterparties that it would not willingly assume if the customer relationship was direct. It is, therefore, incumbent upon each institution to “know your counterparty”.

As noted above, this becomes more difficult as the organization grows and becomes more complex and diverse. Smaller organizations may have a relationship with the business next door. As such, that institution may know the principals of that business and understand that business very well. Larger institutions will need more formal processes to gather information and understand the business of their counterparties.

Not only is it important for an institution to understand its counterparties but it must also make the counterparties aware of its expectations regarding compliance. Each institution will also need to establish monitoring mechanisms commensurate with the type of

relationship and level of activity to ensure ongoing compliance.

Customer Base Characteristics

What kinds of customers make up the institution's target market? Do the customers reflect that target market? Do the customers actually use the products anticipated? When considering customer base characteristics, if the answer to either of the two latter questions is "no," there may be a heightened level of risk. For example, if the target customer base is young college students, it would not expect there to be a large number of CD's opened. Conversely, if the institution were targeting older, more affluent customers, it would not expect there to be a significant number of early withdrawals from CDs.

Scope of Customer Relationships

As the institution considers the characteristics of its customer base, it must also determine the depth and breadth of customer relationships. If the marketing strategy is to expand "wallet share" from each customer, then is it reasonable to expect a large number of long-term customer relationships to be based solely on a single account type?

Products and Services Offered

Larger, more complicated institutions offer a wide range of products and services and each presents a different level of risk. Transaction accounts bring an inherently greater degree of risk than non-transaction accounts. However, the various stages of money laundering (placement, layering, and integration) must be considered when making this determination. That is, transactions such as deposits or withdrawals into checking accounts, present a risk at the placement stage, wire transfers present a risk at the layering stage.

In addition, signs of risk vary by product or service. For example, six withdrawals from a money market account during a statement period may not be unusual but six early withdrawals from a certificate of deposit may be very unusual.

Anticipated Activity Types and Levels

How does one determine whether activity is unusual or potentially suspicious? What is the baseline to which one compares? These are important questions that can challenge financial institutions but must be considered.

It may be appropriate for certain types of accounts or customers to set the baseline by the class of account. For example, retail customers with the same type of account profile, i.e., the same characteristics, may have similar baselines. In other instances, perhaps for non-retail customers, high net worth customers, foreign customers, or others, it might be more necessary to create individual profiles. For those accounts where you set the baseline by class, your institution should analyze the data activity in the accounts to determine consistency with the class. Outliers should be treated individually and account activity monitored against individual account and customer parameters.

Customer Duration or Dormancy

Long-term customer relationships may provide some higher level of comfort as to the purpose of the account or accounts and the activity in them. Certainly, outliers to the historical trends in an account can more easily be identified in an account where the account relationship has existed for years rather than weeks. However, accounts that may be on the books for an extended period of time but be in a dormant state present additional risk when the customer re-activates them. Every institution should look closely at new activity in older, dormant accounts, or less frequently used customer relationships.

Method of Product or Service Delivery

How does one know a "virtual" customer? In today's marketplace there are many instances in which a financial institution may see its customer very infrequently, if ever. Challenges include: How to confirm the identity of the customer and, how to quantify and assess the anticipated level of activity for the account and relationship?

COMPLIANCE PROGRAM

We provide independent insight to examine your compliance program's strengths and weaknesses. We offer solutions that reduce fair lending compliance risks while embracing your existing processes.

Solutions are customized through our experienced assessment of a wide variety of potentially vulnerable areas pertaining to your current compliance program including: your institution's lending monitoring and analytical procedures, the quality of your loan decisioning and loan pricing program, your policies and procedures, your current training curriculum used for new and current employees, compliance communications with senior management and board members and your readiness for forthcoming regulatory examinations.

Following our assessment, we design a number of customized solutions specifically geared to address the needs of your program. With our experience and your input, this phase can include a new monitoring system to alert management of potential vulnerabilities, better processes for data capture and validation by your loan origination system, revised policies & procedures, enhanced broker and loan officer compensation to embrace fair lending policy, new products to meet the needs of underserved markets, and continuing education courses to emphasize the importance of fair lending.

After your compliance program has been assessed and solutions have been designed to address your needs, we then implement the

solutions with you, instead of leaving you with some reports and a bill.

TRAINING PROGRAM

Using the same complete methodology as we do to exceed the needs of our Compliance Program clients, our Training Program clients also see the value of our Assess, Design, and Implement strategy. First, we assess the current program for compliance training. Where enhancements can be made, we work with you to design improvements to the program. Once the designs are created, we then implement the new training program to ensure success.

SELF ASSESSMENT PROGRAM

We will use our proven strategy to provide independent insight to your current methodology of monitoring your lending program. We work using the same tools that you currently own, so that you are able to continue using our tested methods of data analysis without having to purchase specific software or sign up for expensive web-based services. If needed, we can recommend the appropriate tools for you to use with an understanding of your lending situation.

Our self assessment program involves our assessment of the current process used to monitor your lending program. We then design appropriate enhancements to the existing process or develop an entirely new, custom process. To implement it, the process is then created for you and comprehensively explained to you.

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