Designing Successful Know Your Customer Programs

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Association of Certified Fraud Examiners

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Objectives

- Understand the expectations for identifying high-risk customers
- Ability to assign risk ratings to customers
- Minimize any negative impact on the customer experience

Agenda

- Anti-Money Laundering Introduction (AML)
- Regulator’s Elevated Expectations
- Designing Know Your Customer Programs (KYC)
- A Closed Loop Framework
Why the fuss?

- Money Laundering - is not new
- However, since 9/11
  - Law enforcement agencies and bank regulators have shifted their focus to terrorists and terrorist organizations.

USA PATRIOT Act

- Section 352 - Requires banks to implement an Anti-Money Laundering program that at a minimum includes:
  - Develop internal policies, procedures, and controls,
  - Designate a compliance officer,
  - Provide an ongoing employee training program, and
  - Support an independent audit function to test programs.
Regulatory Pressure

- Congressional allegations of lax oversight
  - Made compliance a top examination priority for regulators.
- Regulators are stressing the importance of a Risk Based Approach to Compliance.
  - Know Your Customer (KYC) and Enhanced Due Diligence (EDD) are an increasing focus of the latest examinations
  - Old AML polices, procedures, training and technology are rarely adequate in this new environment.

Key Assumption

- Most of us have some familiarity with Money Laundering
  - Quick review
  - Main focus on Know Your Customer (KYC) programs
Money Laundering

- Initial or Placement Stage
  - Breaking up large sums to smaller amounts
  - Purchasing monetary instruments
- Layering Stage
  - Purchase and sale of investment instruments
  - Wiring through accounts across the globe
- Integration
  - Buying real estate, luxury assets
  - Business ventures

Source - ACAMS
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### Elevated Expectations
- Regulators have ‘raised the bar’ on BSA/AML compliance
  - Record breaking Civil Money Penalties are being handed out!
- Key Elements
  - Identifying and knowing customers
  - Having processes/systems in place to detect, monitor and report suspicious activities.
Elevated Expectations

- AML processes must be proactive rather than reactive.
  - Risk Based Approach Required
  - Exam prep “fire drill” not enough
- This may mean the implementation and use of AML technology to:
  - Identify high risk customer relationships, products and services; and
  - Focus controls and monitoring efforts accordingly.

Handling Elevated Expectations

- Periodically compare customers regularly appearing on large cash reports to customers that also conduct frequent wires or purchases of monetary instruments in order to evaluate the reasonableness and detect unusual trends or patterns;
Handling Elevated Expectations

- Periodically evaluate the reasonableness of high volume cash accounts and watch for sharp increases in cash flowing through them;

- Review large cash reports, monetary instrument records, and wire transfer reports for possible structuring of activity to evade BSA reporting or recordkeeping requirements;

Handling Elevated Expectations

- Use routine internal reports as tools in identifying suspicious activity on bank-wide basis:
  - Kite suspect reports
  - Large balance fluctuation reports
  - Cash collateral reports
  - Wire transfer reports
Handling Elevated Expectations

- AML’s historical focus was on transaction monitoring (after the fact)
- Newer programs focus first on the account opening process
  - To establish expected activity
- Then integrate and analyze
  - Compare expected to actual

High Risk Products and Services

- International correspondent banking relationships
- Wire (Funds) Transfers
- Pouch activity/Cash letters from foreign countries
- Cash Vault
- Payable Thru Accounts
- International Brokered Deposits
- Trust and Private Banking
- Accounts Opened via Phone or the Internet
High Risk Businesses

- Currency exchange houses
- Money transmitters
- Check cashing facilities
- Casinos and card clubs
- Corporations and financial institutions located in tax and/or bank secrecy havens
- Leather-goods stores
- Car, boat, and plane dealerships
- Pawn brokers
- Ship, bus and plane operators
- Telemarketers
- Broker/dealers
- Cash-intensive businesses, such as convenience stores, restaurants, retail stores and parking garages
- Professional service providers (lawyers, accountants, investment brokers)
- Used auto or truck dealers and machine parts manufacturers
- Travel agencies
- Jewel, gem and precious metal dealers
- Import/export companies
- Deposit Brokers
- Auctioneers

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Money Laundering Methods and Trends

- Wires
- Non-profit organizations (NPOs)
- Politically Exposed Persons (PEPs)
- Legal and financial experts

AML and Wires

- The objective is to aggregate funds from different accounts and move those funds through accounts at different banks until the origins of the funds cannot be traced.
- Most often involves moving the funds out of the country, through a bank account in a country without strict bank secrecy laws, and possibly back into the US.
- Catch 22 - Fedwire transactions and banks’ wire rooms are designed to quickly process approved transactions – this is great with respect to expediting the process, but bad because it expedites the process.
AML and Non-Profits

- NPOs are particular Vulnerable to Misuse
  - Are often subject to little regulation
  - Few obstacles in their creation
- Informal Cash Collections Common
- Used to “Move Funds”

AML and PEPs

- You have to identify the PEP
- You also have to see if there is a PEP in a position of influence
  - Don’t forget the potential use of their relatives and associates!
Legal & Financial Specialists

- Growing trend toward involving various legal and financial experts (“Gatekeepers”) in money laundering schemes

- Typical “Gatekeepers”:
  - Lawyers
  - Accountants
  - Financial advisors

Q & A Break

- Press *1 now to ask a live question over the phone

OR

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KYC Program Components

- Start with a Risk Assessment
  - Identify your specific risks
  - Products/Services, Customers, Geographies
- Implementation Requires pulling traditionally separate areas together
KYC Program Components

- Initial Requirement:
  - KYC information is collected based on the unique risk profile of the bank so each bank’s KYC program is unique.

- Ongoing Requirements:
  - To gain an understanding of customer and expected activity in account
  - To continually monitor activity given the financial institution’s understanding of expected customer behavior

Initial Data Requirements

- KYC requires data at both the customer level and the account level
- Customer Data Examples
  - Country of citizenship for an individual
  - NAIC code for a business
- Account Data Examples
  - Expected patterns of activity (such as wires and trading partners)
How do I collect it all?

- CDD vs. EDD
  - Accounts with risk indicators at open might simply be flagged for additional follow up

- Review & Approval Process
  - Do we want to bank this person?
  - Many institutions have exited MSBs

Ongoing Data Requirements

- Transaction Monitoring
  - Who is potentially high risk - used to prioritize alerts
  - Cash transactions that meet the $10,000 threshold are immediately flagged for Currency Transaction Reporting.

- Unusual Activity
  - Customer Service Representatives (CSRs), including tellers and platform agents, are trained to recognize suspicious activity and follow-up based on established procedures.
  - As transactions occur, they are filtered and analyzed for unusual activity.
Pulling it all together

- Account opening needs to feed transaction monitoring
  - Who is high risk, what is expected activity
- Transaction monitoring needs to feed risk scoring
  - Based on CTRs, SARs, Subpoenas, 314 requests, etc.

Record Keeping

- Data must be retained for five (5) years after the date the account is closed
- Any discrepancy or deviation from CIP or KYC procedures must be noted
- Must provide information and records for any account in the US within 120 hours upon request by Federal Banking Agencies
- Must provide a consolidated view of all relationships a customer has with the bank
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Problem/Opportunity Statement

- The requirements are to risk-rate ALL customers opening new accounts
  - Across all subsidiaries — not just banking.
- Permeates every aspect of the customer experience;
  - From service to sales to compliance;
  - Across all channels – branch, call center, Web.

Good
- Get the information needed for risk rating;
- Have a minimum negative impact on the account-opening experience.

Better
- Get the information needed for risk rating;
- Have a positive impact on the experience

Best
- Give your personnel the potential and tools to sell more.

Operational Challenges

- Requirements for what information needs to be collected change faster than traditional bank architectures support;
  - Qualifying questions;
  - Resulting risk scores.
- Unlike credit scoring, each customer’s risk profile varies due to the unique situation and the bank’s risk controls
  - Each bank must develop its own unique customer risk-scoring methodology.
- We’re caught between a rock and a hard place
  - “More risky” customers require more information and due diligence;
  - We don’t know who’s more risky until we collect more information and do the due diligence.
- We still need to sell and maintain an exceptional customer experience in the midst of all this.
Overall Framework Needed

- To guide risk assessment and resulting KYC implementation:
  - Corporate governance
  - Program management
  - Independent audit
  - Policies/Procedures
  - Risk assessment
  - Resulting risk profile
  - Written procedures
  - Implementation
  - Training
  - Self-testing

Framework Example

- A Framework is designed to model the full spectrum of components needed to fulfill the requirements of a comprehensive KYC program
  - It is based on the real-world leading practices of financial institutions;
  - It is scalable, from community banks to the largest diversified financial services companies.
- A framework is valuable in structuring a common nomenclature for communicating within an organization and to external parties;
- An institution’s action plan is guided by where the organization considers the maturity of each component of the framework
**Conceptual AML Framework**

**Blue Box**

**Technology Challenges**

- **Coverage**
  - Most banks have multiple account-opening systems using different technologies;
  - May have multiple core banking systems;
- **A Moving Target**
  - New risk elements need to be incorporated quickly and efficiently;
  - Must also support mergers and acquisitions.
- **Need to maintain an exceptional customer experience all the while**
  - Only ask what you must;
  - Support risk rating over time.
- **And we need it yesterday**
Framework Examples

- Blue Box captures more information
  
  ◆ Pay closer attention to higher risk customer and/or higher risk accounts
  
  ◆ Know Your Customer - establish expected activity profiles

Framework Examples

- Blue Box captures expected activity and passes it to the Yellow Box
  
  ◆ Compare customers regularly appearing on large cash reports to customers that also conduct frequent wires or purchases of monetary instruments in order to evaluate the reasonableness and detect unusual trends or patterns;
Framework Examples

- Yellow Box sends alerts to Green box for follow up
  
  - Evaluate the reasonableness of high volume cash accounts and watch for sharp increases in cash flowing through those accounts;
  
  - Review large cash reports, monetary instrument records, and wire transfer reports for possible structuring of activity to evade BSA reporting or recordkeeping requirements;

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Summary

- KYC is not one thing
  - It is many things, part of an overall framework
  - It starts with the risk assessment
  - It moves through the entire customer experience

Assess  Plan  Implement  Optimize

Summary

- Good
  - Minimum customer impact
- Better
  - Positive customer impact
- Best
  - Positive sales impact
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ACFE and Presenter Contact Information

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