




ABA Professional Development

ABA/ABA Money Laundering Enforcement Conference

**Managing Customer Risk
Risk- Based Customer Due Diligence**




**November 13-15, 2011
Washington, DC**

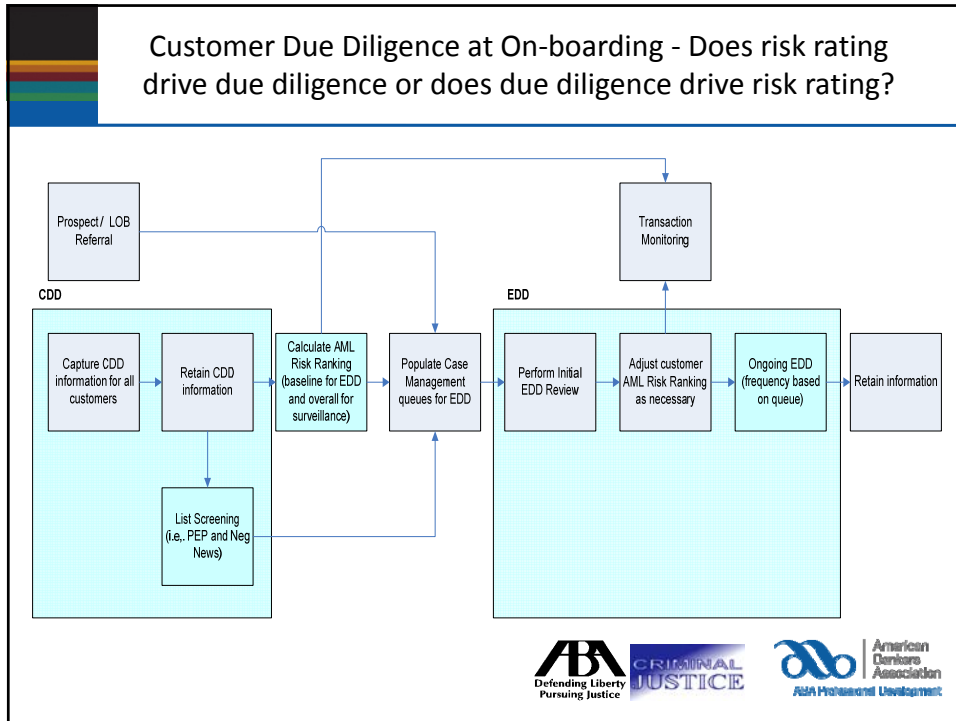
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Overview

- The Purpose of Due Diligence – One Size Does Not Fit All
- Risk Based Due Diligence at Onboarding
- Customer Risk Rating – How to Do It and How to Use It
- Periodic and Event Driven Reviews
- Roles and Responsibilities in the Due Diligence Process
- Common Pitfalls/Best Practices
- Selected Due Diligence Issues in Enforcement Actions






Customer Due Diligence at On-boarding – factors which may trigger data collection

Customer	Geography	Product / Service / Transaction	Channel
Internet Gambling	Non Domestic	Remote Deposit Capture	Non-Face-to-Face
Charities	High Risk Country	Expected Activity	
Correspondents	Country of Citizenship		
Investment Funds	Country of Identification		
Bulk Currency	Expected Activity		
Third Party Payment Processor	Country of Incorporation / Headquarters		
Money Service Business			
Incorporation Type			




Customer Due Diligence at On-boarding – how does the process work?

Flow Through	Hard Stop	Prohibited	Post Booking
Charities	Non Domestic	Internet Gambling	Remote Deposit Capture
Expected Activity	Correspondents	Bulk Currency	Negative News / PEP
Non-Face-to-Face	Country of Citizenship	Third Party Payment Processor	
Investment Funds	Country of Identification	Incorporation Type	
High Risk Country	Country of Incorporation / Headquarters		
Expected Activity	Money Service Business		

Customer Due Diligence at On-boarding – How does the process work?

Flow Through	Hard Stop	Prohibited	Post Booking Actions
Beneficial Ownership 25%	Yes/No Activities	Yes/No Activities	Site Visit
Expected Activity	Site Visit	Incorporation Type	Beneficial Ownership
Account Signors	Documentation Requests (i.e., AML Program)	Prohibited Country Risks	Transaction Reviews
NAICS			Established Expected Profile
Yes/No Activities			Customers Customer
Allowable Country Risks			Common Conductors

Customer Risk Rating

- Back To Basics
- Is Risk Rating Customers Required?
- No regulatory requirement – a regulatory expectation
 - USA Patriot Act Section 326 CIP/KYC - “Risk based procedures for verifying the identity”
- What do you do with risk rating?
 - A foundation for suspicious activity monitoring
 - Use of risk ratings in the AML risk assessment



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Customer Risk Rating

- How do you establish the rating?
 - Existing Customer
 - New Customer
- Manual, Automated, Combination
- When do you establish the rating?





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Customer Risk Rating

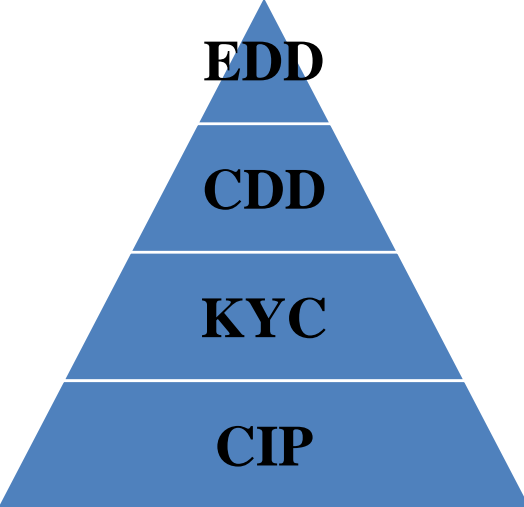
- What Factors are considered?
 - Products and Services
 - Business Type/Occupation
 - Geography
 - Country of Citizenship/Residency/Business Activities
 - Place of Legal Organization
 - Transactional Activity
 - Other History
- Exceptions?





As Risk Increases Expectations Rise

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See Appendix K FFIEC Manual

Special Considerations for Non-U.S. Relationships

- Regulatory focus continues on correspondent bank clients – viewed as one of the highest risk client types
- Unique risk factors drive due diligence requirements:
 - Products utilized – *e.g.*, cross border wires, trade
 - Geographies in which client conducts business – beyond domicile
 - Businesses they support – *e.g.*, MSBs
 - Relationships with their clients – *e.g.*, nested relationships
- Client due diligence requires an understanding of not only the client, but more importantly our client’s client.
- Robust governance process, including business, compliance and risk is critical



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Special Considerations for Non-U.S. Relationships

- Due Diligence components
 - Client profile, including business profile
 - Expected activity – Purpose of accounts, products used, value and volume, specific risks, *e.g.*, nested relationships, significant patterns of activity
 - Assessment of the strength of the clients’ AML program including documentation of any identified specific risks and how they are addressed
 - Risks of the AML Supervisory Regime in which the client does business
- Amount of detail/documentation will vary depending on the risk of the client
- Increased emphasis on involvement of AML subject matter experts in the process



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Periodic and Event Driven Reviews

- Periodic Reviews
 - Based on risk rating of the client and defined KYC renewal cycle, *e.g.*, high = annually.
- Event Driven Reviews
 - Negative news
 - High number of SAR filings on client's activity or activity through the client's account
 - Industry, political, regulatory events
 - 314(b) requests, subpoenas, CISADA requests, etc.
 - Results of reviews of payment trends and product usage, *e.g.*, corridor reviews



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Periodic and Event Driven Reviews

- Periodic Review Components
 - Core KYC data
 - Transaction activity review
 - Updated assessment of client's AML program and any identified issues
- Transaction Activity Review
 - Detailed analysis of client activity for a specified period of time
 - Top originators and beneficiaries
 - Red flags/possibly suspicious activity
 - Productive alerts generated by standard monitoring systems
 - Comparison of activity value, volume, purpose, payment corridors and significant activity to KYC data
 - Review of payment trends – significant growth in volume?



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Periodic and Event Driven Reviews

- Event Driven Reviews
 - Applies similar techniques as periodic reviews
 - Organizational involvement – who owns responsibility?
 - Timely response /action is essential
- Guidelines
 - Expectation is to have a full integration of AML program components and continuous “feedback loop” to identify and evaluate client risks
 - Reviews should clearly evidence knowledge of the nature, characteristics and quantity of risk presented by the client and their activity
 - Identify issues and any remedial actions
 - Determine if the client is an acceptable risk and ensure appropriate governance
 - Document!



Roles and Responsibilities for the Due Diligence Process

- Model will depend on the complexity of the organization
- Begins with the business – which owns the risk
 - Business has the first touch on the customer and the ability to collect information directly
 - Especially effective in relationship managed business like Private Banking
- Operations/back office functions for document collection; Sanctions/PEP/Negative News searches
 - Particularly useful with complex institutional client types
- AML Compliance – Should review high risk relationships and escalations of positive OFAC, PEP and Negative News hits
 - Risk based monitoring – may affect overall risk profile of the customer
 - Should establish and maintain the due diligence requirements



Know Your Customer Pitfalls And Best Practices

- Inadequate resources - at any stage of the due diligence process will lead to backlogs and diminished quality
- Starting with bad data
 - Most institutions have legacy customer data
 - No risk rating attached, missing information,
 - Same client, under multiple names, in multiple lines of business treated differently
 - Cleanse the data, understand the customer holistically
- Complex client types create challenges to understanding and doing due diligence on all relevant parties
 - Hedge funds
 - Special purpose vehicles
 - Role of investment advisors / master/sub accounts



Common BSA/AML Deficiencies Identified in Enforcement Actions

- Inadequate procedures to identify high risk customers and establish and apply CDD procedures, *e.g.*, on MSBs, casas de cambio, foreign correspondent banks, telemarketers, third party payment processors, and customers with RDC.
- Failures to verify identity and account opening documents for foreign customers, including accounts not opened in person.
- Failures to collect and analyze CDD information for foreign and domestic clients on a risk basis, including for clients from high-risk countries and to monitor PEPs.
- Failures to apply commensurate due diligence practices and transaction monitoring for customers rated high risk.
- Missing or inadequate customer profiles.
- Missing or inaccurate documentation of due diligence conducted.
- Delays in periodic reviews because of backlogs.
- Failure to treat affiliates as customers.



Common Due Diligence Related Deficiencies Identified in Enforcement Actions

- Failure to risk rate accurately or update periodically customer information and account activity.
- Failure to implement exception tracking reporting.
- Failures to assess the risks of customers, products and services, transaction types, volume and scope of business, and geographic locations
- Failures to implement a customer risk rating methodology or conduct customer risk assessment and appropriately risk rate account relationships.
- Risk assessment processes that do not distinguish high risk customers, including MSBs, cash intensive businesses, and professional service providers, or include them on the bank's high-risk list.
- Failures to document risk rating methodologies.
- Inadequate support of risk ratings or analysis to support anticipated account activity.



Conclusion

- **What do successful due diligence programs have in common?**
 - Clear risk-based procedures refreshed periodically
 - Identification of high risk customers and appropriate EDD policies, procedures, and internal controls
 - Documentation of all steps taken in the process –information, documentation, and rationales for decisions
 - Consistent risk rating integrated into the risk assessment and transaction monitoring
 - Defined roles and responsibilities and adequate staffing and an effective escalation process
 - Periodic and event driven reviews
 - Exceptions – few and well-documented
 - Adequate training and compliance and independent testing with followup

