




ABA Professional Development

ABA/ABA Money Laundering Enforcement Conference


Independent Testing: The Fourth Pillar of a Sound BSA/AML Program

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Current Regulatory Expectations

- **Independent Testing should be linked to Risk Assessment**
 - Compliance and Audit may consider different risk assessment criteria, weights, and priorities
- **Effectiveness of Management Response**
 - Soundness, proper urgency, reasonable commitment and timetable, good communication, completeness, sustainable.
- **Substantiation of Sample Size/Data**
 - CIP, Due Diligence and Transaction Monitoring should always be tested, and sample sizes should be commensurate with risk
- **Sound judgment, supporting documentation, repeatable**
 - Is your thought process sound, clear, and well-documented? Could an auditor or examiner follow and repeat and reach the same conclusion?
 - CIP, Due Diligence and Transaction Monitoring should always be tested, and sample sizes should be commensurate with risk.
 - Sustainability

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Current Exam and Enforcement Action Issues

- **Incomplete or off-base testing of the AML program.**
 - Effort. Timeliness. Gaps. Outsourced processes.

- **Insufficient robust testing for determining, if the requirements of the BSA/AML laws, regulations and expectations are met**
 - Again effort. Skillset. Not compellingly risk-based.
 - Audit or compliance not balanced or well-coordinated
 - Exams too!

- **Inadequate oversight of independent testing conducted by global auditors of the global service providers/affiliates**

- “Gonna do” versus “done”

- **Sustainability.**



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Competency of Auditors, Compliance Professionals and Work Quality

- **The institution needs to ensure that BSA/AML testing (audit) is independent and whether the persons conducting the testing report directly (i.e. independently) to the board of directors or to a designated board committee, e.g. Audit Committee**

- **Ensure the qualifications of the person (or persons) performing the independent testing are such that the bank can rely upon the findings and conclusion and that regulators have confidence (credentials, experience, subject matter). Is the competency investment internal, external, or both?**

- **Validate the auditor’s reports and work papers to ensure the bank’s independent testing is comprehensive, accurate, adequate and timely.**

- **The audit should contain sufficient information for an examiner to reach a well-supported, repeatable, conclusion about the overall quality of the BSA/AML compliance program.**



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Independence and Reliance

- **Independence has grown in importance and complexity. Make sure that potential independence issues are thoroughly vetted early on and on a recurring basis.**
- **Can't audit your own work.**
- **Testing cycles, periods are important.**
- **Potential independence issues must be disclosed and escalated.**



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Independence and **Reliance**

You must make the compelling case to examiners that they can reasonably rely on your independence, your competence, work quality, level of effort, workpapers, and reports.



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Process and System Validation/Testing

- **Increasing examination focus on processes – technology solutions.**
- **Greater emphasis on system validations and re-validations – even years later.**



How Internal Audit, Compliance and the Business Units should Interact

- **The Business is the first line of defense – Business Quality Control Function (self-assessment)**
- **The second line of defense is compliance monitoring and testing (testing for effectiveness of internal controls, but limited in scope). Also plays a key role in developing and monitoring corrective action plans and issue tracking**
- **The third line of defense is internal audit**
- **The fourth is occasional “kick the tires”.**



Partner with Audit

BSA Officer should:

- Perform a strong, enterprise-wide risk assessment that discusses mitigating controls. Audit should comment upon/agree on the risk assigned to the various persons, products, business lines.
- Coordinate with Audit to assure scope of audit addresses risk appropriately. Recommend areas for testing; discuss areas of weakness.
- Assure Audit is well informed about AML issues, including new rules, hot topics and how they impact your bank.. Share information about program throughout the year; invite internal audit to AML training and other meetings.



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Partner with Audit

- Assure audit scope includes transactional testing, especially high risk accounts.
- Assure agreement on any unusual activity found; take action to address
- Assure audit scope includes review of data integrity for the information used by BSA monitoring systems.
- If audit scope is not comprehensive, escalate concerns to management and/or board of directors. A strong audit program for AML is an important part of the bank's BSA program.
- If internal audit performs BSA audit, consider an occasional BSA audit by external firm for different perspective.



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Post Audit Actions

- If audit report does not list areas tested, request list from auditor to assure scope was comprehensive.
- Be open to recommendations.
- Prepare and execute an action plan to satisfy all recommendations promptly. Assign responsibilities to officers if applicable and follow-up relentlessly.
- Assure you and the auditor are in agreement about the state of the BSA program prior to the BSA exam.



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Testing

- **FRB SR08-08 continues to be key regulatory guidance**
 - Testing linked to risk assessments
 - Scope and frequency of testing based on a comprehensive risk assessment
 - Validate key assumptions, data sources; assess adequacy of policies/procedures; transaction test to ensure controls working as intended
 - Ensure that high-risk compliance elements are not otherwise obscured by a lower overall risk rating of a broadly defined audit entity



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Testing

- **OCC 2011-12 – Supervisory Guidance on Model Risk Management**
 - Model development and implementation
 - Each model should have a clear statement of purpose that is in line with the intended use of the model and the design, theory and logic underlying the model should be well documented
 - Model validation
 - Assess whether models are performing as expected, in line with their design objectives and businesses
 - Performed by persons not responsible for development or use of the model
 - Persons performing model validation should have appropriate technical expertise and knowledge of the business/purpose of the model
 - Governance
 - Policies defining acceptable practices for model development, implementation, and use



Testing

- **Other Challenges**
 - Pros and Cons of centralizing AML compliance testing
 - Consistency in defining the severity of issues
 - Identifying and reporting potential violations of law
 - Testing of remediation activities
 - Looking across the enterprise



Compliance monitoring could include:

Targeted KYC/account docs/risk coding/data integrity reviews

- Based on risk/volume/changes in products or personnel

Lending transactions

- Recent regulator recommendations
- Cash secured; trade finance; real estate, international, other high risk types
- Credit and Loan Review?

OFAC Program

- Testing of interdiction software, list uploads, decentralized reviews, blocked accounts

CTRs

SAR Content/filings

Travel Rule and Recordkeeping



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Reporting to Management, the Board and the Audit Committee

- **The persons conducting the BSA/AML testing should report directly to the Board of Directors or to a designated board committee comprised primarily of outside directors**
- **The testing and reporting to the Board and management should assist in identifying areas of weakness or areas where there is a need for enhancements or stronger internal controls**
- **Reports should be highly relevant and focused, clear, meaningful, and appropriately directed.**
- **Management's responses and updates are very important**



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Pet Peeves

- **Compliance SMEs > Auditors. Why am I teaching our auditors subject matter?**
- **Insufficient LOE**
- **Lack of coordination and communication**
- **Missing the point**
- **Gaps and failure to adequately identify risks**
- **Not risk based**
- **Late. Stale.**
- **Lack of follow-up. Lack of sustainability**
- **Insouciance and lack of engagement.**
- **Auditors making up rules**
- **Lousy documentation and reasoning not well documented**
- **Poor use of technology. Or none at all.**
- **Failure to adequately test written policies and procedures**
- **Confusion about applicability of auditing standards.**

