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EXAMINATION PREPARATION:

**HOW TO ENSURE
YOUR INSTITUTION
IS READY FOR A
BANK SECRECY ACT/
ANTI-MONEY LAUNDERING EXAM**

After the events of September 11, the Bank Secrecy Act (BSA) became an industry hot topic and focus of the regulatory agencies. Although the BSA was enacted in 1970, the Uniting and Strengthening America by Providing the Appropriate Tools Required to Intercept and Obstruct Terrorism Act (USA PATRIOT Act) completely revolutionized the BSA after those tragic events.

BSA examinations became a regulatory focus, and over a decade later it still remains in the spotlight. It is essential for all institutions to be prepared. As is being reiterated throughout this whitepaper series on examination preparation, a proactive BSA program is necessary to ensure your preparation. Your institution needs to know what its BSA/Anti-Money Laundering risks are, that its program goes beyond the minimum requirements outlined in the Act, and ensure that all areas of the financial institution have a thorough understanding of what is required of them so that the institution can do its part in fighting money laundering and terrorist financing.

Background Information

The purpose of the BSA was to create recordkeeping and reporting requirements for financial institutions to help combat money laundering. Money laundering is the process of taking illegally gained funds and disguising the source so that the funds appear legitimate. The motivation is usually profit seeking. It is the responsibility of the entire organization to do its part to identify money laundering. There are three stages to the process that the financial institution should be intimately aware of: placement, layering and integration.

During the placement stage, the illegal funds are introduced into the financial institution. Different techniques include items such as structuring cash deposits and purchasing monetary instruments. Tellers play a key role in this initial detection. During the layering stage, the funds are moved around to confuse the paper trail and help disguise the illegal source. Layering includes things such as conducting numerous transfers between accounts or wire transfers in and out of the financial institution. The Operations Department usually plays a key role. The final stage of integration allows the funds that now appear legitimate to be placed back into the market through additional transactions such as luxury purchases or investments. Here is where your lending, investment, or trust department may come into play.

Terrorist financing was added after the amendments of the USA PATRIOT Act. It differs from money laundering in a number of ways. Funds are derived from both illegal and legal means. The motivation is also ideological, and not necessarily driven by profit. That said,

money launderers and terrorist financiers may use similar methods to move the funds such as monetary instruments, wire transfers, or prepaid cards. Again it is the responsibility of everyone in the institution to do their part to detect suspected terrorist financing.

Your BSA/AML program should encompass all the ways your institution works to detect and prevent money laundering and terrorist financing. Examiners are looking to ensure your program is adequate based on the risk profile of your institution.

A great source to base your examination preparation on is the FFIEC's Bank Secrecy Act/Anti-Money Laundering Infobase (Infobase). The Infobase provides background information on the applicable regulations, examples of red flags, risk assessment, and SAR quality guidance, and even a list of acronyms so you know exactly what examiners are saying when they speak their short-hand lingo. In addition, it also shows the steps examiners will be taking both onsite and off to prepare for the exam from the scoping process through the procedures followed onsite. There are examination procedures that will show the questions examiners will ask while onsite as well as how they will develop conclusions and finalize the exam.

The Infobase is also incredibly informative to aid in the creation of your BSA/AML program, which is the key to a successful exam.

Proactive Compliance Program

The Board of Directors is responsible for the BSA/AML compliance program, with senior management ensuring it is properly implemented. The regulation specifically requires the BSA/AML compliance program to have four pillars:

1. A system of internal controls to ensure ongoing compliance;
2. Independent testing;
3. A designated compliance officer; and
4. Training for appropriate personnel.

In addition, there must be risk-based customer identification procedures that allow the institution to form a reasonable belief that it knows its customers.

Examination preparation should start with these areas.

System of Internal Controls

Internal controls should include the policies, procedures, and processes that help control the BSA/AML risk unique to your institution. Internal controls ensure that all regulatory reporting and recordkeeping is in compliance and provides for things such as dual controls and segregation of duties to the extent possible. They should also identify communication standards that ensure regular reporting to the Board of Directors.

The BSA/AML program should be a written document that includes all necessary policies and procedures. It should be easily accessible by all staff and there should be clear communication about where it is located. At least annually, it should be updated and reapproved by the Board of Directors. Policies and procedures will be relied on heavily by examiners while completing the procedures. It is important they are accurate and reflect actual current practices.

Operational procedures should be reviewed closely so that the steps taken to comply with regulatory requirements such as SAR and CTR reporting, 314(a) and (b), CIP and so on are easily understood and comprehensive. Procedures will be verified by examiners when they complete their transaction testing. They should be able to follow the process outlined with minimal questions. Clarity goes a long way during the exam.

Prior to the examination, make sure you closely review all of your policies and procedures to ensure they are accurate, current, and reflect actual practices. Make sure your BSA/AML program clearly highlights the four required pillars.

Risk Assessments

One of the most important internal controls is the risk assessment. The purpose of a BSA/AML risk assessment is to identify the areas where criminal behaviors are most likely to occur. You need to know where you are vulnerable and show how you are addressing those vulnerabilities. There is no one way to do a risk assessment, however, it is important to ensure your institution has identified the inherent risks, mitigating controls, and residual risks throughout the organization. The risk assessment should include a risk profile based on products, services, customers, entities and geographic locations. It should first identify the specific risk factors that are unique to the institution and then go one step further to analyze the data obtained during the identification stage.

As part of the analysis, you need to identify all the controls in place to determine to determine the areas where additional controls may be warranted. The resulting residual risks should identify the areas where you are adequately covered as well as where further action should be taken. An action plan should be created to determine how any weaknesses can be strengthened as well as identify the areas requiring further review. Finally, the risk assessment should set the tone for the training that should occur as a result.

The risk assessment should always reflect the actual risk profile, meaning it should be continuously updated as changes occur. If no changes are made, then it is important to update at least every 12 to 18 months depending on the size and complexity of the institution. Do not wait until right before the examiners are coming onsite to start the updating process. It is important that you know your institution's current risk profile and that this is well documented. Examiners should not be the ones telling you your strengths and weaknesses.

It is also important that your risk assessment is communicated with the Board. Since the Board is ultimately responsible for BSA/AML compliance, they must know where the risks are and whether those risks fit into the overall risk tolerances of the institution.

Appendix J of the Infobase contains a Quantity of Risk Matrix. The matrix is what examiners use to formulate their conclusions. Your risk assessment will need to go into further detail than the matrix provides, however, it does provide a jumping off point for you to start evaluating your risks.

The risk assessment will be used by examiners while they are scoping the exam. It allows examiners to create a risk based scope and determine what should be focused on as well as those that can be eliminated since they are not applicable. Examiners will also determine an aggregate risk profile for your institution from their assessment. Exams are risk-based so an institution with an aggregate rating of low will most likely have an exam that differs greatly from one that is high risk.

Independent Testing

Every 12 to 18 months, depending on the risk profile, an independent audit should occur on your BSA/AML program. Auditors should be independent, objective, and qualified. The auditors should report to the Board of Directors or a committee thereof to truly ensure the independence.

The audit should be a thorough evaluation of the compliance program, including a review of the risk assessment, transaction testing, review of training, effectiveness of the suspicious activity identification and reporting, and an assessment of the monitoring systems used in the program.

The audit should be thoroughly documented and any findings reported to the Board in a timely manner. Any potential BSA/AML issues should have an appropriate escalation process. The issue should be dealt with immediately and the severity of the allegations should be understood by those at the top.

Prior to the exam, it is extremely important to review previous audit reports. Closely examine the scope. It needs to be at least as comprehensive as the general questions outlined in the BSA/AML Compliance Program Examination Procedures listed under the heading Independent Testing. Your risk assessment should identify the areas that are applicable to the institution, and that are higher risk. The scope's focus should match the risk profile. For example, if CTR exemptions were a higher risk area due to prior findings, they should be included in the audit.

You need to confirm that all recommended corrective action has been taken prior to the exam. If it has not been completed, there better be a really good explanation for why it is still outstanding. Previous audit findings indicate a weakness in the overall program. It is important to document how those weaknesses have been corrected including any policies and procedures that were altered and/or any training that occurred. As with everything compliance, documentation is key.

Examiners will also look at the workpapers to help determine the adequacy of the audit. Although outside of the control of the Compliance Officer, it is important those workpapers are comprehensive and well-documented. Whether auditors are internal or external, they must be qualified, independent and free from coercion. A recent enforcement action illustrates the importance of auditor independence and accurate workpapers. The consulting firm of Deloitte was required to pay a \$10 million fine and refrain from accepting new clients in New York for one year for altering their draft report based on the bank requesting a paragraph be removed. The Bank received an enforcement action as well, but it is unusual for the consulting firm to be penalized. It shows examiners are focusing on the quality of the audit. It is your responsibility that the audit is thorough, effective, and by qualified, independent auditors.

Designated Compliance Officer

Another requirement is that there is a designated Compliance Officer responsible for the day-to-day compliance with BSA/AML. The individual must have the appropriate level of authority and expertise to effectively implement the program.

As the Compliance Officer should be Board designated, it is important to have proof of this designation in the minutes and have these available for examiners. The Compliance Officer and all key players in the BSA/AML department should have their resumes ready outlining their qualifications. You should also have an organization chart ready to show the appropriate level of authority necessary to administer the program.

Training

Training is essential to a BSA/AML program. All areas of the financial institution affected by BSA/AML should be trained including the Board of Directors. Training should be ongoing, current, and specific to the job. Training should be tracked and well documented. It should include both computer-based training as well as face to face training. Training should be based on regulatory requirements as well as current institution specific policies and procedures. Key personnel should have an opportunity to ask questions or bring up any concerns.

It is a good idea to have a training schedule showing how much training is required and when that training will occur. If any training has not been completed, make sure it is completed well before examiners come onsite. Take a look at your risk assessment and compare to the training taken to ensure that all high risk areas were covered for necessary staff. Prior to the exam, review all training documentation. Have agendas, slides or any other training materials used collected and ready to be given to examiners for review.

Regulatory Changes

Your BSA/AML program needs to stay current. As regulatory changes are implemented, it is essential for your program to be updated. Have a process in place that shows how the institution becomes aware of regulatory changes, and how those changes are communicated throughout the organization.

It also helps to read recent enforcement actions which can indicate regulatory focus. If an institution receives a civil money penalty for some action that your institution is currently doing, you may want to evaluate that behavior to determine if there are any changes that should be made.

OFAC

The AML/BSA Program should also include how your institution complies with OFAC requirements. Although not specifically required, it is expected that the institution maintains a written, risk based OFAC program. Similar to the BSA/AML program, there should be sufficient internal controls, risk assessment, policies and procedures, and training that specifically addresses OFAC. OFAC should be included as part of the scope for the independent testing, and it is recommended there be a Board approved OFAC officer.

Prior to the exam, it is important to ensure that processes to test transactions are adequately working. Documentation should address how and when the lists are updated, and how various types of customer and non-customer transactions such as wires, ACH, new account opening, etc. are checked against appropriate lists. Be prepared to provide proof of these updates as well as something that shows how automated and/or manual processes are working as they should.

OFAC is risk based, however, it is imperative that you know your risk long before examiners walk in the door.

Additional Efforts to Help You Prepare

It is extremely important to have comprehensive documentation of your BSA/AML efforts. Documentation must be clear and understandable. Be sure you are providing everything that is being requested. Be prepared with any back-up documentation not requested in the letter, but that may be requested at a later date. Better to be over prepared during an exam. Appendix H of the Infobase provides a sample request letter showing what is typically requested for the exam to give you a better idea of what to expect.

Some areas to look thoroughly at prior to the examination are those included in the core examination procedures specifically risk assessments, compliance program, customer identification program, customer due diligence, Suspicious Activity Reporting, CTR reporting and exemptions, Information Sharing, Monetary Instruments, Funds transfers,

and OFAC. Review policies and procedures to ensure accuracy. Recheck the corrective action log to make sure everything is documented and the violation has been resolved. Ensure that all certifications and reviews are up to date. Know your risks and weaknesses and make sure it is clearly documented what you are doing to control those vulnerabilities.

Also look closely at your high risk customer list. Know who your high risk customers are prior to being told by examiners. Ensure their reviews are thorough, demonstrate enhanced due diligence and follow internal guidelines. If your procedures state that you do semi-annual reviews on high risk customers, make sure there were truly semi-annual reviews. Otherwise be able to document why they have not been completed.

Conclusion

Once you receive the request letter, you will have a better idea of what the examiners will focus on at the upcoming exam. However, it may be too late to correct any risks. At that point, the dates included in the scope have either passed or will be here shortly. Something that could have been easily fixed had your program been proactive and ongoing, is now an issue that cannot be corrected in time. The time after you receive the request letter should be about gathering documents, not creating them. It is a time to give everything a once over so there are no surprises come exam time.

As with any compliance exam, a proactive BSA/AML program is the best way to prepare for an examination. Use the resources available to you from your specific regulatory agencies especially the FFIEC's BSA/AML Examination Manual. A thorough read of the Interagency Examination Procedures will provide great insight to the exam process and allow you to know what to expect when examiners are onsite.