

The anti-money laundering information supply chain: reducing the cost of compliance



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The cost of non-compliance with Anti-Money Laundering (AML) regulations is clear. Recent experience has shown that non-compliance can result in civil and criminal penalties imposed by AML laws as well as other consequences that include public embarrassment, loss of profitable business, liquidity problems caused by deposit withdrawals, increased legal and accounting fees incurred due to regulatory investigations, increased cost and loss of business as a consequence of lower debt ratings, and declines in stock prices. What is not as clear, however, is why the cost of compliance has remained so high.

Diagnosing the Issue

In the past, Know Your Customer (KYC) and AML activity monitoring data was not a priority for many financial institutions. Instead, the data used for monitoring these tasks was a by-product of ordinary business processes such as account opening, transaction processing, and tax reporting. These processes rarely shared common goals, priorities, or owners.

Since the passage by Congress in 2001 of the Patriot Act and several high-profile AML regulatory situations, the level of regulatory scrutiny of AML programs has steadily increased. Various financial institutions concluded that their existing AML programs were inadequate and sought to find new or more sophisticated automated programs to ensure compliance. These systems were often seen as the “silver bullet” to the AML compliance problem, yet many of these systems, as deployed, have fallen and continue to fall short of management and regulatory

expectations. This has led to the high cost of AML compliance. Symptoms include:

- Large numbers of false positives relating to potential suspicious activity creating extensive backlogs in the review process
- Continued regulatory comments on AML systems
- Ineffective AML risk rating of customer base
- Multiple versions of the “truth”, especially as it relates to customer information
- Spreadsheet proliferation
- Missed or inaccurate Currency Transaction Report (CTR) filings
- Undetected anomalies in transaction level data

So if AML system automation alone is not the answer, then what is? The answer exists within the Information Supply Chain (ISC). The ISC not only improves regulatory compliance but also improves the business as a whole.

What is the information supply chain

Similar to the physical supply chain (and fundamentally an integral part of it) is a set of the key data production activities (in effect, discrete corporate processes) that continuously produce and consume data as it moves through one or more information supply chain links on its way to becoming actionable business insight. These critical business processes include business operations, internal management reporting, compliance, and regulation among others.

At every step, the organization’s key data consumers are either pulling data from or adding data to these information supply chains. These data stakeholders or constituencies will vary from company to company and from process to process. However, these groups typically include business executives, industry analysts and Information Technology (IT) administrators, compliance analysts, internal management accountants, and auditors.

At the heart of each ISC process is the Data Life Cycle (DLC). The DLC refers to the discrete data processes in each link of the ISC chain where data is created, sustained, analyzed, reported, and retired. The way to an efficient and effective ISC can be achieved by examining, diagnosing and repairing the data processes in each of the ISC links. **As the saying goes, “a chain is only as good as its weakest link”. The same principle applies to the ISC.**

Anti-money laundering and the ISC

There are specific requirements for AML that can be applied to each link within the DLC. The key to reducing AML compliance costs is to focus on each of the links within the DLC. Financial institutions need to ensure that there are no deficiencies within the links. A financial institution can decrease the cost of AML

Figure 1: the information supply chain

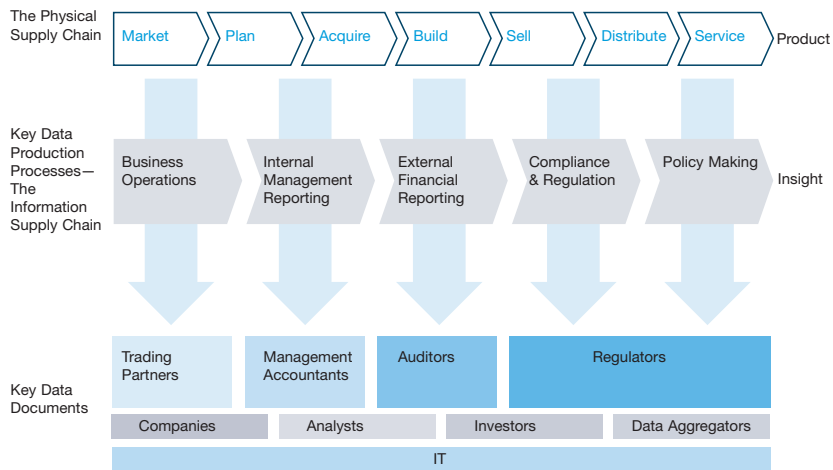


Figure 2: the data life cycle

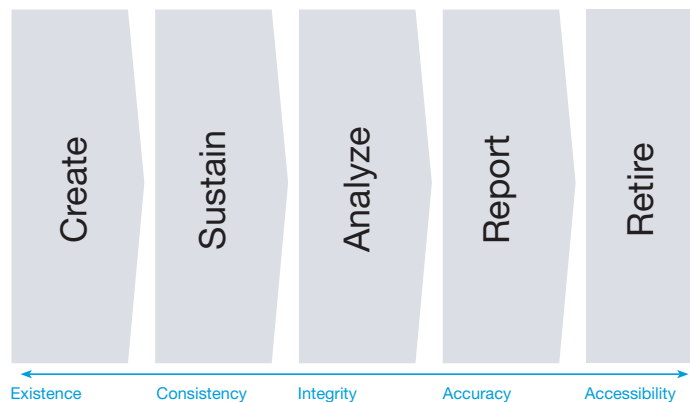
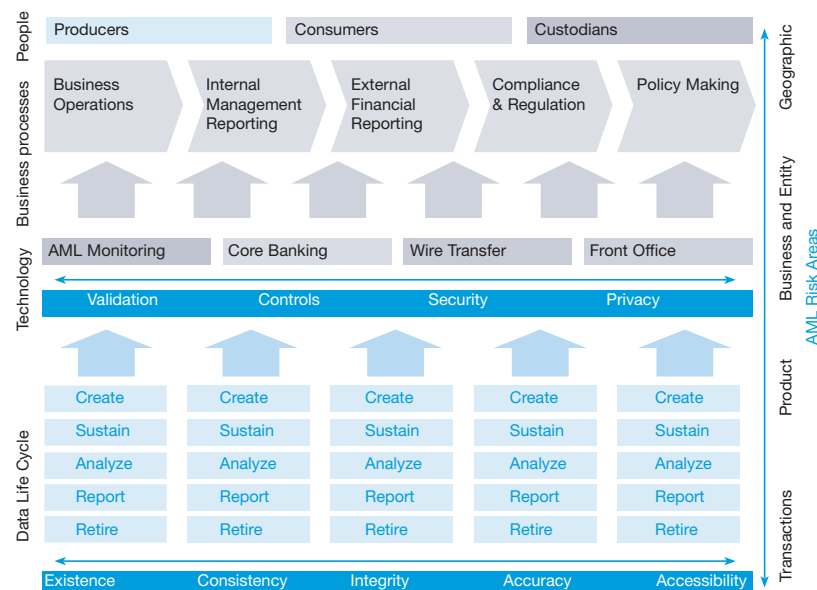


Figure 3: the relation between the information supply chain and the data life cycle



Regulatory

compliance and the risk of not complying with regulatory requirements by committing to strengthening the links in the DLC. An in-depth examination of each of the links in the DLC follows.

DLC links

Create

Creation is the point of entry into the DLC. Financial institutions collect data about their customers, transactions, and processes every day. There are many reasons why data that is created and collected must be complete and accurate in order to have a successful AML program, including regulatory requirements, and internal and external reporting requirements.

Institutions should evaluate the data that is needed for a successful AML program and compare it to the data that is currently being collected. This exercise validates the existence of required data and identifies any gaps in current data collections. Institutions must also apply the necessary levels of controls and validation to the data at the time of creation, thus ensuring the integrity and consistency of the data. For example, when developing an AML risk model that successfully assigns a money laundering risk score to customers, it is necessary to identify all of the data points that are needed to support the risk model. These data points need to be collected or created in a controlled manner at the time of new account opening. If they are not properly collected at that point, the downstream risk scores assigned to the customer will be inaccurate and subject to regulatory scrutiny.

Transaction monitoring is another area within an AML program where creating accurate data is crucial. Various financial institutions do not have the appropriate processes and controls in place to consistently identify true currency transactions. This issue leads to inaccura-

rate AML alerts and structuring reports which increase time required to address false positive results.

Creating a complete data collection that meets or exceeds data quality requirements is the first step in a sound AML monitoring program.

Sustain

Sustaining the integrity of AML data as it flows through systems is a prerequisite to fulfilling compliance obligations. After data is created, it is essential that the data quality remains intact. Data can be used for several different business purposes, such as operations, marketing, and finance. Data is often sent to various systems within an organization, and it has a tendency to be augmented and changed to meet different departmental needs. These data changes can potentially affect the accuracy and completeness of the data which can have a direct impact on downstream uses of this data. Monitoring systems that can be implemented include reconciliation engines and data quality monitoring engines. These systems can continuously compare the data to regulatory and business requirements to ensure that data, critical to a successful AML program, stays accurate and consistent.

Analyze

Analysis is a vital link in the data lifecycle for AML. **An in depth examination of data is crucial for AML systems to be effective.** Most financial institutions have implemented an AML monitoring system that investigates customer transactions to detect possible suspicious activity. These systems analyze customer transaction behaviors, transaction patterns, and transactions that exceed pre-established thresholds. However, these AML monitoring systems are only as effective as the quality of the system's source data, the configuration of the system, and the experience of the analyst

reviewing the results. In addition, to further evolve the improvement of the analysis performed, new ways of mining the data, such as predictive analytics, are necessary. For example, by using predictive analytics an institution may discover a certain region that poses a higher risk of money laundering. This new information can be applied to an AML Risk Model, and customers that fall within this region can be monitored more closely. Furthermore, predictive analytics can be applied to customer transactions to further optimize AML monitoring systems. Transaction patterns associated with money laundering can be used by predictive analytic engines to predict the types of money laundering transaction patterns that may occur in the future. This information can be applied to the AML monitoring applications to optimize the results which will save institutions time and money, and reduce regulatory risk.

Report

Reporting is a vital part of the AML DLC for financial institutions because it is here where processes converge and the transformation of raw data into useful information occurs. Both speed and information integrity is vital to making reporting effective. Financial institutions can apply business and industry experience to the information, assisting them in compliance with fluid regulatory requirements and gaining insight into future regulatory requirements. This insight can be used to create innovative processes and systems that will keep them ahead of the regulatory curve. The long-term success of an AML program ultimately comes from the knowledge gained by the information contained on AML and compliance reports. This knowledge is dependent on each stage of the entire data lifecycle. The integrity of the AML DLC is only as strong as its weakest link. **If there are deficiencies anywhere along the AML DLC reports can be inaccurate and untimely and can**

put a financial institution at risk of regulatory non-compliance.

Financial institutions open themselves up to immediate regulatory risk when reports such as CTRs or Suspicious Activity Reports (SAR) are incorrectly filed or not filed at all. These reports are only as accurate as the underlying data, so it is crucial that the financial institution is confident in the strength of their AML ISC.

Retire

The last stage of a comprehensive AML DLC is the archiving and retention policies of the data and information that has been created throughout the ISC. Retiring data is often overlooked, but there are important decisions that need to be made about what data needs to be retained and the duration of the retention. AML reports such as CTRs, SARs, and the AML monitoring system customer profile reports should be retained for historical reporting purposes. A strategy needs to be developed and adopted for AML related transaction information in order to satisfy potential regulatory requirements, such as FINCEN 314a and 314b requests or subpoenas.

Benefits to repairing the ISC

A financial institution can leverage the benefits of being proactive and maintaining an effective AML ISC. A direct result is the benefit of good governance in the compliance function. But beyond that, there are cost savings within the compliance function as well as the business value added throughout the enterprise as a whole. Some of these benefits include:

- A framework that allows for enhanced all-purpose use of customer data in a cost-efficient manner
- Process improvement gains by consolidating the duplicate account opening

processes that normally exist within banks

- Gains in efficiency and effectiveness of the compliance function due to the increased effectiveness of the AML monitoring system
- Increased confidence that AML systems adhere to specified AML program policies and procedures
- Knowledge garnered from data mining that not only reduces the number of false positives generated by the AML monitoring system but also allows for a deeper understanding of the customer by reporting their behavioral patterns.

AML automated monitoring systems alone may not be the answer to effective AML programs as automation addresses only one area of the ISC and then only two of the dimensions of the underlying data lifecycle, i.e. analyzing and reporting. To reduce the ever increasing cost of compliance, AML automated systems must be implemented in conjunction with an enterprise data management strategy based on a comprehensive view across the AML ISC that addresses each aspect of the DLC.

For more information on “The Anti-Money Laundering Information Supply Chain: Reducing the Cost of Compliance”, please contact Thomas Messina at (646) 471-4757 or thomas.messina@us.pwc.com; or Deven Swim at (617) 530-7875 or deven.swim@us.pwc.com