How to Build an Effective AML/OFAC Compliance Program

23rd Annual ACFE Fraud Conference—Orlando, FL
June 17–22

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Learning Objectives

After completing this session, you will be able to:

• Identify historical context on AML and OFAC regulations.

• Understand regulatory expectations in AML/OFAC programs.

• Recognize what you should not do during program implementation.

• Define what makes a successful AML/OFAC Compliance Program.

• Understand what regulators want (as best as we can).
Polling Question

POLLING STATION
This Has Been Around Since When?
This Has Been Around Since When? – AML

The term “money laundering” was coined at a time when mafias in the United States used laundromats to serve as front-companies for their more nefarious activities. These cash businesses allowed criminals easy access to avoid taxation and also to mix illicit earnings with legitimate ones from the laundry businesses.

In October 1970, the U.S. Congress enacted the Currency and Foreign Transactions Reporting Act, what we know today as the Bank Secrecy Act (BSA). The BSA granted the Secretary of the Treasury authority to impose regulations on insured banks.
This Has Been Around Since When? – AML

The Bank Secrecy Act is comprised of 12 separate legislative acts, including the USA PATRIOT Act.

Other major U.S. AML laws include:
• Money Laundering Control Act (1986)
• Anti-Drug Abuse Act of 1988
• Annunzio-Wylie Anti-Money Laundering Act (1992)
• Money Laundering Suppression Act (1994)
• USA PATRIOT Act (2001)
• Intelligence Reform and Terrorism Prevention Act of 2004
This Has Been Around Since When? – AML

When the BSA was initially enacted, it established requirements for recordkeeping and reporting by private individuals, banks, and other financial institutions. It was designed to help identify the source, volume, and movement of currency and other monetary instruments transported or transmitted into or out of the United States. It required banks to:

- Report cash transactions over $10,000 using the Currency Transaction Report (CTR)
- Properly identify persons conducting transactions
- Maintain a paper trail by keeping appropriate records of financial transactions.

This Has Been Around Since When? – FinCEN

In 1990, the Financial Crimes Enforcement Network (FinCEN) was established as a bureau of the U.S. Treasury Department. The initial goal was that of analyzing data and tracking financial criminals.

In 1992, the Annunzio-Wylie Anti-Money Laundering Act required financial institutions to report suspicious activity.

FinCEN served a key role in 2005 when the first Federal Financial Institutions Examination Council (FFIEC) released their joint examination manual. Today, FinCEN works closely with federal and state law enforcement authorities in its capacity as BSA Administrator. They regularly release updates to existing regulations and solicit feedback from various industries.
This Has Been Around Since When? – OFAC

Economic sanctions have been used throughout history as a valuable tool to destabilize a hostile nation with non-violent means. OFAC is technically one of the oldest law enforcement agencies in the United States.

- The Non-Intercourse Act of 1809 was the first U.S. economic sanctions regulations which lifted embargoes on American shipping except those bound for British or French ports.

- A few years later, in 1812, marked the first involvement of the U.S. Treasury Department in economic sanctions when Secretary Gallatin administered sanctions against the UK in retaliation for the harassment of American sailors.
This Has Been Around Since When? – OFAC

• Between 1940 – 1947, Foreign Funds Control (FFC) and the Office of International Finance (OIF) were established as a unit of the Treasury derived from the Trading with the Enemy Act (TWEA). FFC administered wartime import controls over enemy assets and restrictions on trade with enemy states. It participated in administering the “Black list” and took censuses of foreign-owned assets in the United States and U.S. assets abroad. FFC was abolished in 1947 with its functions transferred to the OIF.

• The Division of Foreign Assets Control was established in 1950, following the entry of the People’s Republic of China into the Korean War. President Truman blocked all Chinese and North Korean assets within U.S. jurisdictions.

• In 1962, a Treasury Department order renamed the Division of Foreign Assets Control to the Office of Foreign Assets Control.
This Has Been Around Since When? – OFAC

OFAC operates through two primary laws, as well as Presidential Executive Orders:

<table>
<thead>
<tr>
<th>Trading With the Enemy Act (TWEA) programs (Cuba, North Korea)—1917</th>
<th>International Emergency Economic Powers Act (IEEPA) programs—1977</th>
</tr>
</thead>
<tbody>
<tr>
<td>Any corporation or company physically located in the United States, including U.S. branches, agencies, and representative offices of foreign corporations</td>
<td>Corporations organized under U.S. law, including foreign branches and foreign-organized subsidiaries of U.S. companies</td>
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This Has Been Around Since When? – OFAC

Today, OFAC operates in various countries throughout the world with the goal of protecting the U.S. monetary system from bad actors. It also acts as a liaison with foreign governments on financial intelligence information sharing on counter-terrorist financing and counter-narcotics trafficking matters.

- OFAC maintains a watchlist of over 5,000 individuals and entities that no U.S. persons or entities can do business with.

- OFAC administers and enforces targeted country- and regime-based sanctions programs against hostile countries such as Cuba, Iran, and Syria.

- Violations of OFAC regulations can lead to some of the largest penalties in financial services, including the $619 million assessed against ING last week.

- Compliance with OFAC is not mandatory within OFAC regulations; however, both federal and state banking examiners will mandate compliance.

- OFAC is not a regulator, rather an enforcement agency.
What Have We Been Told to Do?
What Have We Been Told to Do?

**Risk-Based Compliance Program**
We’re told by our regulators that our specific Compliance Program must be “risk-based.”

**Varied Regulatory Examination Approach**
Historically, each regulatory agency had their own approach to conducting BSA/AML/OFAC examinations.

**Insignificant Civil Monetary Penalties**
It was difficult to compel a Board of Directors or Senior Management for additional investment in Compliance when penalties could be justified as the cost of doing business.

**OFAC**
Little guidance had been given on how to comply with OFAC regulations.
FFIEC Manual

Summer 2005—The Launch of the Inaugural Federal Financial Institutions Examination Council (FFIEC) BSA/AML Examination Manual

The first edition of what would become known as the “FFIEC Manual” provided uniform BSA/AML examination guidelines to be shared ultimately by all federal banking regulators. With MOUs signed with the states, local regulators would begin using the manual in their examinations.

OFAC Inclusion in FFIEC Manual

OFAC was given a module in the manual to provide the first clear guidance on what regulators should be examining compliance programs for, with respect to OFAC regulations.

Four Pillars of an AML Program

The FFIEC Manual clearly laid out the four key pillars of an AML program: Designation of a BSA Compliance Officer; Development of Internal Policies, Procedures, and Controls; Ongoing, Relevant Training of Employees; and Independent Testing and Review.
Four Pillars of an AML Program

“The Four Pillars…”

• Designation of a BSA Compliance Officer
• Development of Internal Policies, Procedures, and Controls
• Ongoing, Relevant Training of Employees
• Independent Testing and Review

The FFIEC Manual encompassed the first clear breakdown of the critical Pillars of a BSA/AML Program.

These Pillars would ultimately form the core examination review by regulators.

“One weak pillar can jeopardize the entire program.”
Four Pillars of an AML Program—Designation of a BSA Compliance Officer

The FFIEC Manual laid out certain “musts” with respect to the designation of a BSA Compliance Officer:

• Board of Directors must appoint the individual.
• The BSA Officer must be charged with managing the institution’s BSA/AML Compliance and is ultimately responsible to the Board of Directors.
• The BSA Officer must be knowledgeable of all applicable AML regulations and have a working understanding of the businesses product and service offerings.
• The BSA Officer must have a direct line of communication into the Board of Directors and Senior Management.
• The BSA Officer will be responsible for managing communication with regulatory authorities for all AML-related issues and reporting.
Four Pillars of an AML Program—
Development of Internal Policies, Procedures, and Controls

Internal controls are comprised of policies, procedures, and controls. The FFIEC Manual breaks down the level of sophistication of internal controls to depend on the size and scale of the institution; however, internal controls should:

• Ensure that a business-specific risk assessment is developed and updated, taking into consideration: products, services, customers, geographic locations, and controls.
• Inform the Board of Directors and Senior Management of compliance initiatives, deficiencies, and corrective actions taken.
• Identify a person responsible for BSA/AML Compliance.
• Meet all regulatory recordkeeping and reporting requirements.
• Identify reportable transactions and accurately file all required reports, including SARs and CTRs.
• Provide for dual controls and the segregation of duties to the extent possible.
• Provide sufficient controls and systems for filing CTRs.
Four Pillars of an AML Program—Development of Internal Policies, Procedures, and Controls

• Provide sufficient controls and monitoring systems for timely detecting and reporting of suspicious activity.
• Provide for adequate supervision of employees that handle currency transactions, complete reports, grant exemptions, or monitor for suspicious activity.
• Incorporate BSA compliance into the job description and performance evaluation of personnel, as appropriate.
• Train employees to be aware of their responsibilities under the BSA regulations and internal policy guidelines.

This pillar in particular covers all internal controls including risk assessment, policies and procedures, transaction monitoring, and reporting.
Four Pillars of an AML Program—
Ongoing, Relevant Training of Employees

Training is the third of the pillars of an AML Compliance Program. Without proper training, staff might leave an institution too exposed to significant money laundering risk. There are several components of a training program that the FFIEC Manual dictates:

- At a minimum, the bank’s training program must provide training for all personnel whose duties require knowledge of the BSA.
- The training should be tailored to the person’s specific responsibilities.
- An overview of the BSA/AML requirements typically should be given to new staff during employee orientation.
- Changes to internal policies, procedures, processes, and monitoring systems should also be covered during training.
- Examples of money laundering activity and suspicious activity monitoring and reporting can and should be tailored to each individual audience.
- Training programs and staff completion should be documented for examiner review.
Independent testing is the fourth pillar of an effective AML program. Independent testing provides verification as to whether your compliance program is operating as effectively as possible and is compliant with the law.

Independent testing should:

• Be conducted by Internal Audit, outside auditors, consultants, or other qualified independent parties.
• Be conducted every 12–18 months commensurate with the institution’s risk profile.
• Have the testers reporting directly to Board of Directors or to a designated Board committee.
Four Pillars of an AML Program—
Independent Testing and Review

The scope of the independent test should, at a minimum, include:

- An evaluation of the overall adequacy and effectiveness of the BSA/AML compliance program, including policies, procedures, and processes
- A review of the institution’s risk assessment for reasonableness given its risk profile (i.e., products, services, customers, entities, and geographic locations)
- Appropriate risk-based transaction testing to verify adherence to BSA recordkeeping and reporting requirements
- An evaluation of management’s efforts to resolve violations and deficiencies noted in previous audits and regulatory examinations, including progress in addressing outstanding supervisory actions, if applicable
- A review of staff training for adequacy, accuracy, and completeness
- A review of the effectiveness of the suspicious activity monitoring systems (i.e., manual, automated, or a combination) used for BSA/AML compliance. Related reports may include, but are not limited to, SARs, CMIRs, CTRs, etc.
- An assessment of the overall process for identifying and reporting suspicious activity
What Do These Companies Have in Common?
What Do These Companies Have in Common? (Cont’d)

No one wants to see their company’s name on this list.

Every employee has the ability to damage the reputation of this company.

Staff in internal control roles today have a tougher job than ever with the ever-changing roster of regulations that we are forced to comply with.

Insert Your Company’s Name Here
What Should You Not Do?
What Should You Not Do?

The FFIEC Manual does a great job of laying out the minimum Compliance standards for the U.S. AML regime; however, what are some things that you should avoid doing when developing and managing a program?

Designation of a BSA Compliance Officer
Many institutions hire personnel not qualified for the roles they are appointed.

Internal Controls
It is very common for an institution’s processes to not match their board-approved AML program.

Training
Annual AML training hasn’t been updated in several years.

Independent Testing
Independent AML testing is conducted by Internal Audit, who has little to no AML knowledge.
What Should You Not Do?  
Designation of a BSA Compliance Officer

What can go wrong with respect to designating a BSA Compliance Officer? Without a strong BSA Compliance Officer, the Compliance program will lack the leadership and mandate to mitigate an institution’s AML/OFAC risk.

• Hiring an inexperienced individual
• Not properly having the BSA Officer approved by the Board of Directors
• The BSA Officer does not have a reporting line into Senior Management or Board of Directors
• Appointing multiple people responsible for AML
• Hiring an experienced BSA Officer, but not establishing a clear mandate
What Should You Not Do?
Development of Internal Policies, Procedures, and Controls

There are many opportunities for process breakdown with respect to development and implementation of internal controls. In theory, the risk assessment should be conducted first to establish significant risks and develop controls and processes to counter those risks. That isn’t always the case...

• Not documenting the AML Risk Assessment
• Operating with processes that don’t match written documentation
• Purchasing “off-the-shelf” transaction monitoring systems without configuring to an institution’s specific needs
• Not conducting regular reviews to update existing documentation
• Not developing and implementing a CTR and SAR quality control process
• When the policy states that senior management must approve the AML policy annually, finding that the only sign-off is from the Chief Compliance or AML Officer.
What Should You Not Do?
Ongoing, Relevant Training of Employees

Training is the most critical control in ensuring that all staff understand the business’ compliance processes and requirements with applicable regulations. Typically, an AML/OFAC training is deployed annually to institutions; however, there are certain mistakes that are commonly seen with these trainings.

- AML/OFAC training is not conducted annually
- Training deadline is not strictly enforced
- Training content is not updated on at least an annual basis
- Purchasing “off-the-shelf” AML trainings without tailoring to your business
- Deploying a training without a questionnaire to ensure knowledge retention
- When staff breach internal policy or regulations, not conducting additional training
What Should You Not Do?
Independent Testing and Review

The Independent Review will give your institution and its management a sound understanding of the programmatic strengths and gaps. If properly written, it should highlight certain remedial actions to bring the institution back into compliance. The Independent Review should be conducted by a person not directly tied to the Compliance Department. In many institutions, it is conducted by Internal Audit, others hire external consultants.

• Person conducting the audit is responsible for the Compliance Department
• Using Internal Audit without proper AML/OFAC subject matter expertise
• Going with the most expensive vendor
• Receiving a review report without an Executive Summary
• Hiring inexperienced auditors
• Not soliciting several bids on the work
What Makes a Successful Compliance Program?
What Makes a Successful Compliance Program?

There is no clear formula for creating a successful compliance program. Unfortunately, the best gauge for success is often driven by regulatory examination ratings and the amount of findings on your independent review report. Even then it can still be viewed subjectively as to whether the program is “successful.”

We are going to discuss certain aspects of a compliance program where there are certain proven areas for success.

At the end of the day, a program should be deemed successful when you feel proud to talk through aspects of the program to Senior Management and Board of Directors, as well as regulators.
What Makes a Successful Compliance Program? Designation of a BSA Compliance Officer

The BSA Officer is a critical role in any Compliance Department. Not only are you required by law to have a BSA Officer, but this individual is charged with protecting an institution from AML and OFAC risk. With penalties reaching the hundreds of millions of dollars, now more than ever it is critical to “get it right.” What are some key steps in ensuring the designation of a good BSA Compliance Officer?

• Ensure that during the interview process the candidate meets with their business counterpart.
• Hiring a person with a professional certification shows commitment to the industry.
• While not necessary, hiring former regulators can help on a variety of fronts.
• Hiring a BSA Compliance Officer who has experience speaking at industry conferences is important.
• Entrepreneurial spirit, the compliance-business relationship should be more partnership than adversarial.
What Makes a Successful Compliance Program?
Development of Internal Policies, Procedures, and Controls

There are many components of an Internal Controls Program. Between the risk assessment, policies and procedures, regulatory reporting, and transaction monitoring, there are many opportunities for mistakes. Having a strong BSA Officer to manage and take ownership of the Internal Control structure will help ensure that the process is sound. Here are some other tactics that will help with the implementation of an effective Internal Controls Program.

• Update the Risk Assessment methodology and risk weightings at least annually.
• Ensure that policy and procedures are updated within the timeframe that the documents state.
• Consistency is critical—many times documents aren’t drafted at the same time; however, ensure that all verbiage and processes remain consistent.
• Establish a QC process for all regulatory filings (i.e., SARs, CTRs, etc.).
• Set up dual review within the sanctions filtering tool.
• Calibrate the AML/OFAC monitoring system to the specific needs of your business.
What Makes a Successful Compliance Program? Ongoing, Relevant Training of Employees

An effective AML training program is critical for ensuring that all personnel are well-versed in the requirements with which the institution must comply. Not to mention, an AML training program is a requirement of BSA regulations. When staff are properly trained on applicable requirements, it makes Compliance and Audit’s roles easier.

• Conduct a training needs assessment.
• Develop specific training depending on department.
• Ensure that the training material is updated annually.
• Update training upon changes to regulations or internal policies.
• Develop quizzes within the training to ensure knowledge retention.
• Determine the frequency that training will be deployed to staff.
What Makes a Successful Compliance Program? Independent Testing and Review

You’ve hired a competent BSA Officer, Internal Controls are developed and approved, and training has been conducted on a regular basis to all staff. How do you know if your program is working effectively? Commissioning an Independent AML Review through either internal or external resources will identify gaps and outline remedial actions.

• If an institution is large enough, create an AML Audit team for the purposes of testing and reviews.
• If using external resources, request bids from multiple firms to reduce costs.
• Review the scope to ensure that it meets regulatory and business purposes.
• Request that the reviewers, in their findings, notate the specific citations of law that were violated, if applicable.
• Upon completion of the review, develop specific remedial action plans.
Polling Question
Poll Question #3
Poll Question #4
How to Know What Regulators Want?
How to Know What Regulators Want?

We’ve explored the history of AML and OFAC regulations and discussed regulatory expectations through documents such as the FFIEC Manual, but how do we know what regulators actually want?

Getting a regulator to speak off the record is a difficult task; however, there are opportunities to get an unbiased view of what items regulators like to see in an AML Program.

- Discussions during examinations
- Contacting a regulator when considering program changes
- Attending industry outreach events
- Networking with regulators at trade conferences

At the end of the day, it is incredibly difficult to get a federal or state regulator to share their personal views. But, if you listen closely, you can pick up certain hints.
How to Know What Regulators Want?

Attendance at certain trade conferences can be hugely helpful in gaining access to regulators. These conferences are valuable, not just for opportunities to hear regulators speak, but trading contact information and building information sharing networks. Regulators know that they need their “business partners” to help them at times in crafting legislation, so this relationship can be mutually beneficial.

Don’t be afraid to ask direct questions so that you might operate your business in as a compliant manner as possible.
Questions?
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