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The National Voice of the State Credit Union System

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Don't Build a House on Sand

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AuditLink
CU*ANSWERS Management Services

Agenda

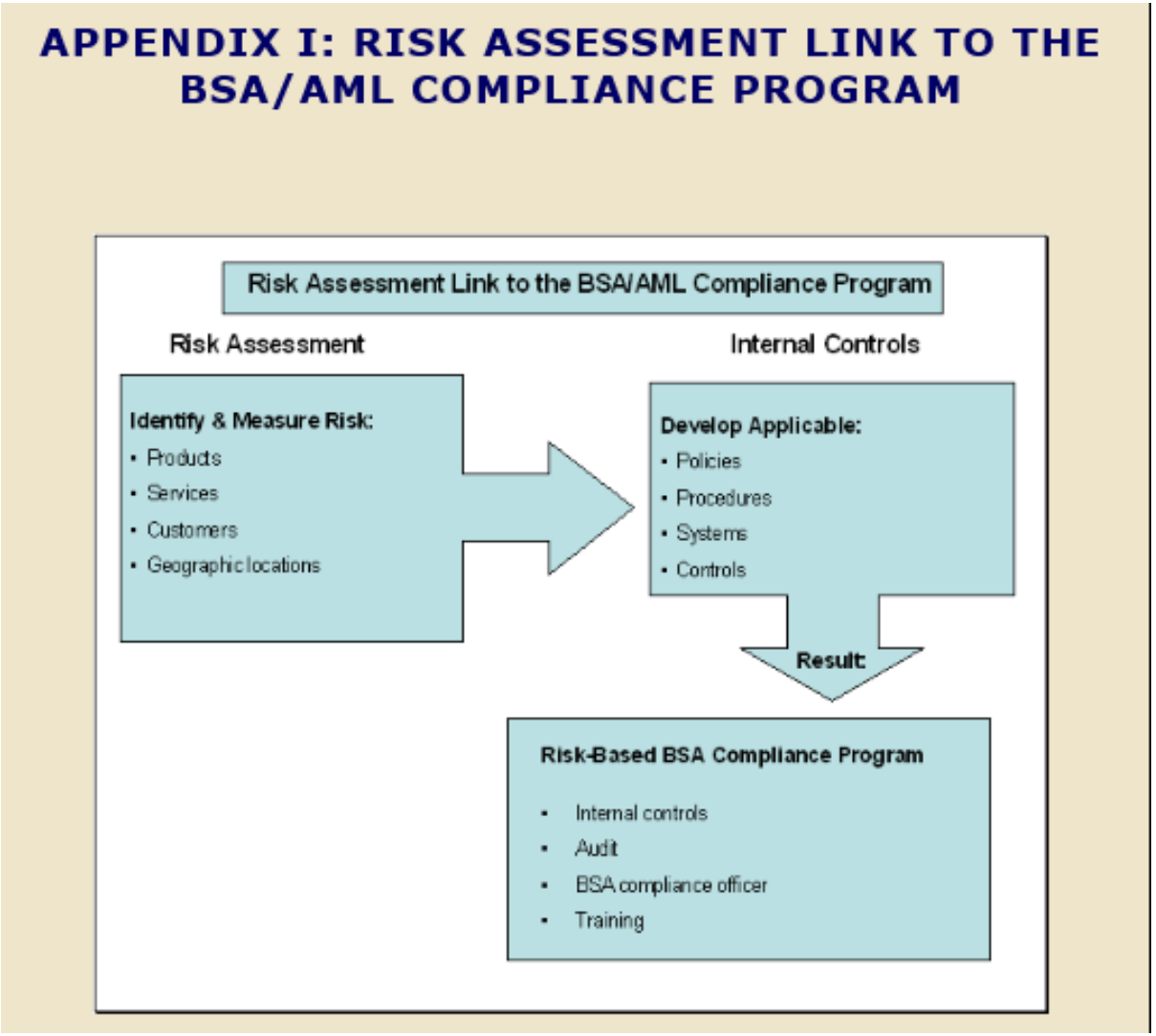
- Basics from the FFIEC
- What is expected
- What is changing
- Qualitative factors
- Risk assessments vs. member due diligence

Our Reality

The shoulders on which all BSA/AML programs sit is the assessment process.

A well thought out assessment will guarantee compliance with regulations and maximize the effectiveness of the program.

What Remains a Constant



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FFIEC on Assessment Process

- Assessment is the basis for the BSA exam
- A poor risk assessment can lead to an exhaustive exam
- An incomplete one, or one that looks like a find and replace, can lead to the examiner completing the assessment
- A well thought out assessment helps win arguments on recommendations to spend on additional resources

BSA/AML RISK ASSESSMENT

BSA/AML RISK ASSESSMENT

Objective: *Review the bank's BSA/AML risk assessment process, and determine whether the bank has adequately identified the ML/TF and other illicit financial activity risks within its banking operations.*

Examiners must develop an understanding of the bank's ML/TF and other illicit financial activity risks to evaluate the bank's BSA/AML compliance program. This is primarily achieved by reviewing the bank's BSA/AML risk assessment during the scoping and planning process. This section is designed to provide standards for examiners to assess the adequacy of the bank's BSA/AML risk assessment process.

https://bsaaml.ffiec.gov/manual/BSAAMLRiskAssessment/01

Reverse engineer what the examiner and auditor will expect

- Analyze and document historical illicit financial activity
- Determine the compliance and transactional risk associated with each category
- Although not required, document triggers that would require a review and update of assessments
- Involve all departments

BSA/AML RISK ASSESSMENT EXAMINATION PROCEDURES

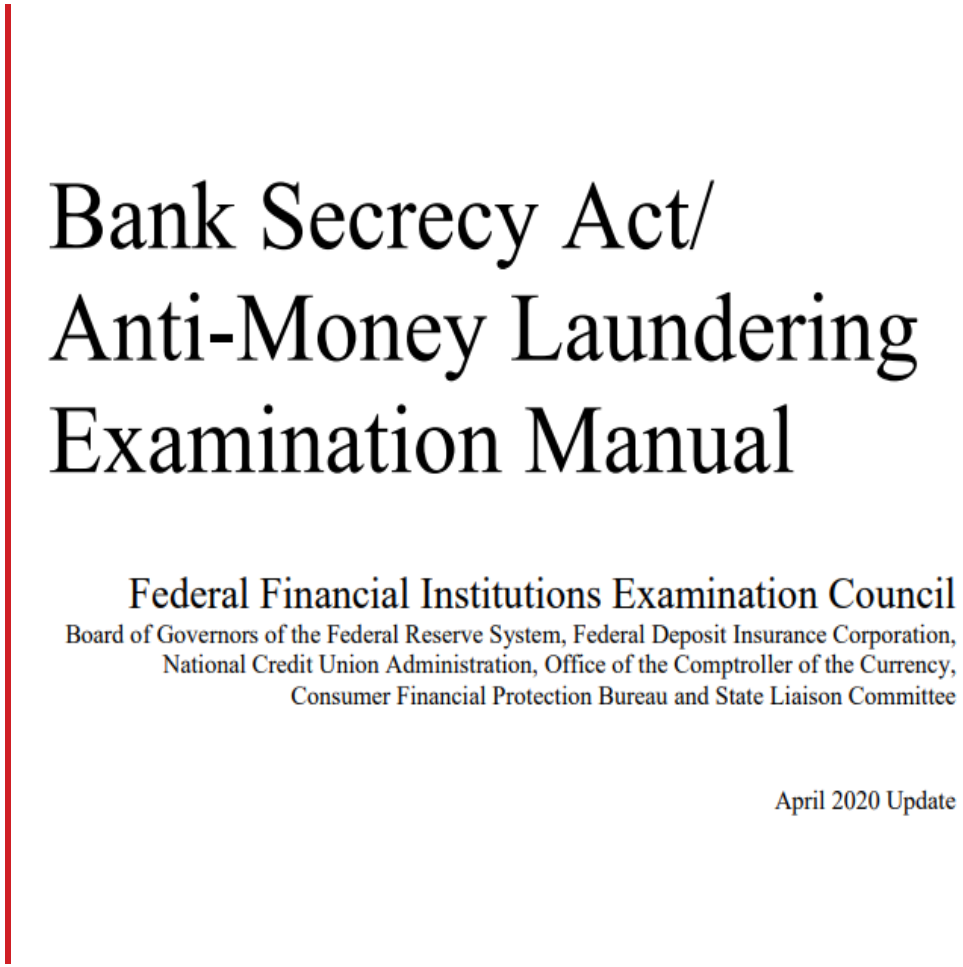
Objective. *Determine the adequacy of the bank's BSA/AML risk assessment process, and determine whether the bank has adequately identified the ML/TF and other illicit financial activity risks within its banking operations.*

1. Determine whether the bank has identified ML/TF and other illicit financial activity risks associated with the products, services, customers, and geographic locations unique to the bank.
2. Determine whether the bank has analyzed, and assessed the ML/TF and other illicit financial activity risks within the products, services, customers, and geographic locations unique to the bank.
3. Determine whether the bank has a process for updating its BSA/AML risk assessment as necessary to reflect changes in the bank's products, services, customers, and geographic locations and to remain an accurate reflection of its ML/TF and other illicit financial activity risks.
4. If the bank has not developed a BSA/AML risk assessment, or if the BSA/AML risk assessment is inadequate, complete a BSA/AML risk assessment for the bank.
5. Document and discuss with the bank any findings related to the BSA/AML risk assessment process.

https://www.nafcu.org/bsa-blast/2020/may/ffiec-updates

4/20/2020 Update to the BSA Examination Handbook

- Instructs examiners to tailor the process based upon credit union's risk profile
- Provides instructions for assessing the adequacy of the credit union's program
- Instructs examiners in evaluating the adequacy of the credit union's risk assessment process, including:
  - Risk categories, and information identified to better assess the risk within these categories
  - Finalizing the exam, reminding them of the inherent flexibility of the design


Bank Secrecy Act/
Anti-Money Laundering
Examination Manual

Federal Financial Institutions Examination Council
Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation,
National Credit Union Administration, Office of the Comptroller of the Currency,
Consumer Financial Protection Bureau and State Liaison Committee

April 2020 Update

https://www.ffiec.gov/press/PDF/FFIEC%20BSA-AML%20Exam%20Manual.pdf

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The New and Old Process

- Do not include risks that are not associated with money laundering, terrorist financing, or other illegal financial activities that would be considered a predicate offense
  - Reputational and operational risks do play a role but that is left for the ERM committee to consider
- Categories remain:
  - Product and services
  - Geography
  - Membership
- Is your data analyst at the table to assist with understanding critical elements for the assessment process?

Appendix J Quality of Risk Matrix

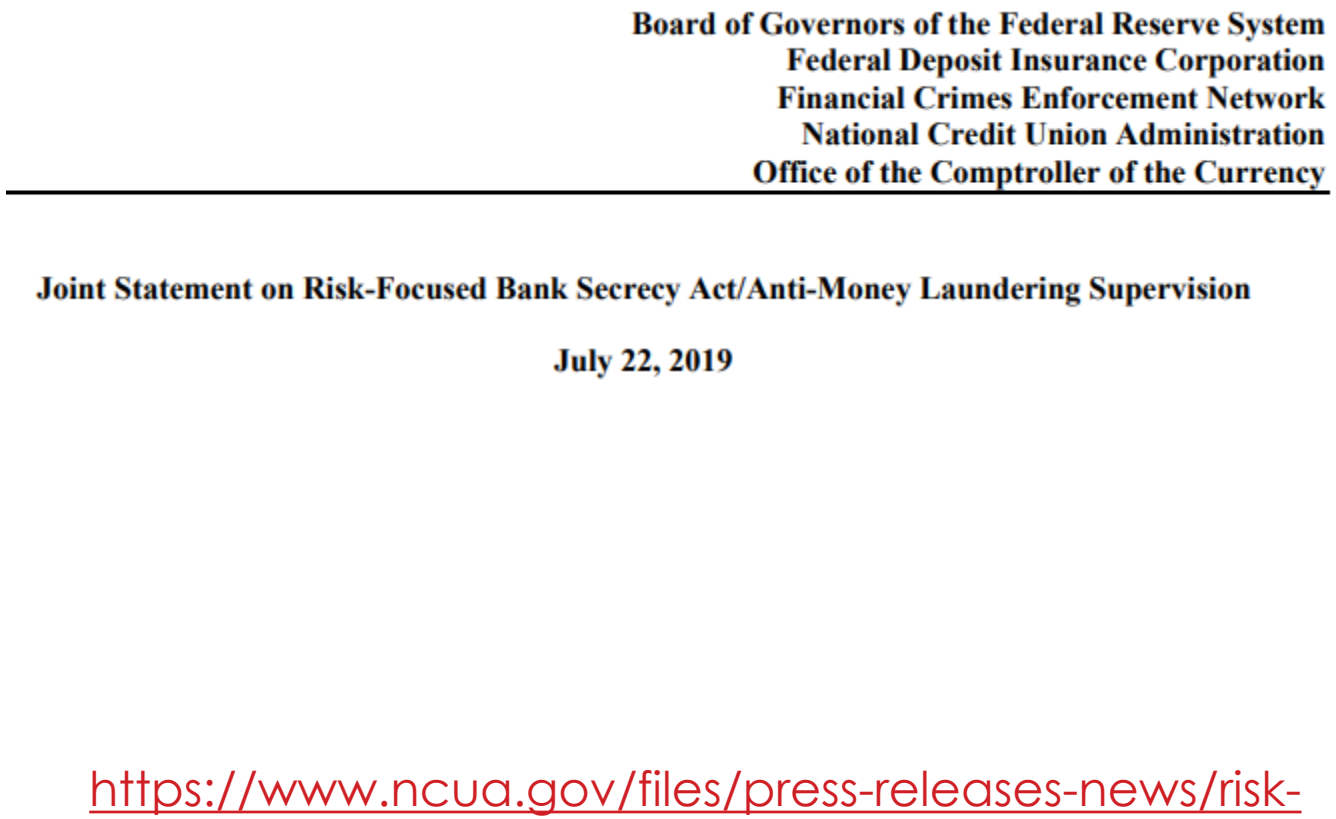
- Fast becoming a template that is viewed as inadequate
- More granularity and a more diverse rating system is now expected
- Does not lead to having all departments in the room when being completed
- Does not show a grasp of categories

Banks and examiners may use the following matrix to formulate summary conclusions. Prior to using this matrix, they should complete the identification and quantification steps detailed in the BSA/AML Risk Assessment Overview section at page 18 of this manual.

Low	Moderate	High
Stable, known customer base.	Customer base increasing due to branching, merger, or acquisition.	A large and growing customer base in a wide and diverse geographic area.
No electronic banking (e-banking) or the Web site is informational or nontransactional.	The bank is beginning e-banking and offers limited products and services.	The bank offers a wide array of e-banking products and services (i.e., account transfers, e-bill payment, or accounts opened via the Internet).
On the basis of information received from the BSA-reporting database, there are few or no large currency or structured transactions.	On the basis of information received from the BSA-reporting database, there is a moderate volume of large currency or structured transactions.	On the basis of information received from the BSA-reporting database, there is a significant volume of large currency or structured transactions.

Including quantitative data into the assessment

- Be one step ahead
- Instructs examiners to evaluate the quality of the risk assessment
- Requires that the scoping of the BSA exam be determined by the risk assessment and accompanying risk profile
- Does your assessment speak to third parties in that your credit union profile is adequately assessed with qualitative data?



Board of Governors of the Federal Reserve System
Federal Deposit Insurance Corporation
Financial Crimes Enforcement Network
National Credit Union Administration
Office of the Comptroller of the Currency

Joint Statement on Risk-Focused Bank Secrecy Act/Anti-Money Laundering Supervision

July 22, 2019

https://www.ncua.gov/files/press-releases-news/risk-focused-bsa-aml-supervision.pdf

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Start with Membership

What qualitative data speaks to your credit union's members?

- What are the demographics?
- How do they use you?
- What types of accounts do they use?
- How many have perpetrated a financial crime involved in M/L, T/F, or other financial crimes?

Compare the two

Success CU membership consists of people who live and reside and Sunny and Lakeside counties. The majority have natural person membership accounts. There was little to no activity in the last year indicating they are using the credit union for money laundering or illegal activity. BSA risk is low.

vs.

Success CU membership consists of 7,321 households with 9,435 membership accounts. 38% reside in Sunny County, 55% reside in Lakeside county, 4% reside in a joining counties, while the remaining 4% our outside of the state.

According to Federal statistics, 44% of residents work in the blue-collar sector, 30% in healthcare, 20% agriculture, and the remaining 6% in other types of business.

The membership accounts consist of 64% natural person members, 10% small business, 6% trust accounts, 4% organizational, 2% representative payee, 10% minor, 1% custodial, and the remaining 3% consist of professional service providers and POA.

In the past year, the credit union has identified 6 accounts used for potential money laundering and is monitoring 12 others for anomalous activity. Listed below are the identified potential threats associated with the Bank Secrecy Act for each membership account type...

CU*BASE Tools to Complete the Work…

- Relationship Analysis (Tool #752)
- Geographic/Zip Code Analysis Report (Tool #382)
- Where Your Members Live (Tool #978)
- Member Retention by Year Opened (Tool #509)
- Tiered Services Monthly Comparison (Tool #856 & Analytics Booth)
- Account Retention by Year Opened (Tool #104)
- Channel Activity by Member Age Group (Tool #200)
- Net Relationships Dashboard (Tool #547)
- Patronage Comparison (Tool #582)
- Portfolio Analysis – CDs (Tool #591 & Analytics Booth)
- Portfolio Analysis – Loans (Tool #595 & Analytics Booth)
- Portfolio Analysis – Savings (Tool #596 & Analytics Booth)

Membership Grasp

Membership Account Type	BSA Threat/Risk	Inherent Risk Level	Mitigating Controls - Controls that would illimate or transfer risk (none, low, moderte, high, severe)	Risidual Risk -Quantity of risk after applying controls (none, low, moderate, high, severe)	Likelyhood - Based upon historical occurances and current environment	Requires additional controls
Natural Person	Account used to layer, structure, or perform other illegal activity	Moderate	Use of core platform to analyze transactional activity that detects transactional patterns which coincide with M/L and other illegal activity	Low	Low - 3 occurances in 2019. Environment stable	No
	Documents used to open account were forged and has lead to opening an account for a criminal	Low	Best practice document and training outlining sound methodogy for analyzing government issued id's	Low	Low - 0 occurances in 2019. Environment stable	No
	Account is taken over and drained through electronic channels	High	Multi layer authentication and other controls outlined in the on-line channel risk assessment	Moderate	Moderate - 6 occurances in 2019. Environment unstable	Requires discussion with upper management
	Account is used to exchange virtual currency	Moderate	Use of core platform to analyze transactional activity that detects transactional patterns associated with virtual currencies	Low	Low - 2 occurances in 2019. Environment under re-evaluation	No
	Account was opened online and CDD did not detect potential fraudulent account	High	Use of a third party to vet information entered and score probability of fraud	Moderate	Moderate - 3 out of 100 memberships in 2019. Environment unstable*	Requires discussion with upper management. Reconfiguration of validation process

Geographic Locations

What qualitative data speaks to your credit union's members?

- What are the demographics?
- How do they use you?
- What types of accounts do they use?
- How many have perpetrated a financial crime involved in M/L, T/F, or other financial crimes?

Compare the two

Success CU membership can be found in 3 northeastern counts in Michigan. The credit union has 6 locations in these counties with the majority of memberships utilizing the main facility in Glen Harbor. The level of crime in the counties remains low and risks found are low.

vs.

Success credit union membership consists of 7,321 households with 9,435 membership accounts. 38% reside in Sunny County, 55% reside in Lakeside county, 4% reside in a joining counties, while the remaining 4% our outside of the state. One adjoining county does fall into a HIDTA with 200 members residing in the county or .2% of the credit unions membership. No counties fall in HIFCA zones.

Financial crimes statistics remain difficult at best to obtain, however, based upon statistics published by county sheriff departments identity theft, fraud, and embezzlement remain at low levels as a percentage of the population.

The credit union does belong to the national shared branching network. Last year members of the credit unions performed 11,265 shared branching transactions and members of other credit unions performed 6,511 transactions at Success credit union. Success CU member transactions consisted of 85% transfers, 10% deposits in check, 5% deposits in cash...

CU*BASE Tools to Complete the Work…

- Geographic/Zip Code Analysis Report (Tool #382)
- Where Your Members Live (Tool #978)
- Where Your Members Branch (Tool #977)

Geography Grasp

Geographical Function	BSA Threat/Risk	Mitigating Controls - Controls that would illimate or transfer risk	Risidual Risk -Quantity of risk after applying controls (none, low, moderate, high, severe)	Likelyhood - Based upon historical occurances and current environment	Requires additional controls
High Intensity Drug Trafficing Areas	A greater propensity to have bad actors open up accounts and use them for illegal activity	The core contains pattern recognition to uncover this type of activity and the nature and purpose of account is documented at account opening	None	Low. Credit Union has no branches in a HIDTA Environment stable	No
Size of credit union and forecasted growth or merger activity	A greater likelyhood that the credit union will open accounts to criminals because of expanded geographies and diversity of membership	The core contains pattern recognition to uncover this type of activity and the nature and purpose of account is documented at account opening	Low	Low - 0 occurances in 2019. Credit union field of membership remains stable	No
Share branching activities	Increases risk of identity theft leading to the theft of customer funds. Also has increased potential of illicit activity as Credit Union likely does not know baseline activity. It also increase the number of locations including high drug traficcing and money laundering areas	Share branching activity is monitored on a daily basis for suspicious activity both by our members and members of other credit unions utilizing our credit teller lines	Moderate	Low - 2 occurances in 2019. Environment is stable	No
High intensity money laundering and related financial crimes areas	Increased risk of money laundering in High Intensity Money Laundering and Related Financial Crimes Area (HIFCA)	The credit union has no locations identified as HIFCA	None	Low	No

Products and Services

What qualitative data speaks to your credit union's members?

- Reference the BSA examination manual for selection
- What are the actual instances of financial crime impacting products and services?
- How are environment factors impacting the future?
- Have products or services been implemented since the last assessment and have they been evaluated? (RDC, remote loan closings, automated account opening...)

Compare the two

Success CU offers a wide array of products and services of which many have inherent risks associated with financial crimes. Products such as wire transfer, home banking, and account to account transfer are the most likely to have risks.

vs.

Success CU has identified 8 products and services that could pose or be used to facilitate financial crimes:

- Home banking - currently being used by 5,434 or 40% of membership, of which 30% are natural persons and remainder by legal entities
- ATM and debit cards - currently being used by 7,120 or 60% of membership
- A2A and P2P - currently being used by 300 members or 2% of membership
- Wire transfers - currently being used by 600 memberships of which 400 are natural person and other legal entities
- Credit Cards - currently being used by 4,100 or 30% of memberships
- ACH – as of year end the credit union processed over 550,000 items, of which 4,580 were international
- RDC – new product in 2020 and currently being utilized by 679 members
- Lines of credit (primarily HELOC) – 1,251 members currently have HELOC, of which 851 remain in their draw period
- Money orders – Credit union sold 6,120 money orders to 3,541 members...

CU*BASE Tools to Complete the Work…

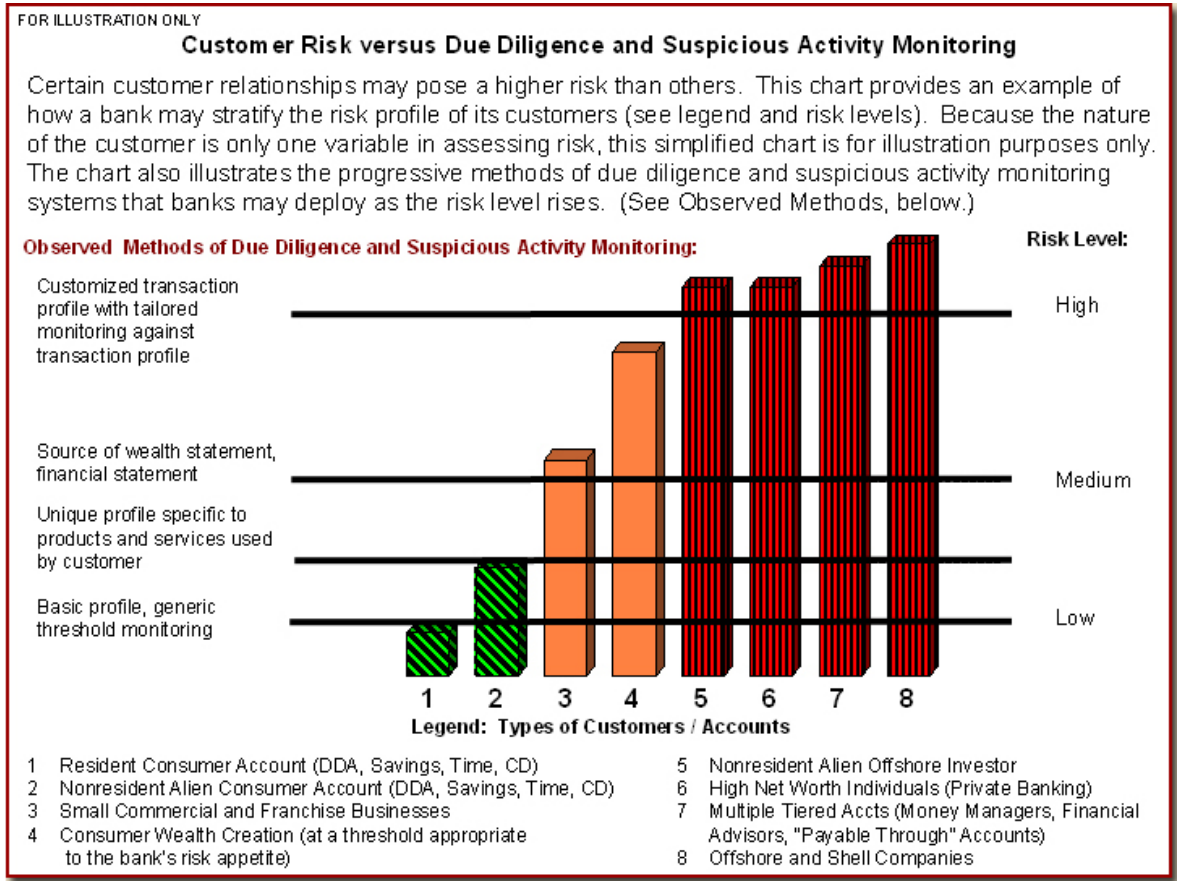
- Products & Services per Member Dashboard (Tool#697)
- Online Banking Activity Analysis (Tool #1750)
- New/Closed/All Accounts Dashboard (Tool #552)
- New/Closed/All Memberships Dashboard (Tool #553)
- Fee Income/Waivers Dashboard (Tool #369)
- Auto-Post RDC Deposit Dashboard
- Where Your Members Pay Bills (Tool #1105)
- Bill Pay Subscriber Analysis Dashboard (Tool #1106)
- Why Your Members Call (Tool #1315)
- Who Earned Dividends (Tool #1405)

Products and Service Grasp

Product or Service Type	BSA Threat/Risk	Inherent Risk Level	Mitigating Controls - Controls that would illimate or transfer risk	Risidual Risk -Quantity of risk after applying controls (none, low, moderate, high, severe)	Likelyhood - Based upon historical occurances and current environment	Requires additional controls
On-line services	Account taken over used to layer, structure, or perform other illegal activity	Moderate	Use of core platform to analyze transactional activity that detects transactional patterns which coincide with M/L and other illegal activity	Low	Moderate - 15 occurances in 2019. Environment unstable (covid related)	Requires discussion with upper management regarding unemployement fraud and member social engineering
	Documents used to open account were forged and has lead to opening an account for a criminal	Moderate	Best practice document and training outlining sound methodogy for analyzing government issued id's	Low	Low - 0 occurances in 2019. Environment stable	No
	Hackers gain access to account information and sell it on the dark web	Low	Multi layer authentication and other controls outlined in the on-line channel risk assessment	Low	Low - 0 occurances in 2019. Environment unstable	Requires discussion with upper management and include in inidence response program
	Used to micro manage account to perpetrate a kiting scheme	Moderate	The number of times a member accesses home banking account is a monitored event. Members signing onto the system more than 3 times per day during a given month are reviewed for deposit and check acitivty	Low	Low - 0 occurances in 2019. Environment under re-evaluation	No

Appendix K

- This illustration should be part of every risk assessment
- Assists in winning the argument relative to up-front due diligence and ongoing monitoring
- For the most part CUs only open accounts in the first three tiers…yet we get recommendations from third parties that we should be doing what is required for the *last* three



Nexis between Assessment and Due Diligence

- Risk matrix questions generally don't uncover nefarious actors
- CIP and risk-based procedures for account opening which is married to the assessment
- Institutional risk assessment has already created for your identified risk buckets
- Unusual activity questions and purpose of account questions increase based upon the level of risk
- **Risk assessment serves as baseline for ongoing monitoring**

Tailored due diligence

- Based on risk identified in types of accounts you will be opening
- Based on a risk-based approach

What is the experience for natural person members at account opening?

Welcome to Success CU! I now have to grill you on information we need to collect to make sure you are not a fraudster:

- Do you expect to do wires?
- What are your anticipated deposit and withdrawals amounts?
- How much debit card activity will you be expecting?
- How much ACH activity should we expect moving through the account?
- Will you have any international transactions?
- Should we expect transactions from outside the state or country, and on what frequency?

VS.

Welcome to Success CU! We just need to ask a couple of questions to better serve you. Can you tell me what is your occupation and the nature of your account?

Due Diligence Performed at Account Opening

For the first time, we have clarity on customer due diligence:

"A covered financial institution may assess, on the basis of risk, that a customer's risk profile is low, and that, accordingly, additional information is not necessary for the covered financial institution to develop its understanding of the nature and purpose of the customer relationship."

FinCEN GUIDANCE

FIN-2020-G002

Issued: August 3, 2020

Subject: Frequently Asked Questions Regarding Customer Due Diligence (CDD) Requirements for Covered Financial Institutions.

https://www.fincen.gov/sites/default/files/2020-08/FinCEN%20Guidance%20CDD%20508%20FINAL___2.pdf

I. Customer Information – Risk-Based Procedures

Q1: Is it a requirement under the CDD Rule that covered financial institutions:

- collect information about expected activity on all customers at account opening, or on an ongoing or periodic basis;
- conduct media searches or screening for news articles on all customers or other related parties, such as beneficial owners, either at account opening, or on an ongoing or periodic basis; or
- collect information that identifies underlying transacting parties when a financial institution offers correspondent banking or omnibus accounts to other financial institutions (i.e., a customer's customer)?

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Open Discussion

"The majority of members will be low risk. Truly focus resources on the riskier buckets, which for the most part should be actively managed and remain small. Very high risk accounts should eventually be moved out, either by ending the relationship or as the activity is eventually considered normal."

Do you agree? Disagree?