

**Information to  
Vision**

**Excellence, reliability, and value** are core principles followed by Idola while working with its clients and partners. This newsletter provides current information to help financial institutions meet their risk and compliance mandates. It is with current, meaningful information that appropriate vision is developed to meet today's challenges.

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**Featured Article**

**[Perspectives on Compliance Process Outsourcing](#)**

**FINCEN releases 14<sup>th</sup>  
SAR Activity Review**

On 23<sup>rd</sup> June 2010, The Financial Crimes Enforcement Network (FinCEN) today released its 14th edition of the [SAR Activity Review – By the Numbers](#), which covers suspicious activity reports (SARs) filed in 2009. The report shows that the total number of all SARs filed by financial institutions declined from 1.29 million in 2008 to 1.28 million in 2009. SARs filed by depository institutions declined for the first time from 732,563 in 2008 to 720,309 in 2009.

For more details, please click on:

[http://www.fincen.gov/news\\_room/rp/files/sar\\_by\\_numb\\_14.pdf](http://www.fincen.gov/news_room/rp/files/sar_by_numb_14.pdf)

**FDIC Mar – May 2010  
– Enforcement Action**

The FDIC processed a total of 104 matters in March. These included 42 cease and desist consent orders; 20 removal and prohibition orders; one order to immediately pay liability; 22 civil money penalties; eight prompt corrective actions; two voluntary terminations of insurance; one section 19 order; six orders terminating an order to cease and desist; one notice of assessment of liability, findings of fact and conclusions of law, order to immediately pay liability, and notice of hearing; and one adjudicated decision.

The FDIC processed a total of 76 matters in April. These included 43 cease and desist consent orders; five removal and prohibition orders; four cross guarantee liabilities; five civil money penalties; nine prompt corrective actions; one order terminating a written agreement; seven orders terminating an order to cease and desist; one notice of intention to prohibit from further participation, findings of fact, conclusions of law, and notice of hearing; and one notice of charges and of hearing.

The FDIC processed a total of 62 matters in May. These included 30 cease and desist consent orders; three removal and prohibition orders; thirteen civil money penalties; eight prompt corrective actions; one section 19; and seven orders terminating an order to cease and desist.

For more details, please click on:

<http://www.fdic.gov/news/news/press/2010/pr10094.html> (Mar 2010)

<http://www.fdic.gov/news/news/press/2010/pr10124.html> (Apr 2010)

<http://www.fdic.gov/news/news/press/2010/pr10142.html> (May 2010)

**Wall Street Reform  
signed into Law.**

On July 21, 2010, the Dodd–Frank Wall Street Reform and Consumer Protection Act was signed into law by President Barack Obama on July 21, 2010. The law creates a new watchdog agency within the Federal Reserve that will be charged with protecting consumers in financial transactions and gives the government more power to break up failing companies. It also gives the Federal Reserve more power, while subjecting the central bank to greater congressional oversight.

For more details, please click on:

[http://banking.senate.gov/public/files/070110\\_Dodd\\_Frank\\_Wall\\_Street\\_Reform\\_comprehensive\\_summary\\_Final.pdf](http://banking.senate.gov/public/files/070110_Dodd_Frank_Wall_Street_Reform_comprehensive_summary_Final.pdf)

<http://thomas.loc.gov/cgi-bin/bdquery/z?d111:H.R.4173>:

**Treasury Issues  
Iranian Financial  
Sanctions  
Regulations**

The U.S. Department of the Treasury has issued the Iranian Financial Sanctions Regulations (IFSR) to implement subsections 104(c) and 104(d) of the Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (CISADA).

Please read details below:

<http://www.ustreas.gov/press/releases/tg829.htm>

<http://www.treas.gov/offices/enforcement/ofac/programs/iran/iran.pdf>

**New Executive  
Order targeting  
North Korean  
Proliferation and  
other illegal  
activities**

President Obama issued an Executive Order freezing the assets of certain persons with respect to the Democratic People's Republic of Korea (North Korea). This new Order expands the scope of the national emergency declared in Executive Order 13466 of June 26, 2008 and takes additional steps to address that national emergency. In the new Executive Order, the President finds that certain actions and policies of the Government of North Korea constitute an unusual and extraordinary threat to the national security, foreign policy, and economy of the United States.

Please read details below:

<http://www.treas.gov/press/releases/tg839.htm>

<http://www.treas.gov/press/releases/tg840.htm>

**Barclays settles US  
Bank-Sanction  
violation case**

Barclays PLC agreed to pay \$298 million to settle charges by U.S. and New York prosecutors that the U.K. bank altered financial records for more than a decade to hide hundreds of millions of dollars in payments flowing into the U.S. from Cuba, Libya, Iran and other sanctioned countries.

For more details, please click on:

[http://online.wsj.com/article/NA\\_WSJ\\_PUB:SB10001424052748703908704575433781894978828.html](http://online.wsj.com/article/NA_WSJ_PUB:SB10001424052748703908704575433781894978828.html)

## ***Perspectives on Compliance Process Outsourcing***

What Your Service Provider May Not Be Telling You

By Salvatore Cangialosi, President of The Josefa Group & Senior Strategic Advisor at Idola

### **Introduction:**

Critical, risky, significant liability, complex, new and costly are attributes that can describe the implementation of an outsourced compliance function. Nevertheless, Compliance Process Outsourcing (CPO) holds the promise of risk mitigation through the access of best practices that have been tested by regulators on other clients. Evaluating whether or not CPO is appropriate for a particular organization requires a comprehensive business case. This article provides an introduction to the issues that must be addressed in the business case.

### **Common Fallacies:**

Business Process Outsourcing has proven to be an important option for many functions within a financial institution. Not surprisingly, there has been an increasing dialog surrounding the value of outsourcing part or all of the regulatory compliance area. Traditional rationales based on cost savings and vendor expertise are often promoted. However, the compliance requirements of an organization have their own unique characteristics and risks that require broader analysis before embarking on a path towards outsourcing. Following are five common rationales for the outsourcing of the compliance function that may prove untrue for a particular company:

1. Cost Savings are first touted as a major driver for an outsourcing initiative. Particularly when outsourcing involves and off shore or near shore facility. Actual costs however turn out to be highly variable and will often exceed the actual cost of in house operations. Factors affecting cost include:
  - a. The ongoing cost of appropriately skilled staff is high in all geographies with availability of properly qualified professionals often limited.
  - b. A risk based approach to customer due diligence, alert detection, case analysis, and suspicious activity reporting leads to differing approaches across institutions. Consequently, the ability to establish repetitive processes and their cost savings is much more difficult when outsourcing compliance compared to other operational functions.
  - c. Consolidating underlying technology and infrastructure support across multiple organizations may offer the potential for cost savings. Again, this often is not the case. Based on the needs of each financial institution, a service provider must support multiple vendors' software products and their required infrastructure. More troubling is the fact that multiple versions for each vendor must be supported and upgraded at different times to meet the specific needs of each client. The result is an aggregation of significant technology issues that will drive cost higher and may lead to lower reliability as compared to existing in house solutions.
  - d. The cost to a service provider of appropriate levels of liability coverage may far exceed the cost of coverage paid by a financial institution.
  - e. Profit margins are an added cost of using a service provider that are not applicable to in house operations
2. Repetitive practices are essential to the efficient outsourcing of an operation. As mentioned above, repetitive processes are difficult to establish given differing risk factors and business activities across a range of financial institutions. In addition to the impact on cost, it is also now necessary to analyze how a risk based compliance program will be established with a service provider and what will the effort be to appropriately make changes as business operations and other risk factors evolve. The need for this level of coordination cannot be underestimated.
3. "Now is the Time" is often quoted by service providers. But is that true? Given the challenges faced today at most financial institutions, one must seriously consider if taking on the risk inherent in compliance outsourcing is warranted. It may be prudent to take a wait and see approach, unless there are compelling, substantiated reasons to outsource.

4. Vendor Expertise is one of the most important aspects to successful outsourcing. But does your vendor have the appropriate breath of experience in all essential areas? At a minimum, there must be strong domain expertise in compliance requirements, regulatory trends, management of outsourcing operations, technology management, and software development to adjust risk models, rules, and reporting.
5. A common misperception of compliance outsourcing is that a broad scope of responsibility can be assigned to the service provider. While alert review, OFAC checking, customer due diligence and report preparation are activities among others that may be outsourced, it is not acceptable to expect a service provider to file SAR's, make decisions, provide final sign-off, or to interact with a financial institutions' clients.

## The Real Value Proposition

The real value proposition for Compliance Process Outsourcing lies in its potential to mitigate risk for the organization. This is far more important than what may prove to be an immaterial cost savings. Some of the key areas for risk mitigation are as follows

1. **Reputational Risk** – Without a doubt, the impact of impairment to a financial institution's reputation can be catastrophic. Deciding to outsource the compliance function must consider this risk with the highest of priority. An appropriate service provider will have developed a business model staffed with leaders in regulatory compliance that can deliver a work product minimizing reputational risk when compared to in house processing.
2. **Regulatory Risk** – A service provider must develop a strong relationship with multiple regulators. They must adhere to all regulatory mandates and assure that they are proactive in addressing changes to regulatory supervision. Their operations must be well documented and offer transparency to auditors, regulators and other supervisory groups. One of the ways in which this

can be achieved is by developing across multiple clients compliance methodologies that are viewed by examiners as de facto standards of performance.

3. **Operational Risk** – Simply the job must be done right. Based on best practice established in coordination with regulators, a service provider must develop techniques that assure that the work product is performed consistently and with the appropriate level of staff expertise. Again, operations must offer transparency to key parties and be based on detailed procedures adapted for the risk based compliance needs of each financial institution.
4. **Information Security/Privacy Risk** – The system management process must address security, disaster recovery, and privacy with a service level agreement that is superior to what is offered by in house processing.

## What Should Bankers Look For

1. A thorough analysis of the identification, selection, contracting, and management of third party service providers is beyond the scope of this article. Significant advice on managing third party service providers has been developed by the FFIEC, the Federal Reserve, and the FDIC among others. A future Thought Leadership article will be prepared which summarizes these recommendations. It is useful however to identify key requirements for the process of selecting a service provider.
2. Develop a comprehensive business case that clearly articulates the goals of the intended relationship. The business case should adequately address risks and their mitigation, regulatory impact, vendor standards of performance, liability, and costs among other critical topics.
3. Given the risk profile of each financial institution, determine the required subject matter expertise needed and assure that it will be made available during the engagement.

4. Evaluate the strength of the management team. Is compliance and business process outsourcing a true core competency?
5. Is the technology, security, and communications support infrastructure adequate for the standards demanded by a financial institution?
6. Assess the maturity of the service providers business continuity planning. Is it well defined? Has it been adequately updated and tested? What is the impact on your organization of failures at the service provider?
7. Is your data adequately secured at the service provider? Are there jurisdictional restrictions to the transmission of client data? Is the legal structure sufficient in the jurisdiction in which the work is done?
2. Determine the characteristics of the target market. Is there an appropriate strategy for what may be termed a “replacement market”?
3. Does the management team have sufficient experience in the following:
  - a. Compliance subject matter expertise
  - b. Commercial software management
  - c. Regulator access and relationships
  - d. Audit
  - e. System, security, and communications infrastructure
4. Has a truly repetitive business model been established? Does it consider the need to base service on the particular risk faced by each client?
5. Is there adequate infrastructure to address the potential complexity of managing multiple software systems and their compliance databases across multiple versions? Additionally, a skill set must be developed that can create and change alert parameters, rules, and risk models.

## What Should Service Providers Look For

Service providers must recognize that the development of a comprehensive CPO function is not a simple migration from a consultancy practice. The level of complexity is far from trivial and the impact on a service provider of a regulatory failure by a client can be substantial. With this in mind, points to consider include:

1. Address the level of risk in offering outsourced regulatory compliance. A failure at a client will call into question the reputation of the service provider. The impact of reputational risk can impact all business lines. For this reason, risk assessment is essential.
6. Has a customer support function been established
7. How restrictive is the contract with the original software provider. Does the client have the rights to transfer access to the software product?
8. Is there adequate insurance coverage in place? If a client is sanctioned by regulators and liability is shared by the service provider, will insurance offer appropriate protection in that event?

## Conclusion

There are many other issues to consider; but this should provide a starting point for a comprehensive business plan.

## About Salvatore Cangialosi

Sal has held various senior management roles with both financial institutions and technology organizations. He brings over 30 years of experience shepherding advanced, industry leading technology. Most notably, Sal was the founder of Prime Associates, Inc; a pioneer and leader of regulatory compliance solutions for financial institutions. Currently, Sal is the president of The Josefa Group ([www.josefagroup.com](http://www.josefagroup.com)) a new services and software product organization dedicated to the changing needs of financial institutions. In this role, the basic principles of **Quality**, **Trust**, and **Value** will be followed to substantively redefine the enterprise risk management and regulatory compliance markets. Sal may be contacted at 732-470-4047 or [sal@josefagroup.com](mailto:sal@josefagroup.com).

## **Share Your Knowledge**

Knowledge sharing among peers is an essential service that helps us all navigate through our responsibilities in our risk and compliance professions. The Idola Report is dedicated to facilitating this valuable service. If you have information that you believe should be shared with other subscribers of the Idola Report or would like to submit an article for publication, please contact Sal Cangialosi at the address below.

## **About Idola**

Idola Infotech was founded in 2002 by a team that specialized in software product development and the deployment of complex technology projects. Its management team consists of banking experts, leaders of the regulatory compliance market, and senior technology specialists. They have developed commercial products for one of the largest vendors of financial services software. Project management experience has been earned across a wide range of financial institutions from some of the largest in the world to small community banks. Idola has implemented and deployed software solutions domestically and internationally earning its reputation for **excellence, reliability, and value.**

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