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The Idola Report

Information to Vision

Excellence, reliability, and value are core principles followed by Idola while working with its clients and partners. This newsletter will provide 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.

To subscribe, add a colleague, or to opt out of the Idola Report, simply send an email request to: mgmt@idolainfotech.com.

SAR Activity by the Numbers

The total volume of Suspicious Activity Reports continues to increase as has been the trend in prior years. Reports of Mortgage Load Fraud and Identity Theft continue to rise as the reports of Terrorist Financing have declined since 2004.

For the complete report, click on:
http://www.fincen.gov/news_room/rp/files/sar_by_numb_11.pdf

For a comprehensive report on the preparation, use, and value of SAR Reports, click on:
http://www.fincen.gov/news_room/rp/files/sar_tti_14.pdf

Money Laundering Rules for Hedge Funds

The Bush Administration has decided to drop proposed money laundering rules for hedge funds. As reported by the Washington Post, Senator Carl Levin was critical of this decision.

To read the Washington Post article, click on:
http://www.washingtonpost.com/wp-dyn/content/article/2008/11/03/AR2008110303001.html

The Idola Report

The Intersection of Risk, Compliance and Fraud

The organizations of many financial institutions have separated the functional management of risk, compliance, and fraud. However, in many respects these functions are complimentary and only with their common oversight will a financial organizations risk be appropriately mitigated. Consequently, software solutions have developed along the same dividing lines resulting in sub optimal support for these essential activities.

Recently, FINCEN Director James Freis spoke before the Florida Bankers Association discussing his views on the intersection of fraud and AML. For a copy of his remarks, click on:
http://www.fincen.gov/news_room/speech/pdf/20080923.pdf

MSB Registration

Money Service Business must renew their registration every two years by December 31st. A new FINCEN form 107 must be used as the older form is unacceptable. Further, the MSB Registration List for November is available and shows an increase of 814 MSB registrations since October, 2008.

For complete details, click on:
http://www.fincen.gov/statutes_regs/guidance/html/registration_renewal_deadline_notice.html

and

http://www.msb.gov/pdf/msb_registration_list.pdf

Internet Gambling

Effective 1/19/09, the Department of the Treasury and the Federal Reserve Board today announced the release of a joint final rule to implement the Unlawful Internet Gambling Enforcement Act of 2006. The Act prohibits gambling businesses from knowingly accepting payments in connection with unlawful Internet gambling, including payments made through credit cards, electronic funds transfers, and checks.

For complete details, click on:
http://www.federalreserve.gov/newsevents/press/bcreg/bcreg20081112a1.pdf

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*Bank
Supervision*

Marc R. Saidenberg has been named a senior vice president for the Federal Reserve's Bank Supervision Group. He will head the financial sector policy & analysis function. Mr. Saidenberg's appointment was made by the Bank's board of directors and is effective November 2008.

For further information, click on:
http://www.newyorkfed.org/newsevents/news/aboutthefed/2008/oa081117.html

*Business
Continuity
Planning*

Continuity Planning is well established at financial institutions. Further, the need to keep the plan up to date while addressing new threats is a normal practice. To facilitate the continuity plan update process, The Federal Reserve Bank of New York has issued a White Paper on Pandemic Preparedness Planning for Systemic Banking Organizations. Information in this White Paper will provide current efforts within the industry as well as guidelines that may be generally applicable to the overall Business Continuity Plan.

For complete details, click on:
http://www.newyorkfed.org/banking/circulars/12029.pdf

*Final CTR
Rules*

FinCEN announced final rules on Currency Transaction Reporting Exemptions. These rules simplify current requirements to exempt eligible customers from currency reporting requirements. The changes include elimination of the annual review for exempt depository institutions and US / state governments, the reduction in time to designate a payroll customer, and a revised (and decreased) definition of "frequent" transactions among other changes.

For complete details, click on:
http://www.fincen.gov/news_room/nr/pdf/20081204.pdf

and

http://www.fincen.gov/statutes_regs/frn/pdf/frnCTRExemptions.pdf

The Idola Report

The Importance of Data Collection for a Look-Back

By Mahesh Viswanathan, CAMS
Managing Partner
Idola Infotech, LLC.

The term "Look-back" in the regulatory world is usually meant for reviewing, analyzing and reporting the transactions of a financial institution for a specified duration of time due to observed internal control weaknesses. The Look-back is usually prompted by the regulators after an examination or is done voluntarily by the institution to be proactive and scrutinize the transactions for various reasons. The financial institution ("FI") discusses the parameters of the Look-back with the regulatory authority based on the deficiencies found during the examination, and usually involves

- Length of the Look-back period
- Type of transactions to be reviewed (e.g. Only Wire Transactions)
- Type of transactions based on customer base (e.g. Correspondent, Bank-Bank customers)
- Specific activity patterns around the type of transactions to be reviewed (e.g. cash-to-wire velocity, multiple originators wiring a common beneficiary)

A Look-back project in general has the following stages
- Defining the requirements of the Look-back
- Acquiring all related data for the specific duration
- Applying different rules based on a risk rating mechanism to identify possible problematic transactions and creation of cases based on the results.
- Investigating the cases that are generated
- Filing SARs for the identified suspicious transactions after investigation.
- Report the findings of the Look-back to the regulators and senior management

Hence, the FI should concentrate on the following
- Management and staffing the Look-back project
- Collect transactional and related data for the Look-back period
- Identify and acquire a suitable tool for performing the Look-back that would be capable of
  - Risk-scoring the customers
  - Handling large data volume

- o Analyzing the transaction for suspicious activity using methods like artificial intelligence, pattern matching and peering algorithms, and create relevant cases for investigation.
- o Proper case management functionality to investigate transactions
- Define case investigation and workflow procedures
- Define SAR filing procedures
- Follow a well-defined Quality Assurance process
- Involve the regulators in the process and keep them abreast of the proceedings of the Look-back
- Since the process of a Look-back is very expensive and could be long-drawn, the importance of acquiring the transactional data for the specified duration should not be neglected. This paper emphasizes the importance of data acquisition on a Look-back project.

Data Collection

Before the Look-back project goes ahead full swing, the project manager and key members of the management team should spend sufficient time in discussing the different data elements that would be required for the review.
The data collection process usually starts with identifying the data sources. The data for the Look-back could be from multiple source systems. Once all of the sources are identified, then the data needs to be extracted using custom scripts or other utilities to format data so that they can be consumed by the Look-back tool. Some Look-back tools might come with pre-built utilities to extract data from certain standard core banking systems.

Data Collection for the Look-back

For a Look-back project the following data is typically required:
- Customer and account information including KYC information that existed during the specified duration and within the scope of the Look-back
- Detailed historical transactional information for the specified period

The following are the potential challenges in acquiring this data

- **KYC information not available in electronic form**: Some FIs may not have a good KYC system or have acquired a KYC system recently and hence the customer/account opening information might not be available in electronic format. In this case the FI would need to make available the paper copies of the KYC/account opening forms so that the investigation can be carried out effectively.

- **KYC system does not have versioning capability:** The KYC system installed at the FI may not have the capability to store all the historical information of a customer. This is important when performing a Look-back as the investigators would like to see the information of the customer as of the time of the Look-back period. If this is not available in the source system, then the FI should acquire the paper copies of the customer information and submit them to the Look-back team to perform the investigation effectively.

- **Stale data:**

  o KYC data may be out of date
  o KYC information may be incomplete for certain customers
  o Account opening forms are not readily accessible, particularly if the accounts have since been closed.
  o Account relationships could have changed over the years

These issues could be related to more generic problems within the FI and need to be resolved separately from the Look-back project, possibly consuming a lot of time. For the purpose of the Look-back, the FI needs to allocate resources to update the customers, accounts and the related data in order to effectively investigate the cases.

- **Ensure *data accuracy***: Some of the data on the source systems might not be normalized or might not be consistently entered by all the users. Hence performing searches and look up on these data will not be efficient. Special care needs to be taken to identify these data elements during the extraction process and normalize the data where appropriate.

- **New *Transactional System implemented over the years:*** When a new transactional system is implemented within the FI, the following cases may arise:
  o The old system is archived and limited data is ported over to the new system. This data might fall directly under the purview of the Look-back project.

- o It is also possible that some of the data elements that are collected currently might not be available in the old system and vice-versa.
- o When the data is ported over to the new system there might be some important information that does not have a place holder in the new system and hence is not ported.

In all the above scenarios, the FI needs to review the data elements, understand the importance of these for the purpose of the investigation and allocate resources to extract the information to the Look-back tool.

- **Database *Backups***: Database backups are from an older version of the application and cannot be restored on the newer version for viewing the data. To resolve this, the FI may need to devise methods to extract the data directly from the backup database. The product vendors may be able to provide this service.

- **Completeness *of Data:*** The FI may have multiple transactional systems and the core banking system is only programmed to receive the minimal information for booking the transactions. For Example:

  - o Wire system may only pass the debit and credit entries to the core banking system whereas all of the beneficiary, originator and country information are not passed.
  - o Some Teller Systems do not have the capability to provide details on mixed transactions information resulting in incorrect coding of transaction types, amounts and details.

To address this, the extract program should get all of the additional data from the source system (Wire system, Loan system, ACH system etc.) Care should be taken to avoid duplication of data, since the same transactions will be available from the core banking system.

- **Multiple *Core Banking systems***: The FI might have multiple core banking systems due to geographic reasons, acquisitions etc. This could impact the data that needs to be collected for the Look-back. The FI may then have to choose to extract information from multiple systems and just perform one Look-back, or choose to perform separate individual Look-backs. The FI needs to review all of the possibilities based on cost and ease of data

extraction from the different core banking systems before proceeding with any approach.

- *Ability to extract the data:* Even if all of the information is available within the FI, the actual process of data extraction might become a challenge due to resource constraints, knowledge bank available, systems written in unsupported languages, timelines and many other factors. The FI should identify and enumerate all of these challenges and look at contacting vendors and third party contractors as an option to complete the Look-back project successfully.

Data collection during the Look-back

During the course of the Look-back project it is important to collect the following data to keep track of the progress of the project and also to report back to the senior management and the regulators.

- *Look*-back summary
    - Number of Customers
    - Number of Accounts
    - Number of Transactions
- *Case* Statistics
    - Number of cases created
    - Number of cases investigated
    - Number of SARs filed
    - Summary information of
    - Number of Customers, Accounts and Transactions for the review period
    - Number of cases processed by investigator by period
- *SAR* Statistics
    - SAR
    - Information on the SAR (i.e. category of suspicious activity reported, suspect information etc)
    - Number of SARs

The above data might be broken down by risk, customer types, location, department and period to provide more detailed drill down information.

Conclusion

Look-backs have become a part of life within the AML world. The Look-back will be more successful if you have good quality of data. There will be challenges, but as long as you identify and address them, you will most likely end up with good quality data. Applying the lessons learned from the Look-back exercise will help improve the general AML governance of the FI.

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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Technology Services for Financial Institutions
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SWIFT Support Services and SWIFT Message Director

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