



COMPLIANCE REIMAGINED



THE AML COMPLIANCE LANDSCAPE

Financial institutions seek enterprise-wide, cost-effective solutions



Earlier this year, the Financial Industry Regulatory Authority (FINRA) issued its annual Regulatory and Examination Priorities Letter to highlight the key issues that FINRA believes could adversely affect investors and market integrity in 2016, and thus are the focus of their examination and enforcement activities for the year. As stated in this Letter:

In 2016, FINRA will focus on four areas where we have observed repeated concerns that affect firms' business conduct and the integrity of the markets: management of conflicts of interest, technology, outsourcing and anti-money laundering (AML)¹.

The regulators' close attention to AML issues, in particular, has been well-known for some time. Yet, the fact that AML remains such a high priority for FINRA suggests that existing compliance solutions are not effective. Many financial institution executives fear that in the face of continued scrutiny of AML exposure, they lack sufficient staff, technology and budgetary resources to support their AML efforts at a level that will satisfy regulators' concerns.

Recent FINRA actions underscore the intense focus on AML issues. In May 2016, FINRA announced it had fined an investment management firm and its holding parent company a total of \$17 million for what FINRA described as, "widespread failures related to the firms' anti-money laundering (AML) programs." The firms were cited for, "failing to establish and implement adequate AML procedures, which resulted in the firms' failure to properly prevent or detect, investigate, and report suspicious activity for several years." A former AML Compliance Officer was also fined \$25,000 and suspended for three months.

AML COMPLIANCE: TOWARDS A MORE INFORMED PERSPECTIVE

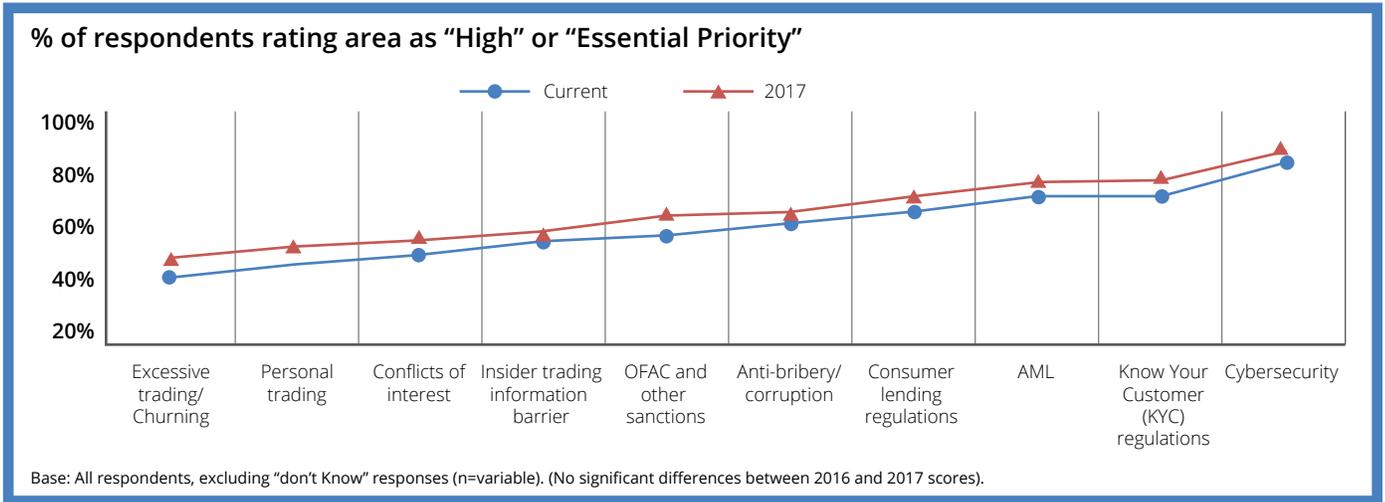
With AML compliance being a high priority, NextAngles believed it would be valuable to gain a deeper perspective on AML in the context of financial institutions' overall governance, risk and compliance (GRC) concerns and initiatives. Accordingly, with the assistance of SourceMedia, we conducted a survey² in May 2016 of 280 senior-level executives from financial institutions with \$3 billion or more in assets, who were active in the compliance function.

Some of the objectives of the survey were: 1) to understand financial institutions' GRC strategies, initiatives and staffing; 2) to identify AML compliance concerns and other related issues; and 3) to determine the extent to which the executives are aware of current technology solutions for AML surveillance and compliance.

Key findings of the survey included the following:

- ❑ The top three priorities for 2016 and 2017 among the largest majority of the respondents are cybersecurity, Know Your Customer (KYC) regulations and AML.
- ❑ With respect to AML compliance specifically, the top concern in the near term (12 to 18 months) is enterprise-wide compliance and integration.
- ❑ Respondents were also concerned that a significant portion of their compliance staff time was concentrated on functions such as data collection and data consolidation, leaving less time for higher-level data analysis.
- ❑ More than one in four respondents report they are using spreadsheets or manual documents for AML solutions. Many have and will continue to upgrade or purchase technology to reduce the risk of money laundering.
- ❑ About half of the institutions surveyed employ at least 1,000 compliance-focused staff. Yet, one in five believes that their compliance staffing levels are lower than what is needed.
- ❑ Nearly two-thirds of respondents expect to increase their overall AML compliance spending in the near term.

¹FINRA, "2016 Regulation and Examination Priorities Letter," January 5, 2016. <http://www.finra.org/industry/2016-regulatory-and-examination-priorities-letter>
²NextAngles Anti-Money Laundering Survey, 2016. <https://nextangles.com/downloads/download-info/nextangles-anti-money-laundering-survey/>

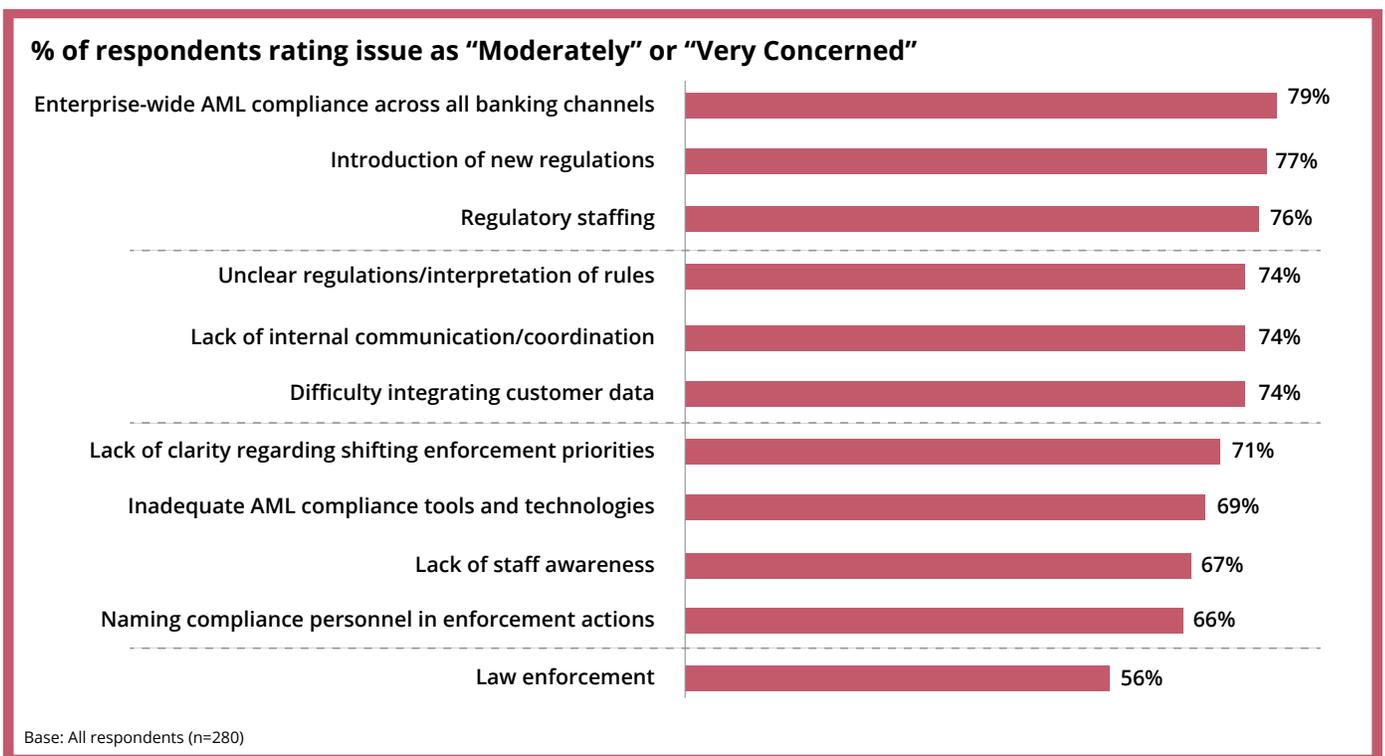


Cybersecurity, KYC and AML are top 2016 and 2017 priorities

In this paper, we have chosen to focus on two of the survey findings: 1) concerns regarding enterprise-wide compliance and the related challenges for AML compliance teams; and 2) compliance staff concentration on lower-value data collection and consolidation functions and the resulting burden on productivity.

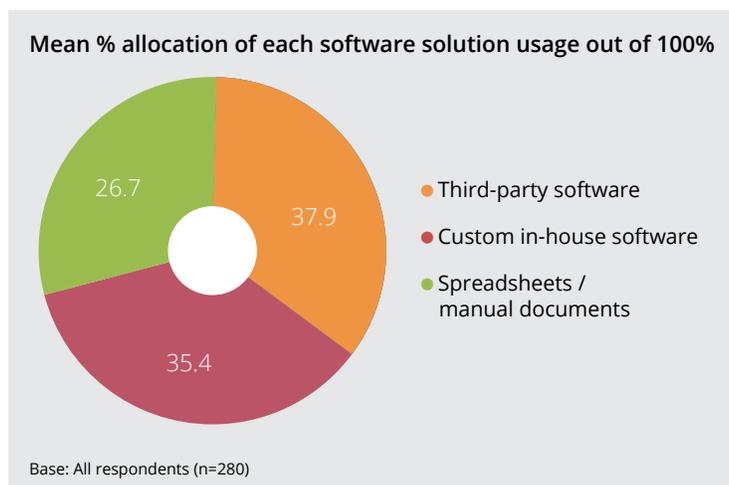
Enterprise-wide AML Compliance: A Challenging Target

Among the principal issues uncovered by the survey is the concern about enterprise-wide AML compliance by the financial institution executives. This was an issue about which 79% of the survey respondents described themselves as "moderately concerned" or "very concerned".



Recent regulatory actions clearly show that the industry's concerns about enterprise-wide AML compliance are justified. We have already noted that FINRA had fined an investment management firm and its holding parent company an amount of \$17 million. In the news release announcing the fine, FINRA noted that the firms', "significant growth between 2006 and 2014 was not matched by commensurate growth in their AML compliance systems and processes. This left... a patchwork of written procedures and systems across different departments to detect suspicious activity. The end result was that certain 'red flags' of potentially suspicious activity went undetected or inadequately investigated."

The enterprise-wide problem is exacerbated because many large financial institutions, especially those that have grown through acquisition, have multiple systems that are not fully integrated. Thus, in an investigation of suspicious AML-related activity, it can be necessary to compile data from numerous sources within the institution and across business lines, such as retail banking, lending, wealth management, etc.



For example, there may be instances where a corporate banking customer of a financial institution is also a private wealth management client. The issue of Ultimate Beneficial Owner (UBO) is a major point of emphasis for the regulators, but a manual system might not be able to identify the UBO in such a case.

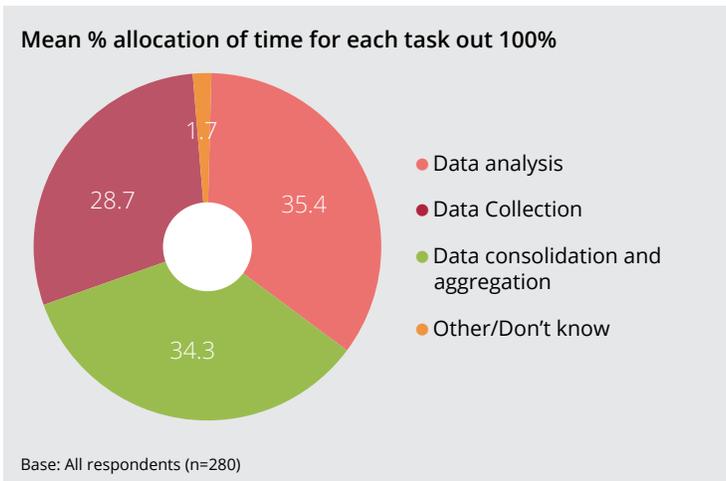
Despite the enterprise-wide AML compliance concerns shown by the respondents of the survey, many say they are hampered by antiquated technology. In fact, nearly 27% of the executives report that they are still using spreadsheets or manual documents in the AML compliance process.

Allocating Staff to AML Compliance: The Time/Value Disconnect

Given the lack of enterprise-wide integration of AML compliance systems, and the persistent use of manual solutions, another key survey finding is that relatively low value compliance functions place heavy demand on staff time.

When a financial institution's transaction monitoring systems generate alerts regarding potentially unusual activity, the compliance staff must scrutinize each alert, investigate the activity, and determine whether it is unusual and up to the level of being reportable in the form of a Suspicious Activity Report (SAR). All too often, this is a laborious and time consuming manual process.

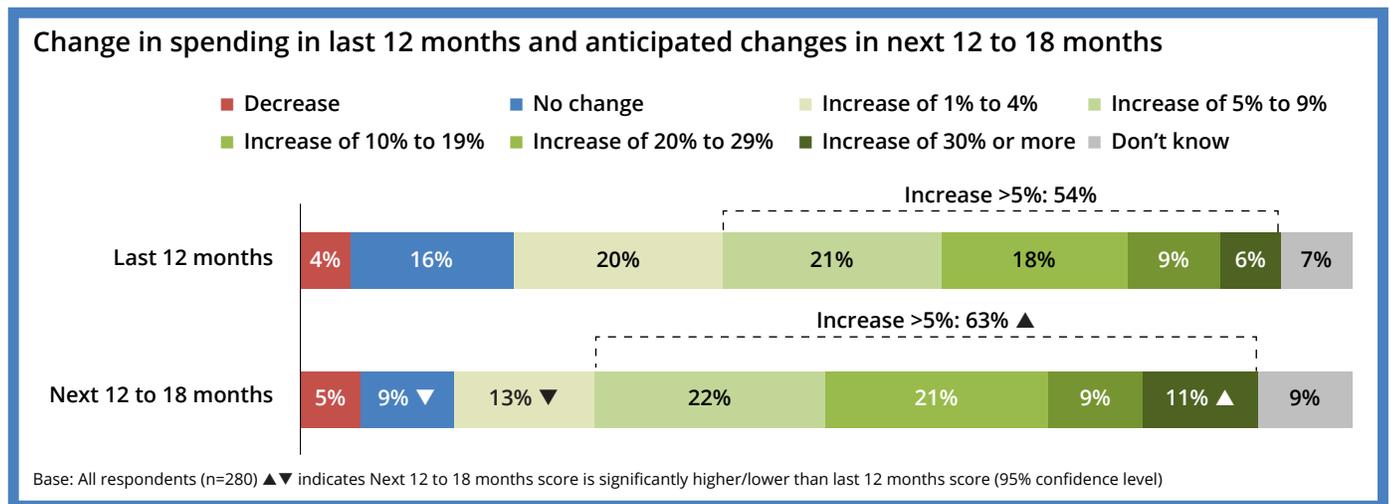
For this reason, the survey respondents reported that case analysis time is skewed toward data collection (an estimated 34% of staff time) and data consolidation (29% of staff time). This leaves very little time for more sophisticated and value-adding functions such as data analysis.



This high concentration of compliance staff time on lower value data collection and consolidation is largely due to a lack of advanced labor-saving technology, and this creates a double burden on financial institutions. First, it leads to institutions being chronically understaffed in comparison to the growing demands of AML compliance. Second, by causing staff to focus on data gathering instead of more knowledge-based functions, it creates an unrewarding work experience that can produce higher staff turnover.

These concerns are borne out by the survey findings. For instance, 62% of the respondents hired compliance staff in the past 12 months, and 55% expect to do so in the next 12-18 months.

The cost of compliance continues to rise. Around 54% of respondents said that their institution's AML compliance spending increased by 5% or more in the last 12 months, and 63% expect an increase of 5% or more in the next 12-18 months.



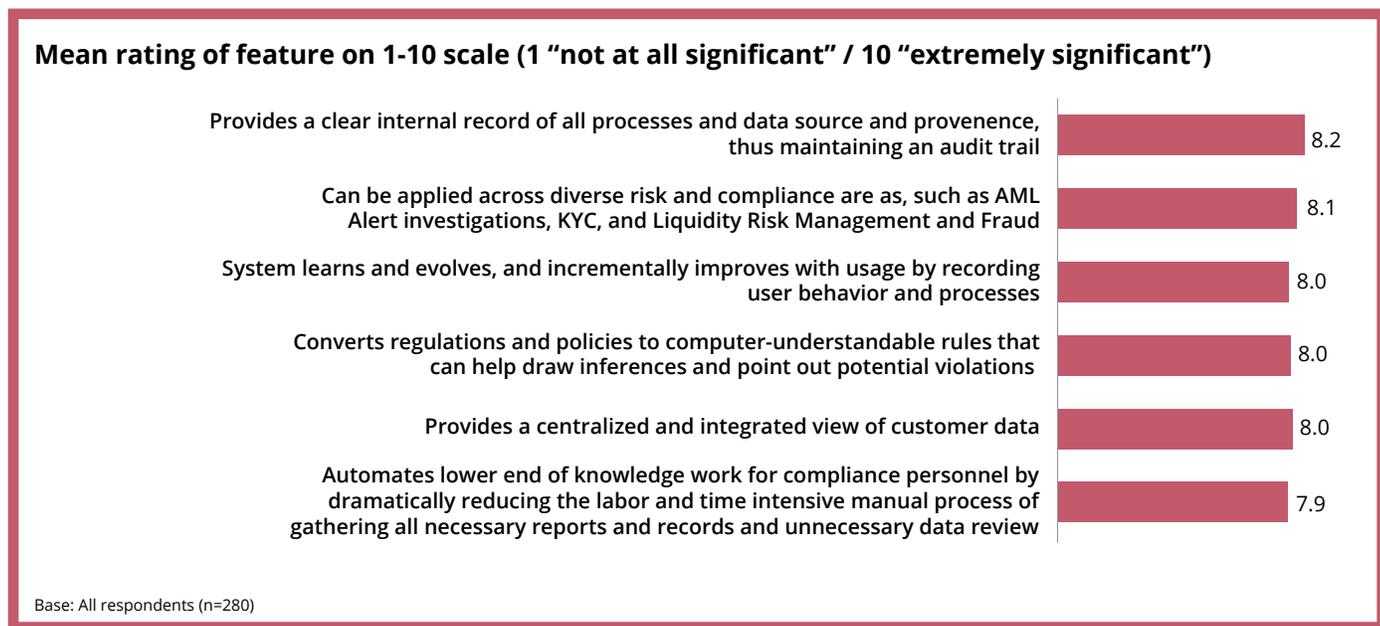
THE ROLE OF TECHNOLOGY IN AML SOLUTIONS

Many of the survey respondents agreed that advanced technology could address the enterprise-wide compliance and staff time allocation predicaments. At NextAngles, we believe the use of artificial intelligence (AI) can provide an effective solution, harnessing data streams to automate fulfillment of complex compliance needs on an enterprise-wide level, while helping to substantially reduce the risk, inefficiency and cost of compliance.

For example, consider that under many current systems, compliance staff must analyze unusual transactions by manually sifting through all known data about the account owner. In contrast, an AI system is based on a knowledge model that enables the system to “understand” and “contextualize” data. Thus, an AI system could examine a cash-intensive transaction between two parties in the context of whether the parties had a customer-supplier

relationship, or a related party relationship. In this manner, the system could better differentiate between truly suspicious activity and false positives.

AI systems can therefore be used to create domain-centric models that replicate the “real world” of banking and regulatory compliance. Such systems are able to perform tasks that would otherwise require human intelligence, such as pattern recognition and even lower-level decision-making. The survey respondents identified the key features they would seek in an AI-based AML compliance system.



It is important for an AI compliance solution to be able to recognize the types of activity likely to trigger an AML investigation, and search across multiple systems to assemble the data required for an investigation. The program should then analyze the data to detect patterns, gather evidence and validate conclusions. Finally, the AI program should automate report generation and provide evidence for every analysis step performed, so that a well-documented audit trail is compiled.

CONCLUSION

Clearly, the attention of financial institution regulators remains sharply focused on AML compliance. Senior compliance executives are concerned that the absence of integrated enterprise-wide compliance systems may leave their institutions exposed to the risk of AML violations, and also believe that the inefficiencies of manual systems impede the productivity of their staffs. However, they see a possible remedy for this situation in the new generation of artificial intelligence (AI) systems, which can be applied to key compliance processes and deliver smart, technology-enabled solutions.



Mallinath Sengupta

Chief Executive - Compliance Automation Program

Mallinath is the CEO for NextAngles, a CART-UP (Corporate Start-UP) unit of Mphasis that is developing AI-driven Smart solutions for Regulatory Compliance. He is a senior professional in the IT Industry with more than 28 years of experience. Mallinath has performed many different roles including sales, account management, pre-sales, domain/practice management.

ABOUT NEXTANGLES

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NextAngles is an Mphasis venture developing a new breed of disruptive solutions for regulatory compliance and risk management. Our vision is to make compliance easy through a highly automated and knowledge-centric approach that provides a centralised and integrated view of data. The NextAngles solution suite can be applied across diverse risk and compliance areas, such as AML Alert Investigations, KYC, Trade-Based Money Laundering, Financial Crimes Investigation and Liquidity Risk Management, to create a smart compliance experience. This disruptive approach not just reduces compliance burden, but also increases the speed of response to business and regulatory changes significantly. In addition, it scales to meet the most demanding enterprise-class financial regulatory requirements.

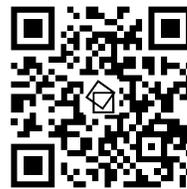
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