METAVANTE WHITE PAPER

Utilization of Rules in Anti-Money Laundering Compliance Monitoring Programs

Chris Price
Compliance Consultant

Metavante®

1-800-822-6758

Background Information

The financial services industry is under unprecedented regulatory pressure to improve upon and expand monitoring and surveillance for the purposes of preventing and detecting money laundering, terrorist financing, and internal fraud or embezzlement. Title III of the USA PATRIOT Act significantly expanded the definition of a "financial institution," which includes, but is not limited to, banks, broker-dealers, money service businesses, investment bankers, futures commissions merchants, and insurance companies. These financial services players face varying money laundering risk exposure and, as such, require monitoring capabilities that fit their unique business structure. Rules-based monitoring tools, in conjunction with sound risk practices and compliance programs, can be effective in achieving optimal monitoring that is adapted to specific business environments.

Rules-Based Monitoring

Rules are designed to monitor customer activity using methods outside the scope and ability of profile-based monitoring. They can meet any monitoring need as long as sufficient data is available to support the context of the program. In building or choosing rules, the Compliance Risk Manager or Anti-Money Laundering (AML) Officer must look at various risk factors, many of which would already have been considered in the institution's Enterprise-Wide AML and Customer Risk Assessments. These risk factors include:

- What businesses the financial institution is engaged in
- What product lines/services are offered
- What jurisdiction the financial institution is located in
- Customer base (type of customers, i.e., domestic individual, non-resident aliens, foreign banks, etc.)
- Client locations (are they all domestic, foreign, or a combination?)
- Politically exposed persons among the client base
- Volume of activity for various products, services, or customer types
- Customer/Account population

After considering these factors, the types or categories of rules that fit the institution's risk profile can be chosen.

SCENARIO 1: ABC BANK

The first hypothetical scenario involves ABC Bank, a $2 billion retail/small business bank located in Miami, Florida. Many of the bank's customers are citizens of Central and South America with net worth ranging from $500,000 to $2,000,000. In addition, ABC Bank also services the accounts of some local money service business (MSB) customers engaged in wire remittances, mostly to the Caribbean and Central/South America.

Since ABC Bank is located in a High Intensity Financial Crime Area (HIFCA), ABC is already considered to be a high-risk bank. The MSB cash and international transfer activities and foreign customer base significantly increase ABC's exposure for potential money laundering. The bank's monitoring and surveillance program must take into account these particular risks, which are inherent in its location and customer base.

Due to its retail customer base and cash activity, ABC is particularly exposed to the placement phase of money laundering, in which cash proceeds that have been derived from an illicit source are first introduced into the financial services industry. The rules utilized by a monitoring system should include placement phase rules for the detection of cash structuring or smurfing, which is the deposit or withdrawal of funds that individually fall below the IRS reporting requirement for cash amounts greater than $10,000, but in the aggregate, exceed that reporting threshold.

Placement rules should be able to detect deposit structuring by one or more individuals at various bank locations within a day or over time; notably this can also include ATMs. Large wire remittance customers, such as MSBs, will deposit cash more often and in greater volumes than typical customers. Rules to detect large cash placements, using various methods and locations, in a single day, week, or month, would therefore be well-suited for the monitoring purposes of ABC.

SCENARIO 2: XYZ BANK

In contrast to ABC Bank, XYZ Bank is a $22 billion wholesale banking institution based in Los Angeles, involved in trade finance, construction, commercial lending, and foreign correspondent banking. XYZ does not service individual customers and does not accept cash transactions. Deposit accounts consist of commercial demand deposit accounts and commercial time deposits. Wire transfer services are provided for loan disbursements, letter of credit settlements, and dollar clearing for foreign bank customers. XYZ presents a risk profile that varies significantly from ABC, because placement phase money laundering is not a plausible consideration given its wholesale business mission and lack of cash transactions. However, XYZ's foreign respondent bank customers, as well as its commercial lending profile, expose it to the layering and integration phases of money laundering.

In the layering and integration phase, illicit funds that have already been introduced into the financial services industry are "layered" through other transactions, such as wires or the purchase of products for import/export. Effective rules-based monitoring for XYZ will reflect wire transfer monitoring, loan repayments, and volume detection in correspondent bank accounts to detect nesting, the use of the correspondent account by foreign banks other than the bank that holds the account with XYZ.

Different Types of Institutions, Different Types of Rules

Rules vary in complexity, depending upon the monitoring needs of the financial institution. An insurance company, for example, will require rules that consider the time frame between the establishment of an insurance policy and the termination of that policy by the customer. Savvy money launderers will sacrifice a portion of the principal amount to receive a check well in advance of the due date of the policy in order to "clean" the illicit funds with a check from a respectable and established insurance company.

High-volume retail banks need rules that compare the initial deposit date and amount to both the date of subsequent withdrawals and the amounts as a percentage of the initial deposit, otherwise known as velocity rules. All banks should consider internal control rules to monitor for possible embezzlement, such as rules that detect activity in dormant and closed accounts.

The securities market, which is particularly vulnerable to money laundering for a variety of reasons, including the high-pressure commission environment and the rapid pace of transaction activity, has specific monitoring concerns. For example, broker-dealers and other securities market players will require rules that monitor for offsetting transactions, wherein the launderer, in an attempt to avoid the banking industry and its more well-developed compliance programs, opens multiple accounts across brokerages, with the intention of taking long positions in one account and short positions in another. This gives the appearance of legitimacy because there is active trading, but profits and losses are offset. The funds are now placed and layered, and ready for wire transfer or withdrawal at a short-term future date.

Electronic Monitoring Solutions

Software solutions can provide various categories of rules that permit financial institutions to input varying parameters, depending upon the institution's unique business profile. Vendors can present and categorize rules from different perspectives, as they typically carry sets of conventional rules that can be adjusted. In addition, if a customer identifies a particular monitoring gap that is not accounted for in conventional rules, vendors can build a rule to suit the specific monitoring needs of the customer – and then add that rule to the arsenal of tools available to all customers.

For example, rules can be based upon activity type (cash-based rules or wire rules), along industry lines (retail bank rules, wholesale bank rules, and insurance rules), and for a specific monitoring purpose (placement phase rules, layering phase rules, rules to detect terrorist financing, and internal control rules). Rules can be parameterized for consistency with regulatory requirements or best practices, thus allowing for minimum transaction amounts and counts, specific countries involved in transactions, number of days between activities, and percentage differences between activities, to name a few. For example, IRS regulations require cash reporting for any dollar amount greater than $10,000, and structuring rules would be parameterized to detect attempts to fall below the $10,000.01 radar.

The following chart provides some examples of typical rules and the financial services players that can utilize them:

Rule and Short Description	Function	Sample Categorization	Financial Services
Multi Cash-In/Cash-Out – Detects structuring of cash deposits and withdrawals, smurfing, and avoidance of IRS reporting requirements. Can be parameterized to reflect international standards.	Detects multiple cash deposits or cash withdrawals by customer or account across branches. Allows for input of number of days and minimum dollar thresholds per transaction. CTR amount of $10,001 or 15,000 Euro.	Cash Rule, Placement Phase Rule, Structuring Rule	Retail Commercial Banks
X Days Between Deposit/Withdrawal – Flags accounts where there is rapid movement of funds into and out of the account.	Detects activity in an account where a large percentage of a deposit of cash, check, wire, or other credit is debited from the account in a short period of time. Allows for input of activity types, percentage difference of credits vs. debits, and number of days.	Velocity Rule	Banks, Broker-Dealers
Multi Originator to Beneficiary – Flags transactions that have a common point of origin, such as region, accounts, or institution, to a common beneficiary.	Detects a many-to-one combination of transactions. Can red flag layering phase money laundering and possible terrorist activity. Originators and beneficiary can be customers of the financial institution, or parties to transactions in which the financial institution acts as an intermediary. Allows input of minimum transaction count and minimum transaction amounts, region, or country.	Wire Rule, Layering Phase Rule, Terrorist Finance Rule	Banks, Broker-Dealers, Money Remitters

Metavante®

Policy X Days In/Out – Monitors loans taken out within a specified number of days of policy establishment, as well as policies that are terminated within a specified number of days from policy establishment.	Detects activity in an insurance policy where a specified percentage of the principal amount is taken out as a loan in a specified number of days compared to the date in which the policy is established.	Insurance Rule, Velocity Rule	Insurance Companies, Banks
Cash Collateral Loan – Monitors for credit accounts that are cash collateralized.	Alerts compliance personnel to any extension of credit, including revolving credit and insurance policies, which are collateralized by cash.	Cash Rule, Insurance Rule	Banks, Insurance Companies
Travelers Check In/Out – Monitors for the purchase and sale of negotiable instruments with cash.	Alerts compliance personnel to the purchase with cash of monetary instruments aggregating to $3,000 or greater. Also detects multiple, sequentially numbered negotiable instruments deposited for cash. Allows for input of minimum count and minimum amount.	Structuring, Placement Phase Rule, Layering Phase Rule, Cash Rule	Money Service Businesses, Currency Exchangers, Banks
Dormant Account – Monitors for activity in dormant accounts.	Alerts compliance personnel to accounts that have been dormant for a specified number of days that suddenly have activity.	Internal Controls, Embezzlement, Terrorist Financing	Banks, Broker-Dealers
High-Risk Country – Monitors for activity originating from or destined to a country specified for monitoring.	Detects activity in countries deemed by compliance personnel to be of high risk. Can include USA PATRIOT Act Section 311 “primary money laundering concern” jurisdictions.	Wire Rule, Terrorist Financing	Banks, Money Service Businesses, Broker-Dealers, Insurance Companies, Credit Unions, Investment Bankers

These are just a few examples of the many rules that can, in addition to profile-based monitoring, provide the tools necessary to fine-tune a financial institution’s AML monitoring program.

For More Information

Metavante Risk and Compliance Solutions assist financial institutions in developing efficient and sustainable risk programs. With compliance consulting from Metavante Risk and Compliance Solutions, financial institutions gain the expertise to help them evaluate the strengths and weaknesses of their AML efforts, define enterprise-wide and customer-level risk models, and gain a solid business perspective during the implementation of AML software solutions. To learn more, call 1-800-822-6758 to talk with one of our consulting professionals, or visit us at metavante.com.

Metavante®