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Great Expectations: Establishing an AML and Sanctions Risk Assessment Framework to Support Sustainable Risk Management

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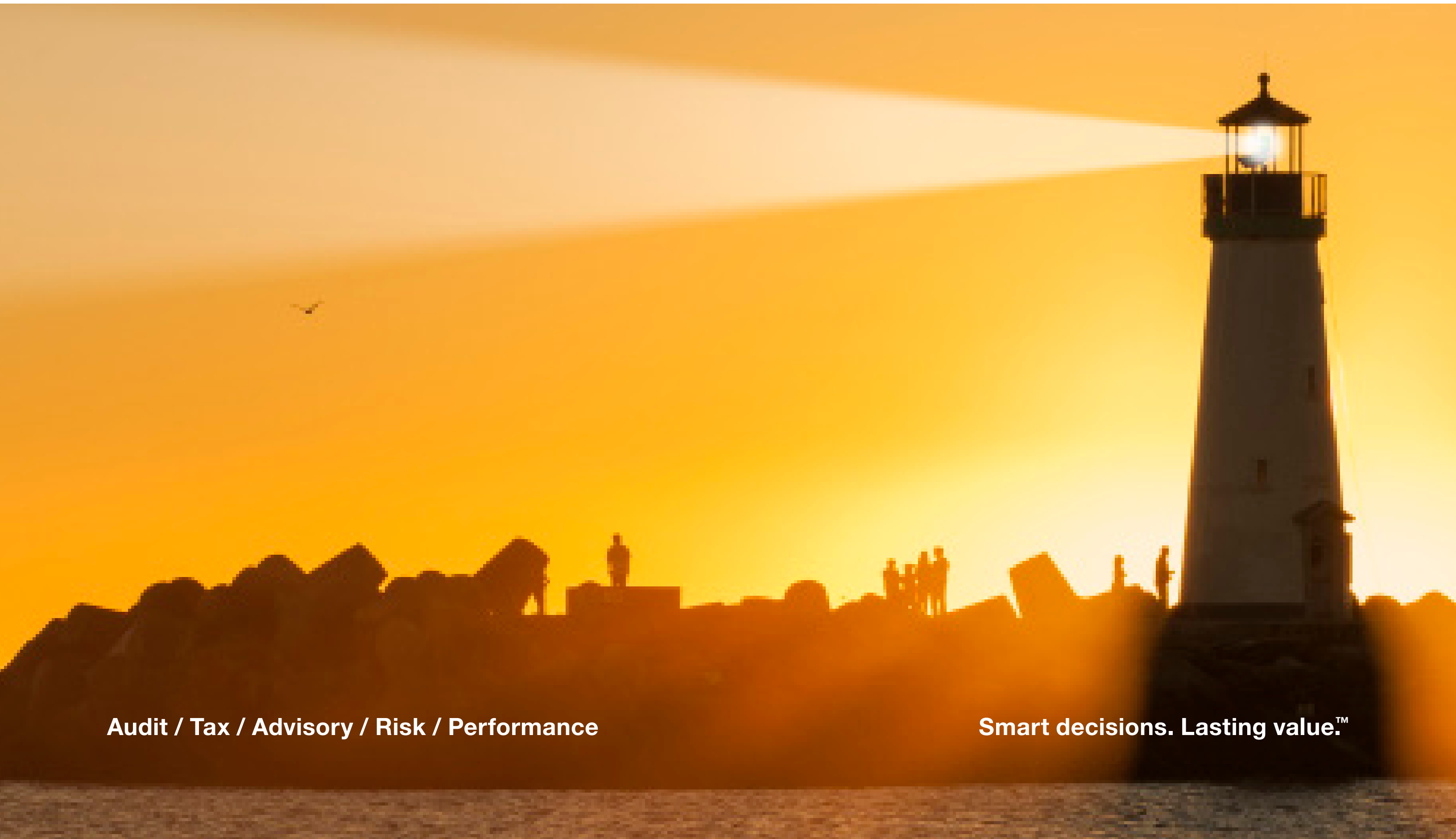

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The need for financial institutions to assess and accurately document their anti-money laundering (AML) and sanctions risk is nothing new. However, in addition to meeting the expectations of regulatory scrutiny, institutions should think more strategically about what their risk assessment results tell them about their organization so that leadership can be better prepared to leverage valuable business intelligence in order to make informed and sustainable risk management decisions.

An AML and sanctions risk assessment is the key to determining where money laundering and terrorist financing risks exist in an institution. By critically analyzing the results of an AML and sanctions risk assessment, an institution can better understand:

- Trends and change management
- What the risk levels are for the institution
- How those levels compare to the institution's risk appetite and what was expected
- Whether a variance exists and, if so, how it might be resolved
- What steps might need to be taken to develop and execute corrective action plans for risk remediation

This deeper level of understanding enables an institution to develop tactical road maps to address identified gaps or weaknesses that might exist in the control environment, and understand the root causes of risk to allow for targeted and strategic planning. The valuable information gained through a comprehensive risk assessment not only assists an organization with informed, risk management decision-making, but also can enable an organization to realize increased revenue recognition by tying risk levels back to the risk appetite.

Why This Matters

In today's constantly and rapidly evolving AML and sanctions regulatory environment, a comprehensive and structured AML and sanctions risk assessment process alone is simply not enough. Institutions must look beyond just using a properly executed and robust methodology. They must establish the ability to extract meaningful information while reducing surprises, which enables informed decision-making about sustainable risk management. An effective AML and sanctions risk assessment allows management to:

- Have direct insight into the presence and impact of risk
- See where the institution's weaknesses might be and devise a road map to strengthen those deficiencies
- Understand the trends and direction of risk of their institution, and make strategic and tactical decisions on risk remediation activities
- Demonstrate risk management that is fully integrated into the risk appetite, organizational strategy, culture, systems, and processes of a financial institution

This type of AML and sanctions risk assessment framework provides financial institutions subject to regulatory standards and supervisory expectations with a road map to support sustainable risk management. Using a structured approach to institute, execute, and maintain ongoing AML and sanctions risk assessments clarifies the concept of risk management and facilitates the aggregation of accurate, timely intelligence, which enables informed decisions throughout the organization. The information that an organization gains about its own areas of AML and sanctions risk leads to actionable business intelligence. In addition, this information better positions the organization not only to retain more of its customers, but also to identify which customers or products/services might pose an increased money laundering, terrorist financing, or sanctions risk. Ultimately, this valuable business intelligence can also lead to increased revenue as well as identify new business opportunities for further growth.

Risk Assessment Objectives

The objectives of an AML and sanctions risk assessment process must be well conceived from the start, and the process must be clearly communicated to management and individual stakeholders. By establishing the framework and implementing its process, the assessor (or the person or team responsible for the AML and sanctions risk assessment) aims to:

- Define the governance structure of the institution
- Determine an institutional baseline for efficiently and consistently measuring AML and sanctions risk throughout an enterprise
- Identify inherent risks across the lines of business of the institution and its subsidiaries
- Use quantitative and qualitative data to support risk determination
- Identify direction and trending of risk
- Provide a structured, risk-based approach to developing a corrective action plan tailored to mitigate the money laundering, terrorist financing, and sanctions risks throughout the institution when a gap in required controls or residual risk that exceeds established tolerance has been identified

A Carefully Designed Approach

With these objectives in mind, the assessor should detail a carefully designed approach to execute an AML and sanctions risk assessment. The assessment should encompass all the institution's in-scope lines of business, applicable support areas, and subsidiaries. Once identified, the targeted areas of risk are aggregated in order to define individual AML and sanctions risk factors, risk categories, and the risk of the overall enterprise. Executing the AML and sanctions risk assessment should include taking the following actions:

Understand the scope of the assessment and the business. To thoroughly assess the financial institution's appropriate level of risk and conduct a process that yields valuable results, the assessor first must understand the institution's business and define the scope of the AML and sanctions risk assessment. To understand an institution's business, the governance structure must first be defined to understand the roles and responsibilities of management, lines of business, and other associated parties.

Identify key risk indicators to measure risk. Once the scope of the AML and sanctions risk assessment has been defined, it is necessary to determine and evaluate the institution's key risk indicators (KRIs) to support risk scoring. To do so, the assessor determines the in-scope risk factors and KRIs used to support the inherent risk scores for each of the applicable risk factors. During this phase, it is also critical to identify the data necessary for supporting the evaluation of risk. The use of data analytics lends credence to the scoring and evaluation of risk and makes the risk assessment efficient, quantifiable, and repeatable. When examining an institution's AML and sanctions risk, an assessor should make sure that the risk factors under consideration align with guidance from the Federal Financial Institutions Examination Council, which provides guidance on AML through its Bank Secrecy Act/Anti-Money Laundering Examination Manual.

Measure and evaluate controls. After inherent risk has been calculated, the assessor evaluates the identified controls to determine their ability to mitigate identified risks across the organization. This evaluation includes the design and operational effectiveness of the identified controls, which is critical to the understanding of how effective a control is and whether there might be a gap in the control environment.

Evaluate residual and enterprise risk. Once the controls have been evaluated, the next step is to evaluate the residual risk. Doing so requires determining the amount of risk that remains when control mitigation is applied against inherent risk. By calculating the residual risk score for each risk factor, the assessor is able to determine more accurately the effectiveness of the existing controls. This information allows the assessor to understand if, and in what areas, the risk level exceeds the institution's risk appetite.

Develop a plan and maintain the risk assessment. After a financial institution's risk has been determined and evaluated, the next step in the AML and sanctions risk assessment framework is to develop a plan and road map moving forward. The risk assessment process is not a one-time exercise, and regulators expect a strong

response from management after the identification of risk factors and control gaps that require attention and perhaps enhancement. This road map demonstrates an understanding of the risks that have been identified at various levels (for example, risk-factor, line-of-business, and enterprise), and then prioritizes the necessary plans to strengthen the financial institution's overall risk management program.

By following a structured and repeatable approach, financial institutions are more likely to meet their business objectives; understand where money laundering, terrorist financing, and sanctions risks exist in their institutions; determine how effectively the current controls mitigate those risks; and identify any enhancements that might be required.

The Importance of Communication

A financial institution's AML and sanctions risk assessment establishes the foundation for the governance and oversight of money laundering and terrorist financing risk management, and it demonstrates an enterprise-based culture of support for, and promotion of, risk management initiatives. As such, it is crucial that any changes to the risk profile are communicated in a timely manner to both the institution's management and its board of directors to see that these changes align with the institution's overall risk appetite. Transparent and timely communication of risk assessment results empowers management to make informed decisions on the allocation of financial and personnel resources for effective risk management, and can allow for increased revenue recognition for the organization.

Learn More

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