



Actuarial Society of South Africa

ERM Seminar

Integrated Financial Crime Risk Management

May 2013



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Background:

Marc, a South African Chartered Accountant, is a Partner in the Financial Services Capital Markets team of Deloitte South Africa and has 20 years of experience working in professional services at Arthur Andersen, E&Y and Deloitte. He has recently transferred over from the UK , where he has spent 18 years working with a wide range of clients, in both retail banking , asset management and insurance. He has worked extensively on financial crime related projects over the past 12 years including a number of large Banking AML reviews.

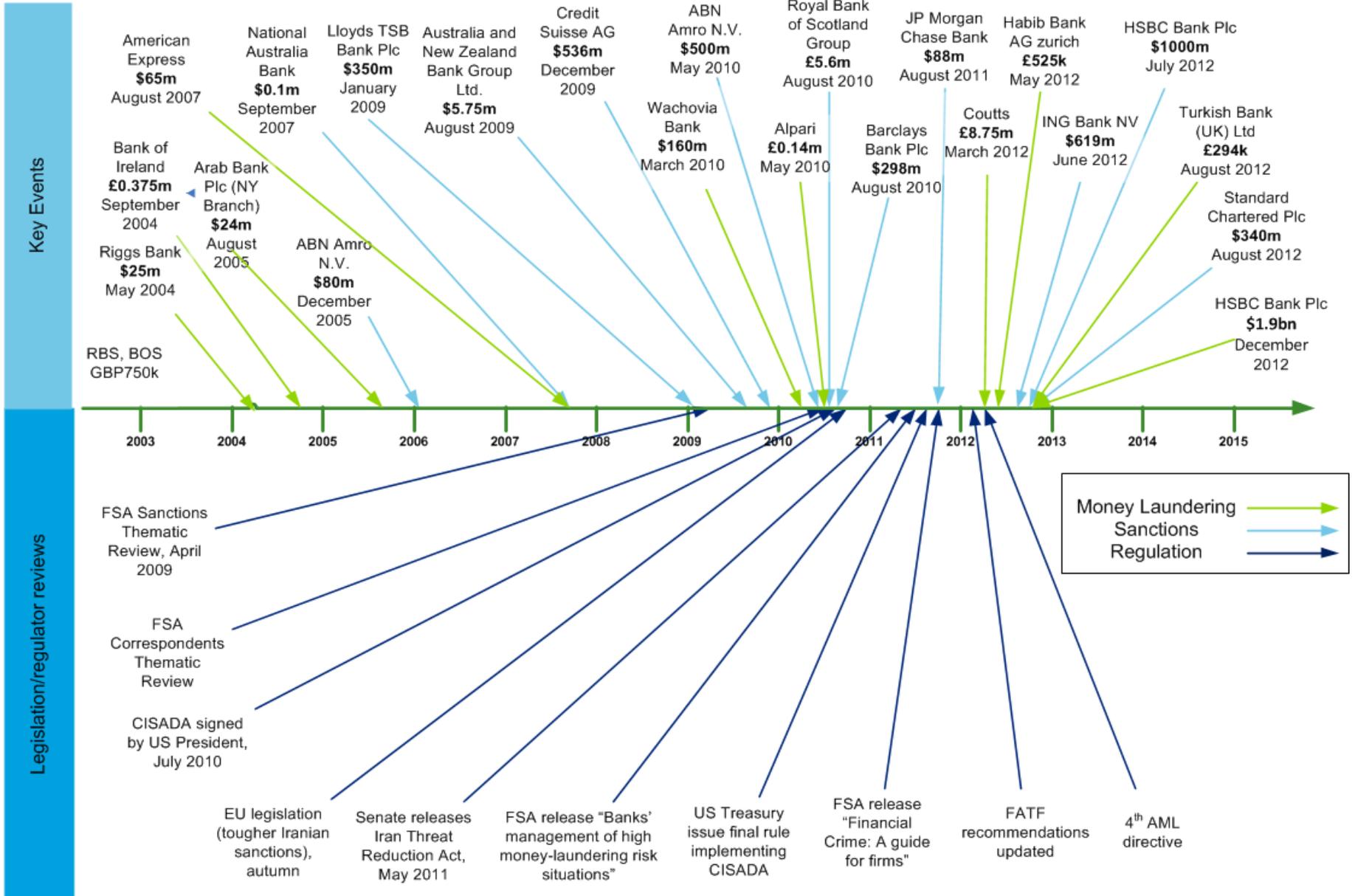
Relevant experience:

- He was seconded to a large bank as acting head of AML for 9 months and has a led a number of financial crime projects focused on improving the effectiveness and efficiency of financial crime risk management.
- Marc led the internal audit review at Bank of Scotland in 2001 that resulted in the first KYC fine in the UK.
- He has supported clients address remediation issues ranging from CDD to the wider elements of the Financial crime risk management (Governance, polices, procedures, MI, Training, Risk Based Approach, Systems / Tools and Data).
- Marc has developed the Deloitte Integrated Financial Crime Risk Management Framework that assists clients address Financial Crime Risk in a consistent and joined up way across all areas of financial crime.
- He is current supporting a number of banks address Financial Crime issues raised by the central regulator

Agenda

- 1 Financial Crime – what is the issue?
- 2 What do we mean by Financial Crime?
- 3 Integrated Financial Crime Risk Management
- 4 Regulatory developments
- 5 Case Study – HSBC
- 6 Selection of other recent cases
- 7 Focus on KYC – Customer Centricity
- 8 Top 10 industry issues

1. Financial Crime Risk Management? What is the issue?



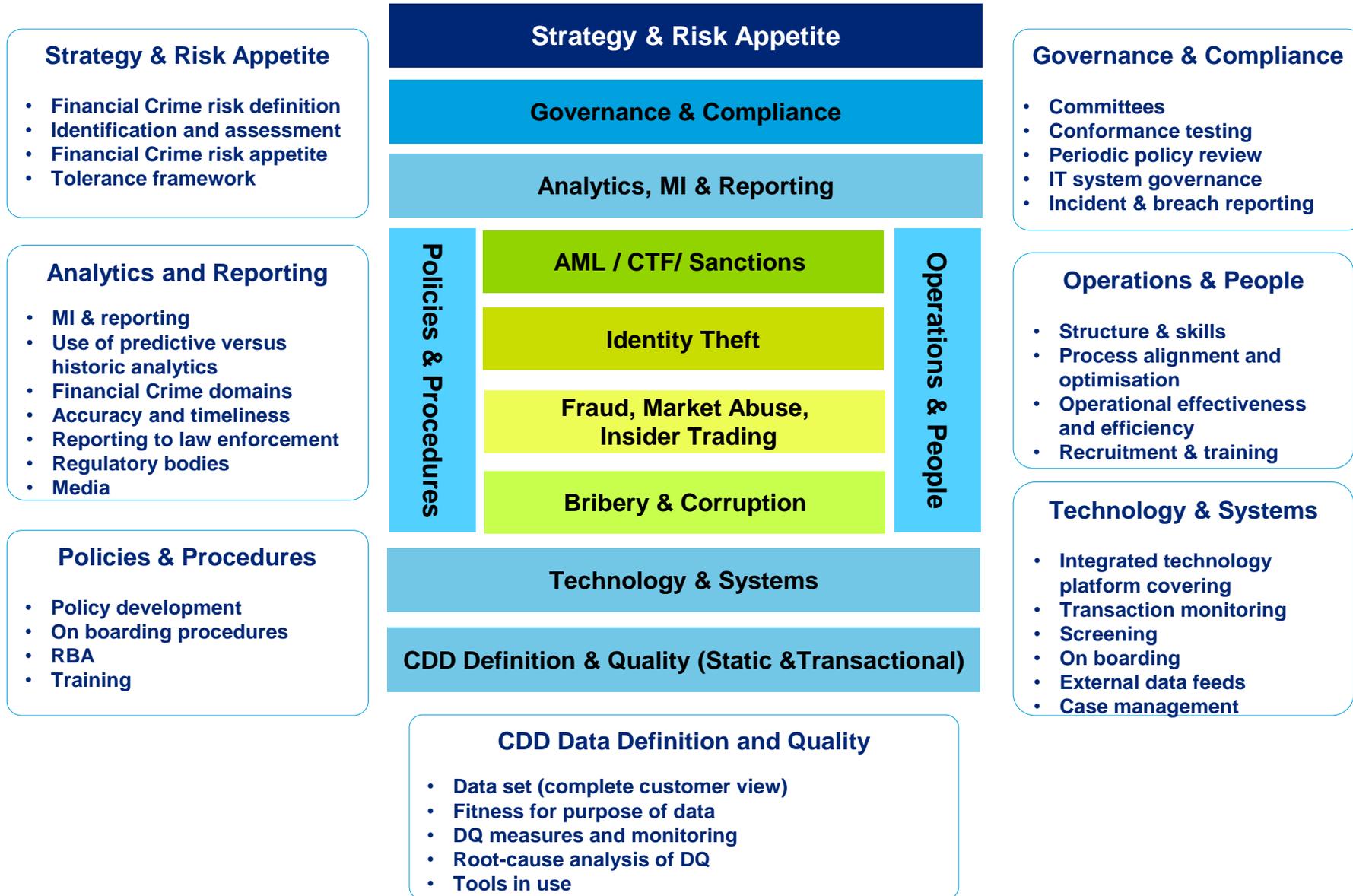
2. What do we mean by Financial Crime?



- Variety of types of crime – but many interconnected
- Bribery ⇔ PEPs
- Market Abuse / Insider Trading ⇔ Terrorist Financing
- ID theft ⇔ impersonation fraud ⇔ Money Laundering
- Tax Evasion ⇔ Money Laundering
- Fraud ⇔ Money Laundering ⇔ Terrorism

How does this apply to insurance companies / asset managers?

3. Integrated Financial Crime Risk Management Model



4. Financial Crime regulatory developments?

- Revision to FATF 40 Recommendations
- 4th AML directive
- JMLSG – Update to guidance notes
- FSA – “ Financial Crime Guide for firms”
- Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 (“CISADA”)

5. Lessons from HSBC - Introduction

Permanent Sub-Committee on Investigations – HSBC Case Study

- Weak AML program
- Many jurisdictions across the world that have:
 - weak AML controls
 - high risk clients
- Acquired a number of affiliates especially in Latin America
- HSBC affiliates provide foreign financial institutions with access to US clearing and financial system
- HBUS has to interact with its affiliates around the world
- Case study to focus on AML and terrorist financing issues that still affect banking in US

5. Key areas of challenge

Area	Details
Long-standing severe AML deficiencies	<ul style="list-style-type: none">• dysfunctional AML monitoring system (and alerts backlogs),• insufficient staffing,• no country / client risk assessment• late / missing SARs)
Servicing high-risk affiliates	<ul style="list-style-type: none">• correspondent banking relationships opened with no risk assessment• failed to spot high risk affiliates
Circumventing OFAC prohibitions	<ul style="list-style-type: none">• Manipulation of Iranian transactions• Affiliates acted to circumvent OFAC filter
Disregarding terrorist links	<ul style="list-style-type: none">• Accounts provided despite links to terrorists
Clearing Suspicious bulk travellers cheques	<ul style="list-style-type: none">• Cleared \$290m sequentially numbered, illegally signed bulk travellers cheques obtained in Russia
Offering bearer share accounts	<ul style="list-style-type: none">• Over 2000 high risk bearers shares

6. Other key cases?

1 Coutts Bank – £8.75m – widespread failings in AML programme

2 AON

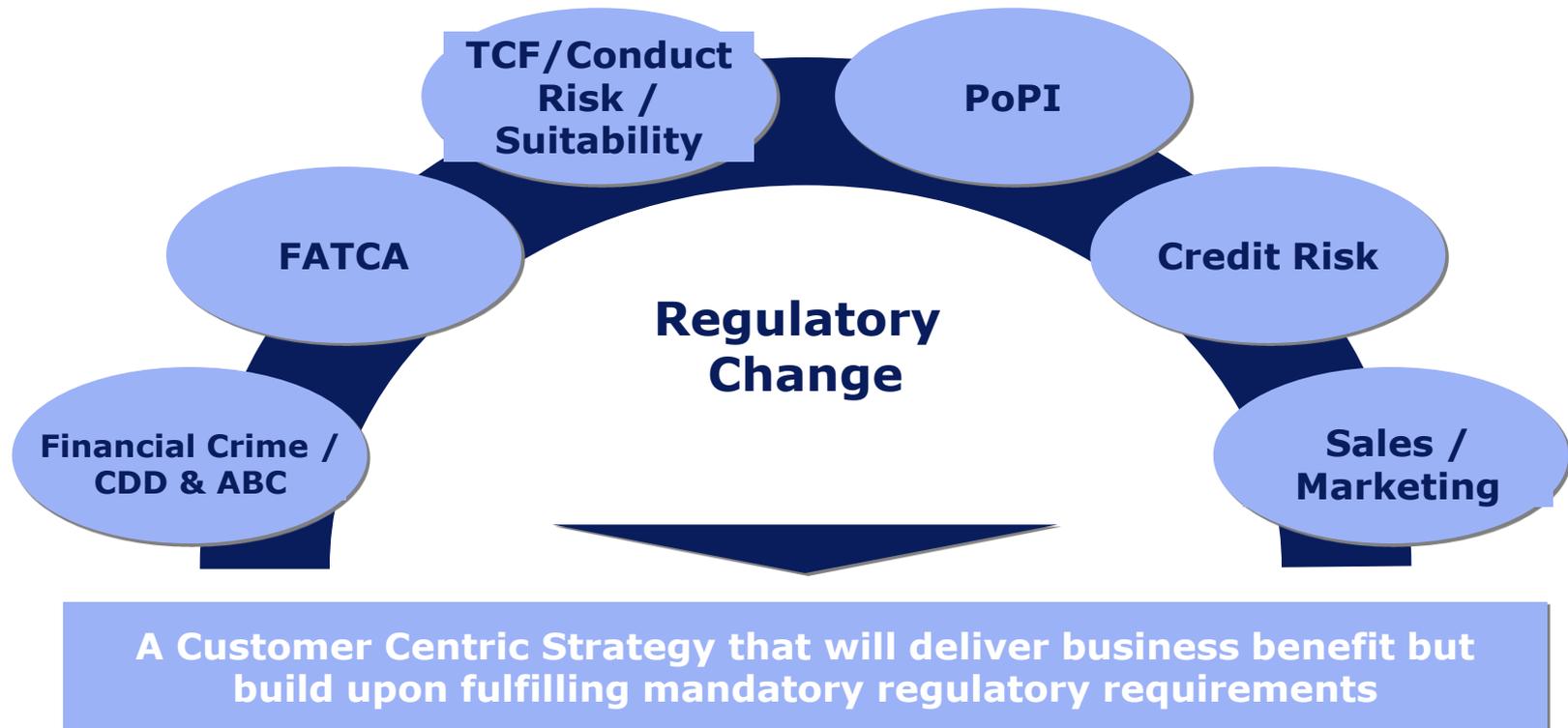
- Jan 2009, Aon was fined £5.25 million by FSA for inadequate bribery and corruption controls,

- In Dec 2011, Aon Corporation paid a \$16.26 million penalty to the SEC and DOJ for violations of the US (FCPA)

3 RBS – Sanctions Compliance - £5.60m

7. Drivers of change to Customer Data

A variety of regulatory changes is driving the need for new, revised or refreshed Customer Data. Are you seeking to obtain this data in a consistent, integrated manner as well as identify business opportunities from using this customer data.



8. Current industry hot topics

Core areas of focus

- 1** **KYC Data Quality**

Poor DQ (Data Quality) is a universal challenge. Poor DQ for Financial Crime increases the risks of compliance failure and regulatory action and reduces the ability of the client to leverage Financial Crime data for other purposes. E.g. When using KYC data for marketing purposes. The FSA have said that "... *Firms should also be able to demonstrate to the FSA that its data governance procedures both currently and in the future are sufficient to maintain the quality of the data to the standards applicable to their data.*"
- 2** **Sanctions Optimisation**

Testing continues to be a live issue for all FIs to help tune existing systems and demonstrate evidence based regulatory compliance. We can test and measure both efficiency and effectiveness. We have been successful through regulatory reviews but BAU activities around efficiency as much as effectiveness are a key focus. Efficiency plays resonate with cost cutting measures.
- 3** **Sanctions Assurance**

Regulator scrutiny remains, the sanctions environment is fast-changing (see Libya, Syria). The need to demonstrate assurance will be a focus this year. In the words of a large banking client, there is a clear need to "show me, tell me, prove it".
- 4** **PEP Screening**

FSA will be far more intrusive this year in AML, all firms struggle with identifying PEPs and dealing with them in line with regulation. The FSA reviewed this, and other areas in June 2011, they found that "*More than a third of banks visited failed to put in place effective measures to identify customers as PEPs.*"
- 5** **AML TM Optimisation**

FSA focus on AML will shine a light on the ability of systems to spot unusual activity effectively. The current cost focus in all FS businesses will highlight the need for this to be done as efficiently as possible. Optimising the alerts generated by any system (Sanctions, Fraud, AML, Market Abuse, ABC) means understanding data, systems, people and processes. Strategies for alert optimisation will be to the fore.

8. Current industry hot topics (cont.)

Core areas of focus

- 6 **Integrated Financial Crime**

Opportunities exist to enhance both detection and prevention of Financial Crime through the better use of analytics. Despite guidance from the Joint Money Laundering Steering Group (JMLSG) suggesting that firms need to have "close liaison" between those responsible for fraud, market abuse, money laundering and terrorist financing, this rarely happens.
- 7 **Refinement of the risk based approach**

Clear understanding of how customers are split across H, M, L risk ratings and tracking this.
Refinement of risk assessment model elements (Industry, inherent client risk, product types, distribution channel, geography)
- 8 **Proliferation finance**

An area of increasing focus driven by FATF
On a practical level - How do you obtain, scan and review documents to confirm no proliferation links / sanctioned individuals
- 9 **SPVs and complex structures**

Understand why these structures are established – normally to avoid tax or hide identity
Some firms have introduced a policy of not accepting clients until the rationale is clear and transparent.
- 10 **Dormant account policy**

Some firms have implemented a policy that if an account is inactive for say 2 years, full CDD is required before the account can be used again. This allows focus to be on active clients and allows you to bring all clients up to most recent CDD standard.

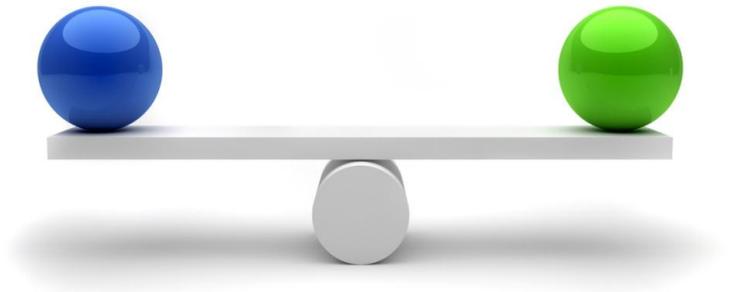
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ORSA – A balancing act !

May 2013

Private and Confidential



Contents

- 1 ORSA on a page
- 2 Life before and after the ORSA
- 3 Embedding an ORSA
- 4 Lessons learnt from UK / Europe

1. ORSA on a page

Specific expected elements in the ORSA process reporting template

Risk Appetite and Strategy	Business objectives, background and Risk Profile	Validation and Review process
<ul style="list-style-type: none"> • Risk Appetite framework across Group • Appetite, tolerance and limits by risk class • Linkage between strategy and appetite 	<ul style="list-style-type: none"> • Summary of legal and management structure • 3-5 Strategic Business Plan • Annual business plan • Overview of risk profile and Solvency 	<ul style="list-style-type: none"> • Independent external review • Internal Audit report • Validation and Review process across risk, actuarial and finance areas
Results and analysis of the Solvency Position	Risk & Capital management Framework	Responsibilities of Key Personnel Involved in ORSA
<ul style="list-style-type: none"> • Description of overall solvency needs • Description of risk profile (long and short term) • Demonstration of current and projected compliance with capital requirements and technical provisions • Analysis of change in capital and risk from previous periods 	<ul style="list-style-type: none"> • Governance and system of risk management • Risk and capital management policies • Risk mitigation methods and analysis • System and Controls • Internal model oversight and validation 	<ul style="list-style-type: none"> • BU Board • Group Board • Risk function • Actuarial function • Finance departments • Technology
Stress Tests Used and the Results	Use tests and Decision making	Process for Conducting the ORSA
<ul style="list-style-type: none"> • Suitability for company's business • Compatibility with SCR results • Reverse stress testing 	<ul style="list-style-type: none"> • Use of ORSA output for key decisions • Use test compliance in key business activities and risk management. e.g. <ul style="list-style-type: none"> – Capital Allocation – Pricing and product development – Reinsurance purchase – Investment management – Performance management and remuneration 	<ul style="list-style-type: none"> • Description of ORSA process and methodology • Policies for assigning responsibilities as above • Frequency <ul style="list-style-type: none"> – at least annual – when major changes in risk profile ('triggers')

2. ORSA on a page – examples areas of change

Specific expected elements in the ORSA process and reporting template

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3. ORSA embedding

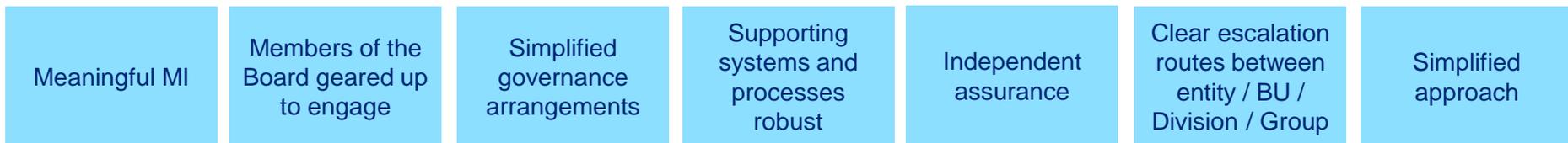
Board engagement and business decisions



Board / Executive engagement and use:

- After Board and Executive training sessions, the focus has been on ‘using’ the information in Board and Executive activity:
 - Specifically requesting approval from the Board on what basis to calculate the ORSA
 - Approve the ORSA on the basis that the Board have understood and challenged the results and conclusions
 - Board challenging and deciding on how the process should be improved
 - Using outputs of the ORSA process (results from stress testing, risk profile (current and projected) in the business planning process
 - Linking performance review and incentivisation to performance of ‘ORSA’ activity
 - Use of ORSA output and MI in oversight committees to challenge and oversee management

Key enablers to demonstrating Board and Executive engagement and use:



Evidenced in business decisions:



3. ORSA embedding

Management information

- **ORSA is a continuous process**
- Daily
 - Monitoring against capital policy
- Monthly
 - Solvency MI
 - Risk reporting
- Quarterly
 - Balance sheet refresh
 - Business risk profile
 - True-up of solvency monitoring
 - Stress testing refresh
 - Projections refresh
- Annual
 - Annual operating plan
 - Formal ORSA report

Supported by an annual report

- Group and entity level reports
 - Business environment
 - Risk environment
 - Solvency assessment
 - Risk ranking
 - Stress & scenario testing
 - Reverse Stress Testing
 - Projections
 - Use in decision making
 - Appropriateness of SCR
 - Methodology and assumptions
 - Planned and potential management actions
- Process subject to independent review

4. What does a good ORSA look like?

- 1 ORSA Vision and Framework – Universally understood
- 2 Build incrementally – around the framework – not big bang
- 3 Embedding – daily, monthly, quarterly & annually
- 4 Clear alignment with regulatory returns (QRT, SFCR in particular)
- 5 ORSA = main risk report used, replacing old reporting
- 6 Applied to entire business not just regulated entities
- 7 Drives alignment / co-operating of the Finance, Actuarial, Risk and Technology community