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AML Reporting: Investigation Is the Key

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SUMMARY

In the years after 9/11, filing accurate and timely Suspicious Activity Reports (SARs) became a priority for banks. And effective investigation is the key to effective ALM compliance. But hiring retired law enforcement agents as suspicious activity investigators has become increasingly problematic as costs rise and the talent pool becomes shallower. Banks need to upgrade the training of their in-house investigators with the interactive simulation training.

ABOUT THE AUTHOR

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Investigating and reporting suspicious activity: It is the one problem of AML compliance that if solved makes all other problems solvable. Yet if investigations were easy, regulatory enforcement actions would be rare, not common as they now are.

The most difficult task in anti-money laundering (AML) compliance is filing complete, accurate and timely Suspicious Activity Reports (SARs). And the financial service industry has collectively spent hundreds of millions of dollars installing, tuning, testing, and supporting software systems design to detect suspicious transaction activity. Yet, while some systems work better than others, they all fail to compensate for the absence of skilled and experienced investigators.

Investigating and reporting suspicious activity properly is the one aspect of AML compliance that, if solved, makes all other aspects solvable. If investigations were easy, regulatory enforcement actions would be rare, not common as they now are. But finding skilled investigators has become an increasing challenge in the banking industry as costs rise and the talent pool of former law enforcement agents gets shallower.

Since AML compliance requirements are here to stay, banks will need to put more emphasis on hiring and training their own investigators. And simply providing a good background on laws and regulations is not enough. In order to train investigators possessing the necessary skills, institutions will need to offer simulated training similar to that required of pilots – hands-on training that simulates real-world conditions.

New Regulations

While AML compliance has been with the banking industry for decades, emphasis on adequately filing SARs evolved through three stages.

The first occurred in the mid-1990s, when the Treasury Department replaced criminal referral forms with SARs. Even then, many institutions went years without filing a SAR and those that did were much more likely to file them for matters involving traditional fraud, such as check kiting or forgery, rather than for AML purposes.

The second stage came after the terrorist attacks of September 11, 2001, when SARs began to pour into the Financial Crimes Enforcement Network (FinCEN). Some institutions had a low threshold for what they considered suspicious and thus many hundreds of thousands of SARs were filed. Meanwhile, the regulatory agencies and their examination staff were learning the elements of the new Patriot Act law and trying to understand the torrent of new regulations raining down from Treasury.

The third and current stage of SAR filing, which began in 2004, is the "post-Riggs" stage, where the failure to file SARs is the most significant of all Bank Secrecy Act (BSA) failures and will lead to severe criticism and likely to informal or formal enforcement actions. In the most egregious cases, civil money penalties are issued. How did we get here and what to do about it?

In 2004, it was revealed that Washington, D.C.-based Riggs National Corp. failed to identify suspicious activity related to the Saudi Embassy, the leaders of the government of Equatorial Guinea and former Chilean general and president Augusto Pinochet. Much of the activity in question occurred during prior years. Several congressional committees criticized banking regulators for being slow to identify the failures and neglecting to address them with the necessary severity once they were identified. It's not surprising that suspicious activity identification subsequently became the central focus of BSA examinations.

The largest banks have long had fraud investigation departments typically led by and staffed with former law enforcement agents, such as from the FBI and Secret Service. As AML requirements grew over the years, one of three things occurred. First, the fraud departments shunned the work of suspicious activity identification because it lacked the characteristics of more "traditional" financial crimes such as check fraud, forgery and kiting.

Second, because the BSA is a compliance regulation, the responsibility for adherence was placed upon a compliance department that rarely reported to the same executive as the fraud department. As a result, when the BSA compliance requirements around suspicious activity identification grew, the compliance department naturally saw this as its purview, along with the traditional policy and procedures requirements of the BSA. Third, in very rare instances, a bank's existing fraud and loss prevention department did take on AML transaction monitoring and investigations.

In most cases, institutions opted, either willingly or by default, to have a new group of staff investigate potential money laundering and terrorist financing. Most of these groups report to a compliance chief. As with their creation and operation of fraud departments, the country's largest banks have sought out and, in most cases, hired former law enforcement agents to manage and staff senior positions in units established to detect and investigate potential money laundering and terrorist financing. While these agents almost always lack experience in the BSA regulation and examination process, they are well versed in the elements of investigation, case documentation and case management – all essential components of a good suspicious activity reporting program.

Shallow Talent Pool

While that system may still work for the top three or four largest banks, institutions below that top tier face a substantial challenge in finding, hiring and retaining skilled and experienced people to analyze, investigate, and report suspicious activity. Unfortunately many institutions are unaware of this challenge until informed by a regulatory examiner of a program deficiency. By the time they seek to fix the problem, they may find the talent pool to be shallow.

Consider that talent costs are rising. Salaries for senior investigators at mid-size institutions are topping $100,000. Salaries for directors of suspicious activity identification and reporting departments exceed $200,000. A good analyst, someone whose job it is is to review transaction monitoring alerts to determine if they should be passed to an investigator, can earn $75,000 or more.

Several years ago, institutions were able to fill their investigator ranks by poaching from fellow institutions. That is no longer likely to lead to much success. The good investigators are well paid by their current employers, who are likely to match competitive offers.

Turning to retiring law enforcement can be helpful, but by no means is it the solution it once was. The prospect of working long hours analyzing customer transactions trying to spot something suspicious is not necessarily the way many agents pictured retirement. It can also be a challenge to transition from 25 or more years in government service. While most former agents eventually do well in the financial service sector, it takes time for them to become acclimated to the highly automated environment in today's AML departments. They may also consider some suspicious activity reporting to be "trivial" in comparison to the life-and-death issues they had become accustomed to in their former jobs.

AML compliance groups are very focused on production, i.e., how quickly they can investigate, document and determine the outcome of an investigation and move to the next one. The volume of work generated by transaction monitoring systems and the expectations of auditors and regulatory examiners is such that cases must be timely as well as accurate and complete.

Even for institutions with sound detection and investigation processes, the "30-day requirement" to file a SAR is a constant burden, although regulators have recently issued guidance enabling some leeway in interpreting the requirement. Still, examiners are watchful of institutions that appear unable to keep up with their monitoring and investigations work load.

Another burden facing institutions is keeping AML investigators up-to-speed on emerging regulatory concerns and priorities. For example, in the last year there has been a spate of episodes involving the use of foreign and domestic shell companies to launder money. Experienced law enforcement agents will tell you that while not all shell companies are nefarious – most are not – all good money laundering schemes use shell companies. So now, AML compliance investigators have to understand why shell companies are so attractive to criminals. What are the signs of a shell company? What are the attributes of ownership or activity that make it suspicious? How does one go about identifying beneficial owners? All these questions are being asked by regulators.

Many institutions encourage their staff to become certified in a field related to AML compliance. These programs are beneficial to the industry in that they provide a good background and foundation for general AML compliance. But institutions who believe being certified in laws, regulation and guidance makes someone a good investigator should reconsider. These programs are not designed to teach the elements of investigation nor do they devote much of their curriculum to how money laundering and terrorist financing schemes work and the level of sophistication of those plying this trade.

Simulation Training

So where do you find experienced suspicious activity investigators in an environment where the costs are high and the talent pool shallow? The simple answer is to train existing staff or hire staff with potential to become strong investigators. While the answer is simple, implementation is difficult.

An investigation is a series of complex thoughts, data and events strung together to tell a story. Even the most seemingly simple case requires analysis and associative memory use, that is, the ability to recall where you have seen similar events in previous investigations and reach a sounder conclusion as to what is occurring. And therein lies the key to good investigations – teaching people how to review events (both confirmable and those unable to be confirmed); decipher patterns; spot anomalies; recall related events or cases; process the information; draw a conclusion; and support that conclusion with evidence and a well written report.

In other words, investigation is a skill; the skill is to spot things that are indicative of potential wrongdoing. Just as a structural engineer needs to spot things that may make a building unsafe, or a software developer needs to identify source code that will cause a program to seize up, an investigator needs to spot phenomena that suggest suspicious activity.

Also like an engineer or software developer, an investigator needs a certain amount of study in the principles of the field. In the case of an AML investigator, it's the knowledge of FinCEN regulations and guidance. But as with any professional, an investigator only gets better through experience.

By conducting investigation after investigation, an investigator learns the nuances of how a small, cash-intense business may be structuring to avoid Currency Transaction Report (CTR) requirements and nothing else, compared to a business that portrays itself as cash-intense but is not structuring only to avoid a CTR but also because it is a front operation for organized crime. Repeated investigations train an investigator to spot an anomaly among the beneficiary information on a wire transfer. Why, an investigator may ask, did this customer send 20 wires a month every month to businesses, but this one wire to an individual? Maybe that is the clue that uncovers a corruption scheme. Maybe it's not, but only an experienced investigator is going to spot it and resolve it.

But institutions may not have the time to wait for an inexperienced investigator to become experienced. Or they may not want to risk hiring someone who appears to have strong potential but ultimately disappoints. What to do?

Other professions face similar challenges and they solve them through highly interactive simulation training. Pilots, for example, are required to regularly participate in flight simulation training where they have to take off and land in foul weather, fly after losing power to an engine and also simply perform routines duties on a normal, uneventful flight. Investigators should learn the same way.

The basis for simulated investigator training will be to re-create money laundering, terrorist financing and financial crimes scenarios like those actually occurring at institutions today. The system would be populated by transaction alerts similar to those generated from the numerous monitoring software programs currently used by banks. The trainees would have access to the same tools available to them in real life. These would include the simulated customer's complete transaction history; Customer Identification Program and other Customer Due Diligence information; simulated deposits; wire transfer and imaging systems; public records databases; "bad guy" lists; and the internet. The trainee would then need to determine, based upon the information contained in these simulated systems, whether the matter that generated the alert is suspicious and would require a SAR.

The simulated training must be designed so that in order for users to satisfactorily complete a course of study (i.e. a case) they would have to conduct their investigation, write a report, populate a case file with supporting evidence and, when necessary, prepare a SAR according to the requirements and guidance issued by the Federal Financial Institutions Examination Council (FFIEC) and FinCEN. A training officer, the trainee's supervisor or a peer could then review the results of the simulated investigation to ensure that the required learning and improvement are taking hold.

While creating such a training program would be costly, it would help ensure that the institution is capable of conducting complete, accurate and timely investigations. And that would lower its AML compliance risk substantially.

ABOUT THE DOMINION ADVISORY GROUP

Dominion Advisory Group is the leading provider of comprehensive and sustainable anti-money laundering programs and critical investigations services for top domestic and international financial institutions, law firms, and other organizations. Dominion Advisory Group has 15 years of extensive experience in banking, compliance, law enforcement, regulatory oversight, technology, and consulting to help financial institutions and corporations navigate the complex regulatory environment and address the needs of regulators, customers, and the institution.

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