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The Case for FIU Mutualization

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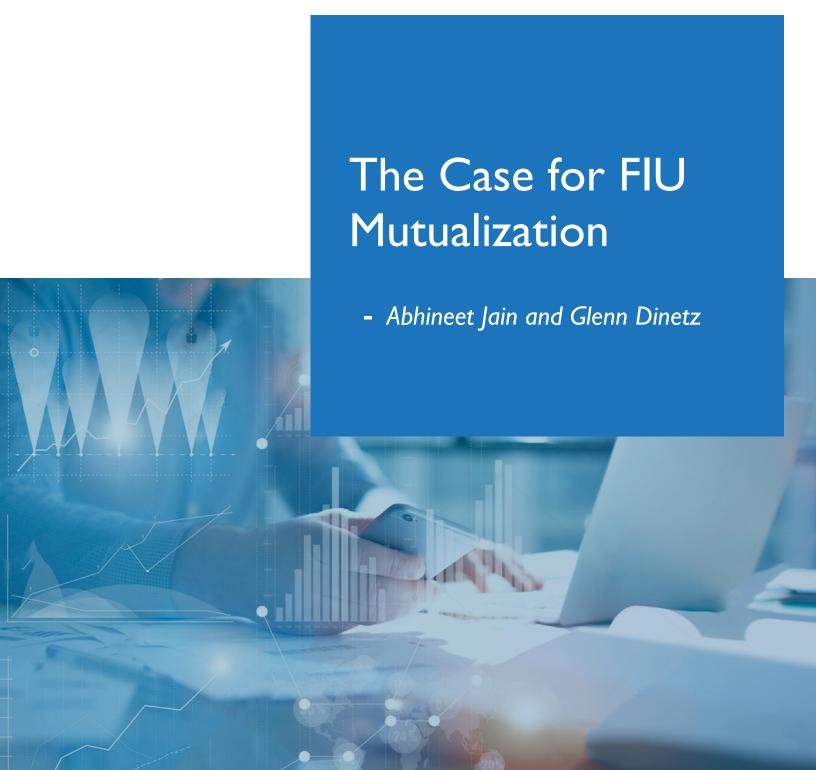
AML Transaction Alert Adjudication Innovation
The Case for a Civilian FIU Collaboration

"Financial institutions have been experimenting with new technologies. They rely on Artificial Intelligence and Machine Learning to improve their ability and efficiency in detecting illicit activity. Many institutions are also collaborating by sharing germane information to form a more accurate picture of risks and illegal activity. We applaud and encourage these new ideas and innovation," remarked Ken Blanco, Director of FinCEN, during ACAMS's 24th Annual International AML & Financial Crime conference in Hollywood, Florida. He added, "Incorporating innovation into the BSA framework is a key priority at FinCEN and we are committed to being more forward-leaning in this regard. It is critical and essential that we innovate and plan how to move forward in this area."

Currently, innovations based on artificial intelligence and machine learning are the hot topics in the R*egTech* universe. RegTech, FinTech as well as financial institutions and service providers spend millions of dollars in the race to develop the most efficient and effective risk management solutions. However, when you combine the dynamic regulatory environment with the changing nature of financial crime, this race has no discernible finish line.

Perhaps progress does not require a race. Can transaction monitoring yield a competitive advantage for financial institutions? Perhaps it would be to our mutual interest to work collaboratively and share information, technology and innovation to achieve the common goal of a robust Bank Secrecy Act (BSA) risk framework.

Financial institutions and their regulatory agencies have long recognized the benefits of sharing information and service frameworks but their inherent risk aversion has impeded commitment. The operational and cost efficiencies, in addition to risk pooling and a data driven analytics approach are potential remedies for the increasing costs of AML Compliance.

We believe that the benefits of mutualization and information sharing within the framework of the law that monitors customer activity extend well beyond operational and cost efficiencies. For example, 'Project Protect,' a partnership between stakeholders from several major Canadian financial institutions, regulators, and law enforcement agencies, policymakers, and technology companies in an effort to combat human trafficking in Canada. In this instance, FINTRAC played a major role by publishing typologies and red flags associated with these crimes to all partners. These participants developed an improved 'mouse trap' to identify human trafficking using the mutualization of information. This result suggests that the potential is limitless for mutualization of technology, risk models, risk scenarios and, of course, individuals.

A solution is only as good as its creator. That's why we believe it is a most opportune time to bring together multi discipline industry professionals to work toward developing a streamlined mutualization framework for monitoring customer activity and alert adjudication.

Monitoring Customer Activity

Law enforcement officials tasked with investigating SARs/STRs emphasize the mindset that all SARs are critical to criminal prosecutions and anti-terrorist financing efforts. However, recent studies supported by our own experience do not sync with that assessment. Based on the RUSI[1] study, 80% - 90% of SARs reporting is not useful to law enforcement. Furthermore, the report states, the number of SARs in the UK and USA are growing by 11% annually.

These statistics lend weight to our assessment that the AML customer activity monitoring and SAR/STR creation process requires a seismic overhaul.

Our experience with financial institutions indicates the following:

- Only 2% to 3% of all machine-generated alerts (through automated transaction monitoring systems) result in SARs
- HUMINT (Human Inteliigence) alerts result in >50% conversion to SARs

It's important to note however, that the number of machine generated alerts exceeds HUMINT alerts by hundreds of thousands.

An Incomplete Ecosystem

We believe that the existing SAR/STR reporting system neither produces the results that were intended nor provides metrics that can be used to fine tune transaction monitoring algorithms. To further explain, after a financial institution submits a SAR to their respective country FIU (such as FinCEN, FINTRAC FCA), no feedback is provided on the SAR status or disposition. Indeed, the current SAR process is certainly an instant wherein the axiom, 'If it's worth doing, it's worth measuring' does not apply. Without direct metrics from country FIUs across the world, how can financial institutions develop meaningful key performance indicators (KPIs) to measure alert adjudication and SAR effectiveness and quality?

Similar to many professional and managed service providers, we have been intimately involved in a number of regulatory remediation and lookback projects for financial institutions. Many of these focus on SAR quality and require financial institutions to gather transactions across various geographies and timeframes. This effort places a significant burden on an institution's AML and investigative staff. In some cases, financial institutions recommend or prefer the use of a third-party consultancy that integrate their own "black box" transaction monitoring system to compare alert results. However, this option more often than not results in 'apples vs oranges' comparisons.

The black box transaction monitoring systems are unable to keep up with the increasing sophistication of financial crime, and require significant investments for the programming of new scenarios. This in-turn generates a vast number of alerts requiring large operations teams to triage.

[1]*RUSI (Royal United Services Institute https://rusi.org/)*

Presently, we are observing the following additional issues in the transaction alert adjudication process.

- Increased volumes of transactions due to strengthened risk models, new threshold and scenario algorithms
- Shortage of experienced investigators, creating poaching situations in tight market regions
- Application of robotics and artificial intelligence technologies in an ongoing effort to mitigate constant cost reduction pressure

We believe there is a precedent for a mutualized FIU framework in two areas. First, FINRA has proven to be an effective, self-regulating organization for the Securities industry. The effectiveness of their governance and enforcement can serve as model for a confederated FIU effort.

Second, a number of efforts have been made to create KYC utility models over the past decade. While we expect the shared utility model to gain greater traction as the quality of data and economies of scale increase, the word 'utility' is associated with a Regulated Utility. Perhaps the precedent before creating a utility is mutualization.

Our recommendation for a self-regulated FIU stems from alert adjudication efforts for several financial institutions. After numerous process reviews, it was observed that the financial institutions' FIU investigators were spending an inordinate amount of time and resources on administrative tasks including:

- Case management administration
- Case evidence file preparation such as signature cards, last 90 days of transactions, CDD reports, etc.
- Level I false positive adjudication such as transposed account numbers and amounts, identity resolution, etc.

As a managed service provider, eClerx undertook specific alert case administrative tasks which produced the following results:

- 50 % increase in the financial institution's FIU investigative alert adjudication productivity through the production of read-to-use case alert investigations files
- Reduction in FIU Investigator attrition allowing investigators to investigate rather than perform clerical work
    - This was also cost effective for the financial institutions in the areas of recruitment, onboarding and having to hire contingent investigators to manage case loads

Working with multiple financial institutions on transformation projects enabled us to gain trust and introduce robotics, artificial intelligence and managed service processes into customer transaction monitoring, case preparation and false-positive disposition processes. Assuming responsibility for the adjudication of obvious false-positives meant the financial institution was now able to review those cases in less than half the time than if they had done the work themselves. Consequently, we established that a managed service was feasible for customer transaction monitoring and alert adjudication functions.

Going a Step Further

eClerx has received requests from numerous financial institutions to augment their FIU investigator staffing to meet peak demands. Most financial institutions deploy an ancillary workforce to support peak demands especially when running strategic programs, adding new scenarios or tuning the thresholds on their transaction monitoring systems. We've found that every financial institution undergoes this phase at least once a year.

Creation of a Self-regulating Financial Services FIU

Let us imagine the many benefits of creating a self-regulating Financial Services framework? The framework would include the following components:

- An opt-in federation of financial services firms that would act as a self-regulating body
- Procurement of a secure, on-shore dedicated facility
- An open source information sharing system for FIU investigators for use within onshore delivery centers, invoking permanent use of Section 314b of the Patriot Act
- Implementation of analytics and advanced automation (robotics and artificial intelligence) technologies to further refine financial crime information and predication
- Establishment of consistent metrics and KPI's around SAR production and effectiveness
- Close liaison with local FIUs and/or appropriate Federal Law Enforcement agencies

We are confident that there are immediate benefits to a collaborative, shared FIU service. One clear benefit is early identification of structuring activities. Instead of having several banks creating multiple SARs on suspected structuring, a mutualized FIU could identify possible suspicious activities stemming from inputs from multiple institutions and create a comprehensive SAR/STR report that would detail transactions amounts and deposit times as well as patterns of suspected deposits.

Secondly, immediate benefits would be realized in the form of lowered costs and increased productivity. Instituting a consistent case management and evidence production factory would allow investigators to focus on investigations, rather than on administration and preliminary research. Other areas of immediate cost savings could include:

- Shared IT infrastructure costs
- Compliance data vendor costs
- FIU Investigator recruitment and onboarding costs

Where to Begin

We envision three scenarios in which we may move forward in implementing a self-regulated FIU. Below, we ranked each scenario in the order we feel they may be most successful:

1. **Canadian Financial Institution Market**
    ➢ Canada's AML policies closely mirror the US. However, the Canadian FI marketplace is somewhat more manageable in the following areas:
       - A mature marketplace with fewer institutions
       - Precedent of effective public-private partnership such as Project Protect
       - Less complex regulatory environment consisting of two main regulators: FINTRAC and OSFI (in comparison   to US which has FinCEN, FINRA, OCC, FED, SEC, FDIC, etc.)
       - Lessons learned in an initial Canadian venture could be immediately exported to the US.

2. Second and Third Tier US Banks

We believe that smaller US banks will come under increased transaction monitoring scrutiny from regulators. Many of these banks do not yet realize all the potential challenges inherent to the issues they'll face. Neither do they have the funds necessary to finance discreet FIU's. Additionally, in some cases, these banks do not have comprehensive, up-to-date automated AML transaction monitoring systems.

In this scenario, an additional technology to set up a mutualized transaction monitoring system is a smart solution.

3. Large Global Banking Consortium

Of course, global financial institutions have many advantages that can be brought to bear including deep pockets and extensive professional and industry expertise. However, lessons learned from ongoing KYC mutualization efforts indicates a marked reluctance to share information, risks and investment concerns.

Ultimately, we believe that the time is now to cooperate and participate in the customer transaction monitoring process, arguably the most important aspect of the BSA regime. At the highest levels, the innovation produced from this effort will provide law enforcement with authentic, actionable intelligence to fight financial crime. On the institutional side, the cost and production savings speak for themselves.

About Authors

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About eClerx Markets

For financial organizations across the world, eClerx Markets, offers consulting, technological innovation, and process management expertise to uniquely solve operational challenges. With nearly two decades of industry experience complemented by the application of smart automation and robotics, our team of experts deliver holistic solutions across the trade life cycle, change management, data analytics, compliance, cash securities operations, document digitization and generation, and outreach.

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