

# **Compliance and Financial Crime Risk in Banks**

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# **Compliance and Financial Crime Risk in Banks: A Practitioners Guide**

BY

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INVESTOR IN PEOPLE

*To my daughter Shikurah Velez, you are my biggest cheerleader, and I am thankful  
for your love and support.*

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## About the Author

**Sophia Beckett Velez, PhD**, has worked for over 16 years as a Certified Public Accountant (CPA) with large banks providing consulting services. Her work experience has provided her with valuable background information on the banking industry in general. As a CPA, she worked for firms such as PricewaterhouseCoopers, where she performed financial audits, attestation services, and risk management analysis of large banks. Many of the regulatory compliance problems noted during her review of the large banks required her to cultivate relationships with line of business managers, and work with them to develop action plans and solutions to the issues noted. This has sparked her research interest in exploring the issues at hand in global banks.

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# Preface

The US and global banking regulators have enforced regulatory compliance laws to minimize (money laundering, terrorist funding, human trafficking, fraudulent banking activities, bad mortgage loans) that exposed banks to significant risks and losses which banks have complained that it is over regulation. This book discusses anti-money laundering standards, counter-terrorist financing measures that are aligned to AML program that cover BSA laws and control activities (prevent, detect, monitor) designed to mitigate breaches.

A qualitative e-Delphi study of 10 banking finance experts were convened to build consensus on compliance practices senior bank managers can implement that can be effective in reducing losses in banks/bank holding companies. This book offers consensus on (a) maintenance of effective and independent compliance consistent with the organizational objectives, (b) clear definition of data source for compliance analytics, (c) compliance monitoring, (d) reporting activities promptly to upper management, (e) top leadership must be a champion of code of ethics, and (f) understanding regulatory compliance activities that are effective.

This book offers an original contribution to the field of banking that undergraduates, master's, PhD students, academics, and researchers can use to gain a deeper understanding of compliance and AML risks in banks and the use of effective management practices. This book will be the first to discuss consensus on effective compliance practices in banks. Sophia Beckett Velez PhD has over 16 years of experience as a Certified Public Accountant (CPA), providing consulting services to large banks.

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# Introduction

## Outline of Chapters

This book is divided into three parts. Part 1 discusses Regulatory Compliance in Domestic and Global Banks. Part 2 examines Compliance Laws and Requirements (BSA/AML). Part 3 reviews Compliance Environment and Effective Leadership Practices.

## Part 1: Regulatory Compliance in Domestic and Global Banks

This part of the book discusses regulatory compliance laws that have placed stress both financially and operationally on large global banks in the United States of America (USA) and around the world. The lack of effective compliance risk management practices to control growth of fraud and money laundering spread throughout the global economy.

## Chapter 1: Regulatory Compliance Requirement and Practices

In this chapter, I discuss increased in regulatory compliance laws that have placed stress both financially and operationally on global banks in the United States and around the world business practices. US and global banking regulators have enforced regulatory compliance laws to minimize bank risks (money laundering, terrorist funding, human trafficking, fraudulent banking activities, bad mortgage loans) that exposed them to significant losses which banks have complained that it is over regulation.

## Chapter 2: Regulatory Compliance in Global Banks

The US and global banking regulators have enforced regulatory compliance laws to minimize bank risks (money laundering, terrorist funding, human trafficking, fraudulent banking activities, bad mortgage loans) that exposed them to significant losses which banks have complained that it is over regulation. This chapter highlights penalties and punishment issued to banks and other financial institutions for being not in compliance with SAR requirements as noted in anti-money laundering laws that have been astronomical.

### **Chapter 3: Compliance Requirements in BHC and International Holding Companies (IHC)**

This part of the book discusses compliance costs have increased for banks, and regulators have seen an increase in their monitoring costs of these compliance regulations. An in-depth look at some of the significant increases in banks compliance costs are related to complex tracking and reporting systems to meet the enhance compliance requirements.

### **Chapter 4: Compliance Failures in Global Banks**

Global banks have failed to implement an effective compliance program to address regulatory requirements of AML, Basel III, and Dodd Frank 2012 Bill. Banks assigned low-risk rating to high risk countries ignoring serious money laundering risk and opted to have lax AML control, which incentivized drug cartels and money launders to use the bank as their preferred financial institution.

### **Part 2: Compliance Laws and Requirements (BSA/AML)**

This part of the book discusses risk of not meeting government compliance requirement referred to as compliance risk. An in-depth look at banks and financial institutions efforts to prevent themselves from being exposed to receiving penalties due to the business risk exposure of where they transact business (high risk countries, individuals, companies) that are susceptible to the risk of money laundering.

### **Chapter 5: Implications of Compliance Weakness in Banks and Regulatory Penalties**

This chapter discusses banks argument that they lost their competitive edge because they have been cut back on business in some countries to meet AML regulations. Banks have failed to report accurate and complete/updated information that result in them receiving penalties.

### **Chapter 6: BSA AML Compliance Practices – Ineffective Practices**

BSA AML requirements have intensified in recent times to counteract the significant increase in money laundering activities; such as; currency transaction reporting (CTR) thresholds, suspicious activity reporting (SAR), and responses to 9/11 'Know Your Customer (KYC) requirements. This chapter examines significant number of banks moved from manual face-to-face know your customer exercise KYC check to an automated process, which turned out to be ineffective.

## **Chapter 7: Capital Requirements – Ineffective Practices**

This chapter discusses capital requirements were highlighted as key risk mitigation measure that banks and SIFIs need to sustain and survive in a financial crisis. OCC made changes to risk weights of the Advanced Approach system, made updates to the market risk rule to exclude credit rating-based risk assessment, introduced additional capital rules, bank capital levels increases, create a Capital Conservation Buffer, and required banks to have additional capital beyond required levels to mitigate ineffective capital practices.

## **Chapter 8: Training**

This chapter discusses the importance of training employees and stakeholders at all levels within banks. The need for training has been highlighted after the continuous passing of new compliance laws and the severity of risk exposure stemming from lack of knowledge.

## **Part 3: Compliance Environment and Effective Leadership Practices**

This part of the book discusses BSA AML practices when implemented within a framework that includes executive management at the governance and board levels. The use of effective leadership can garner success in the banking sector when top leadership acts as a champion of code of ethics.

## **Chapter 9: Sanctions**

This chapter discusses banks actions to ensure they do not violate the various levels of sanctions imposed by international governments. The United States sanctions are imposed against countries, companies, and individuals that banks are prohibited from conducting business.

## **Chapter 10: Office of Foreign Assets Control (OFAC) Compliance Practices**

Office of Foreign Assets Control (OFAC) implements and manages US economic sanctions. This chapter looks OFAC maintains a website which entails countries, companies, and individuals who act on behalf of terrorist that are placed on a blocked person list known as a Specially Designated Nationals (SDN) and Blocked Persons List. Countries that are on a blocked list are prohibited from sending funds to and from these nations.

## **Chapter 11: Capital Requirements – Effective Practices**

This chapter discusses effective compliance requirements such as maintenance of effective and independent compliance consistent with the organizational objectives; clear definition of data source for compliance analytics; ensure compliance monitoring and reporting activities promptly to upper management; top leadership must be a champion of code of ethics; strong morals and integrity; right products for clients; understanding regulatory compliance.

## **Chapter 12: BSA AML Compliance Practices – Effective Practices**

This chapter discusses BSA AML practices when implemented within a framework that includes executive management at the governance and board levels can garner success in the banking sector. An in-depth review of various lines of defenses involved in the monitoring of the compliance environment in the bank which includes: (i) First line of defense are business level executives/managing directors (create policies and procedures, personnel communication); (ii) Second line of defense Chief Risk Officer (monitoring of AML/CFT policies) independent of business line responsibilities; (iii) Third line of defense – internal audit (audit banks activities and report to audit committee) working collectively to create a low-risk control environment.