

AML Independent Test: Tips for Engaging a Qualified Provider

By Laura H. Goldzung, CAMS, CFE, CFCS, CCRP

Like most things in business, it's best to conduct a little research before engaging a third party to provide needed services, and this couldn't be more true when engaging a consultant to conduct your annual AML independent test. This wisdom comes in handy particularly after regulators have scrutinized institutions' not having a full understanding of regulatory expectations. After countless disciplinary actions in a variety of sectors including those within the FINRA regulatory scheme, I offer the following insights.

What should a firm know?

Most important to financial institutions is their third party provider's underlying knowledge of the institution's business model and their knowledge of what the regulators expect in terms of scope, plan, and testing. There are all kinds of providers who claim that they can conduct your test. Some independent consultants are former law enforcement agents or ex-regulatory examiners and staff, and others are from the big accountancy and consultancy firms, CPAs or industry professionals striking out on their own. Just because they come from related backgrounds doesn't mean they have the knowledge of AML to do the best job possible.

Comparing Apples With Apples

From the small consultancy to the big name companies that we all know from their abundant exhibits at conferences, comparison shopping will benefit you in the long run. Obtain a few proposals, not just quotes. You may get a low quote for a less than optimal scope. There is a plethora of providers to choose from. Ask some of your networking friends or others in your institution if they know of anyone. Take a look at LinkedIn. Perform a Google search using a simple phrase like broker-dealer AML or AML independent test for broker-dealers.

Don't Sacrifice Certified Professionals to Save Money

It's no surprise that BDs are accustomed to a transactional mindset, but don't apply this to an engagement for the AML test. If you simply go for the lowest quote, you will get only what you pay for. AML testing requires a comprehensive knowledge of Bank Secrecy Act, USA PATRIOT Act and OFAC laws and regulatory requirements, as well as the skills to scope, plan and conduct transaction testing, and to write a comprehensive report of findings while providing a set of work papers, as required by virtually all regulators upon request. The work papers are made available to the regulator, however, the report is made available to the Board of Director/senior management and sometimes the banking relationship, state examiners, and partners, i.e. clearing firm, upon request.

Know Your Regulator!

Just as you apply KYC to your customer base, you should know FINRA and what their expectations are as to “adequate” AML testing. Like other regulators, FINRA makes no secret of the fact that it has certain expectations about the comprehensiveness of the AML testing. In fact, a recent disciplinary action¹ was brought against BBH and its AML Compliance Officer, which included failure to conduct adequate AML testing.² It is incumbent on the firm to know what adequate testing consists of in the context of the engagement and the scope should be spelled out very clearly in the engagement letter.

Be Aware of Time Required

It makes sense that independent AML testing for a small broker-dealer will take less time than for a large complex firm. But take notice that just because you may be on a biennial schedule, for those BDs in the M&A space, for example, your independent audit doesn’t necessarily take less time than will a firm on the annual schedule. For the M&A-Private Placement types, there is testing that will entail reviewing client agreements, third party agreements and other differences. Many small firms who seek providers will automatically think that because they are small it equates to less time. Remember that only 20% or so of FINRA members are large firms. Most are small firms, and many are micro firms. Thorough is thorough, and all the steps must be taken to ensure your AML program is compliant and adequate.

Understand the Service Offered

Make sure you understand what is being offered in their standard program. Hiring a third party to conduct your test is like hiring a business partner, not an “examiner.” Many firms initially think of the AML third party provider as they would a regulator coming in. AML consultants are advisory in the context of conducting the independent test, not adversarial. They are there to assist and educate you, not only about the testing process, but the regulatory process, the AML laws and how they apply to your business model and other value-added benefits in the relationship context. Make sure you understand what is being offered in their standard program. A reputable company will include the following:

- Engagement Proposal containing the following elements:
 - Audit Plan & Objectives
 - Scope of Work including what will be tested
 - Review Period for Testing
 - Methodology

¹ Brown Brothers Harriman & Company

<http://www.finra.org/web/groups/industry/@ip/@enf/@ad/documents/industry/p443448.pdf>

² Failure to Conduct Adequate AML Testing: FINRA found that, during the Relevant Period, the Firm failed to conduct adequate AML testing. FINRA Rule 3310(c) requires member firms to arrange independent testing for compliance with its AML program. Although the Firm conducted such tests, FINRA found that the tests failed to address the primary risks associated with the Firm’s brokerage business involving penny stocks, including the identification of any of the shortcomings in the trade monitoring and asset movement monitoring related to penny stocks. FINRA also found that, during certain years of the Relevant Period, the tests failed to address penny stock activity despite such activity involving high-risk transactions for the Firm’s customers.

- Deliverables with time frames
 - Professional Fees including retainer payment and time frames for payment
 - Number of persons conducting the test
 - Terms of Engagement including confidentiality of data and documents collected, disclosures, invoicing, etc.
 - Biographies of professional(s) conducting the audit
 - Signatures
- The Independent Testing Service should include:
 - Conducting initial discovery about the firm, its business model, AML compliance officer and program elements
 - Review of Documents (Request List) and statistics about the firm
 - Onsite visit to your offices
 - Conduct entrance meeting with Compliance Officer and key stakeholders
 - Conduct interviews with key personnel
 - Compliance process walk-throughs including technology tools used in AML program, manual or automated transaction monitoring, dispositioning of alerts, documentation of changes to automated monitoring and tuning
 - AML policies, procedures and controls review, testing policies against procedures
 - Risk assessment or methodology – test for reasonableness
 - CIP & risk-based verification sampling/testing
 - CDD/KYC review and sampling/testing
 - EDD at onboarding and ongoing for higher risk customers
 - AML Training including review of content for comprehensiveness of training, and how tracking and recordkeeping is managed
 - Information Sharing: Section 314(a) process review and testing; voluntary participation in Section 314(b) and provisions for confidentiality
 - Independent Testing – comprehensiveness of previous test, findings or recommendations, and testing of corrective actions from past reviews and sustainability of corrective controls
 - Corrective actions from previous regulatory (FINRA/SEC/State) examinations and sustainability of corrective controls
 - Reliance with other third party providers/vendors (know your vendors)
 - Records of Funds Transfers under the joint and travel rules
 - Suspicious activity monitoring (system as a whole), red flags and escalation, investigations and case management
 - Suspicious activity reports sampling/testing for accuracy, narrative, and timely filing
 - OFAC sanctions compliance including screening tools used, monitoring, training, and processes for rejecting/blocking, reporting and recordkeeping, customer and employee batch screening provisions, sampling/testing
 - Other BSA reports where applicable – FBAR, CTR, CMIR, sampling/testing
 - Law Enforcement Requests tracking, confidentiality, and resolution of requests
 - Recordkeeping, record retention and accessibility of records
 - Business continuity with respect to recordkeeping
 - Exit Meeting with AML stakeholders

- Deliverables will include:
 - Comprehensive Report identifying scope, review, testing, analysis, requirement, observation and recommendation for enhancement, or deficiency or violation and requirement to bring into compliance
 - Overall statement of condition of AML Compliance Program, i.e. adequate
 - Risk-based action plan to resolve recommendations or deficiencies
 - Work papers with all documents referenced and containing objectives and rationale for analyses and testing, and outcomes

Be wary if a company guarantees you a problem-free result

There's a lesson in this statement. That old adage, "If it looks too good to be true, it probably is" applies in AML too. The purpose of the AML test is to ensure conformity with the laws and regulations and to ascertain the adequacy of the program controls. A reputable provider will not guarantee anything, least of all that it can provide a report that is sure to win over a regulator. Nor are third party providers "endorsed by FINRA." In the post-incident scenario where FINRA requires a firm to engage an independent consultant to conduct certain tasks, FINRA may find a third party provider to be "*not-objectionable*," clearing the way for selection by the firm.

Conduct Due Diligence

Conducting due diligence is important when hiring a qualified and experienced AML professional to conduct your independent test. Not all AML professionals are created equal. An AML consultancy may be great at developing policies and procedures and even delivering custom training and performing due diligence, but this doesn't necessarily mean they are skilled in delivering the audit and test. I know of one institution that was disappointed with their audit report because they learned after the fact that the consultants had never audited a firm, and had only performed other services. The result was a 225-page report! The lesson here is to ask the right questions, such as:

- Have you conducted independent test for a broker-dealer? Do your professionals have testing experience with FINRA firms? Are they qualified or even certified?
- Do you provide an engagement letter spelling out the plan, scope, what will be tested and timing for the report delivery?
- What is your process for conducting the test? What information do you need before providing a written proposal?
- What is your scheduling? How long does it take from start to finish?
- Do you offer multiple year agreements with reduced pricing?
- Ask for references! While most consultancies cannot publicize the names of clients, most will have a list of a few willing references.

About the Author

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