VERAFIN
A STEP AHEAD

How to Effectively Manage High-Risk Customers

Four Key Areas of Focus for your End-to-End CDD/EDD Program

SEGMENTATION | STRATIFICATION | EDD REVIEWS | SURVEILLANCE

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Introduction

A strong BSA/AML program should include Customer Due Diligence (CDD) and Enhanced Due Diligence (EDD) processes for financial institutions to maintain regulatory compliance and protect themselves from illicit activities, such as money laundering or terrorist financing.

Today, institutions are facing increased regulatory pressures governing due diligence procedures, particularly regarding high-risk customer types.

According to the FFIEC BSA/AML Examination Manual, all financial institutions must develop and implement appropriate risk-based procedures for conducting ongoing CDD, including:

- Obtaining and analyzing sufficient customer information to understand the nature and purpose of customer relationships for the purpose of developing a customer risk profile;
- Conducting ongoing monitoring to identify and report suspicious transactions and, on a risk basis, to maintain and update customer information, including information regarding the beneficial owner(s) of legal entity customers.

Your institution's risk-based CDD policies, procedures, and processes should be commensurate with your BSA/AML risk profile, *with an increased focus on higher-risk customers*.

This eBook discusses the challenges of conventional approaches to managing high-risk customers and highlights four areas of focus to strengthen your CDD/EDD program: **High-Risk Customer Segmentation; Risk Stratification; EDD Reviews; and High-Risk Customer Surveillance.**

Categories of High-Risk Customers

- Private ATM Owners
- Cash Intensive Businesses (CIBs)
- Remote Deposit Capture (RDC)
- Third-Party Payment Processors (TPPP)
- Money Services Businesses (MSBs)
- Cannabis-Related Businesses (CRBs)
- Non-Banking Financial Institutions (NBFIs)
  such as casinos, insurance companies, loan companies, or commodity firms
- Professional Services Providers (PSPs)
- ACH Originators
- Non-Governmental Organizations and Charities
- Foreign Individuals
- Non-Resident Aliens (NRAs)
- Politically Exposed Persons (PEPs)
- Embassies, Foreign Consulates, or Foreign Missions

The cornerstone of a strong BSA/AML compliance program is the adoption and implementation of risk-based CDD policies, procedures, and processes for all customers, particularly those that present a higher risk for money laundering and terrorist financing.

FFIEC BSA/AML Examination Manual

Challenges of a Conventional High-Risk Customer Management Approach

Conventional approaches to high-risk customer management are largely manual, resulting in inefficient and ineffective processes. These processes often rely on disparate systems, such as isolated software for capturing account opening data, and multiple transaction monitoring systems siloed within their own transaction channels.

- ⚠ **Identification** of high-risk customers relies on the accuracy of Account Opening Questionnaires (AOQs) and manual keyword searches.
- ⚠ Customer **Risk Scoring** is largely based on generic risk models that broadly assess your customer base.
- ⚠ Periodic **Enhanced Due Diligence Reviews** of high-risk customers are manually tracked with spreadsheets.
- ⚠ Tedious **High-Risk Customer Surveillance** efforts include manually managing spreadsheets, calendar reminders and transactional information.

Without a robust high-risk customer management process, you could be banking high-risk customers you do not know about.

Customers that do not properly self-identify as high risk at account opening, legacy customers with changing risk factors, and newly acquired customers in high-risk categories can slip through the cracks in your CDD processes. Generic risk models can result in rating all customers in high-risk categories with equal risk scores, resulting in large numbers of high-risk customers to review. Large numbers of manual reviews, without automated review reminders, can be inefficient and costly, resulting in missed reviews and BSA/AML compliance risks.

PROCESS	CHALLENGES OF A CONVENTIONAL APPROACH	IMPACT	RESULT
IDENTIFICATION	• Customers that do not self-identify at account opening • Legacy customers without an accurate risk profile • Customers whose activity or risk factors change over time • Customers gained through acquisition	• High-risk customers are unidentified and uncategorized in your customer base	• Increased compliance costs • BSA examination risk
RISK SCORING	• Risk models that are overly complex and/or broad • All customers in high-risk categories are rated as High	• Too many customers scored as high-risk	
EDD REVIEW	• Too many reviews to be conducted • Lack of automated workflows for review	• Strain on internal resources • Missed reviews due to manual error or time constraints	
SURVEILLANCE	• Customer reviews only occur during pre-defined, generic review cycles • Manual management of spreadsheets, calendar reminders and transactional information can be prone to error	• Risky activity between reviews may be missed	

End-to-End High-Risk Customer Management

This eBook considers an end-to-end process for effective High-Risk Customer Management, with four key areas of focus:

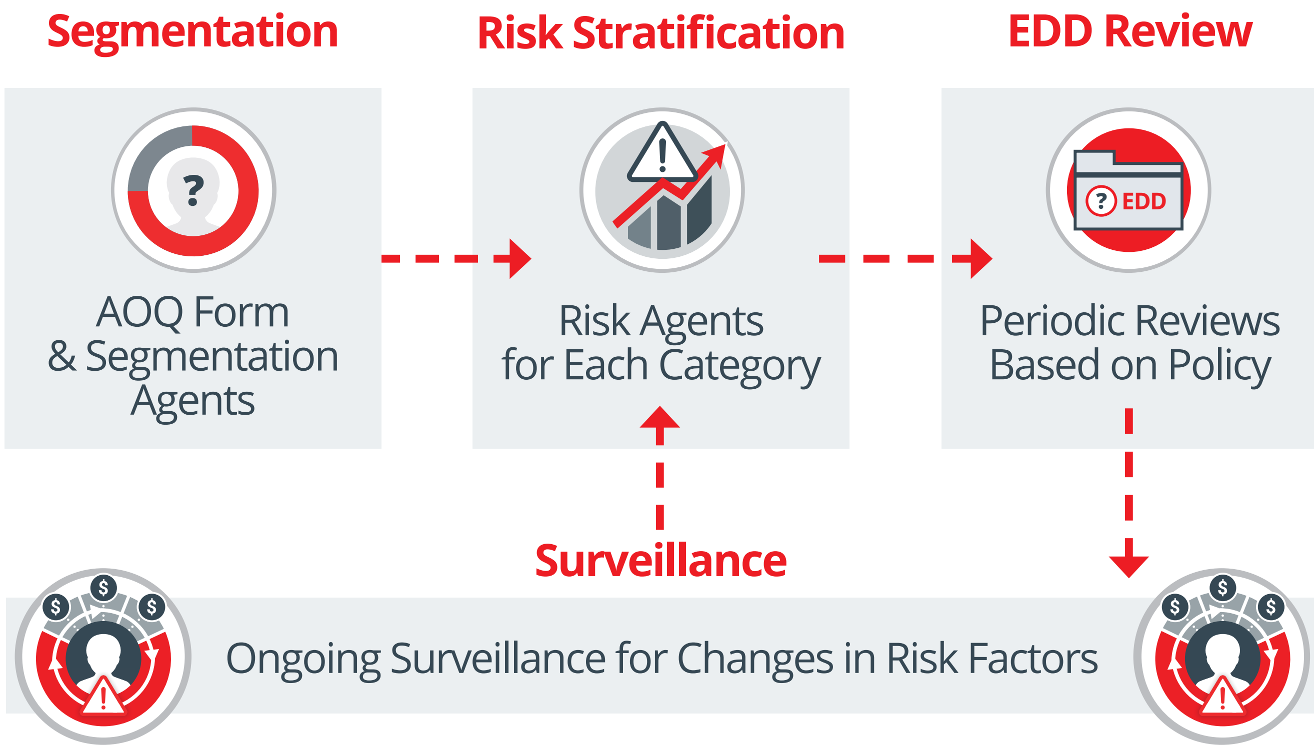
1. **Segmentation of high-risk customers**
   Institutions should aim to identify high-risk customers at account opening and within their existing customer base. Once identified, customers should be segmented into high-risk categories based upon customer type.

2. **Risk stratification of high-risk customers within each high-risk category**
   Customers should be rated against each other to stratify risk within each category, instead of rating each customer within each category with the same level of risk. Configurable risk agents, based on your institution’s policies and procedures, can ensure your customer risk profile aligns with your institution’s risk appetite.

3. **Effective management of Enhanced Due Diligence policies and procedures**
   Align your EDD review procedures with your stratified high-risk customer categories to ensure reviews are timely and accurate. Leverage your case management system to track and organize your high-risk customer reviews. Your EDD review outcomes should integrate with your high-risk customer assessments to ensure accurate risk scoring and efficient due diligence.

4. **Continuous surveillance of high-risk customers**
   Ongoing monitoring may indicate when updates to customer information are required, or customer risk profiles should be reassessed.

End-to-End High-Risk Customer Management with Intelligent Segmentation



*An **intelligent risk segmentation approach** identifies, segments, stratifies, and actively monitors ongoing high-risk customer activity. This enables BSA/AML professionals to perform powerful and efficient ongoing due diligence that is in line with the true risk the customer poses to the institution.*

Segmentation

Institutions should have CDD procedures in place to identify newly onboarded high-risk customers at account opening. In addition, your identification procedures should include analysis of your existing customer base to uncover customers who do not self-identify at account opening, or whose risk factors may have changed over time.

> **"Improper identification and assessment of a customer's risk can have a cascading effect, creating deficiencies in multiple areas of internal controls and resulting in an overall weakened BSA compliance program."**
> *FFIEC BSA/AML Examination Manual*

When high-risk customers are properly identified, they can be segmented into high-risk customer categories for more tailored risk stratification and monitoring.

Methods to identify customers in high-risk categories:

1. **Customize your Account Opening Questionnaire (AOQ)** to identify high-risk customers new to the institution and segment them into their appropriate high-risk customer category. Your institution can then decide whether or not to bank these customers, based on your internal risk policies.
2. **Evaluate your customer base** to identify previously unknown, hidden high-risk customers, including customers that did not properly self-identify at account opening and customers with evolving risk profiles, such as previously lower-risk customers that have begun to engage in higher-risk activities.
3. **Engage AML transactional monitoring**, including the demographic information of transactions, to identify suspicious activity within your customer base. Your transactional monitoring software can integrate with your AOQ for ongoing surveillance of customers to alert staff when additional scrutiny is required.

Leveraging Data to Identify & Segment High-Risk Customers

Financial and Demographic Data:

- Using *ATM Settlements* to find Private ATM Owners
- Using *Cash Volume* to find CIBs
- Using *Country of Origin* to find Foreign Individuals
- Using *Keyword Searches* to find CRBs, PEPs, ATM Owners, etc.

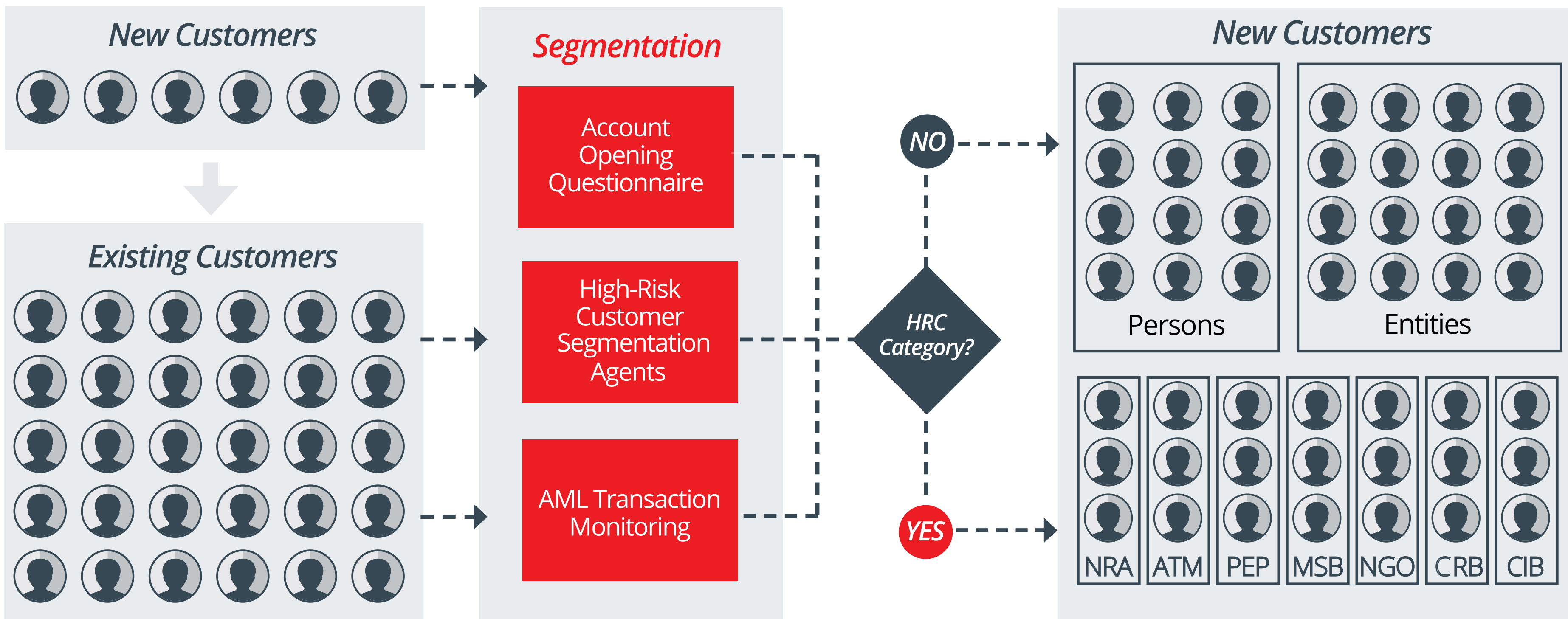
Third-Party Data:

- FinCEN Registry for MSBs
- State Registries, such as California Secretary of State Cannabizfile for CRBs
- IRS Database for NGOs and Charities

Getting the Most From Your AOQ

- **Create customizable** questionnaires, tailored to your institution's risk policies and procedures
- **Add stop notifications** for front-line staff, enabling them to consult with BSA/AML professionals when required
- **Integrate collected customer information** with transaction monitoring for risk stratification and surveillance, enhancing ongoing due diligence efforts

Segmentation



Risk Stratification

Not all customers within a high-risk customer category pose the same level of risk to a financial institution.

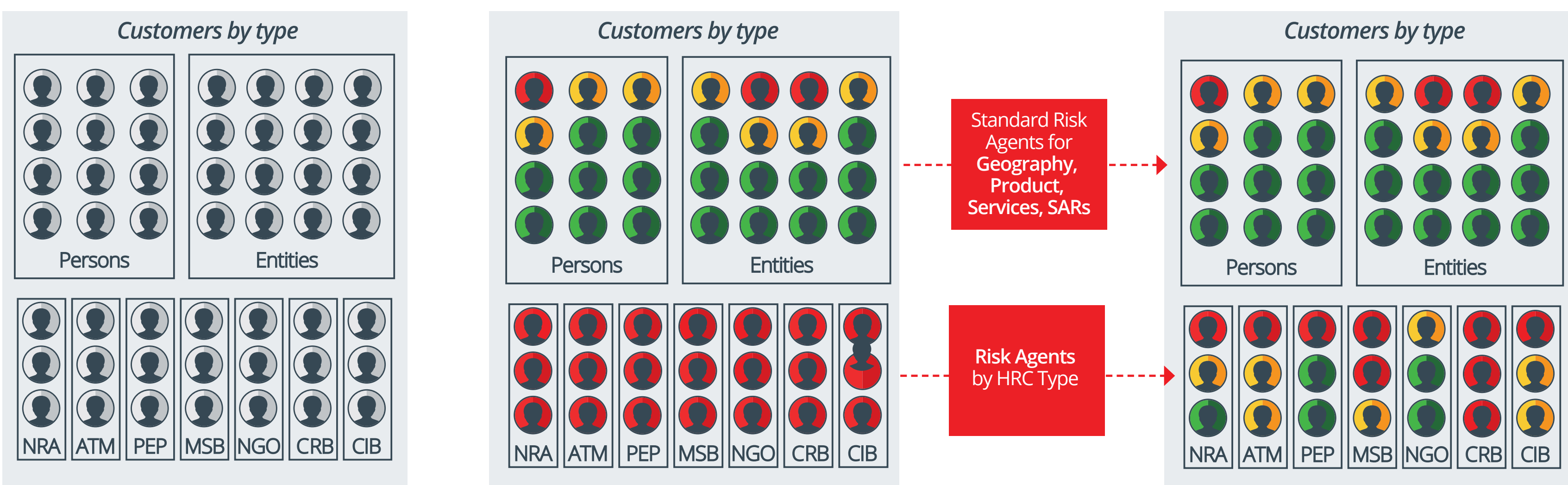
Risk stratification creates a spectrum of risk within a single high-risk customer category, to address differing levels of risk within a single group. Customer risk scoring for higher-risk accounts must go beyond broader risk models to stratify risk *within categories*, to identify the customers that pose the greatest risk to an institution.

By stratifying risk, **institutions can create a more accurate picture of the risk they face**, and they can tailor policies and procedures relative to their defined level of risk. Instead of conducting ongoing reviews of all customers within a high-risk category with the same review frequency, reviews can be conducted based on stratified risk levels — allowing you to focus on the higher-risk customers. Your institution can prioritize the higher-risk customer reviews that are most important, and reduce time spent on reviews for customers that fall below your high-risk thresholds. All high-risk customers are reviewed with the necessary level of due diligence, at the right time, reducing the overall compliance cost to the institution.

Typical Customer Base

Conventional Approach

Stratified Approach



Risk Stratification: Configurable Risk Agents

Institutions should employ configurable risk agents based on the risk assessment outlined in their policies and procedures.

With potentially large numbers of high-risk customers within an institution's customer base, ongoing assessment can be extremely challenging.

A conventional approach to risk scoring, based on generic risk agents for all customers, forces institutions to monitor and review large volumes of high-risk customers with the same level of due diligence.

Risk agents, aligned with your internal risk policies, allow you to define what risk means to your institution. You can then tailor your high-risk customer monitoring requirements to focus on the factors most relevant to your institution. Instead of reviewing all high-risk customers for the same activities and with the same frequency, you can configure your process to look for specific activities per high-risk customer, and review customers with varying levels of frequency.

Money Services Businesses (MSBs) may be one high-risk customer category, but it can include customers with varying levels of risk. A corner store cashing checks for their customers may be less risky than an international MSB sending wires overseas, and may require less monitoring and review. If both organizations are given the same risk rating, the corner store may be reviewed too frequently, while the international MSB may not be reviewed frequently enough.

> A spectrum of risks may be identifiable even within the same category of customers. The bank's program for determining customer risk profiles should be sufficiently detailed to distinguish between significant variations in the money laundering and terrorist financing risks of its customers.
>
> *FFIEC BSA/AML Examination Manual*

Enhanced Due Diligence Reviews

Higher-risk customers require additional scrutiny throughout their relationship with your institution, including periodic due diligence reviews on a more frequent basis than lower-risk accounts.

Managing the volume of reviews created as a result of generic risk agents, as well as identifying previously unidentified high-risk customers, can be overwhelming, especially with a manual process.

Tracking EDD reviews for high-risk customers in spreadsheets can strain resources and increase opportunity for errors. This can put your BSA/AML compliance program at risk for regulatory scrutiny.

> **Financial institutions should consider collecting and managing EDD information within a case management system that can automate workflows, including review date alerts, task assignments, and investigation documentation.**

Your EDD processes should integrate in a continuous loop with customer risk and targeted surveillance. The output of your EDD review process should dynamically impact customer risk to ensure an accurate risk score and efficient due diligence process.

This dynamic integration ensures customers that pose the greatest risk to your institution are reviewed with the necessary level of due diligence, providing a more accurate institutional risk profile and reducing the overall compliance cost to the institution.

EDD Benefits with High-Risk Customer Management

- **Identification of truly high-risk customers** results in enhanced, high-quality EDD reviews when required.
- Identification and segmentation of high-risk customers at account opening and within your customer base ensure **risky entities do not go unnoticed.**
- Accurate, stratified risk assessment of customers in your customer base can result in fewer high-risk customers, resulting in fewer EDD reviews and **significantly reducing workload and cost.**
- **Effective case management** with automated reminders ensures necessary reviews are not forgotten and review frequency requirements adapt as customer risk profiles evolve.

High-Risk Customer Surveillance

Ongoing monitoring is a critical process required for high-risk customer due diligence, to determine changes in behavior or risk factors and uncover suspicious activity.

To ensure high-risk customers are effectively monitored and properly assessed, institutions should employ a behavior-based approach and targeted analytics to continuously monitor customers in higher-risk customer categories, alerting investigators when:

- A customer's risk factors have changed, requiring review of the customer's risk profile
- A customer's risk profile requires adjustment
- A customer's risk profile requires additional information or updates
- A customer is engaged in potentially suspicious activity

Robust BSA/AML compliance programs should include changes in customer behavior and risk factors, observed through ongoing high-risk customer surveillance, within their EDD review policies.

Targeted Surveillance Examples:

- **ATM Owner** - Unknown source of cash
- **NGO** - International activity
- **MSB** - Source of cash
- **CIB** - Cash volume
- **CRB** - Cross-state transfers

> The bank's procedures should establish criteria for when and by whom customer relationships will be reviewed, including updating customer information and reassessing the customer's risk profile.
>
> *FFIEC BSA/AML Examination Manual*

How to Strengthen Your Regulatory Compliance

An end-to-end approach to high-risk customer management that focuses on critical processes can strengthen financial institutions' regulatory compliance programs by accurately identifying and managing customers in high-risk categories.

Focusing on four key areas of your high-risk customer management process allows you to identify high-risk accounts, then segment and stratify those customers relative to their high-risk category. By continually monitoring activity and automating review cycles, you can reduce time spent on EDD reviews, allowing you to focus on only the high-risk customers that pose the greatest risk to your institution. You review the right customers at the right time, providing greater visibility of your institution's risk profile to your examiner, and strengthening your end-to-end CDD/EDD program.

Automated end-to-end high-risk customer management solutions help institutions:

- Reduce time spent on manual due diligence and compliance workload
- Reduce costs associated with CDD processes where risk is properly stratified
- Focus efforts on truly high-risk customers, in line with your institution's risk appetite
- Improve accuracy of customer and institutional risk profiles
- Accurately assess risk in acquisitions and mergers
- Increase confidence in regulatory examinations
- Reduce risk of money laundering and terrorist financing activities within your customer base

Verafin's **intelligent risk categorization approach** identifies, segments, stratifies, and actively monitors ongoing high-risk customer activity.

This enables BSA/AML professionals to perform **powerful and efficient ongoing due diligence** that is in line with the true risk the customer poses to the institution.

> Learn more on Verafin's High-Risk Customer Management Product page
verafin.com/product/high-risk-customer-management/

Verafin is the industry leader in enterprise Financial Crime Management solutions, providing a cloud-based, secure software platform for Fraud Detection and Management, BSA/AML Compliance and Management, High-Risk Customer Management and Information Sharing.

Nearly 3000 banks and credit unions use Verafin to effectively fight financial crime and comply with regulations.

Leveraging its unique big data intelligence, visual storytelling and collaborative investigation capabilities, Verafin significantly reduces false positive alerts, delivers context-rich insights and streamlines the daunting BSA/AML compliance processes that financial institutions face today.

Verafin is the exclusive provider for Texas Bankers Association, Western Bankers Association, Florida Bankers Association, Massachusetts Bankers Association, and CUNA Strategic Services, with industry endorsements in 48 U.S. states.

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