How to Audit an Effective AML Governance Committee Structure and AML Issue Escalation Protocol

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The views expressed in this paper are those of the author. The author is not necessarily representing the views or opinions of Protiviti.

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1 See Appendix section for descriptions of all acronyms used within.
2 The analysis in this white paper is designed around the governance of auditing larger banking financial institutions and not specifically around community bank governance.
3 “Regions” will be defined in this paper as groups outside of the US (this includes groups of countries, jurisdictions, or legal entities as applicable to the bank).
4 “Holistic” is defined in this paper as providing more coverage firm wide.
Executive Summary

The intended audience for this white paper is individual auditors who work in the Anti-Money Laundering (AML) space. The primary objective is two-fold:

1. How to audit an effective AML governance committee structure for a large financial institution while ensuring that adequate oversight is captured from not just the Bank Secrecy Act/anti-money laundering (BSA/AML) Compliance Group of the U.S. Head Office, but also from each of the regions and lines of businesses (LOBs)

2. How to audit an effective and transparent AML issue escalation process between each of these three groups to ensure that an AML issue can be captured and recorded from start to finish while being reported to the appropriate parties (committees), promoting a culture of compliance that is not comprised by revenue interests

This is a significant problem as financial institutions have been receiving more and more impactful consent orders and matters requiring attention and matters requiring immediate attention (MRAs/MRIAs) in the past decade from regulators with issues concerning banks not having a sufficiently defined and transparent governance structure that includes a defined AML issue escalation protocol. Consent orders are issued by regulators to enforce wholesale changes across the institution’s AML risk controls and systems, whereas MRAs/MRIAs are issued by regulators to enforce more specific deviations from effective AML risk management. As financial institutions are spending significant amounts of time, money and resources addressing these specific consent order requirements, they are finding the need for a sustainable process going forward. A large part of demonstrating that there is clear AML program sustainability is through the actions of the financial institution’s internal audit function (or third line of defense). The challenge for audit departments at banks is being able to give evidence to regulators that they are promoting this AML program sustainability by changing methods of testing, documenting, and reporting on the effectiveness of having a sufficiently defined and transparent AML governance structure that includes a defined AML issue escalation protocol.

These consent orders and MRAs/MRIAs enforced on the first and second lines of defense of larger banks trickle down to the third line of defense because additional responsibility is then placed on audit. The message of this increase in consent orders is that regulators are raising the bar with higher expectations brought to banks in the ‘format of an unsatisfactory review.’ If these banks wish to be free from their past, present and future consent orders, they inevitably will need to demonstrate a clear AML program sustainability, which includes audit combating the following three challenges within AML governance:

- Audit Challenge #1 – Auditing the holistic view of the AML governance committee structure
- Audit Challenge #2 – Auditing vague AML issue escalation protocol definitions
- Audit Challenge #3 – Auditing the LOB role (making money vs. AML compliance)

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5 “Banks” and “Financial Institutions” is used interchangeably throughout.
6 “BSA/AML” is noted as simply “AML” going forward in this paper.
7 See “Audit Challenge #1” section below for cited references to Consent Orders with these identified regulator issues.
8 See https://blogs.thomsonreuters.com/answerson/jpmorgan-internal-controls-regulatory-relations/.
9 “Internal Audit” and “Audit” is used interchangeably throughout.
10 See Exhibit 6 for illustration of this trickle-down effect to Audit.
Introduction

Before understanding how to audit an effective and transparent AML issue escalation process between the AML compliance group from the U.S. Head Office, regions and LOBs, it is important to have a clear understanding of what a strong and transparent global AML governance committee structure of a large financial institution with multiple LOBs and multiple jurisdictions/regions (in addition to the U.S.) could look like. Audit needs to validate that adequate AML oversight is captured from not just the compliance group of the U.S. Head Office, but also from each of the banks’ regions and LOBs, which also should have AML-designated individuals in a senior management role. See an example of a high-level breakdown of an AML governance committee structure in Exhibit 2.

An Effective AML Governance Committee Structure2 – US Head Office, LOBs, and Regions

The Federal Financial Institutions Examination Council (FFIEC) was established “to prescribe uniform principles, standards, and report forms for the federal examination of financial institutions” by the various regulators.12 The FFIEC also periodically releases a BSA/AML Examination Manual to provide banks some transparency of what these regulators would be using in their examinations.13 The FFIEC manual examination guidance describes the structure of banks as including controls across business lines, legal entities, and jurisdictions of operation, and it says that a larger more complex bank may establish a corporate AML compliance function to coordinate some or all AML responsibilities.14 This paper will refer to business lines as LOBs, legal entities and jurisdictions as regions, and corporate as the U.S. Head Office. These larger and more complex banks normally have a corporate U.S. Head Office with the role of oversight and coordination of AML and sanctions coverage across the firm. Across the firm includes AML compliance senior management roles designated to the applicable regions, LOBs, and core AML functions of the bank who all report to the U.S. Head Office. See an example of a larger financial institution’s AML compliance senior management across the firm in Exhibit 1:

Exhibit 1. AML Compliance Across the Firm

![Exhibit 1](image)

The FFIEC examination guidance also establishes the importance of senior management being responsible for communicating and reinforcing the AML compliance culture as established by the board of directors, and it says that committees can be used to assess the effectiveness of the AML program around significant AML compliance matters.14 Clear lines of authority, responsibility and AML issue escalation requirements are established through various committees that discuss and vote on significant AML issues and matters.

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12 See https://www.ffiec.gov/about.htm.
such as ongoing negative AML metrics and strategic decisions. See the three lines of defense below as defined by OCC 12 CFR Parts 30 and 170 as of 2014:15

- **First line of defense**: Any unit that is designed to generate revenue for the Bank or provides services such as administration, finance, treasury, etc.
- **Second line of defense**: Independent risk management including the control functions that oversee risk that the front line of defense is taking. This includes the compliance department (such as AML compliance), controls, and legal. These departments often have monitoring and reporting responsibilities, which independently assess the effectiveness of the first line of defense.16
- **Third line of defense**: Internal audit is the third line of defense in the organization of the bank with the responsibility of providing the board and management with independent assurances “on the effectiveness of governance, risk management, and internal controls.”

FinCEN’s “Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance” article, released in 2014, also reinforces the notion that a “financial institution can strengthen its AML compliance culture by ensuring its leadership actively supports and understands compliance efforts and also by ensuring that relevant information from various sections or groups within the bank is shared with the U.S. Head Office compliance group to further AML efforts.”

**An Effective and Transparent Escalation Process**

Audit needs to validate that adequate AML oversight is captured from not just the compliance group of the U.S. Head Office, but also from each of the banks’ regions and LOBs, which also should have AML designated individuals from a senior management role. See an example of a high-level breakdown of an AML governance committee structure in **Exhibit 2**.18

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16 See additional information at http://hrbc.com/articles/?p=38.
18 Committee Structure boxes and escalation path arrows will vary by financial institution. Audit needs to validate that their AML compliance team has a well-documented committee structure and escalation protocol.
An effective AML governance structure is only possible when its leaders (senior management) of the organization consistently remain informed of the state of AML compliance within the institution across the firm.\textsuperscript{17}

**Defining Escalation Requirements for U.S. Head Office, Regions, and LOBs (Roles of Senior Management from These AML-Related Committees)**

See Exhibit 2 “AML Governance Committee Structure Table” above:

1. **Second Line of Defense AML Committees (U.S. Head Office)** – Larger banks often have one main global or holistic AML compliance committee, with the main purpose of discussing the AML program’s status and issues. The majority of members include AML compliance designated senior management from the U.S. Head Office, each of the LOBs, and each of the regions. Senior management from this committee and each of the committees below outside of the Board of Directors is ultimately responsible for implementing the board-approved AML program.\textsuperscript{14}

   **Escalation Path ‘A’**: The LOB committees and U.S. Head Office AML committees should escalate relevant AML issues back and forth as necessary as this promotes a culture of AML compliance with all necessary senior management parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items to promote a committee structure with transparency around escalations to the regulators.

   **Escalation Path ‘B’**: The region committees and the U.S. Head Office AML committees should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management parties involved for awareness and decision making purposes. AML compliance should track and document these escalated items as it signals a committee structure with transparency around escalations to the regulators.
2. **First and Second Line of Defense AML Committees (LOB Risk, Compliance, Control, or Business Committees)** – Larger banks often have LOB-specific committees that discuss risk, compliance, and/or controls for that LOB. The topic of AML will either have a sub-committee for each LOB or have a specific section within this LOB governance committee. The majority of committees will include senior management from each of the LOB three lines of defenses, but they should include an AML compliance designated senior management from that LOB.

**Escalation Path 'A':** The LOB committees and U.S. Head Office AML committees should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items as it signals a committee structure with transparency around escalations to the regulators.

**Escalation Path 'B':** The region committees and LOB committees should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items as it points to a committee structure with transparency around escalations to the regulators.

**Escalation Path 'C':** The individual LOB committees and the AML committee designated by the board should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management and board parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items as it expresses a committee structure with transparency around escalations to the regulators.

3. **First and Second Lines of Defense AML Committees (Region Committees)** -- Larger banks often have region-specific committees that discuss risk, compliance, and/or controls for that region. A region can also be referred to as a group of countries, jurisdictions, or legal entities. The topic of AML will either have a sub-committee for each region or have a specific section within the region's committee. The majority of committees will include senior management from each of the region's three lines of defenses but should include an AML compliance designated senior management from that region.

**Escalation Path 'B':** The region committees and U.S. Head Office AML committees should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items as it signals a committee structure with transparency around escalations to the regulators.

4. **AML Committee designated by the Board of Directors** – The board of directors is responsible for ensuring the bank has a comprehensive and effective AML program with oversight that is designed to promote compliance with AML regulations. It will also often have one committee designated to the AML program.
Escalation Path 

The individual LOB committees and the AML committee designated by the board should escalate relevant AML issues back and forth as necessary to promote a culture of AML compliance with all necessary senior management and board parties involved for awareness and decision-making purposes. AML compliance should track and document these escalated items as it demonstrates a committee structure with transparency around escalations to the regulators.

5. **Third Line of Defense (Internal Audit)** – Audit needs to demonstrate the effectiveness of the governance of the AML program by testing and documenting the existence and effectiveness of these escalations from start to finish. This demonstrates the holistic viewpoint of a global AML program. Audit must also be able to evidence to regulators through their test work papers, documentation, and final report issued that they validated the existence of a sufficiently defined and transparent AML governance structure. This structure should include an effective AML issue escalation protocol that is followed by the U.S. Head Office AML committee, LOB committees, region committees, and the board designated AML committee. Having a third line of defense that is able to opine on this AML governance committee structure transparency contributes to a stronger AML program from a holistic viewpoint.

An effective AML governance structure is only possible when leaders of the organization consistently remain informed of the state of AML compliance within the institution across the firm. The Audit Challenge #1 section below discusses solutions for audit to take a holistic approach when verifying that this is being accomplished by appropriately testing the AML governance committee process for the U.S. Head Office, regions and LOBs. Next, the Audit Challenge #2 section below then presents solutions for verifying that the constant interaction and communication of these governance committees is accomplished through an effective AML issue escalation protocol. Lastly, the Audit Challenge #3 section below presents solutions for verifying that the LOB role in this entire process promotes a culture of compliance that is not comprised by revenue interests.

**Audit Challenge #1 – Auditing the Holistic View of the AML Governance Committee Structure**

Since 2010, financial institutions have received significant consent orders with issues identified around banks not having a sufficiently defined and transparent governance structure that includes a defined AML issue escalation protocol:

**Capital One OCC Consent Order 2015:** “[the AML program] shall include…a governance structure with clear lines of responsibility, including for escalation of AML risk control decisions, beginning with senior management and including each effected line of business…in which accountability for BSA compliance is clearly communicated and enforced.”

**HSBC OCC Consent Order 2010:** “AML program is in place which…has an effective governance structure to allow the BSA Officer to administer the program, with clear lines of responsibility beginning with senior management and including each line of business ("LOB") that is required to comply with the BSA.”

**JPMC OCC Consent Order 2013:** “The Bank shall ensure there are clear lines of authority and responsibility for AML and OFAC compliance with respect to lines of business and corporate functions…”

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Wells Fargo OCC Consent Order 2015: “The Bank shall ensure and document that there are clear lines of authority and responsibility for AML compliance responsibilities within the Wholesale Banking Group (i.e., first line of defense) and within corporate oversight functions (i.e., second and third lines of defense)…”  

Citibank OCC Consent Order 2012: “The Bank shall ensure there are clear lines of authority and responsibility for compliance management and AML compliance…”  

Habib Bank (Pakistan) New York DFS Consent Order 2015: “The plan shall provide for a sustainable governance framework that…measures to ensure AML issues are appropriately tracked, escalated, and reviewed by the Branch’s senior management…”  

Agricultural Bank of China New York DFS Consent Order 2016: “The plan shall provide for a sustainable governance framework that…measures to ensure AML issues are appropriately tracked, escalated, and reviewed by the Branch’s senior management…”  

These consent orders illustrate that the regulators are demanding that the banks demonstrate clear AML program sustainability by implementing a governance framework that clearly defines the lines of authority and responsibility of AML senior management and the protocol to which AML control decisions and AML issues are to be escalated. These enforced actions on the first and second lines of defense of larger banks inevitably then trickle down to the third line of defense, or audit, to be able to evidence to regulators that they validated the existence of a sufficiently defined and transparent AML governance structure that includes an effective AML issue escalation protocol followed by the AML governance committee across the firm (U.S. Head Office, LOBs, regions). Audit can evidence completion of this newer responsibility by linking horizontal (or global) audits between the U.S. Head Office, region, and LOB audits, which are often tested by different audit teams around the same time of the year.

Linking Horizontal Audits between the U.S. Head Office, Regions, and LOBs

In the past, it was common for there to be standalone audits for one region or LOB for one part or process of the bank’s AML program. With the increased consent order environment, there has recently been a standardized approach across financial institution audit plans to take a horizontal (i.e., across all of the LOBs or globally) approach to the audit plan each year. Regulators have requested for audit to report findings with more of a holistic view of the AML program (i.e., auditing all of the LOBs and regions for one specific AML process or auditing the entire AML program for one legal entity or branch). OCC Testimony before the Homeland Security committee in 2012 even foreshadowed future examinations that will take more consideration of the holistic view of a bank’s AML program. The OCC further signaled the importance of this view in their 2014 Annual Report, where they reported that they will continue to focus on the holistic view of a bank’s AML compliance and that they will have a cross-functional review team to ensure consistency in large bank AML supervision and enforcement.

Even during a holistic or horizontal approach of an AML core function, a common problem is that these separate audits (performed by separate LOB or region audit teams) are not documented in work papers and final reports in such a way to evidence to regulators that audit not only tested the U.S. Head Office, each LOB and region, but also tested the interactions between the three groups. To link to the objectives of this paper, the common problem would be the challenge for audit-evidenced validation of the presence and effectiveness of escalations flowing between these different AML audits (i.e., between the U.S. Head Office, regions, and LOBs).

27 https://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG15024.pdf.
Office AML committee (that the U.S. Head Office Audit Team is testing), the LOB committees (that each of the individual LOB audit teams is testing), and the region committees (that each of the individual region audit teams is testing). The solution is for these separate audit teams to be in constant communication to ensure that these escalations between committees are tested and documented from start to finish. Both a weak and a strong example for an escalation originating in the U.S. Head Office AML committee is listed below:

**Weak**: The U.S. Head Office audit team identifies an LOB-related issue originating in one of the U.S. Head Office AML committee meetings that required escalation to that LOB committee. The U.S. Head Office audit team then documents that it traced this escalation to that LOB committee’s next meeting while documenting that no exceptions were noted.

**Strong**: The U.S. Head Office audit team identifies an LOB-related issue originating in one of the U.S. Head Office AML committee meetings that required escalation to that LOB committee. The U.S. Head Office audit team then documents that it traced this escalation to that LOB committee’s next meeting while documenting that no exceptions were noted. Next, the U.S. Head Office audit team communicates this AML issue escalation identified to that LOB’s audit team. Each audit team then documents the AML issue escalation from origination to destination to conclusion, including that the AML issue was appropriately handled at the destination committee (LOB committee). Then, in addition to audit teams documenting their work papers with the handling of this escalation, each team should also consider disclosing this communication and consideration between teams in their final report.

This evidences to the regulators that the third line of defense effectively communicated and worked together to validate that an AML governance committee structure is in place and that an effective and transparent AML issue escalation process was validated firm wide and not only from one of the three group’s viewpoint.

**Audit Challenge #2 – Auditing Vague AML Issue Escalation Protocol Definitions**

In addition to auditing that there is an AML issue escalation protocol in place, a common regulator examination weakness identified is that the types of issues and materiality thresholds of AML matters that warrant escalation are not clearly documented. It is important for audit to verify that there are processes in place to track each issue from start to finish from the originating committee (committee making the escalation) to the destination committee (committee receiving the escalation) and that the requirement and purpose for this escalation was appropriately defined and understood by both parties. Examples of purposes of AML issues requiring escalation vary by each financial institution, but common examples are awareness, action plan required, or for a decision of what the next steps should be from the destination committee. The challenge for audit is when the U.S. Head Office AML Compliance Group uses vague defining terms of what issues should be escalated. See Exhibit 3 below:

**Exhibit 3: AML Issue Escalation Gray Areas**

<table>
<thead>
<tr>
<th>Vague Terms of AML Issues That Require Escalation</th>
<th>Audit Needs to Get on Same Page with AML Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Significant AML Issues</td>
<td>What constitutes &quot;Significant&quot;? Does it vary based on AML topic or LOB?</td>
</tr>
<tr>
<td>High Risk AML Issues</td>
<td>What constitutes &quot;High Risk&quot;? Does it vary based on AML topic or LOB?</td>
</tr>
<tr>
<td>New AML Items or Issues</td>
<td>What constitutes &quot;New&quot;? Is there a threshold on which items are &quot;new&quot;?</td>
</tr>
<tr>
<td>Updated Procedure/Policy/Standard</td>
<td>What updated documents? Is this for all updated documents, or is there a threshold on when it needs to be escalated?</td>
</tr>
<tr>
<td>Negative AML Metric Trends</td>
<td>What are examples of what would be a negative AML Metric Trend? Is it a trend month over month or over three months...?</td>
</tr>
<tr>
<td>New Product or Services</td>
<td>What constitutes &quot;New&quot;? Is there a threshold on which items are &quot;new&quot;?</td>
</tr>
<tr>
<td>Updated BSA/AML Regulations</td>
<td>What updated regulations? Is this for all updated regulation considerations, or is there a threshold on when it needs to be escalated?</td>
</tr>
</tbody>
</table>
It is the responsibility of audit to verify that the U.S. Head Office AML compliance has a standard definition of exactly what will be escalated between all AML-related committees. It is not possible to capture 100 percent of possible scenarios, but the escalation requirements should not be so vague that it is difficult to effectively test for AML issue scenarios that should have been escalated but were not.

**Identifying What Types of Issues/Matters Should Really Be Escalated**

It is not the responsibility of audit to develop the types and thresholds of AML issues that require escalation; it is, however, audit’s responsibility to verify that the U.S. Head Office AML compliance has a standard definition of how and what will be escalated between all AML-related committees. All seven Consent Order examples identified in Audit Challenge #1 above have reference to either an inadequate escalation protocol or inadequate governance structure with clear lines of communication. Creating a framework or procedural document that defines the types of issues requiring escalation is only the first part of answering these regulator concerns. The bank’s AML compliance senior management must also clarify what constitutes “significant,” “high risk,” “new” or other adjectives used to describe AML issues, events, process or procedure updates, or business changes (see Exhibit 3 above). These types of issues requiring escalation between the various senior management governance committees (LOBs, U.S. Head Office, regions, and board designated AML committee) can only truly be standardized and understood by all committees when the definitions are detailed and not vague. This can be accomplished by adding detail to each AML issue escalation type or providing examples of each. If audit can test and verify that the escalation protocol is followed and tracked globally, then this evidences to the regulator that the three AML compliance groups (U.S. Head Office, LOBs, regions), through the AML-related committees, are linked holistically and that all participate in the AML issue escalation flow process/protocol.

**Identifying Where Types of Issues/Matters Should Be Escalated**

See the “Defining Escalation Requirements for U.S. Head Office, regions, and LOBs (roles of senior management from these AML-related committees)” section above for escalation paths that must be considered, documented and tested by audit.

**Tracking the Escalations from Start to Finish**

Audit can evidence the effectiveness and holistic flow of an AML program’s governance structure by testing and documenting both the existence and effectiveness of these escalations from start to finish between all applicable AML committees listed in Exhibit 4. Audit’s validation of these escalation paths increase the transparency of the information that is available to regulators, resulting in stronger AML programs and higher rated future regulator examinations as a direct result of participation from all lines of defense.28

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See the Exhibit 4 “AML Committee Escalation Paths” above:

It is important for audit to verify that there are processes in place to track each issue from start to finish from the originating committee (committee making the escalation) to the destination committee (committee receiving the escalation) and that the requirement and purpose for this escalation was appropriately defined and understood by both parties. In each of the possible AML issue escalation paths above (A-C) as illustrated in Exhibit 4, audit must indicate the effectiveness of this portion of their AML governance testing by documenting the existence and effectiveness of these escalations from origination to destination. A financial institution with a third line of defense that is able to appropriately opine on the AML governance committee escalation structure transparency contributes to a stronger AML program from a holistic viewpoint.

Solutions to this challenge above will help audit validate that the bank has an effective and transparent escalation process between all AML-related committees. This evidences to regulators that an AML issue is appropriately communicated across the firm to all applicable stakeholders and that U.S. Head Office AML compliance ensures that each is captured and recorded from origination to destination to conclusion.

Audit Challenge #3 – Auditing the LOB Role in the AML Governance Committee Process (Making Money vs. AML Compliance)

FinCEN’s “Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance” article reinforces the notion that a “financial institution can strengthen its AML compliance culture by ensuring efforts to manage and mitigate AML risks while not being compromised by sales interests.” Jennifer Shasky Calvery served as director of FinCEN. One of her most impactful messages to the larger banks was that “Compliance should not be compromised by revenue interests.” OCC 12 CFR Parts 30 and 170 as of 2014 define the first line of defense as any organizational unit within the bank that “engages in activities

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28 FinCEN, “Advisory to U.S. Financial Institutions on Promoting a Culture of Compliance.”
29 OCC, “12 CFR Parts 30 and 170.”

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designed to generate revenue for the parent company or Bank.” From an AML governance committee structure view (Exhibit 2), this corresponds to the LOB committees.

Larger banks often have LOB-specific committees that discuss risk, compliance, and/or controls for that LOB. The topic of AML will either have a sub-committee for each LOB or have a specific section within this LOB governance committee. The majority of members will include senior management from each of the LOB three lines of defenses but should also include an AML compliance designated senior management from that LOB. As LOB committees are involved in the AML issue escalation communication process, audit’s challenge also includes ensuring that revenue interests of the LOBs do not threaten noncompliance with BSA regulations.

### Exhibit 5. LOB Committees and AML Committee Culture of Compliance

1. Second Line of Defense AML Committees (US Head Office)

2. First and Second Line of Defense AML Committees (LOB Risk, Compliance, Control, or Business Committees)

As illustrated in Exhibit 5 above, LOB committees and the U.S. Head Office main AML committee should have some type of back and forth escalation path between the two (see escalation path ‘A’ illustrated in Exhibit 5 above). One way audit can validate that a culture of compliance is being demonstrated from an LOB viewpoint is to confirm that the LOB committees have an AML compliance senior manager (or at least a compliance senior manager) as a second line of defense member with the ability to question the strategy and specific actions of other LOB senior management members from the first line of defense (such as the CEO). Also, the U.S. Head Office AML committee should have an AML compliance senior management member from each LOB. This demonstrates that the structure is set up to promote AML compliance, with senior management having a voice in any revenue-driven decision that could bring too much AML risk. Audit should also verify that AML compliance senior management from each of the LOBs is involved and part of the approval process for any new businesses or services that each business’s first line of defense is planning or reviewing the possibility of adding. The first line of defense senior management members that sit on these LOB committees will often have the bank’s revenue interests as a number one priority compared to the second line of defense AML compliance senior management who counters this and provides a balance with the role and responsibility for considering the risks of potential BSA non-compliance. Audit’s responsibility from the third line of defense is to confirm that this is occurring to evidence to regulators in future examinations. It would be beneficial to add a specific test step for validating that the AML governance committee structure promotes a culture of compliance with all revenue-driven decisions being reviewed for AML risk and consequences before implementation or approval.

### Takeaway – Designing the Audit for these Challenges Will Strengthen the Audit and AML Program

Financial institutions have been receiving a significant number of consent orders from regulators with issues identified around banks not having a sufficiently defined and transparent governance structure that includes a defined AML issue escalation protocol. These enforced actions on the first and second lines of defense of larger banks inevitably then trickle down (see Exhibit 6) to the third line of defense, or audit, to be able to evidence to regulators through testing work papers, documentation, and final reports issued that they appropriately validated the existence of a sufficiently defined and transparent AML governance structure that includes an effective AML issue escalation protocol followed by the AML governance committee across the firm (U.S. Head Office, LOBs, regions), while also promoting a culture of compliance that is not comprised by revenue interests.
There have also been regulator recommendations for audit to test and report at more of a holistic or cross-LOB level similarly to how the second line of defense is being instructed to create a governance structure with clear lines of responsibility and inclusive of AML risk control decisions escalation, beginning with senior management and including each effected line of business.19 OCC Testimony, before the Homeland Security Committee in 2012, foreshadowed future examinations that will take more consideration of the holistic view of a bank’s AML program.30 The OCC further demonstrated the seriousness of this view in their 2014 Annual Report, where they reported that they will continue to focus on the holistic view of a bank’s AML compliance and that they will have a cross-functional review team to ensure consistency in bank AML supervision and enforcement31.

Implementing the recommended solutions to these audit challenges will solidify audit’s role in demonstrating clear AML program sustainably. This can be demonstrated through smarter validation approaches that the bank has an effective AML governance committee structure to ensure that adequate oversight is captured from not just the AML Compliance Group of the firm-wide U.S. Head Office, but also from each of the regions and LOBs. These solutions and strategies will also help audit validate that the bank has an effective and transparent AML issue escalation process between each of these above groups to evidence that an AML issue can be captured and recorded from origination to conclusion while promoting a compliance culture uncompromised by revenue interests. Audit departments of banks should understand that they are not simply implementing and documenting escalation protocols for the sake of compliance, but rather they are increasing the transparency that financial institutions provide under regulator examinations, resulting in not only a stronger final issued audit report but also a stronger AML program from all lines of defense.32

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31 https://www.treasury.gov/about/organizational-structure/ig/Audit%20Reports%20and%20Testimonies/OIG15024.pdf.
Appendix

Acronyms and terms defined:

AML: Anti-Money Laundering
BSA: Bank Secrecy Act
CEO: Chief Executive Officer
CFR: Code of Federal Regulations
DFS: Department of Financial Services
FDIC: Federal Deposit Insurance Corporation
FFIEC: Federal Financial Institutions Examination Council
FinCEN: Financial Crimes Enforcement Network
HSBC: Hong Kong and Shanghai Banking Corporation Limited
JPMC: JP Morgan Chase
KYC: Know Your Customer
MRA: Matter Requiring Attention
MRIA: Matter Requiring Immediate Attention
OFAC: Office of Foreign Assets Control
OCC: Office of the Comptroller of the Currency