



## 5 Five questions to ask yourself about your DFS readiness

New requirements from the New York Department of Financial Services (DFS) provide opportunity to strengthen sanctions quality assurance and testing programmes.

Last year, the New York Department of Financial Services (DFS) announced the adoption of new risk-based anti-terrorism and anti-money laundering regulation.

The rules, which apply to banks operating in New York State, require banks to maintain appropriate watch list filtering and transaction monitoring programmes. Under the new rules, banks also have to ensure that their systems are working correctly and certify that their filtering and transaction monitoring programmes are compliant.

It is important to note that complying with the DFS requirements doesn't need to be a sunk cost – and that the new rules should be approached as an opportunity rather than a challenge.

Instead of viewing DFS as a tick-box exercise, banks can use the new requirements as an opportunity to build comprehensive and ongoing quality assurance programmes and implement regular testing.

The benefits of this approach can be considerable: armed with a greater understanding of how their screening systems work, banks may be able to tune their systems more effectively and thereby reduce false positives.

By documenting how their systems work, banks may also be able to make their compliance regimes more robust, resulting in greater confidence during regulatory examinations. As such, the new requirements can enable banks to reduce costs while improving the effectiveness and efficiency of their whole environment.

First, though, financial institutions will need to understand both the requirements themselves and the steps that will need to be taken in order to achieve compliance and leverage opportunities for improvement. As such, banks should ask themselves several questions, as outlined further.



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## SWIFT's utility model delivers:

- Scalability to address the needs of customers of different sizes, in different locations, with different compliance requirements
- Secure SWIFT hosting for rapid implementation, cost transparency and data security
- Integration of third-party services such as PEP and research-based 'sectoral sanctions' lists
- The combination of – and interaction between – different services in the portfolio

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### Should we tackle this in-house or work with an external provider?

One of the key questions to ask is whether testing should be tackled in-house, or whether an external provider should be used. On the one hand, it may be beneficial to empower resources within the organisation with the ability to provide the necessary assurance. However, not all institutions will have the necessary resources available, meaning that an external provider may be required.

It is important to understand that providing the required level of assurance can be a complex and costly undertaking. The difficulty involved in solving this complex problem manually is often underestimated, as there are many different changes that banks can make to their policies and to the way in which they approach screening. If this is tackled internally, it is likely that the results can only be superficial. If a bank wishes to go to the heart of the problem, it will be necessary to work with an external provider.

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### Does our filter supplier provide reporting to support our self-certification?

Regulators are increasingly asking questions about how financial institutions' filters operate. These questions can focus at a granular level on issues such as how different algorithms operate and what will happen if certain settings are changed. This level of understanding only comes from having a robust testing arrangement in place for the filter.

Banks often believe that there is no need to test their filters because their filter provider does this for them. However, this somewhat misses the point: the provider may be in a position to certify that the filter works, but what really matters is how banks are using the tool within their businesses to implement their respective policies. In any case, many filter suppliers are not independently tested.

As such, banks don't just need to test the filter, but also its effectiveness in conjunction with the relevant controls, processes and policies. However, it can be difficult to do this in-house due to the depth and breadth of testing knowledge required.

One way in which institutions can carry out testing is by asking one of the large consulting firms to run a test on their filter, although as a one-off exercise this may have limited value. For many institutions, a better option might be Sanctions Testing, from SWIFT. Sanctions Testing can be used by the organisation as often as necessary with different parameters to assess the performance of filters and the quality of list data in order to provide independent quality assurance.

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### How can we align procedures with our internal risk appetite, policies and standards – and how can we demonstrate that we have done so?

As part of compliance with the DFS requirements, it is essential to be able to demonstrate the correlation between regulation, policy, implementation and testing. As such, it is important to have proper procedures that document how people should handle specific tasks. Aligning procedures, standards and policies needn't be problematic – with the right procedures in place, people will be able to comply with the relevant standards and policies.

Demonstrating that this has been achieved is a slightly different challenge, however. An annual appraisal will typically be carried out by the bank's internal audit team, providing an opportunity to demonstrate that a set of procedures is in place in accordance with the bank's standards and policies. This will also be reinforced by a quality assurance exercise in order to assess the competency of the individual who is undertaking the investigation. In many cases, the people in question will have an internal level of accreditation, and will be removed from carrying out investigations and retrained if they drop below a certain level.

Finally, under the DFS regime a senior compliance person will need to sign off to the board annually that everything is working as it should do. Having the proper procedures and quality assurance mechanisms in place and ensuring that they are being followed will enable the responsible person to certify compliance with confidence.

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### How can I compare what we are doing against the rest of the industry?

Beyond testing, a lot of banks are looking for assurance that they are approaching this area in the same way as their peers. However, it is not always easy to achieve this in practice. For one thing, many banks regard their settings as intellectual property and may therefore be unwilling to share information about what they are doing. It is also important to note that there is little benefit to comparing the approaches taken by a large global bank and a small regional bank.

Any meaningful comparison therefore has to be made by comparing like for like, and by doing so in an anonymous way without divulging the settings that particular banks are using. Sanctions Testing, for example, enables banks to compare the performance of their filters against that of peer institutions with similar business profiles and risk appetites.

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### How can I inspire confidence in my board and overseer?

When it comes to inspiring confidence in the board, evidence is key. The more evidence the compliance staff can provide that procedures are working as expected, the greater the level of confidence the board will have.

Compliance staff therefore need to give board members clear, understandable headline messages. Being able to say that every single record on the list has been tested, or that the institution's continuous assurance programme is resulting in a deeper understanding of its screening capabilities, can go a long way towards providing the required level of confidence.

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## Conclusion

The new DFS requirements have substantial implications for banks. As such, institutions need to be aware of their obligations under the rules, from inspiring confidence in the board to testing the effectiveness of filters.

While this presents certain challenges, banks should approach the new DFS rules not as a tick-box exercise, but as an opportunity to improve the efficiency and effectiveness of their existing processes. Rather than setting out to comply with the requirements, banks should consider how they can use these requirements to their advantage – for example, by adopting sophisticated quality assurance programmes and implementing regular testing regimes.

This approach may enable banks to achieve considerable benefits beyond the required level of compliance, from reducing false positives to improving confidence levels during a regulatory examination.

## Sanctions Testing

Sanctions Testing is a secure, hosted tool that enables banks to test their sanctions filters and lists and optimise screening performance, either at scheduled intervals or on demand.

As well as delivering independent quality assurance of banks' transaction, customer and PEP filters, the service assesses filter models, fuzzy matching and false positives in order to improve performance iteratively.

Peer Assessment, an optional add-on, enables users to evaluate the performance of their filters against data from other participating users.

### SWIFT's sanctions compliance services

#### Sanctions Screening

This fully-managed, securely hosted service lets you screen incoming and outgoing transactions against all leading watch lists, Sanctions Ownership Research lists from Dow Jones, and your own private lists.

#### Name Screening

Hosted by SWIFT, Name Screening enables you to screen individual customer names (and soon customer and PEP databases) as part of your ongoing compliance process.

#### Sanctions Testing

Enables customers with their own sanctions filters to test and certify the effectiveness and efficiency of their transaction, customer and PEP filters.

#### Sanctions List Distribution

Packages up-to-date public watch lists with additional BIC enrichment for download in standard and advanced XML format.



## About SWIFT

SWIFT is a global member owned cooperative and the world's leading provider of secure financial messaging services. We provide our community with a platform for messaging and standards for communicating, and we offer products and services to facilitate access and integration, identification, analysis and regulatory compliance.

Our messaging platform, products and services connect more than 11,000 banking and securities organisations, market infrastructures and corporate customers in more than 200 countries and territories. While SWIFT does not hold funds or manage accounts on behalf of customers, we enable our global community of users to communicate securely, exchanging standardised financial messages in a reliable way, thereby supporting global and local financial flows, as well as trade and commerce all around the world.

As their trusted provider, we relentlessly pursue operational excellence; we support our community in addressing cyber threats; and we continually seek ways to lower costs, reduce risks and eliminate operational inefficiencies. Our products and services support our community's access and integration, business intelligence, reference data and financial crime compliance needs. SWIFT also brings the financial community together – at global, regional and local levels – to shape market practice, define standards and debate issues of mutual interest or concern.

Headquartered in Belgium, SWIFT's international governance and oversight reinforces the neutral, global character of its cooperative structure. SWIFT's global office network ensures an active presence in all the major financial centres.

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