

# Independent Verification and Validation (IVV) Survey: Result Details

Conducted 1st quarter 2015

## *Introduction:*

In the first quarter of 2015, we conducted a survey about an Independent Verification and Validation (IVV) to get a better understanding of what financial institutions are doing about them, if at all. We wanted to know if the institutions we spoke have had their anti-money laundering (AML) software program, which including BSA, OFAC, CDD/KYC and FinCEN 314(a) software; if so, who conducted it; how frequently; who remediated; were the costs associated more or less costly than the validation itself. If not, why haven't they conducting an Independent Verification and Validation (IVV) of their AML software; when were they planning on doing so; what software program would they focus their efforts on. Some of the answers were what we expected, some were not.

Before we asked any questions, we defined what we meant by an Independent Verification and Validation (IVV). We defined Model Validations; Independent Verification and Validation; IVV; or just "Validation" as a system review and written report for your financial institution on your AML compliance software. Further, we define "AML compliance software program" as an anti-money laundering compliance software program, which includes BSA, OFAC, CDD/KYC, and FinCEN 314(a).

For the summary of the Independent Verification and Validation (IVV) Survey, [click here](#). This report compares five types of businesses (Retail, Commercial, Wholesale, Correspondent and Broker Dealer/Securities) who responded to our IVV survey to demonstrate the differences.

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## Retail Bank Details:

Figure 1: Type of Institution, Retail Banks

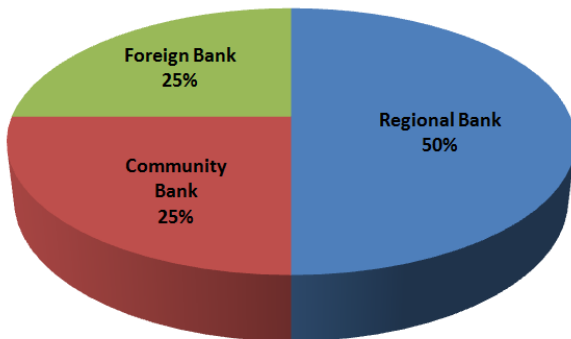


Figure 2: Job Title, Retail Banks

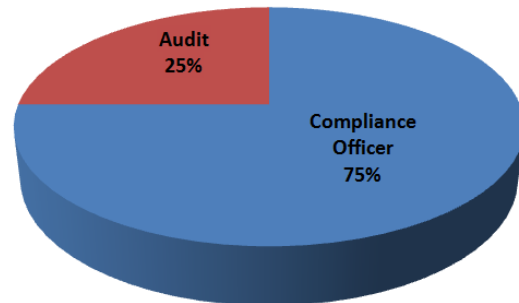


Figure 3: Have you ever conducted a model validation, Retail Banks

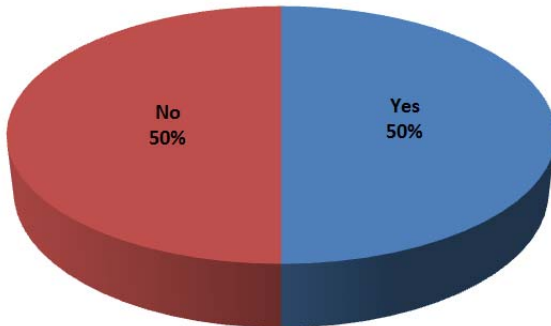


Figure 4: When was the last time you conducted a model validation, Retail Banks



Figure 5: What program(s) have you completed a model validation on, Retail Banks

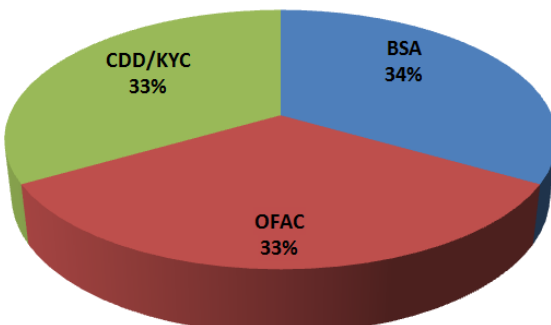


Figure 6: How often do you conduct a model validation, Retail Banks

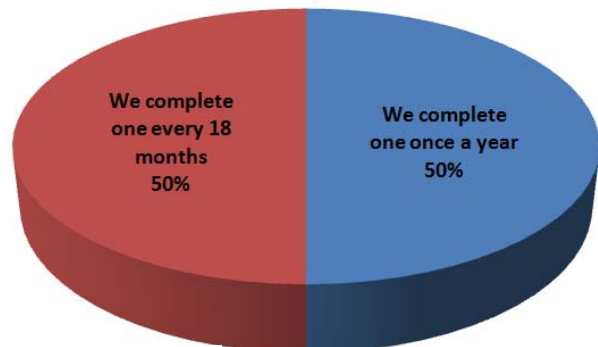
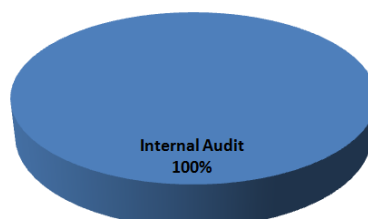
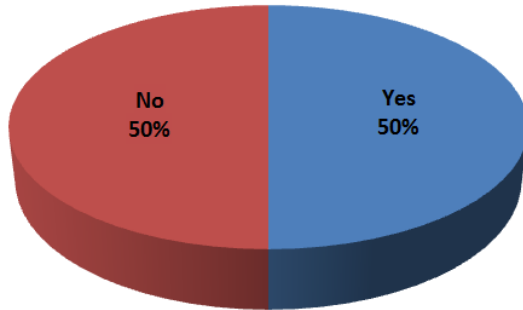


Figure 7: Who conducted your model validation, Retail Banks

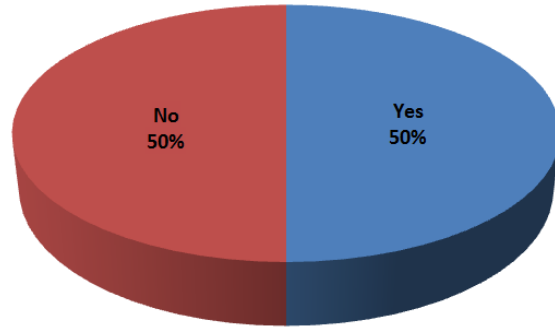


*Retail Bank Details cont.:*

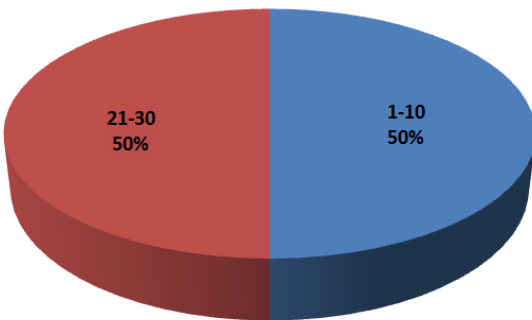
**Figure 8: Has a model validation helped with regulatory compliance, Retail Banks**



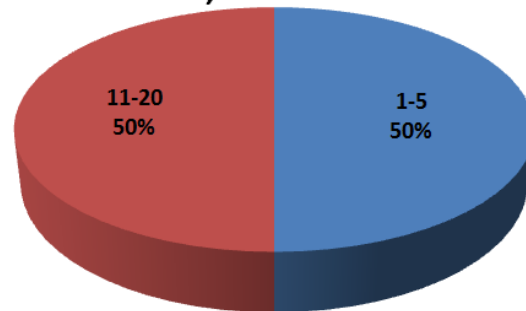
**Figure 9: Did you conduct a model validation because of regulatory requirement, Retail Banks**



**Figure 10: How many issues did you discover through a model validation, Retail Banks**



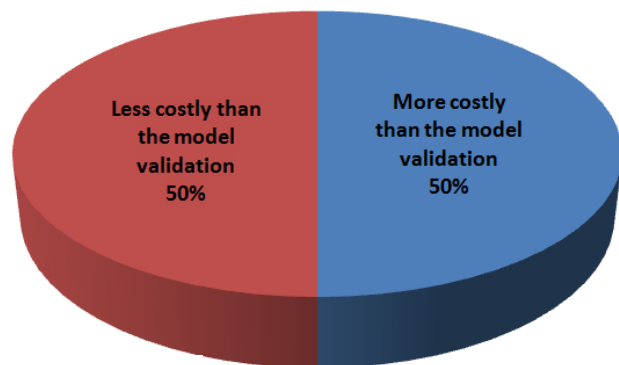
**Figure 11: How many were critical issues, Retail Banks**



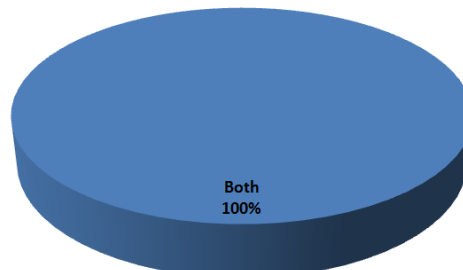
**Figure 12: How did you remediate, Retail Banks**



**Figure 13: Was remediation more or less costly than the model validation, Retail Banks**



**Figure 14: Of those who conducted a model validation, do you conduct continuous monitoring, self-assessments or both, Retail Banks**



## Retail Bank Details cont.:

Figure 15: Why haven't you completed a model validation, Retail Banks



Figure 16: Are you planning on conducting a model validation, Retail Banks

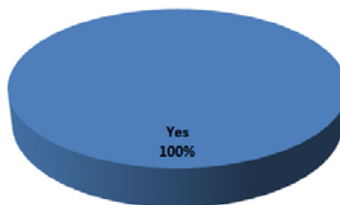


Figure 17: When are you planning on conducting a model validation, Retail Banks

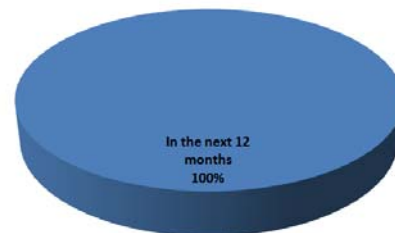


Figure 18: What program(s) are you considering to complete a model validation on, Retail Banks

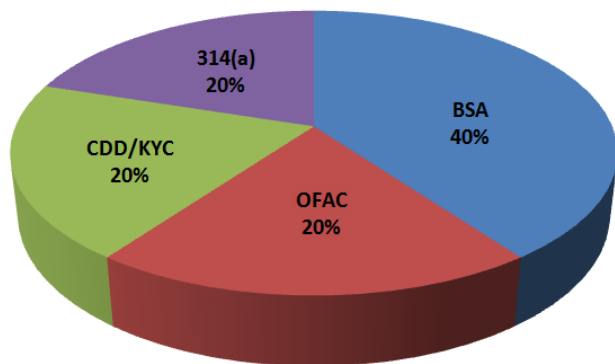
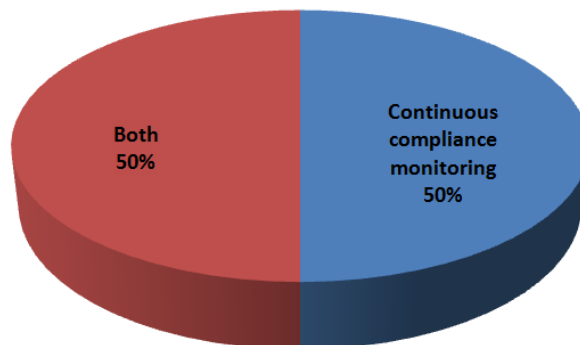


Figure 19: Of those who have not conducted a model validation, do you conduct continuous monitoring, self-assessments or both, Retail Banks



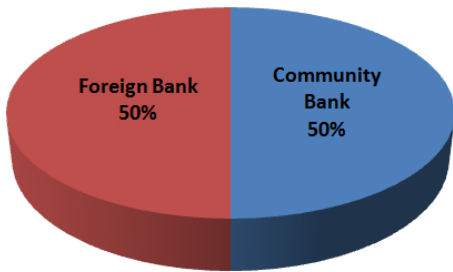
### Retail Bank Summary:

A majority of the retail bank respondents represent a compliance officer at a regional bank. They're split equally between those who have conducted a model validation vs. those who haven't; however, for those who have, they utilized their internal audit to complete it in the last six months. They're also equally split between the software systems they focused on: BSA, OFAC and CDD/KYC. They completed a model validation once every 12 or 18 months. Half of all respondents conducted a model validation because of regulatory requirement, but half of them also said that it did not help with regulatory compliance. All respondents remediated the 1-30 issues of which 1-20 issues were listed as critical internally with 50% saying that the remediation was less costly than the model validation itself. Further, all retail bank respondents conducted both an on-going continuous compliance monitoring program and self-assessments.

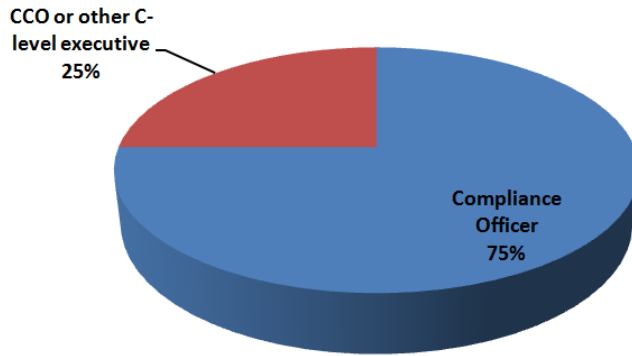
They were the only business type to represent the 18% of overall respondents that have not conducted a model validation ever. They said their biggest challenge is budget constraints. However, they do plan on conducting one in the next 12 months most likely on their BSA system, followed by in order of importance: OFAC, CDD/KYC and FinCEN 314(a). Finally, half of this group conducted only an on-going continuous compliance monitoring program while the other half conducted a continuous compliance program as well as self-assessments.

*Commercial Bank Details:*

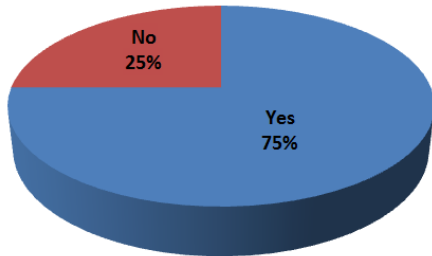
**Figure 1: Type of Institution, Commercial Banks**



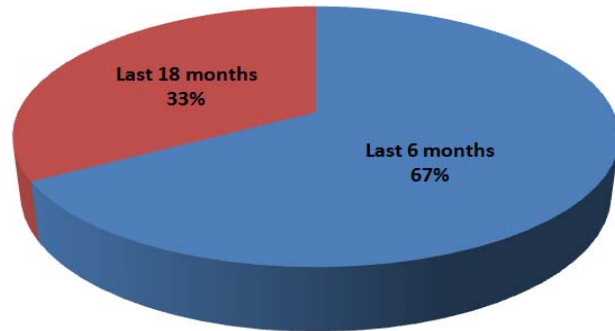
**Figure 2: Job Title, Commercial Banks**



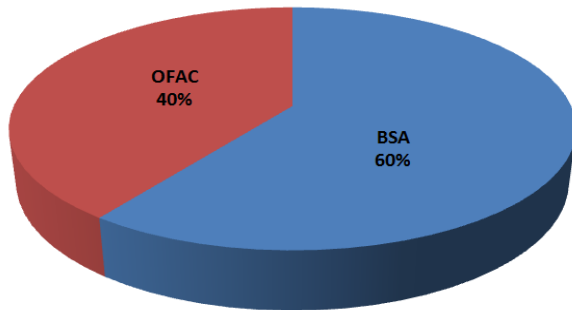
**Figure 3: Have you ever conducted a model validation, Commercial Banks**



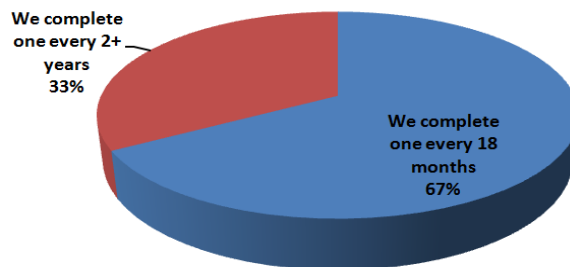
**Figure 4: When was the last time you conducted a model validation, Commercial Banks**



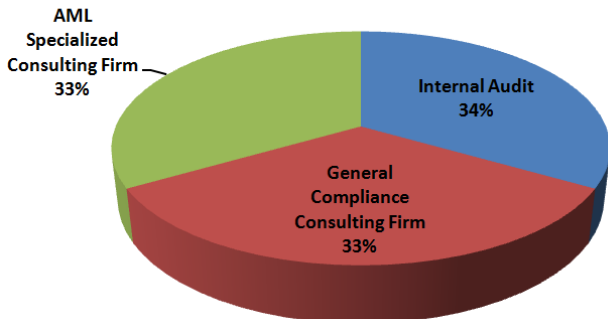
**Figure 5: What program(s) have you completed a model validation on, Commercial Banks**



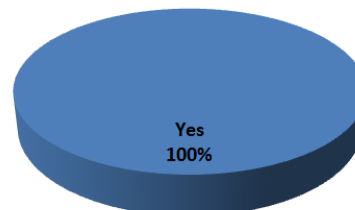
**Figure 6: How often do you conduct a model validation, Commercial Banks**



**Figure 7: Who conducted your model validation, Commercial Banks**

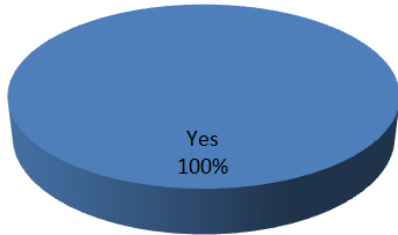


**Figure 8: Has a model validation helped with regulatory compliance, Commercial Banks**

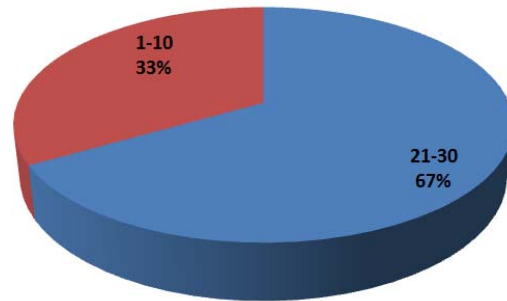


*Commercial Bank Details cont.:*

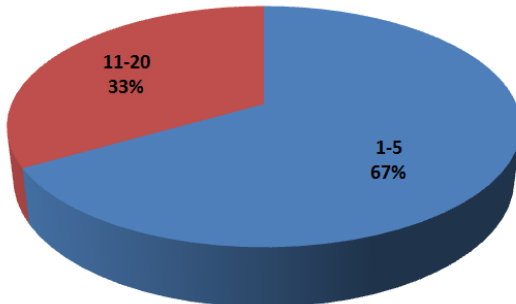
**Figure 9: Did you conduct a model validation because of regulatory requirement, Commercial Banks**



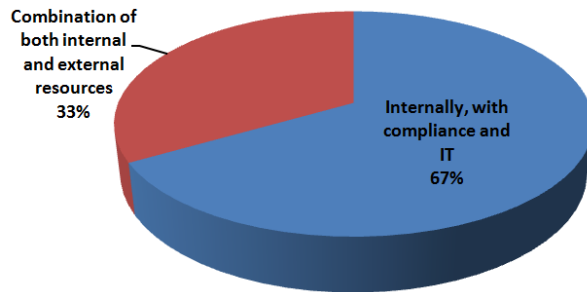
**Figure 10: How many issues were discovered because of a model validation, Commercial Banks**



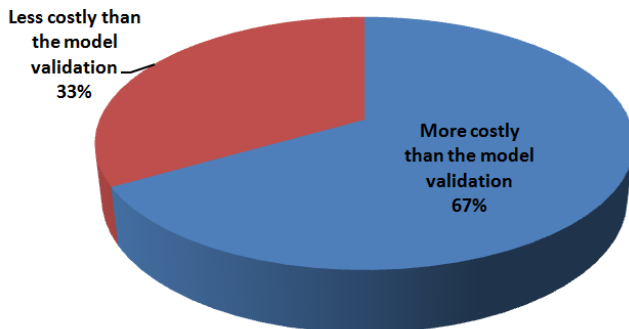
**Figure 11: How many were critical issues, Commercial Banks**



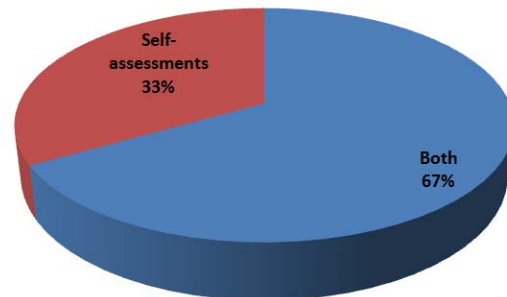
**Figure 12: Did you remediate internally, externally or a combination, Commercial Banks**



**Figure 13: Was the remediation more or less costly than the model validation, Commercial Banks**



**Figure 14: Of those who conducted a model validation, do you conduct continuous compliance monitoring, self-assessments or both?**

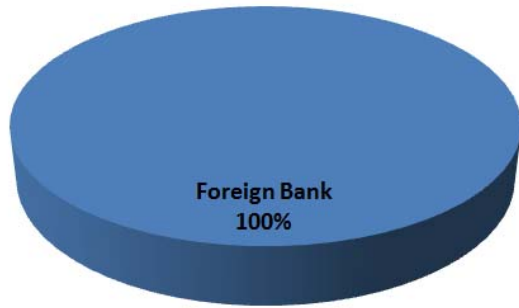


**Commercial Bank Summary:**

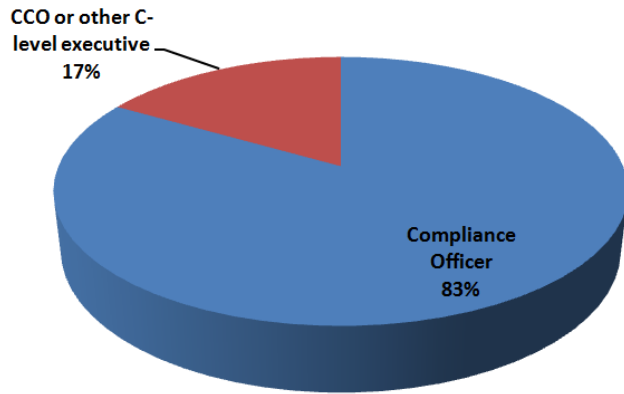
A majority of our commercial bank respondents represented a compliance officer at a community bank or foreign bank. Most of them have conducted a model validation in the last 6 or 18 months. They're primarily focused on BSA; however, they have also conducted a model validation on an OFAC system as well. Historically, they have conducted a model validation every 18 months to 2+ years, but they're equally split on who they prefer to complete the model validation between internal audit, a general compliance consulting firm, and an AML specialized consulting firm. They all said that they conducted a model validation because of regulatory requirement, but that it helped their regulatory requirements. They have discovered anywhere between 1-30 issues of which 1-20 were critical. A majority of respondents utilized their compliance and IT departments internally to remediate, but a third of them also brought in external resources. Regardless, the majority spent more on the remediation than the model validation itself. Most of them conducted both an on-going continuous compliance monitoring program and self-assessments.

*Wholesale Bank Details:*

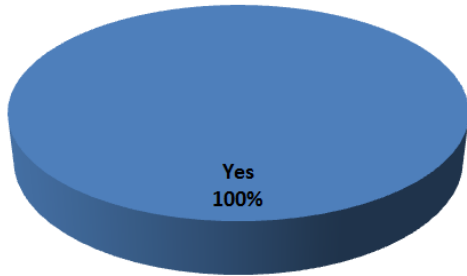
**Figure 1: Type of Institution, Wholesale Banks**



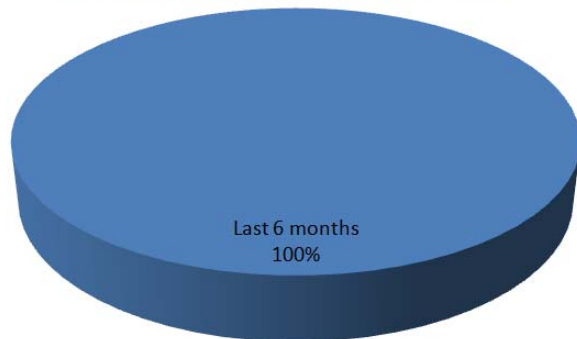
**Figure 2: Job Title, Wholesale Banks**



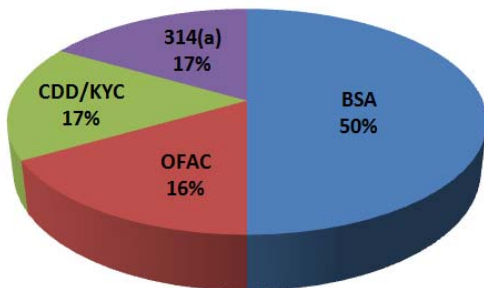
**Figure 3: Have you conducted a model validation, Wholesale Banks**



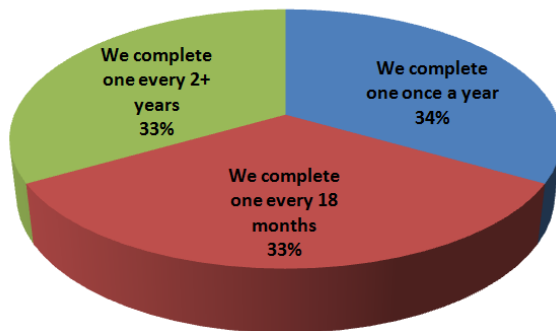
**Figure 4: When was the last time you conducted a model validation, Wholesale Banks**



**Figure 5: What program(s) have you conducted a model validation on, Wholesale Banks**



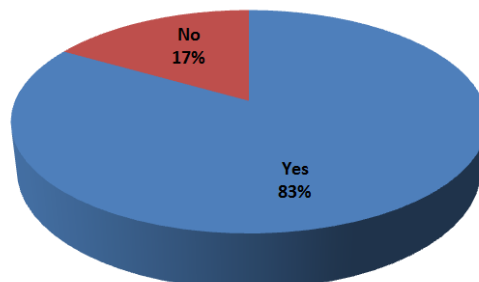
**Figure 6: How often do you conduct a model validation, Wholesale Banks**



**Figure 7: Who conducted your model validation, Wholesale Banks**

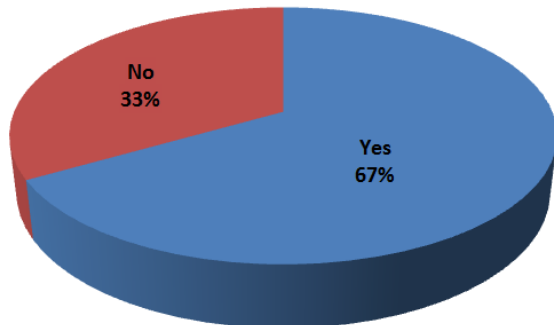


**Figure 8: Has a model validation helped with regulatory compliance, Wholesale Banks**

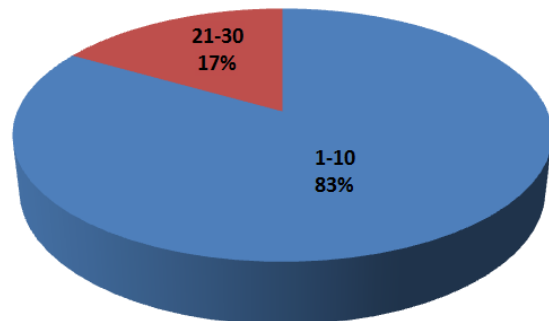


**Wholesale Bank Details cont.:**

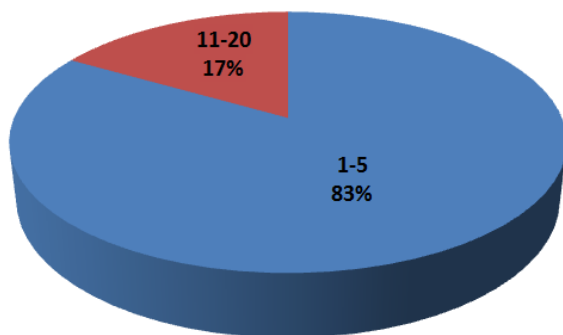
**Figure 9: Did you conduct a model validation because of regulatory requirement, Wholesale Banks**



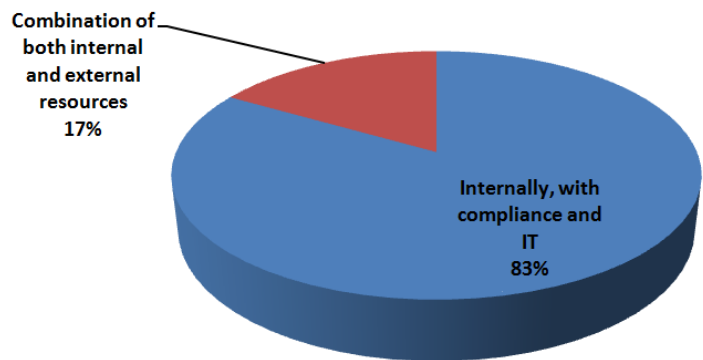
**Figure 10: How many issues did you discover through your model validation, Wholesale Banks**



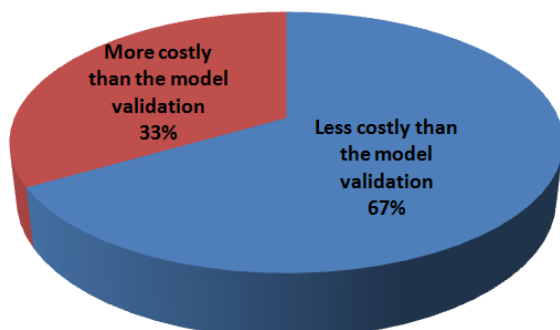
**Figure 11: How many were critical issues, Wholesale Banks**



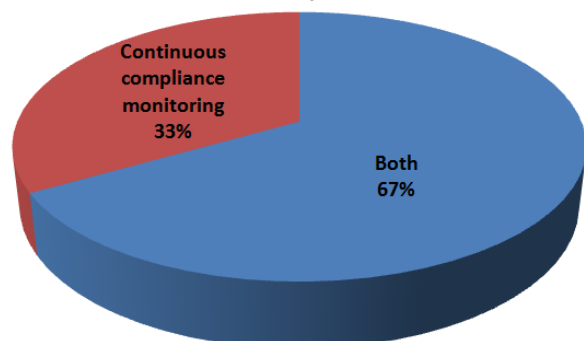
**Figure 12: Did you remediate internally, externally, or a combination, Wholesale Banks**



**Figure 13: Was the remediation more or less costly than the model validation, Wholesale Banks**



**Figure 14: Of those who did conduct a model validation, do you conduct continuous compliance monitoring, self-assessments or both, Wholesale Banks**



**Wholesale Bank Summary:**

A resounding 100% of our wholesale banks represented a foreign bank, and most of them are compliance officers. All of our respondents have conducted a model validation in the last six months. Their primary focus has been on a BSA system. They're equally torn on how often they conduct a model validation but it ranges from every year to two. Half of our wholesale respondents utilized their internal audit to conduct their model validation, whereas the other 50% utilized an AML specialized consulting firm. A majority of them conducted a model validation because of regulatory requirement and most of them agree that it has helped with their regulatory compliance. They discovered anywhere between 1 and 30 issues of which 1-20 were listed as critical. Most of them spent more on the remediation than the model validation itself but used internal resources, such as compliance and IT. Most of them conducted both a continuous compliance monitoring program and self-assessments.



## Correspondent Bank Details:

Figure 1: Type of Institution, Correspondent Banks

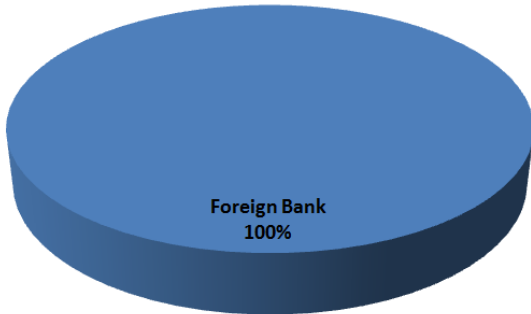


Figure 2: Job Title, Correspondent Banks



Figure 3: Have you ever conducted a model validation, Correspondent Banks

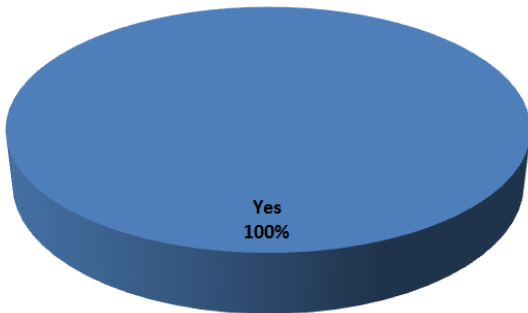


Figure 4: When was the last time you conducted a model validation, Correspondent Banks

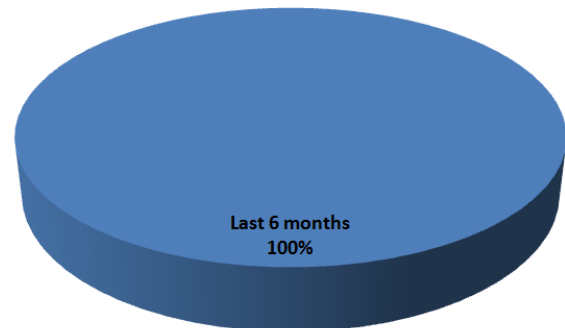


Figure 5: What program(s) have you completed a model validation on, Correspondent Banks

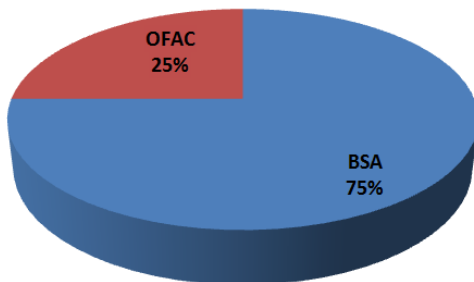


Figure 6: How often do you conduct a model validation, Correspondent Banks

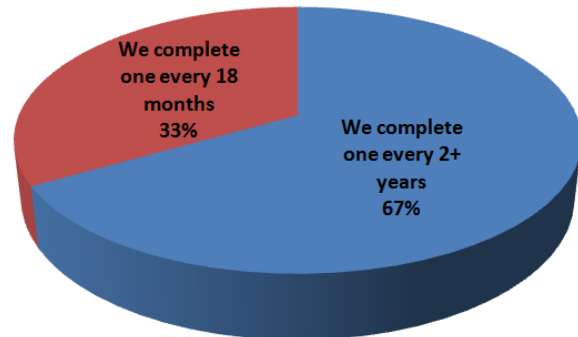


Figure 7: Who conducted your model validation, Correspondent Banks

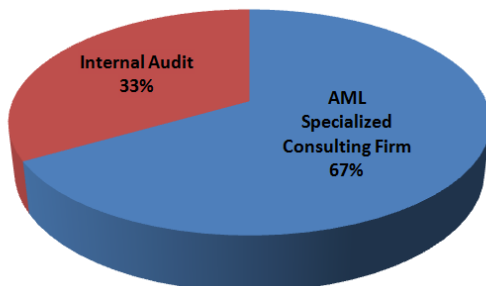
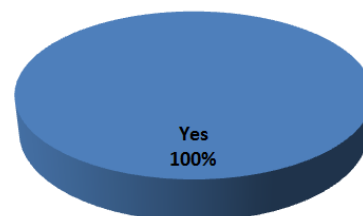
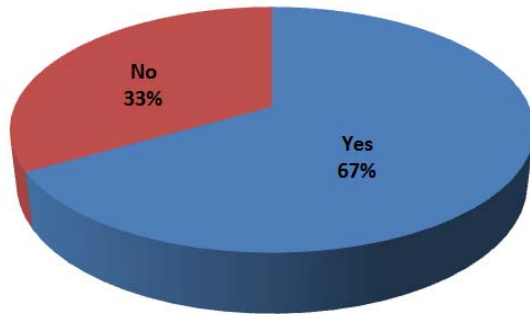


Figure 8: Has a model validation helped with regulatory compliance, Correspondent Banks

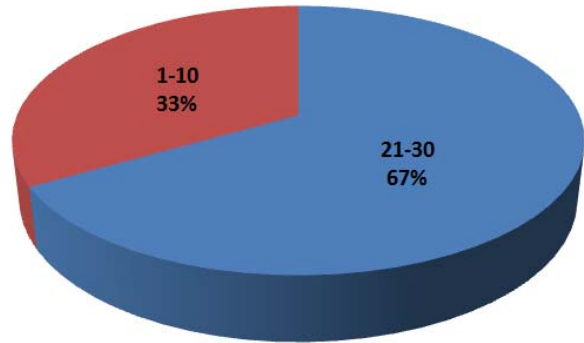


## Correspondent Bank Details cont.:

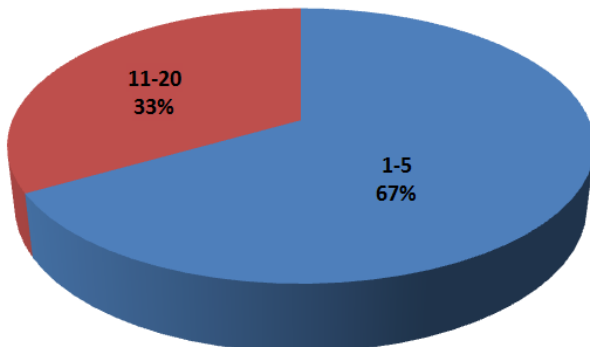
**Figure 9: Did you conduct a model validation because of regulatory requirement, Correspondent Banks**



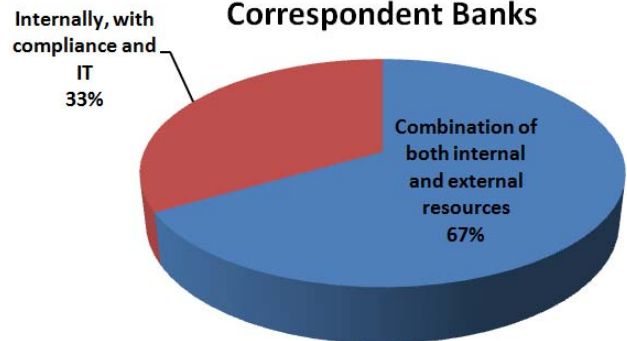
**Figure 10: How many issues did you discover, Correspondent Banks**



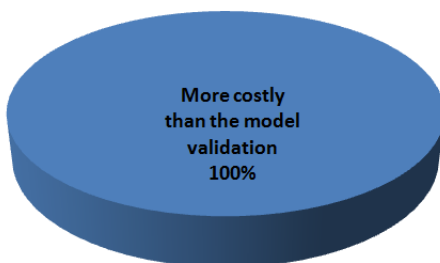
**Figure 11: How many issues were listed as critical, Correspondent Banks**



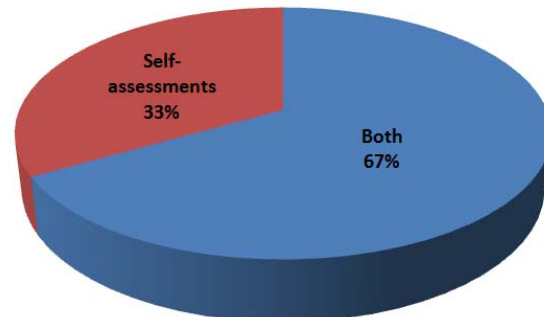
**Figure 12: Did you remediate internally, externally, or a combination, Correspondent Banks**



**Figure 13: Was the remediation more or less costly than the model validation, Correspondent Banks**



**Figure 14: Of those who conducted a model validation, do you conduct continuous compliance monitoring, self-assessments or both, Correspondent Banks**

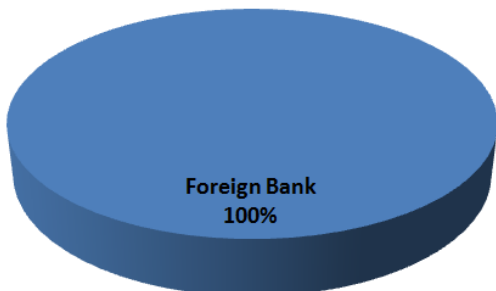


### Correspondent Bank Summary:

All of our correspondent bank respondents represented a compliance officer at a foreign bank. All of them have also completed a model validation in the last six months, and most of them were completed by an AML specialized consulting firm. Historically their focus has been on their BSA software system, but they only conduct a model validation every 18 months to 2+ years. A majority of respondents said that they conducted a model validation because of regulatory requirement, but 100% of them said that it helped with their regulatory compliance. They discovered anywhere between 1 and 30 issues of which 1-20 were listed as critical. All respondents said that they spent more on the remediation than the model validation itself but most of them used a combination of internal and external resources. Finally, most of them conducted both a continuous compliance monitoring program and self-assessments.

**Broker Dealer/Securities Firm Details:**

**Figure 1: Type of Institution, Broker Dealer/Securities Firm**



**Figure 2: Job Title, Broker Dealer/Securities Firm**



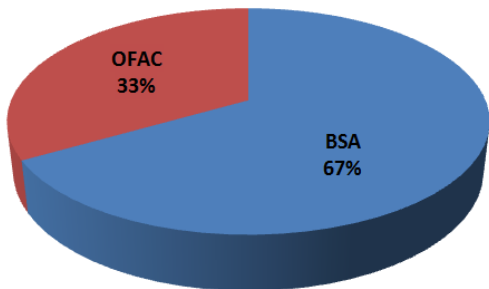
**Figure 3: Have you ever conducted a model validation, Broker Dealer/ Securities Firm**



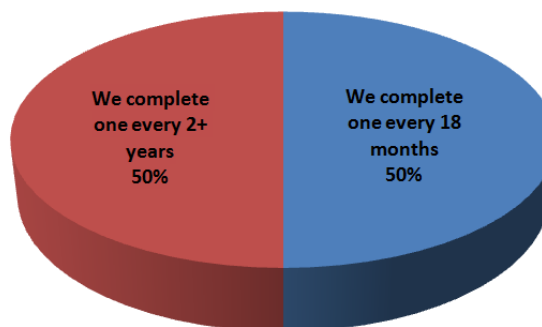
**Figure 4: When was the last time you conducted a model validation, Broker Dealer/ Securities Firm**



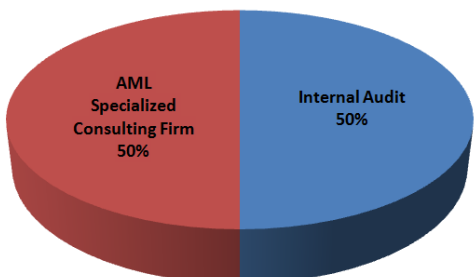
**Figure 5: What program(s) have you completed a model validation on, Broker Dealer/ Securities Firm**



**Figure 6: How often do you conduct a model validation, Broker Dealer/ Securities Firm**



**Figure 7: Who conducted your model validation, Broker Dealer/ Securities Firm**

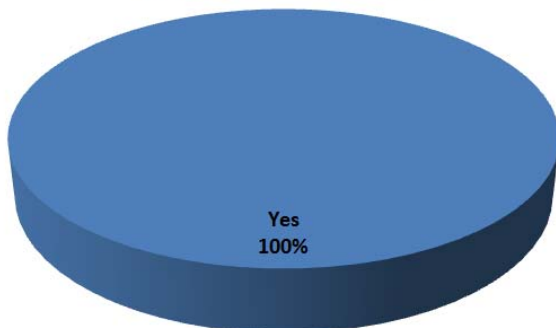


**Figure 8: Has a model validation helped with regulatory compliance, Broker Dealer/ Securities Firm**

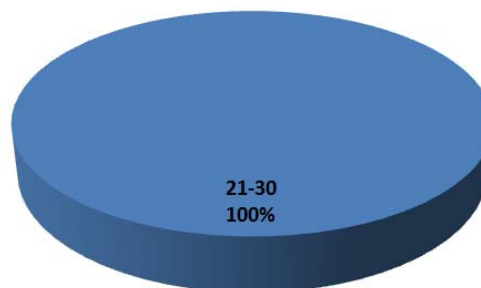


## Broker Dealer/Securities Firm Details Cont.:

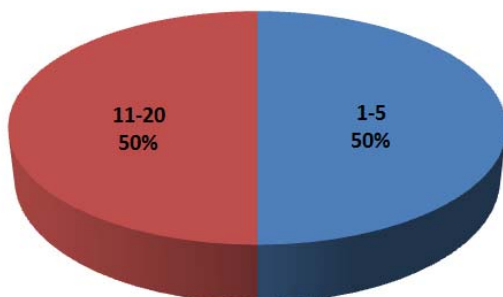
**Figure 9: Did you conduct a model validation because of regulatory requirement, Broker Dealer/ Securities Firm**



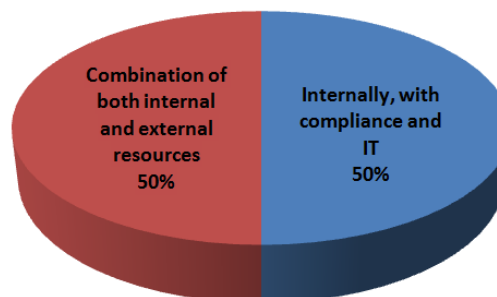
**Figure 10: How many issues did you discover through your model validation, Broker Dealer/ Securities Firm**



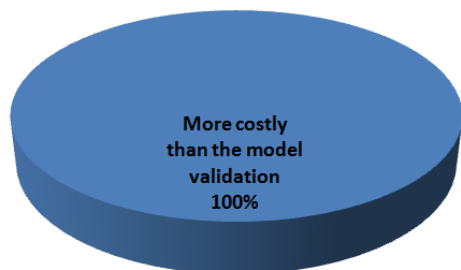
**Figure 11: How many issues were listed as critical, Broker Dealer/ Securities Firm**



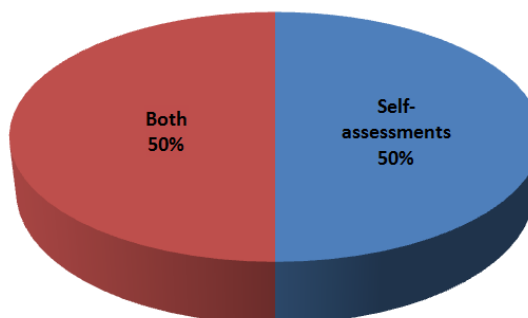
**Figure 12: Did you remediate internally, externally, or a combination, Broker Dealer/ Securities Firm**



**Figure 13: Was the remediation more or less costly than the model validation, Broker Dealer/ Securities Firm**



**Figure 14: Of those who conducted a model validation, do you conduct continuous compliance monitoring, self-assessments or both?**



### Broker Dealer/Securities Firm Summary:

All of our BD/SF respondents represented a compliance officer at a foreign institution, and all of them have completed a model validation in the last six months by internal audit or an AML specialized consulting firm. Historically, their focus has been on their BSA software system. They only have conducted a model validation every 18 months to 2+ years. All respondents said that they conducted a model validation because of regulatory requirement, and they all agreed that it helped with regulatory compliance. They discovered anywhere between 21 and 30 issues of which 1-20 were listed as critical. All respondents said that they spent more on the remediation than the model validation itself but they utilized both a combination of internal and external resources or only utilizing their internal resources. Finally, half of them only conducted self-assessments and half of them conducted both a continuous compliance monitoring program and self-assessments.

## Conclusion:

Based on these results, a majority of financial institutions are conducting a model validation of one or more of their AML software systems, and they're focusing their efforts on a BSA/Transaction Monitoring system. This especially makes sense given Benjamin Lawsky's speech in February 2015 and he asked "But...what if those monitoring and filtering systems are flawed or ineffective?" (Lawsky, 2015). He went on to say:

"Problems with transaction monitoring and filtering systems can be the result of one of two situations:

- First: Through inadequate or defective design, or programming of the monitoring and filtering systems, faulty data input, or a failure to regularly update these detection scenarios, which may be attributed to lack of sophistication, knowledge, expertise, or attention by the management and/or employees.
- Or two, perhaps more disturbingly, willful blindness or intentional malfeasance by bank management, or employees - who, for example, turn down the sensitivity of the filters so the systems do not generate enough alerts and therefore suspicious transactions go undetected." (Lawsky, 2015)

With that said, we are surprised that a majority of the respondents would utilize internal audit for conducting the model validation since they often lack the technical expertise to test the technology/software, which is what Benjamin Lawsky is referring to above. Further, for the 66% of respondents who say they conduct a model validation only every 18 months to 2+ years, we're concerned that they aren't validating the system frequently enough, which the OCC says that "Banking organizations should conduct a periodic review-at least annually but more frequently if warranted-of each model to determine it is working as intended and if the existing activities are sufficient" (Board of Governors of the Federal Reserve System (SR 11-7), 2011, p. 3).

Since a majority of respondents said that they conducted a model validation because of regulatory requirement, we're not surprised that they also said that the model validation helped with regulatory requirement. However, we were surprised with the number of issues found - both 1-10 and 21-30. We would challenge that if a large number of a financial institution's model validation report points to policy and/or procedure changes, than they should challenge the report's findings and consider more technical based internal or external resources. Technology changes frequently, along with a bank's products and services, so there is a possibility that the software system is no longer doing what it was intended to do.

Further, we're pleased to see that in a majority of respondents the model validation report clearly defined the changes necessary giving the financial institution freedom to choose the most cost effective remediation plan.

We believe that a model validation of an AML software system is a very proactive approach to AML compliance, along with a continuous compliance monitoring program, so we're not surprised that of this group of respondents a majority of them are doing both. However, it would be interesting to see if they believe the continuous compliance monitoring program limited the issues in their model validation report, and if not, what changes could be done to their monitoring program to fix that.

Here are the most notable differences we've found of our respondents comparing business types.

- Of our respondents, only retail banks represented the percentage that had not conducted a model validation. This surprised us because many clients we speak to in other financial institutions have not seen the regulatory pressure so we expected to see that response from those areas.
- All respondents indicated that they conducted a model validation in the last six months or in the last 18 months; however, commercial banks were the only business type to represent the group that indicated they had conducted a model validation in the last 18 months.
- Retail banks and wholesale banks are the only banks who have validated a CDD/KYC software system. They're also the only financial institutions who say they conduct a model validation annually (50% of retail banks; 34% of wholesale banks) vs. 18 months or 2+ years.

## *Conclusion cont.:*

- Retail banks were the only group where 100% of respondents said they utilized Internal Audit to conduct a model validation of one or more of their AML software systems.
- Retail banks and wholesale banks were the only business types where a percentage said that a model validation did not help with regulatory compliance. For those that said “no” it did not help with regulatory compliance, the reasons given were that it “Never came up” and “Due to the model validation, management has not supported efforts to remediate issues properly (budget, planning or focus).”
- Commercial banks and broker dealer/securities firms were the only business types who conducted a model validation because of regulatory requirement.
- Both retail banks and broker dealer/securities firm respondents said that they discovered 11-20 critical issues because of their model validation (50% each), which is a greater percentage than what commercial banks, wholesale banks and correspondent banks cited (33%, 17%, and 33% respectively).
- Retail banks were the only business type who completed all remediation completely with internal resources, with compliance and IT.
- Correspondent banks and broker dealer/securities firms were the only business types who said that remediation was more costly than the model validation itself. They were also the two business types where a larger percentage utilized a combination of internal and external resources to remediate than commercial banks and wholesale banks (33% and 17% respectively).
- Retail banks were the only business type where 100% said that they do both self-assessments and an on-going continuous compliance monitoring program. A majority of commercial banks, wholesale banks and correspondent banks do both as well, whereas only 50% of broker dealer/securities firms say they do both.

We provide this value-add service to the compliance community to better the anti-money laundering community as a whole. Thank you to everyone who participated. We hope you will participate in future surveys as well.

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