Case Study – AML Model Validation

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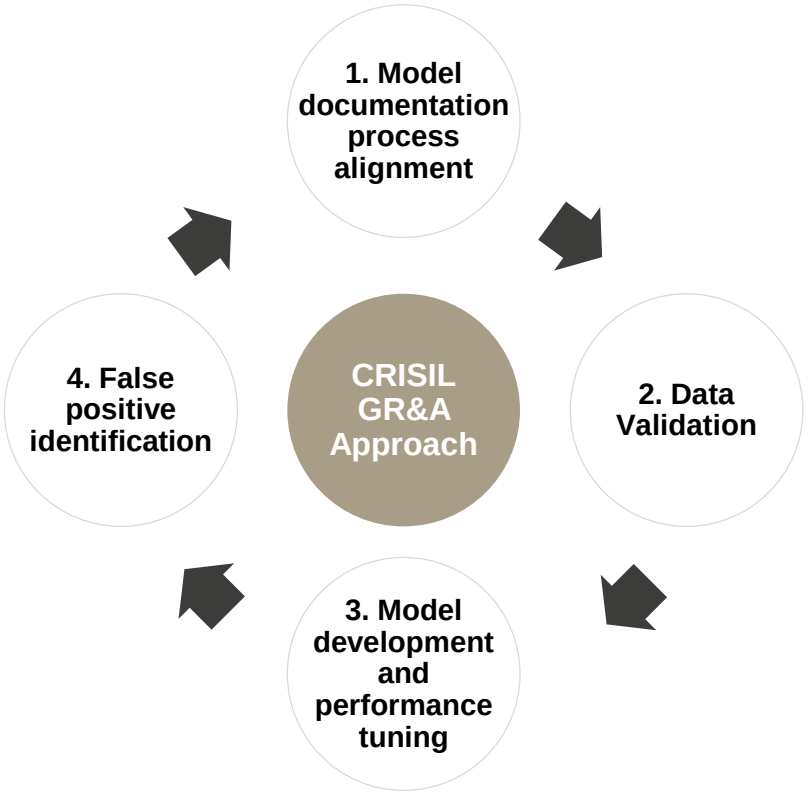
Case Study: AML Model Validation (1/2)



Background

- A US BHC wanted CRISIL to validate the anti money laundering (AML) model (hereafter called as “the model”; vendor model from Actimize) required as per the Bank Secrecy Act (BSA) /AML regulatory guidelines
- The model helps identify the high risk entities who may be partaking in money laundering and terrorist financing activities via:
  - Customer due diligence (CDD) and know your customer (KYC) for new customers
  - Real-time monitoring of the existing customers

Business Objective

- Ensure that the model is aligned with the regulatory requirements and effectively captures risk factors and scores
- Data, process, and system validation
- Complete the exercise within the stipulated (rigorous) time-frame

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Case Study: AML Model Validation (2/2)

Validation Process

- Per SR 11-7 guidelines, “Vendor products should nevertheless be incorporated into a bank's broader model risk management framework following the same principles as applied to in-house models, although the process may be somewhat modified.” The model validation consisted following activities

1. Model documentation alignment w.r.t

- BSA/AML regulatory guidelines. For instance, whether the model identifies a PEP, gives a higher risk to the geography which has been identified as high risk by certain sources.
- Internal model documentation standards (based on SR 11-7 guidelines). For instance, whether the model documentation contains results for the User Acceptance Testing (UAT), results for the system integration testing, assumptions with their relevance, risk and limitations, roles and responsibilities for the model implementation, validation, and use.
- Values in the production system i.e. confirming that the risk factors, their attributes and sores, LOBs covered are same in the production system as provided in the model documentation/other documents.

2. Data validation/integrity check

- Sufficiency of controls around the data mapping process
- Results of data mapping process done as part of UAT to assess whether the model is capturing complete and accurate information from the source data
- M&M plan to determine if the data mapping process will be monitored on a regular basis in the future

3. Model Tuning

- The Model Tuning done during implementation would determine the performance of the model and provide basis for further tuning.
- Changes made, in various tuning processes, to the risk factors, attributes of the risk factors, and scores given to various attributes of the risk factors

4. Evaluation of overrides (identified false positives)

- Made during the model production and whether the overrides are being tracked and monitored on a regular basis

Client Impact

- The models were validated within a stringent deadline and the multiple processes including tuning process were improved. Model documentation deficiencies were identified and resolved.

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