

Internal Security and Fraud Issues

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Your Presenter

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What is Security?

What is Fraud?

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NCUA Involvement

- Safety and Soundness issue
- Part 748 Security Concerns
- Reputation risks

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Security Related Regulations

- BSA/AML
- Patriot Act
- Electronic Fund Transfer
- Bank Bribery Act
- GLB – Part 748
 - App A: Safeguarding Member Info
 - App B: Response Programs for Unauthorized Access to Member Info
- Fair Credit/FACTA
- Internet banking guidance
- SAFE Act
- UCC
- Collections laws
- Employment laws
- ADA
- State and Federal Criminal laws
- OSHA regulations
- Disaster and Pandemic Planning
- Lending Laws and Regs
- Accounting Guidelines
- Bylaws

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Part 748 Requirements

- Part 748 of NCUA's regulations requires a federally insured credit union to develop a written security program designed to:
 - Ensure the security and confidentiality of member records and information;
 - Protect each credit union office from robberies, burglaries, larcenies and embezzlement;
 - Prevent destruction of vital records;
 - Assist in the identification of persons who commit or attempt such crimes.

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Security Program

- When developing and implementing a security program, the credit union should:
 - Involve the board of directors
 - Assess its risk
 - Manage and control the risk
 - Oversee its service provider arrangements,
 - Implement the standards
 - Adjust the program as needed
 - Train the staff and volunteers

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NCUA Security Audit

- Comprehensive Security Policy
- Areas of Security
- AIREs Questionnaires
- Document everything!

Risk

- Identify it
- Categorize it
- Deal with it

- Rinse, wash, repeat.....

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Risk Management Processes

- Planning
- Risk identification and assessment
- Controls
- Measuring and monitoring

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Your Functional Areas

- 1) Accounting
- 2) Administration
- 3) Business Development
- 4) CUSO
- 5) Finance
- 6) Human Resources
- 7) Information Technology
- 8) Lending
- 9) Marketing
- 10) Service Delivery/Branch Operations

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Role of a Security Officer

- Types of security
- Job Description
 - Experience
- Certifications

- Is this an “elephant burial ground” of tasks?
- Level of authority
- Chain of command
- Training
- Resources

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Internal Security Considerations

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Internal Fraud

- Very sensitive issue for a credit union
- Most dangerous type of fraud
- Employees are “inside the wire”
- FBI reports 80% of financial institution fraud is internal!
- Do you have a Code of Ethics or an Internal Fraud Policy?

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What Is Internal Fraud?

- Intentional violation of credit union rules, regulations, internal controls, or procedures.
- Intentionally failing to take necessary or appropriate action to secure collateral or to properly record a security interest in collateral, or pledging a member's shares as collateral without that member's authorization.
- Granting or requesting preferential treatment for anyone including consideration that is more favorable to a member, employee, relative, friend, vendor, etc. than the consideration offered by the credit union to any other credit union member.

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Employment Practices

Pre-Employment Screening

- An ounce of prevention.....
- State law
- Employment Application
- Credit Report
 - Employment Report only
 - Proper Authorization
 - Interpreting the report
 - Adverse Action

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Employment Practices

Pre-Employment Screening

- Comprehensive background checks
 - Criminal convictions (Lying, cheating, stealing or violence)
 - Bondability
- Detailed reference checks – 30% of resumes contain serious falsehoods
- Contingent offer

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Balancing Employee Moral and Security

- Create the proper expectations
- Financial institutions require more security
- No real right to privacy while at work
- Most aspects of internal security will be transparent
- Leverage systems that are already in place within the credit union (BSA, Patriot Act, etc.)

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Employment Practices

Employee Monitoring

- Ongoing screening program to detect lifestyle changes
- Credit checks, and updated background checks
- Proper authorization

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Employment Practices

Employee Monitoring

- Drug testing
- Employee reviews
- Whistle Blower or Hot Line Possibilities

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Employee Discipline

- State and Federal Law
- Have qualified employment counsel
- Employee Handbook and Policies (Where are your signatures?)
- Progressive Disciplinary Actions
- Consistency

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The Role of Insurance

- The truth about “bondability”
- Transfers risk, but does not eliminate it
- Portfolio management and annual review
- What’s in your coverage?

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Insider Fraud Detection

Experience and common sense are key elements in the identification of potential insider loan fraud. If something does not look right or does not seem to make sense, further analysis is usually needed. In addition, communicating your concerns to the appropriate party early on is critical loss avoidance

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Audit Function

- Scope includes compliance with code of ethics, employment practices, loan review systems and internal controls
- Specific audit procedures targeted at insider loan fraud
- Frequent confirmation of loan balances
- Audit includes GL suspense accounts, employee accounts, wire transfers and charged off loans for insider involvement

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Internal Controls

- Role of the Supervisory Committee
- Internal fraud risk assessment
- Anti-fraud policies and procedures in place
- Internal control effectiveness assessment

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An Ounce of Prevention

- Defending the Integrity of the Organization
- Reputation Loss Risk is more costly than the financial loss
- Adopting a Comprehensive Approach throughout the organization
- Board Training
 - Policies, Procedures, Practices of Management and Staff reports
 - Roles and Responsibilities (fiduciary roles)

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An Ounce of Prevention

- Internal Financial Controls (Preventive and Defensive)
- Policies, audit, procedures, authorities, review, accountability, vendor support
- Departmental Participation
 - Human Resources (identifying vulnerable employees)
 - Computer system security (passwords, access hours)
 - Building and offices security (locks, limited access)
- Officers, Directors and Employee Fidelity Insurance

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What is the BSA?

- The Bank Secrecy Act (BSA) requires all financial institutions, casinos, and certain other businesses to:
 - Monitor member behavior
 - File reports on transactions that meet certain dollar amounts
 - Maintain records of certain transactions
 - The Currency Transaction Report (CTR), which records cash transactions that exceed \$10,000.
 - The Suspicious Activity Report (SAR), which records any known or suspected federal violation of federal law.
- The BSA aids law enforcement by uncovering criminal activities such as money laundering, drug trafficking, tax fraud, and possible terrorist financing.

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NCUA §748.2

- Requires Formal BSA Plan in writing
 - System of internal controls
 - Independent testing
 - Designation of individual responsible (§748.2 c (2))
 - Training for all

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Written Compliance Program

- Has the BOD established an appropriate written program to ensure the CU meets BSA reporting and record keeping requirements?
- Remember: A BSA policy must provide for the following items:
 - Internal Controls
 - Independent Testing
 - Responsible Individual
 - Training
 - Customer Identification Program

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Suspicious Activity Report (SAR)

- A Suspicious Activity Report (SAR) must be filed on any known or suspected federal violation of law. Suspicious activity requires reporting if it involves at least \$5,000 aggregate, and the institution knows or suspects that (for example):
 - The funds are derived from illegal activities
 - The funds are part of a plan to violate or evade any federal law or regulation
 - The transaction is designed to evade other reporting requirements
 - The transaction is not the sort in which the particular member would normally be expected to engage, and the institution knows of no reasonable explanation for the transaction.

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Other Types of Reportable Activity

- Bribery
- Check Fraud
- Check Kiting
- Computer Intrusion
- Counterfeit Check
- Counterfeit Credit/Debit Card
- Credit/Debit Card Fraud
- Embezzlement
- False Statement
- Loan Fraud
- Misuse of Position
- Mysterious Disappearance
- Wire Transfer Fraud
- Tax Evasion
- Terrorist Financing
- Identity Theft

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Board Responsibilities

- Board, appropriate committee, or designated employee in senior management should:
 - Assign specific responsibility for the Program's implementation
 - Approve initial Program and changes and record in the board's minutes
 - Review annual reports regarding compliance
 - Have staff responsible for Program report to the board

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Questions?

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