elucidate
EVALUATING DATA, ILLUMINATING RISK

WHITE PAPER
SUMMARY V2.0

Elucidate FinCrime Index ("EFI")

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1. Elucidate's Outlook

Elucidate is committed to performing comprehensive data analysis for the measurement, assessment, standardisation and reporting of financial crime risk, including money laundering, terrorism financing, sanctions, corruption, tax evasion, employee misconduct, and fraud.

The genesis of Elucidate lies in a series of systemic misalignments: between respondents and correspondents, supervisors and regulated entities and trading partners and counterparties. This misalignment manifests itself in numerous operational contradictions as well as the ongoing and costly regulatory exposure experienced by several financial institutions. Critically, this focus on regulatory risk exposure often overshadows the commercial, moral and social imperatives behind the need to ensure that all parties are protected from financial crime.

REGULATORY RISK MANAGEMENT	FINANCIAL CRIME RISK

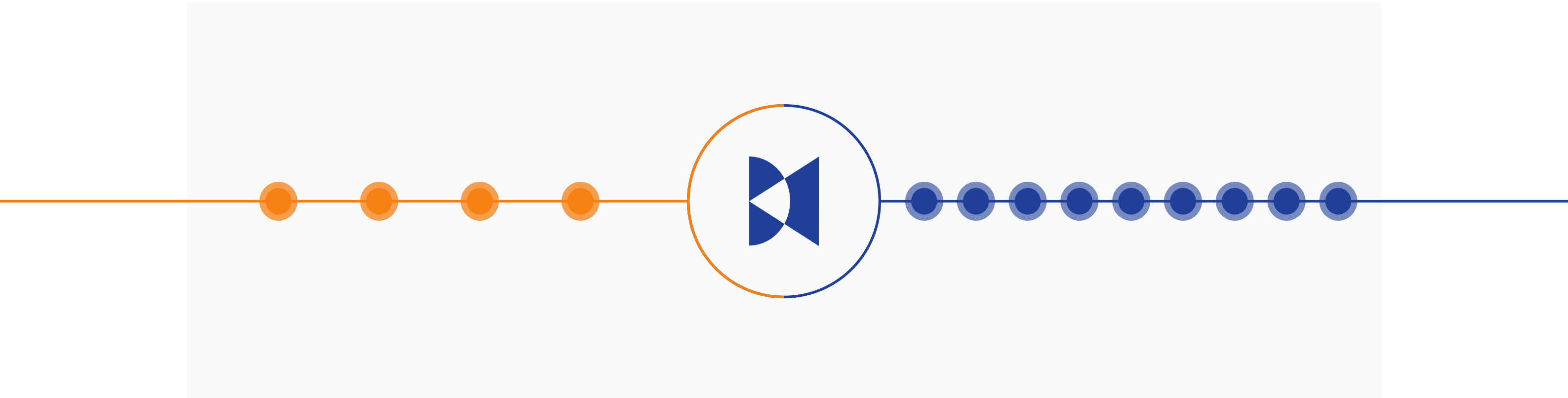
We distinguish between **regulatory risk management** and **financial crime risk**.

Regulatory risk relates the risk of not maintaining a programme that meets all legal and regulatory requirements, whilst financial crime risk is the risk of illicit activity being executed by or through the financial institution, either knowingly or unknowingly.

We aim to bring about a paradigm shift in the way the market views financial crime risk management and in doing so **to bring greater clarity to financial crime risk**, as opposed to regulatory risk.

Our position is that compliance is achieved by focusing on financial crime risk and taking commensurate mitigating actions. Compliance is, therefore, a factor which exists to measure the results of risk management against legal and regulatory expectations, rather than being an independent objective.

2. The Elucidate FinCrime Index (EFI)



The introduction of the risk-based approach ("RBA") as a conceptual change has yet to be fully integrated into and optimised within the financial sector for the assessment and mitigation of financial crime risk.

The EFI platform aims to provide consistency within the risk assessment process, while providing tailored inputs for risk mitigation.

> The goal and intent are to use proven best practices in risk management to enable the industry through a common basis for **outcome-focused and fact-based interaction on risk profiles** and its mitigation.

Management of risk must be data-driven. It is for this reason that we have built our model on the basis of an extensive dataset that substantially exceeds existing compliance mechanisms, assessing transactions, customers, and control process outcomes. The index is designed so that it is further enhanced as increased data becomes available.

Additionally, the EFI uses institutions' data to assess the effectiveness of the financial crime risk management controls and their proportionality to inherent risks identified. The combination of the Wolfsberg Group Correspondent Banking Due Diligence Questionnaire ("CBDDQ") responses and the EFI Data Protocols enables the identification of risks that may have been otherwise overlooked by manual or basic due diligence practices and procedures.

Finally, another key benefit of the EFI's data-based approach includes the lessening of dependence on subject-matter experts and their biases. This is particularly impactful in markets or for institutions that do not have access to experts or that are most affected by industry biases.

3. The EFI Risk Model

The EFI is regulated by the BaFin and utilises a structured framework, which is built upon the CBDDQ and is enhanced by more than 1200 specific tests, referred to as eventualities, aimed at further assessing financial crime risk-based on a combination of public data, institutional data and sub-models. These eventualities have multiple purposes, such as:

THE TESTING OF CONTROL EFFECTIVENESS

e.g. Do > 98% of outgoing payments include account name, address and number?

THE ASSESSMENT OF CUSTOMER OR PRODUCT RISK

e.g. Does the private banking portfolio consist of > 25% of total clients, with > 25% offshore/ Non-Resident portfolio?

THE ASSESSMENT OF CONDUCT AND CULTURE RISK

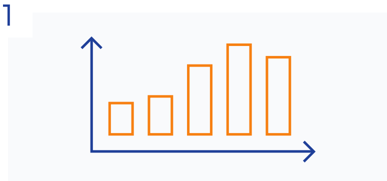
e.g. Do > 2% of employees have an outside or conflicting business interest?

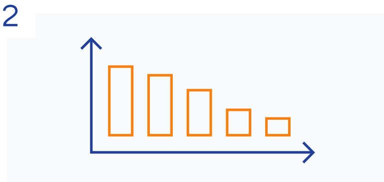
These eventualities are classified as inherent risk contributors or control effectiveness contributors, and are assessed on a zero to ten risk-driven impact scale. Eventualities indicating the presence of a significant inherent risk factor or control failure, including a potential violation of law, are marked as “Functional irregularities”.

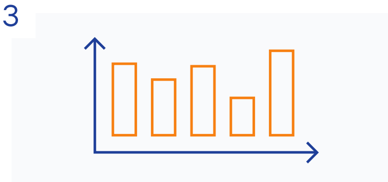
Should such an eventuality be found to be valid, **the user will receive notice within their EFI report** as a matter for immediate attention.

The model is distinct in incorporating risk probability informed by an aggregation and analysis of demonstrated risk events in the industry from over 10,000 regulatory actions across 17 public authorities, as well as anonymised and aggregated data from EFI users. As jurisdictions become both more active and transparent, the risk event database may be expanded and likely enhance the reliability of this input to the model predictability.

Therefore, along with its aforementioned impact rating, each eventuality is also subject to a probability rating. The impact and probability ratings are used to determine the weighting of specific eventualities within a set of nine aggregated risk themes:

1

ORGANISATIONAL REPUTATION

2

CULTURE AND EMPLOYEE CONDUCT

3

BRIBERY AND CORRUPTION

4

GEOGRAPHIC FOOTPRINT

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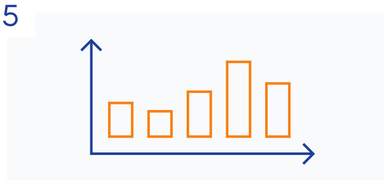
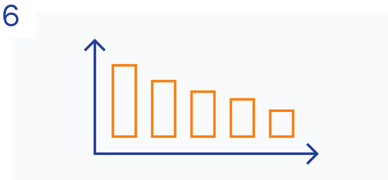
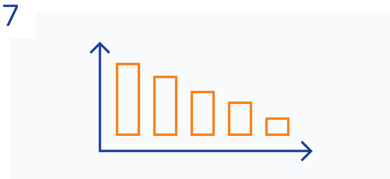
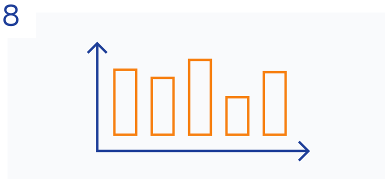
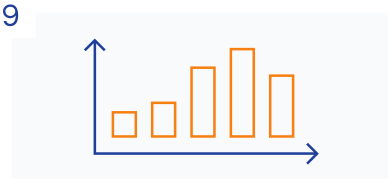

SANCTIONS

6

CUSTOMER PORTFOLIO

7

PRODUCTS AND CHANNELS

8

TRANSACTIONAL ACTIVITY

9

GOVERNANCE FRAMEWORK

Each of these themes are thereafter assigned an aggregated risk score. This is the primary tool for designating and monitoring financial crime risk appetites. The theme level scores are measured on a scale from 0 to 100, where 100 is the best possible score. All risk themes are averaged to produce the overall EFI Rating.

The EFI model was designed in order to adapt to varying levels of data availability.

After all the eventualities for which there is sufficient data are evaluated, the rest of the eventualities are subjected to independent Monte Carlo simulations to estimate their likelihoods of being true. For each risk theme, the aggregate score of the evaluated eventualities is added with the median result of the simulations to produce the final theme scores. The medians of the simulations for each of the 9 themes are averaged with each other (via mean) to produce a final EFI rating. In order to provide transparency to the model, we also report the percentage of eventualities that had the necessary amount of data for calculation.

4. Model Governance

To ensure adequate governance of the platform, we have established a model control lifecycle which includes:

01 The identification of model risks through the performance of regulatory gap analysis against key financial crime and risk modelling regulations and guidance issuances.

02 The quantitative as well as qualitative validation of the model through the establishment of key model performance indicators combined with extensive stress testing.

03 Model risk mitigation through continuous model calibration and optimisation.

The model is overseen by the Model Governance and Control Framework, wherein results from model validation and model changes are reviewed before being communicated to the users through the platform. Immediate changes are reflected in the model, wherever there are changes in the input parameters, model assumptions and settings during the model calibration process.

The model governance and control framework has been built, **keeping in view the periodic monitoring of the model** using quantitative tests and model risk tiering approach, in order **to detect poor performance of the model** at an early stage.

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