

## Navigating through AI and Machine Learning Supervisory Expectations for Anti-Financial Crime Applications

### **Machine Learning & AI as remedies for heavy and imprecise AFC Compliance programs**


Throughout the last roundabout 20 years, regulatory pressure led to the establishment of huge Compliance programs, especially in areas such as Anti-Money Laundering, Sanctions or Fraud Prevention.

Driven by scandals and subsequent monitorships, Financial Institutions deployed Compliance Management Systems heavily relying on manual labor, e.g., in areas such as KYC (“Know Your Customer”) and CDD

(“Customer Due Diligence”), Transaction Monitoring or SAR filing.

Not only since the rise of GenAI but also through the overall maturity of new technological advancements, financial institutions are increasingly exploring real-life use cases for machine learning (ML) applications, particularly in the areas mentioned above.

By promising equal risk coverage, those applications can lower (manual labor) costs up to 60%.

However, by venturing into this new technological space, financial institutions also experience hands-on the complexity of the ever-increasing regulatory landscape for Machine-Learning-based applications, especially for this highly (ethical and data-) sensitive topic of Anti-Financial-Crime prevention. 

**Navigating through regulatory and supervisory expectations, especially in the highly sensitive topic of AFC, is a non-trivial task**

Even though AI and machine learning are a promising path to remediate the rampant cost increases in AFC Compliance programs, many Financial Institutions are still hesitant when it comes to fully embrace this new technology due to risk and regulatory concerns.

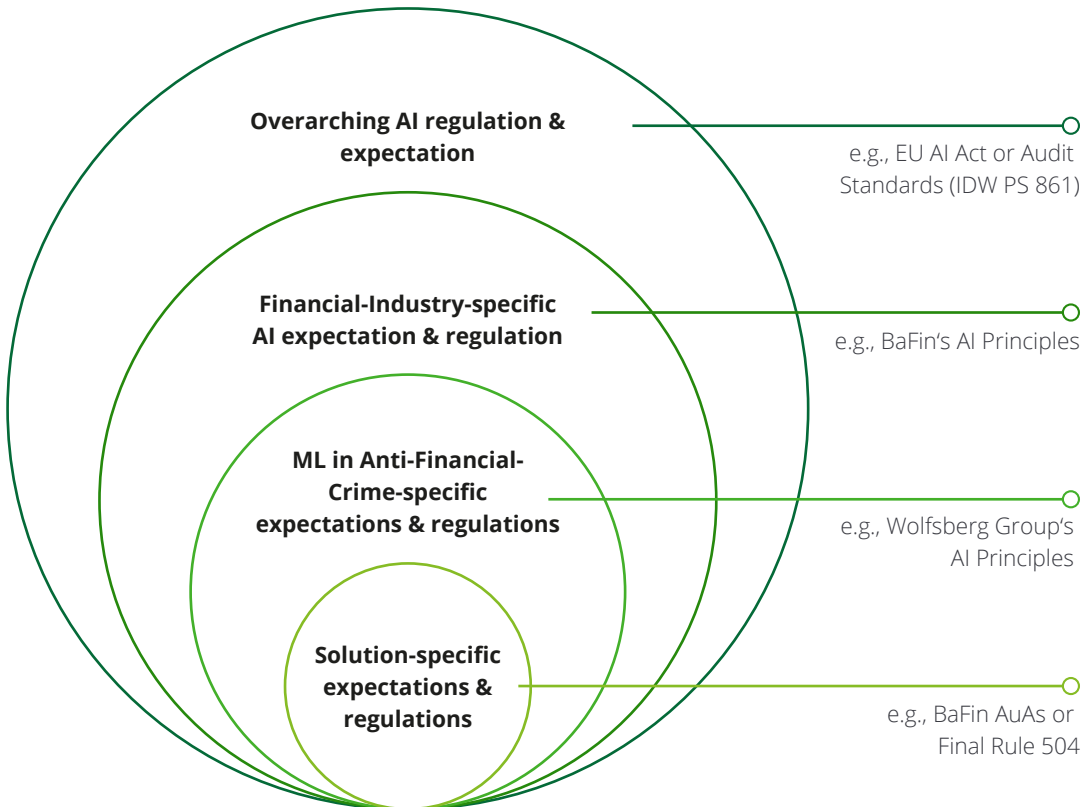
Especially in the field of AFC, where wrong decisions and faulty systems can have devastating reputational, legal or operative consequences, each step towards the supposedly “black-box” technology of Machine Learning needs proper consideration.

A baseline for gaining security is that it is ensured that everything one does in this space is in line with regulatory and supervisory expectations.

However, the regulatory and supervisory expectations are in fluid state, for AFC e.g.:

- Existing regulations not yet adjusted to Machine Learning applications (e.g., Auslegungshinweise BT6)
- Specifically dedicated guidelines from supervisory side (e.g., BaFin principles) and the private sector (Wolfsberg Guidance)
- Audit standards for ML applications (IDW PS 861)
- Regulations from other areas, impacting also ML-based AFC applications (e.g., BAIT and GDPR)
- And there is – hanging as a Damocles sword over all ML based applications – the upcoming EU AI Act.

**Fig. 1 – Landscape of relevant Regulation for AI in AFC**



Given the evolving regulatory landscape, there is still no established, generally accepted best practice—particularly in the AFC space—that financial institutions can rely on to ensure their efforts in the ML field will be accepted and successful.

Especially on key topics and their documentation, such as:

- Machine-based decision making, in the sense of “auto-closure” and human in the loop
- Independent model validation
- Model transparency and explainability
- Model governance
- Model risk assessment

Clarity is far from being available for Financial Institutions.

However, the uncertainty regarding whether a proposed use case can pass regulatory and supervisory scrutiny is crucial in deciding whether to pursue ML-based solutions. Without this assurance, significant effort, time, and money could be spent developing use cases, only to ultimately discover that regulators will not accept them or will only do so in ways that negate any efficiency gains.



**We support your journey with structure, early-mover insights and hands-on deliverables**

We help you navigate the regulatory landscape so that you can safely venture into ML-based AFC use-cases and solutions:

**AFC ML Regulatory Health Check**

First, we provide you a structured approach to check-box all relevant aspects of ML-Compliance for Anti-Financial Crime solutions based on our AFC AI Regulatory Framework comprising relevant requirements from the above mentioned regulations.

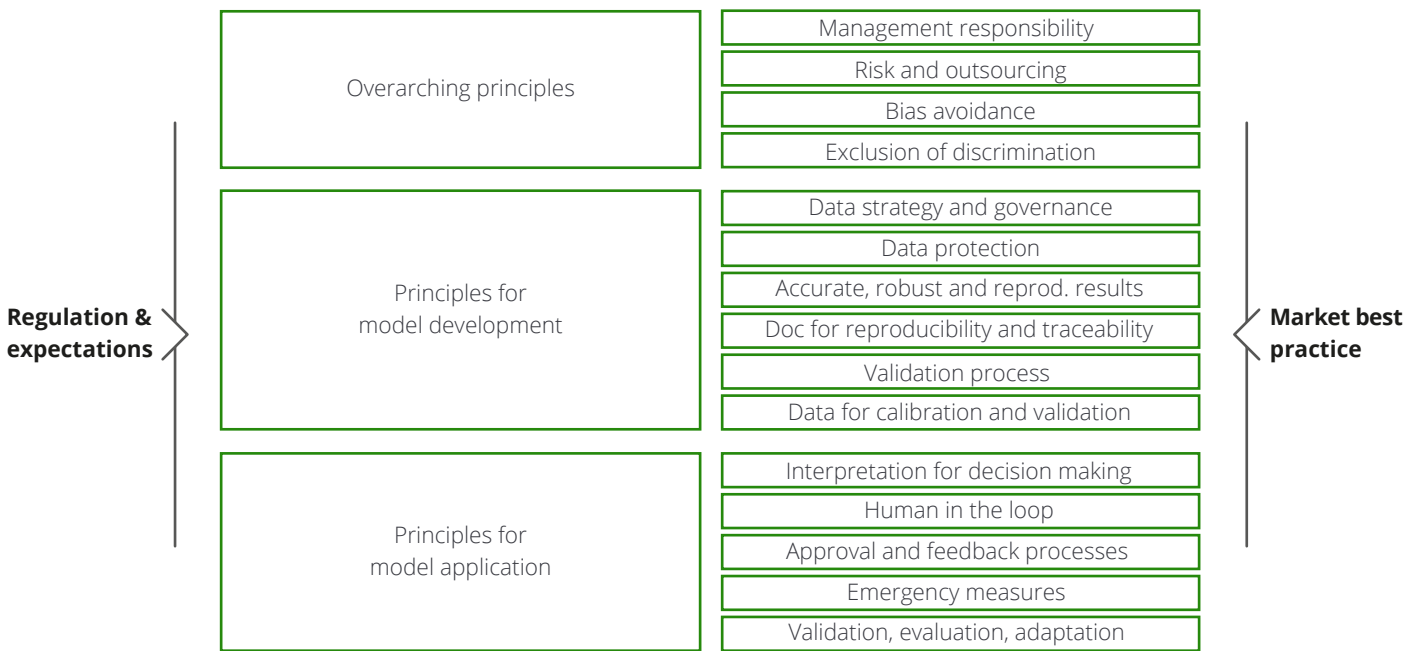
**First-Mover Best-Practice Insights**

Second, we fill that structured approach with practical regulatory journey project experience gained through supporting first-mover financial institutions implementing ML-based solutions in the AFC space.

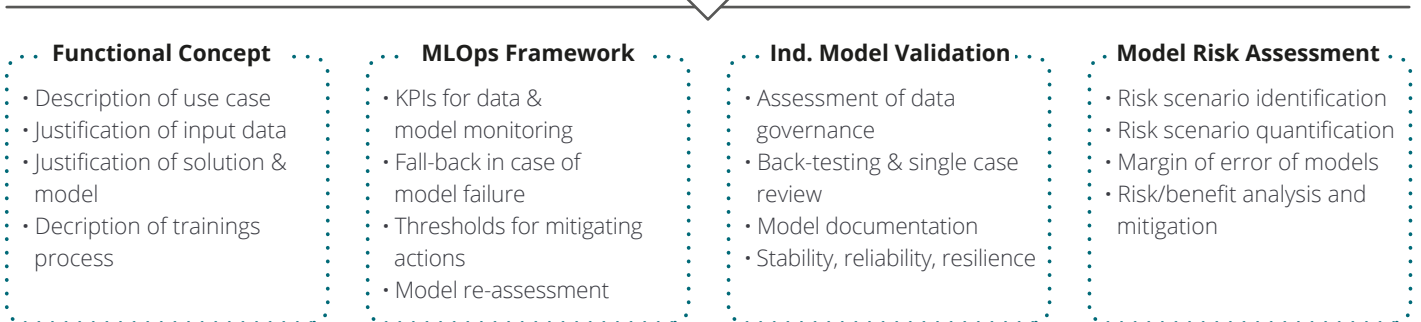
**Remediation and Regulator Preparation**

Third, we support you not only in identifying existing gaps in your current setup towards regulatory expectations, but we also support you in remediating those gaps by, e.g., writing necessary documentation, performing independent model validation, risk assessments or providing necessary trainings.

**Fig. 2 – AI in AFC Review Framework and Exemplified Areas of Deep-Dive Elaboration**



**Elaboration of single relevant topic areas, e.g.,**





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