	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

Introduction

Financial, stock market, insurance and any other activities related to the management, use and investment of people's savings are of public interest and can only be exercised with prior authorization from the State (article 335, Political Constitution). This authorization seeks to avoid the negative social consequences derived from poor risk management of these activities.

Poor risk management in the financial system can create financial crises, which in the short term, increase poverty, reduce investments in education and health, and reduce social cohesion; in the long term, development indicators regress, poverty traps remain, and progress towards the millennium development goals slows down (World Bank, 2013).

Financial services must be provided in conditions of seriousness, liquidity, and efficiency, capable of generating national and international public trust (SU 157 of 1999, Constitutional Court). Regarding trust, the State also intervenes in these activities to prevent criminal behaviors such as money laundering, financing of terrorism and proliferation, which purposes are other than public interest (SU 166 of 1999, C-851 of 2005, Constitutional Court).

One way to generate national and international public trust in the Colombian financial system is through the supervision of its activities. The purpose of supervision is to preserve the stability, security, and trust of the system; and to promote, organize and develop the country's stock market and, to protect investors, savers, and insured persons (Article 11.2.1.3.1, Decree 2555 of 2010).

One of the primary objectives of supervision is to oversee both financial and non-financial programs to mitigate various types of risks. These risks include credit and counterparty risk, market and liquidity risk, operational and cybersecurity risk, as well as the risk of money laundering and terrorist financing (ML/TF) (Decree 2555 of 2010). These programs are also known as risk management systems and their purpose is to prevent or avoid the materialization of events that may affect the normal development of businesses (Chapter IV, Title I, Part I of the Basic Legal Circular).

When supervising AML/CFT programs (SARLAFT), the primary focus of resources should be on monitoring the levels of exposure to these risks and evaluating the effectiveness of financial institutions in managing them. (Decree 2555 of 2010).

Historically, the supervision of the SARLAFT has focused on monitoring the regulatory compliance of the program. Although compliance is a necessary condition, supervision must also evaluate whether the program achieves its proposed objectives and monitor its performance. In Colombia this is achieved through the Comprehensive Supervision Framework (MIS) of the Financial

	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

Superintendence (SFC), which provides a comprehensive approach to supervising financial institutions and ensuring compliance with regulatory requirements.

After framing the evaluation of AML/CFT programs, a key question arises: how can we evaluate whether the program achieves its proposed objectives and monitor its performance? This document offers a possible solution to the question. It is divided into three parts: the first part presents the conceptual framework to evaluate results-oriented programs, the second part uses this framework to propose a value chain for SARLAFT, and the last part utilizes this value chain to present the SARLAFT monitoring and evaluation guide.

Theory of change

Public programs are based on “theories of change”, explicit or implicit, of how they achieve the expected outcomes. The evaluation of the program must then reveal, in as much detail as possible, the assumptions that make it up. From this point, the evaluators will collect data and analyze whether the assumptions of the program are supported, to conclude if the expected outcomes are achieved within the framework of the proposed theories (Connell, 1995).

Revealing the proposed theories facilitates communication between stakeholders. For example, some financial institutions have proposed that their SARLAFT focus on the operational risks of their processes. The implicit assumption here is that by minimizing operational failures, the institution obtains the expected results. Not revealing this assumption can hinder communication between the evaluator and the evaluated person, since the evaluator may have another "theory" on how the expected outcomes are achieved, making communication more complex due to the differences in focus.

Similarly, identifying the underlying assumptions that inform decision-making can help to clarify and define the scope of the program. For instance, a financial institution may decide to intensify monitoring of clients included in suspicious transaction reports (STRs), with the assumption that this will result in the desired outcomes of the SARLAFT program. This example demonstrates how an assumption can help to explain the scope of a decision.

Evaluations guided by the theory of change help to focus on the key aspects of a program. For instance, by evaluating the identification of ultimate beneficiaries, efforts can be concentrated on addressing one of the most significant preventive measures against ML/FT. Criminal organizations often use shell or fictitious companies to give the appearance of legitimacy to their operations and gain access to financial institutions. Therefore, evaluating the effectiveness of beneficiary identification can be a crucial step in preventing such activities.

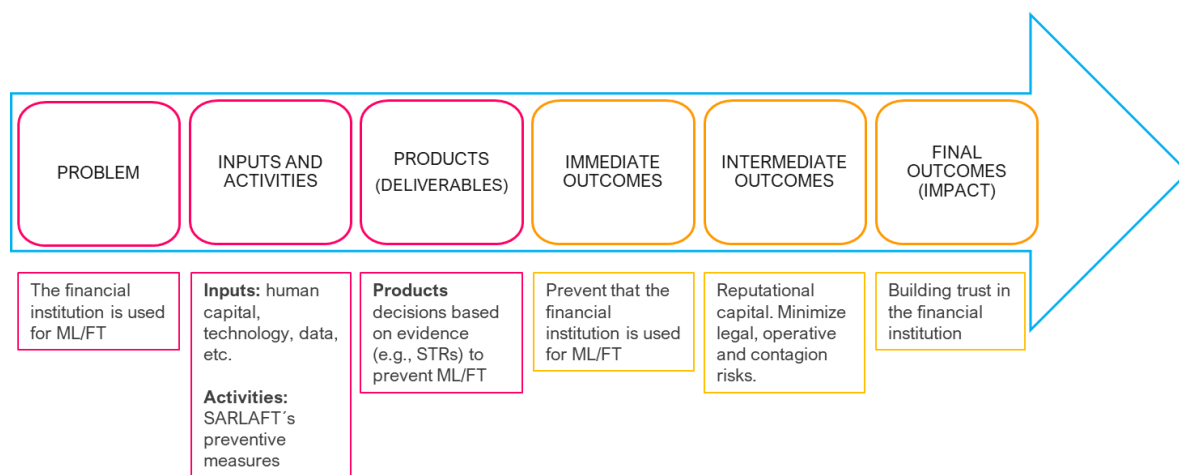
The evaluation of the key aspects of the program allows to add and compile results of the different stages and assumptions that support it, which improves the practical and theoretical knowledge of the program. For example, tracking statistics of red flags and suspicious transactions reveals the results of the monitoring strategies, facilitating learning and improving the program.

In summary, the theory of change:

- Facilitates communication with the different stakeholders in the program.
- It makes the executors of the program make explicit their assumptions that guide decision-making and unifies the vision of what they want to do and what for.
- Focuses attention and resources on evaluating key aspects of the program.
- Aggregates and compiles the results, which improves the theoretical and practical knowledge of the program (Connell, 1995).

SARLAFT's Theory of Change

The theory of change describes how and why the expected outcomes will be achieved in a particular context. It models how those outcomes will be obtained from its actions and deliverables (World Bank, 2021). There are many ways to make a program's theory of change explicit; the value chain is one of the most used techniques. The SARLAFT's value chain is described below.



- **Problem:** One of the key risks associated with the activities of the financial system is the threat of money laundering and terrorist financing (ML/FT). Financial institutions face the problem of being used to carry out operations involving resources linked to criminal activities that run counter to the public interest. This undermines confidence in the financial system and can have serious consequences for the economy and society as a whole.

	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

- *Outcomes*: are the expected outcomes of the program. The executor hopes that outcomes will be achieved through its products; this is precisely where the “theory” comes in, and the assumptions of the program must be confirmed. It is important to remember that external factors also influence the results (IPA, 2016). Outcomes are organized as follows:
 - *Immediate*: in the short term, the SARLAFT seeks to prevent a financial institution from being used for ML/FT, which means, that a potential client or client does not carry out LAFT operations through it.
 - *Intermediate*: the direct effect of the immediate outcome reflects in reputational capital and the minimization of legal, operational, and contagion risks.
 - *Final*: in the long term, the SARLAFT helps build trust in the financial institution. Trust is important for the stability of the financial system (DNB, 2020) and the proper functioning of the economy (OECD, 2019).
- *Products*: they are the deliverables that allow to obtain the expected outcomes; products are the result of the activities carried out within the framework of the program; they are the mechanism designed by the SARLAFT. The products are under the control of the executor and are associated with the quality and quantity of the implementation (IPA, 2016).

To achieve the immediate outcome, a financial institution needs to make decisions regarding potential or existing clients suspected of engaging in money laundering or terrorist financing activities. These decisions must be made using objective criteria derived from the client's due diligence process, as per FATF Recommendation 10. The decision-making process should be preceded by an analysis of red flags and transactions that appear suspicious.

Decisions regarding clients or potential clients will vary depending on the type of relationship, but they must be made with the aim of achieving the expected outcomes. Some examples of such decisions include:

- *Restrictive*: These are decisions that prevent the potential client from being linked, lead to the disengagement of a client, block an operation, among others.
- *Monitoring*: These are decisions of intensified monitoring on the clients, to collect more information to determine if there is a need for restrictive and/or business measures.

	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

- *Business*: Refers to decisions that lead to updating the terms of the relationship with the client, updating policies and procedures, reviewing the specific business strategy for the potential or existing client, among others.

Since decisions are the deliverables of the AML/CFT program, they result from the activities carried out within the program. The development of these deliverables can be presented as a linear process, which includes, among other activities, the identification of ML/FT risks and their causes, the implementation of controls that give rise to alerts, which are analyzed to determine, based on objective criteria, whether they are suspicious.

- *Activities*: these are the daily tasks that must be carried out to transform the inputs into the products of the program (IPA, 2016). The guidelines for carrying out these activities are described in Chapter IV, Title IV, Part I of the CBJ of the Superintendency of Finance, applicable laws, and are also guided by the 40 Recommendations of the FATF, and international standards of good practices (e.g., ISO 31000).
- *Inputs*: they are the necessary elements to carry out the activities and therefore, for the generation of value of the program (DNP, 2014). The minimum inputs for SARLAFT are:
 - *Human resources* are the financial institution staff in charge of carrying out the program's activities.
 - *Technological resources* refer to the technology used by human resources to carry out the program's activities and produce deliverables.
 - *Data* refers to the source of information used in the processes and technological tools for the execution of activities and deliverables elaboration.

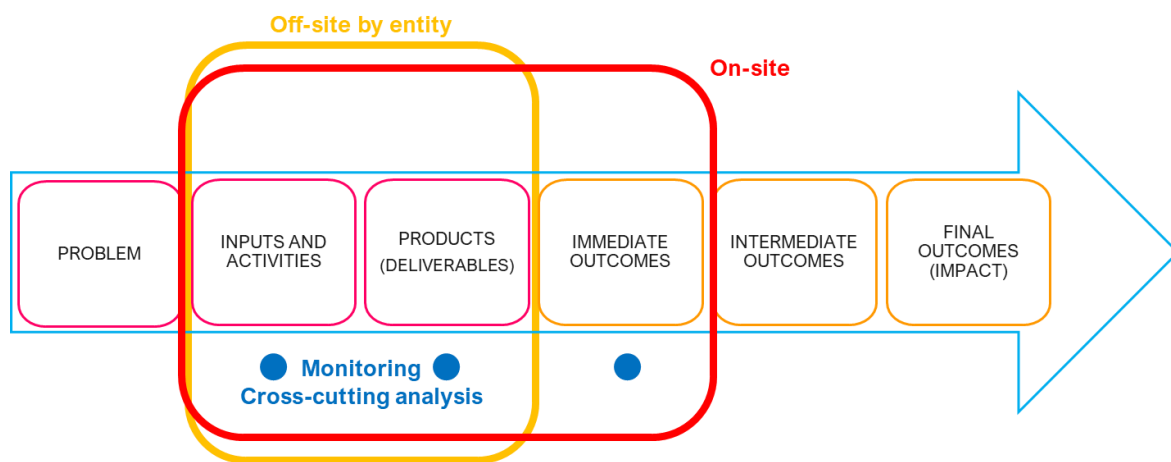
SARLAFT Supervision

As mentioned earlier, SARLAFT supervision mainly consists of evaluating and monitoring it, where both activities are supported by the conceptual framework of the theory of change (i.e., value chain).

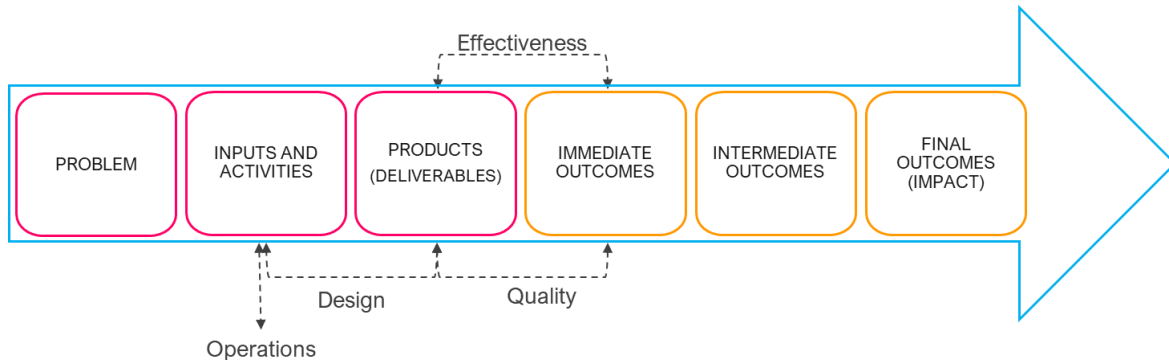
The theory of change, following the CART principles, guides the collection and analysis of data because it ensures the credibility of measurements and data analysis, supports decision-making, and helps define which data to collect and which not (actionable), promotes responsible decisions on data requirements

(responsible), and allows identifying if adjustments to the program are necessary or if it can operate in other contexts (transportability) (IPA, 2016).

The collection and analysis of data are carried out through different supervisory mechanisms, namely: on-site, off-site by entity or cross-cutting, and periodic off-site (SFC, 2022). The following chart proposes the scope of these mechanisms based on the value chain. The blue dots indicate monitoring tasks (periodic off-site) or cross-cutting tasks (cross-cutting off-site) that focus on a single link in the chain. The yellow line represents the scope of off-site processes (by entity), through which the relationship between two links in the chain is evaluated, either between activities and products or between products and immediate results. Finally, the red line represents the scope of on-site processes, which seeks to evaluate how the program's immediate results are obtained from its initial activities.



Monitoring and cross-cutting analyses are essential for both compliance and program performance evaluations. While off-site and on-situ evaluations assess the program with different scopes, they rely on information from follow-up activities and data collected during these processes. The value chain framework enables various types of analyses that provide useful insights into programs' results-oriented management (DNP, 2014). The following graph illustrates the types of analyses that can be conducted for SARLAFT:




These types are described below:

- **Operations:** This analysis aims to determine if the inputs and activities of SARLAFT comply with regulatory provisions and whether their performance is adequate. For instance, this analysis can collect operational indicators like data quality, beneficial owner, and consistency of the risk matrix.
- **Design:** This analysis aims to determine how consistent the designed activities are with the products produced by a financial institution. For example, this analysis can be conducted by contrasting the approach to risks, causes, and controls with the red flags and STR indicators.
- **Quality:** This analysis aims to determine whether the products meet the expectations and needs of interested parties. For instance, it may involve inquiring with senior management of financial institutions whether proposed and taken decisions were based on objective criteria.
- **Effectiveness:** This analysis aims to determine to what extent the products achieve the expected immediate results. Effectiveness is understood as the degree to which the results are achieved through the deliverables (DNP, 2014). For example, this analysis can be conducted in conjunction with the evaluations of operations and design, as well as the indicator of alerts generated before authorities' request.

The expected outcomes of these evaluations are:


Type	Expected outcomes
Operations	SARLAFT inputs and activities are adequate and work properly.
Design	The SARLAFT modeling allows the elaboration of products that meet the conditions to achieve the expected immediate outcomes.
Quality	The products meet the expectations and needs of the interested parties.

	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

Effectiveness	The decisions made help prevent the financial institution from being used for ML/FT.
----------------------	--

Conclusion

The theory of change provides a results-driven conceptual framework for evaluating and monitoring SARLAFT in financial institutions under the supervision of the SFC. This framework guides supervisory activities and aims to integrate the efforts of the Colombian financial system to enhance the National Anti-Money Laundering and Counter-Terrorism Financing System.

	CONCEPTUAL FRAMEWORK FOR MONITORING AND EVALUATING AML/CFT PROGRAMS OF FINANCIAL INSTITUTIONS	20/04/2023 English version 1
---	--	------------------------------------

Bibliography:

- Carin van der Crujisen, Jakob de Haan and Ria Roerink. *Trust in financial institutions: A survey*. DNB Working Paper. 2020.
- Código Penal. *Artículo 323, Ley 599 de 2000*.
- Connell, James P. et al. *New approaches to evaluating community initiatives. Concepts, methods, and contexts. Roundtable on comprehensive community initiatives for children and families*. Aspen Institute for Humanistic Studies. 1995.
- Constitución Política de Colombia. *Artículo 335*.
- Corte Constitucional. *Sentencias SU-157/99 y SU-166/99*.
- República de Colombia. *Decreto 2555 de 2010*.
- Departamento Nacional de Planeación (DNP). *Guía metodológica para el seguimiento y evaluación de las políticas públicas*. 2014.
- Financial Action Task Force (FATF-GAFI). *International standards on combating money laundering and the financing of terrorism and proliferation*. 2022.
- Innovation for Poverty Action (IPA). *Goldilocks deep dive. Guiding your program to build a theory of change*. 2016.
- Innovation for Poverty Action (IPA). *Goldilocks toolkit. Theory of change: laying the foundation for right-fit data collection*. 2016.
- OECD. *Why trust is important in business and finance*. OECD Business and Finance Outlook 2019: Strengthening Trust in Business. 2019.
- Superintendencia Financiera de Colombia. *Circular Básica Jurídica*.
- Superintendencia Financiera de Colombia. *Manual de condiciones generales del proceso de supervisión*. Marzo de 2022.
- World Bank. *Designing a theory of change for a community of practice*. Blog. 2021.
- Otker-Robe, Inci; Podpiera, Anca Maria. The social impact of financial crises: evidence from the global financial crisis (English). Paper is funded by the Knowledge for Change Program (KCP), Policy Research working paper ; no. WPS 6703 Washington, D.C. World Bank Group.
<http://documents.worldbank.org/curated/en/498911468180867209/The-social-impact-of-financial-crises-evidence-from-the-global-financial-crisis>