



## Internal Audit

### Planning and Scoping Memo

<b>Audit entity:</b>	BSA/AML
<b>Audit entity residual risk rating:</b>	High

Planning Memo Review History			
Preparer:	Erin Demarco	Date Prepared:	01/23/2023
Reviewer:	Dana Sanders	Date Reviewed:	02/07/2023
PNFP IA Manager:	Erin Demarco	Date Reviewed:	01/23/2023
CAE:	Dana Sanders	Planning Tollgate Meeting Date:	02/07/2023
Planning Tollgate Meeting Notes:	<ul style="list-style-type: none"> <li>The AET met with the CAE on February 7, 2023 to review the proposed RCM and PSM. The CAE was in agreement with the planned scope but asked the AET to consider the following: <ul style="list-style-type: none"> <li>2022 Comments from the FDIC BSA Examination audit around SAR Decisioning, wire transfers, P.O., model validation, ACH, and RDC.</li> </ul> </li> <li>Additionally, the CAE asked the AET to focus on the functionality of the current system (P.O.) in assessing each area as many processes are forced to be performed manually.</li> </ul>		

## A. Audit Entity Overview and Considerations

### Key management or process owners

- Tim Ayala, Chief Risk Officer
- Alanna Williams, BSA Officer
- Nora Klein, BSA Manager (Alerts)
- Teresa Clanton, BSA Manager (High Risk)
- Lisa Burkhart, BSA Manager (CTR)
- Valerie Partlow, BSA Manager (QC/Risk Assessment)

### Audit Entity Overview

Pinnacle Financial Partners, Inc. (PNFP, Pinnacle, or the Company) is a \$41 billion bank holding company whose primary operations run through Pinnacle Bank (the Bank). The Bank offers a full range of lending and deposit services. PNFP also offers a variety of investment, trust, and insurance services, M&A Advisory and Securities Offering Services, and Other Banking Services through Pinnacle Bank and other subsidiaries and affiliates. All applicable business operations conducted by PNFP are governed by the Enterprise-Wide Bank Secrecy Act / Anti-Money Laundering (BSA/AML) Program and Procedures Manual.

The BSA/AML team is a centralized, 2nd line of defense function responsible for managing risks related to money laundering and financial crimes. Additionally, the BSA Department supports the Bank's compliance with the Bank Secrecy Act and Office of Foreign Assets Control laws and regulation.

The primary objective for the BSA Department is to identify and monitor the Bank's risk related to money laundering and financial crimes. The activities of the BSA Department are guided by the required elements (i.e., Pillars) of an effective BSA/AML program as defined by the FFIEC:

- Pillar 1 – System of internal controls: includes the bank's policies, procedures, and processes designed to limit and control risks and to achieve compliance with BSA/AML/OFAC requirements.
- Pillar 2 – Designated BSA Officer: the board of directors must designate a qualified individual to serve as the BSA/AML/OFAC Officer who is responsible for coordinating and monitoring day-to-day BSA/AML/OFAC compliance;
- Pillar 3 – Employee Training Program: the Bank must ensure that its personnel receive general and role-specific training in applicable aspects of BSA/AML/OFAC;
- Pillar 4 – Independent Testing: The Program must to be independently tested (audited) by the internal audit department, outside auditors, consultants, or other qualified independent parties, with a frequency commensurate with the BSA/AML/OFAC risk profile of the bank;
- Pillar 5 – Customer Due Diligence / Beneficial Ownership: New Customer Due Diligence Requirements for Financial Institutions went into effect on May 11, 2018, requiring covered financial institutions to identify and verify the identity of beneficial owners of a legal entity at the time the legal entity opens a new account, as well as develop risk profiles and conduct ongoing monitoring of applicable beneficial owners.

The department is led by designated BSA Officer, Alanna Williams, and consists of 41 associates (including the BSA Officer) as of January 2023. The BSA Department consists of 4 BSA Managers over Alerts/SARs, High Risk Monitoring, CTRs, and QC. All managers and team leads report directly to the BSA Officer.

1. The **Alerts and SAR team**, led by Nora Klein, is responsible for reviewing and dispositioning all suspicious activity alerts generated from the Patriot Officer Program. Alerts are generated based on a set of rules in the system designed to detect potential suspicious activity. Each alert is researched by the team and either closed or escalated to the SAR team for further analysis and potential SAR filing. The SAR team researches and analyzes account information of customers who generated an alert in the Patriot Officer and are escalated for further review by the Alerts Team. If suspicious activity is detected, the team files a SAR to FinCEN in accordance with law. Additionally, the SAR team performs research on internally generated suspicious activity reports (SAIF).
2. The **High-Risk team**, led by Teresa Clanton, monitors the Company's higher risk customers such as Money Services Businesses (MSBs), Check cashers, Private ATM owners, and cash intensive businesses. The team is responsible for required periodic reviews of high-risk customers as well as risk rating and risk rating reviews of the customer base.
3. The **CTR team**, led by Lisa Burkhart, is responsible for the daily review of cash activity within PNFP to identify and file Currency Transaction Reports (CTRs) in accordance with Federal requirements.
4. The **QC team**, led by Valerie Partlow, performs monthly and quarterly quality control (QC) reviews on alert dispositions and SAR analyses and filing to ensure quality and consistency across the Alerts and SAR teams

The BSA/AML function manages oversight activities related to the prevention of money laundering and financial crimes. Major processes include:

- Quarterly BSA/AML Enterprise-Wide Program management and approval
- BSA/AML/OFAC annual risk assessment
- Monthly BSA Program performance metrics reporting
- Annual BSA/AML Enterprise-wide training
- Annual BSA/AML Targeted Training
- CIP – Account Opening Requirements
- CIP exception management & reporting
- CDD – Account opening requirements
- CDD – Beneficial Ownership Account Opening requirements
- EDD – Customer risk rating reviews
- EDD – Requirements and Procedures
- Daily Transaction Monitoring – Alerts Review
- Monthly Transaction Monitoring – Patriot Officer Rules Review
- Daily Suspicious Activity Reporting
- BSA Compliance QC Reviews – Alerts and SARs
- Daily CTR Monitoring & Reporting
- Monthly CTR Exemption Monitoring & Review
- Information Sharing (314a & 314b)
- Daily Wires transaction review
- OFAC Screening – Account opening
- OFAC Screening – Ongoing Monitoring
- OFAC List Management
- Daily Review of Monetary Instruments sold for Cash
- Periodic Model Validation (MRM)

- Record Keeping Requirements
- Compliance with Special Measures (Section 311)

#### Key strategic and/or change initiatives (current or future)

During the course of 2022, the BSA Department added 8 new associates, bringing the total associate count for the department to 41 (including the BSA Officer). As a strategic initiative in 2023, the BSA Officer intends to continue the process of evaluating a new vendor/system for suspicious activity monitoring. The bank's current solution (Patriot Officer) will become less effective as the bank continues to grow. As such, the BSA Officer is considering moving to an AI driven system such as VeraFin.

Additionally, the BSA Officer and BSA Managers will continue to cross-train associates from the Alerts and SARs teams. The objective is to allow more access to associates who can research and write SARs.

#### Key Regulations and Guidance

The following BSA/AML and OFAC regulatory requirements and guidelines were reviewed to determine the scope of this internal audit:

##### 1. **Federal Deposit Insurance Corporation (FDIC) –**

<https://www.fdic.gov/resources/bankers/bank-secrecy-act/>

- BSA Statute and Regulations establish program, recordkeeping, and reporting requirements for financial institutions
- 12 CFR 326 Subpart B — Bank Secrecy Act Compliance establishes requirements for a BSA monitoring program to reasonably assure compliance with the BSA statute and regulations
- 12 CFR 353 — Suspicious Activity Reports addresses suspicious activity reports that must be filed when a bank detects a known or suspected criminal violation of federal law or a suspicious transaction related to money laundering activity or a violation of the BSA

##### 2. **United States Department of Treasury's Financial Crimes Enforcement Network (FinCEN) –** <https://www.fincen.gov/resources/statutes-regulations>

- Bank Secrecy Act ("BSA") – Requires U.S. financial institutions to assist U.S. government agencies to detect and prevent money laundering. Specifically, the act requires financial institutions to keep records of cash purchases of negotiable instruments, file reports of cash transactions exceeding \$10,000 (daily aggregate amount), and to report suspicious activity that might signify money laundering, tax evasion, or other criminal activities. It was passed by the Congress of the United States in 1970. In conjunction with the Title III of the USA PATRIOT Act, outlines procedures for information sharing with the government, and information sharing with other registered financial institutions. Codified and / or amended by 31 USC 5311-5330 and 31 CFR Chapter X [formerly 31 CFR Part 103].
- USA PATRIOT Act of 2001 – The purpose of the USA PATRIOT Act is to deter and punish terrorist acts in the United States and around the world, to enhance law enforcement investigatory tools, and other purposes, some of which include:
  - To strengthen U.S. measures to prevent, detect and prosecute international money laundering and financing of terrorism.
  - To subject to special scrutiny foreign jurisdictions, foreign financial institutions, and classes of international transactions or types of accounts that are susceptible to criminal abuse.
  - To require all appropriate elements of the financial services industry to report potential money laundering.

- iv. To strengthen measures to prevent use of the U.S. financial system for personal gain by corrupt foreign officials and facilitate repatriation of stolen assets to the citizens of countries to whom such assets belong.
3. **Office of Foreign Assets Control (OFAC)** – Administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals.  
<https://home.treasury.gov/policy-issues/office-of-foreign-assets-control-sanctions-programs-and-information>
4. **Federal Financial Institutions Examination Council (FFIEC), BSA/AML Examination Manual** – This manual compiled by FFIEC will be used as a guideline to evaluate risks, examine the scope identified and consider any relevant compliance considerations within the AML audit area. <https://bsaaml.ffiec.gov/manual/>

### Key Applications

Based on the relevant risk to key BSA/AML processes, the following applications are in scope.

- **Silverlake Teller (also referred to as “Vertex”)** – Used for CTR aggregation – As part of this internal audit, we will consider controls related to completeness and accuracy of system output that are used for CTR filing.

### Key Models

The following models are considered key for the BSA/AML in-scope key processes:

- **Patriot Officer: Compliance Software: BSA, CTR, SAR**
  - Model status; In-Use
  - Version 9.4 was implemented in December 2019 with validation conducted August 2021. The final validation report was issued on January 5, 2022. The next full validation of the P.O. system is scheduled to be completed by January 2024. However, MRM conducted an annual review of the system in January 2023. The review was ongoing at the time of this audit.
  - Model Owner: Alanna Williams
  - Risk Rating: High
  - Model Purpose: Patriot Officer is the primary model used by the BSA team to perform BSA/AML related functions such as CTR Filing, OFAC Screening, Risk Analysis, as well as suspicious activity monitoring and reporting.

Patriot Officer was updated from version 9.3 to version 9.4 in December 2019. The most recent model validation (version 9.4) was reviewed during the 2022 BSA/AML Audit. 2023 audit coverage of Patriot Officer will focus on risk governance related to the model to include the annual rules review (control CMP 40-31).

- **ChexSystems**
  - Model status; In-Use
  - Last Validation date: May 2022
  - Model Owner: Pat Pritchard
  - Risk Rating: Moderate
  - Model Purpose: Evaluates the risk of the deposit account applicants. Powered by multiple data sources and public records, the solution provides real-time account opening decisions for deposit accounts based upon risk tolerance. Pinnacle has chosen the moderate risk strategy. The QualiFile risk assessment score is used to predict the likelihood of the client's account being forcibly closed within the first 12 months of the account being opened. Part of the account opening process within Argo Connections (Jack Henry account opening software).

As it relates to BSA/AML, ChexSystems facilitates OFAC screening for new to PNFP clients. The model was last validated in May 2022. 2023 Audit coverage of ChexSystems will focus on the production of OFAC screenings in conjunction with CIP/KYC testing.

- **BizChex**

- Model status; In-Use
- Last Validation date: January 2022
- Model Owner: Pat Pritchard
- Risk Rating: High

**Out of scope for 2023 audit coverage, as the validation performed in 2022 was reviewed as part of the 2022 BSA/AML internal audit.**

#### Key Third Party Vendors

As it relates to this audit, IA categorized our review of key third-party vendors into the following buckets:

- **Outsourced processes** – Per discussions, there are no AML processes outsourced by Pinnacle to third parties classified as vendors. However, Pinnacle has a third-party relationship with Raymond James Financial Services, Inc. (RJF). BSA/AML policies and procedures established by RJF are in effect for Pinnacle associates are dually employed and licensed to sell non-insured investment products. As part of this audit, IA will review the BSA oversight provided through the annual attestation process.
- **Software as a Service (SAAS)** – The following vendors provide key applications or models that support key AML processes. For these vendors, we will take a risk-based approach to review these vendors as part of our model and application control coverage.
  - Global Vision (Patriot Officer)
  - LexisNexis
  - WEX
  - Pathfinder (WITS System)
  - Apex CC
- **BSA/AML risk and associated monitoring activities for all relevant vendors at Pinnacle** – Within the scope of the BSA/AML audit, IA will consider OFAC screening controls over new and existing vendors. Additionally, IA will coordinate with the 2022 Vendor Management audit team to consider BSA oversight of third-party due diligence and risk monitoring processes for new and existing third-party service providers that poses heightened BSA/AML risk.
- **Affiliated Businesses/Partners** – Within the scope of the BSA/AML audit, IA will consider program requirements and oversight of the following affiliated businesses
  - Raymond James Financial Services, Inc (RJF) (PWA)
  - Bankers Healthcare Group, LLC (BHG)
  - Advocate Capital
  - Miller Loughry Beach Insurance Services, Inc.
  - HPB Insurance Group, Inc.
  - JB&B Leasing

#### Fraud Considerations

The FFIEC BSA/AML Examination Program contains many components of a fraud review process which will be covered as part of this internal audit from an AML perspective. One primary fraud consideration within the BSA/AML function is intentional non-reporting of suspicious activity (collusion). Testing of controls related to the Suspicious Activity Reporting (SAR) will include an assessment of no-SAR decisions for adequacy and appropriateness.

#### SOX Considerations

- Control *DO 10-01 – Deposit Setup Review* is a control to independently review each new deposit account for critical attributes. These attributes include KYC/CIP information. IA will evaluate 2022 testing of this SOX control for the purposes of control reliance.

#### Prior Audit / Regulatory Results

Since the prior audit (2022), the BSA Department underwent an FDIC examination. The examination resulted in no supervisory recommendation (SR). However, The following items were discussed between the FDIC and management during the BSA Exit Meeting. While SRs were not provided for these items, IA tracked these items for continuous monitoring activities and will follow-up on progress towards remediation during the 2023 audit.

- SAR Decisioning (CMP 40-32, 40-33, and 40-34)
- Wire Transfers (Funds Transfers Testing)
- Patriot Officer (Assessed throughout/Application Controls)
- Model Validation (Application Controls)
- ACH (Funds Transfers/TPPPs)
- RDC (CMP 40-43)

The 2022 BSA/AML Internal Audit resulted in four audit issues (listed below). To date, 3 of 4 issues were validated by IA and closed. The validation over the remaining open issue (2022 BSA-A1) will be covered as part of this review.

- IA to perform issue validation and sustainability testing as part of this internal audit
  - **2022 BSA-A1 – CTR System Aggregation** – Still in remediation work flow. IA will evaluate progress towards remediation and will also perform testing of all CTR controls as part of this audit.
- Closed; processes will be tested as part of general IA testing approach:
  - **2022 BSA-A2 – Patriot Officer Rules Review**
  - **2022 BSA-A3 – BSA/AML Regulatory Change Management**
  - **2022 BSA-A4 – Management and Board Reporting Enhancements**

#### Thematic Control Issues



The following Thematic Control Issues (TCI) were reported to the Audit Committee at the January 2023 meeting:

- Some concern regarding opportunity to “right-size” Pinnacle’s legacy customer service practices. This thematic issue is applicable to the bank’s effort to properly authenticate clients while maintaining our legacy personal touch. IA will consider this TCI as processes and controls are reviewed.
- Some areas of the Bank may benefit from a holistic review of governance / oversight, processes, and procedures (via Internal Audit) to ensure that we have an appropriate macro view of the risks and opportunities and have implemented the appropriate related strategies and tactics. IA will consider this TCI as processes and controls are reviewed.
- The third Thematic Control Issue relates to the lack of clearly defined business level responsibilities as it relates to third-party vendors. IA will include an evaluation of management’s response to third party vendors in its audits.
- Audit will consider the above TCIs throughout the execution of this audit activity.

#### Results of Testing by Other Groups (1<sup>st</sup>/2<sup>nd</sup> Lines)

Within the BSA Department (2LOD function), there is a quality control (QC) function. The QC performs testing over alert management and SARs. IA will test QC controls as part of this audit.

Operational Risk has not yet performed RCSAs over the BSA Department. However, RCSAs over BSA/AML are planned for 2023. The BSA RCSA was originally planned for 2022 however, competing priorities (i.e. PRC Library enhancements, Supervisory Recommendations, etc.) caused a delay in the execution of RCSAs in 2022.

#### Management View of the Control Environment, Concerns and Self-Identified Issues

Per discussion with Management, the following items are self-identified concerns/issues:

- The system used for suspicious activity monitoring, Patriot Officer, is forecasted to become less effective as the bank continues to expand. As such, the BSA Officer is working to switch to a new system that can better handle the volume and complexity of transactions as the bank grows.
- Late CTR filings were identified by the BSA Team during the course of 2021 and continued in 2022. Management believes this is a front-line processing issue and has evaluated multiple options for risk mitigation in accordance with a 2022 audit issue. IA will follow up on the progress toward remediation as part of this audit.

## B. Audit Objectives and Scope

### Audit Program Scope and Details

Based on the very high inherent compliance and operational risks as well as the high reputation and information technology risks noted in the Risk Assessment, the audit will focus on assessing the department’s operational effectiveness in maintaining firm-wide compliance with the requirements of the BSA/AML laws and OFAC rules and restrictions. The audit scope primarily addresses compliance risk with reputational risk inherently being considered as any discrepancies in compliance with the BSA/AML laws and OFAC rules and regulations could result in severe reputational repercussions for the bank. Additionally, audit work will address the IT risk related to, and primarily derived from, the Patriot Office suspicious activity monitoring system through testing of the most recent model validation and/or model risk management oversight efforts. Operational risk will be covered through transaction testing of cases, SARs, CTRs, and SAIFs.



The audit scope and control testing approach will be informed and guided by the FFIEC BSA/AML Examination Manual and will focus on assessing the Company's compliance with these guidelines in establishing and maintaining the five pillars of an effective BSA/AML program.

Key Processes within scope for the 2023 BSA/AML Audit are as follows:

- Governance and oversight
  - BSA / AML & OFAC enterprise-wide program
  - BSA/AML annual risk assessment
  - BSA Officer appointment / designation
  - BSA program reporting - Board Risk Committee and BSA Oversight Committee
  - Regulatory change management
- Training
- Customer Identification Program (CIP)
- Customer due diligence (CDD) / enhanced due diligence (EDD), including customer risk scoring, beneficial ownership, politically exposed persons (PEPs), etc.
- Transaction monitoring / investigations
- Suspicious Activity Report (SAR) filing
- Quality control (QC)
- Currency Transaction Reporting (CTR) and CTR exemptions
- Information Sharing – 314(a) and 314(b)
- Funds transfers (i.e. Travel Rule)
- Office of Foreign Assets and Control (OFAC) / sanctions screening
- Monetary instruments
- Special measures
- Subsidiary and affiliate oversight
- Application controls (e.g. model validation, CTR aggregation)
- Documentation and recordkeeping requirements

The following processes were out of scope for the 2023 audit as these items were covered within other 2022 audit activities:

- New Products and Services is out of scope as IA recently conducted a consulting review around the bank's processes.
- Vendor oversight as a Vendor Management audit was in process at the time of this audit.

The following processes were deemed out of scope as they do not apply to the Pinnacle business model:

- Foreign Bank and Financial Accounts Reporting (FBAR)
- Foreign correspondent accounts
- Private Banking
- Report of International Transportation of Currency or Monetary Instruments (CMIR)

Legal entities considerations:

- Pinnacle Bank: This audit focuses on the AML Program for Pinnacle Bank.
- The below legal entities are considered as part of the testing over the BSA/AML risk assessment. Additionally, BSA/AML is considered within the standalone audits performed for each of below legal entities:

- Pinnacle Wealth Advisors, Inc. (Raymond James)
- Pinnacle Capital Markets
- BHG
- Miller Loughry Beach Insurance Services, Inc.
- HPB Insurance Group, Inc.
- Advocate Capital, Inc. (Advocate Capital)
- JB&B Leasing

## C. Audit Team, Budget, and Timeline

### Internal Audit Team

- Chris Loyd – Elliott Davis Engagement Partner
- Drew Young – Elliott Davis Senior Manager
- Erin Demarco – PNFP Internal Audit Manager
- Jennifer Bledsoe – Elliott Davis Audit Manager
- Niki Henry – Elliott Davis Audit Staff
- Tricia Kutzli – Elliott Davis Audit Staff
- Jordan Evans – PNFP Audit Senior
- Aimee Bush – PNFP Audit Staff

### Consideration of Audit Team Skill Requirements

Oversight of the BSA/AML audit team is provided by Erin DeMarco (IA Manager), who has 10 years of IA experience primarily focused on banking compliance. Erin's internal audit and risk experience comes from 5 years as a Bank Examiner with the OCC as well internal audit experience in public accounting and now at Pinnacle. Erin has been with Pinnacle IA department since 2019 and she's overseen the BSA/AML audit since 2020. Erin is a Certified Public Accountant (CPA) and Certified Anti-Money Laundering Specialist (CAMS).

Drew Young (Elliott Davis Senior Manager) will provide co-source support in oversight in the oversight and execution of the 2023 BSA/AML Audit. Drew has over 14 years of experience and works exclusively with financial institutions to provide regulatory compliance services, including risk-based regulatory compliance review, Bank Secrecy Act review, fair lending analysis, consultation, audit and training. He has worked for and served financial institutions of various asset sizes throughout the United States. Drew is a Certified Regulatory Compliance Manager (CRCM) and Certified BSA/AML Professional (CBAP).

Jennifer Bledsoe (Elliott Davis Manager) will provide co-source support in the oversight and execution of the 2023 BSA/AML Audit. Over the course of 11 years with a large financial institution, Jennifer held an internal auditor position as well as a compliance specialist position, lending to years of firsthand experience in complying with BSA requirements and implementing practical processes in order to mitigate compliance risk.

The audit execution team is additionally comprised of two Elliott Davis audit senior associates. All Elliott Davis associates have experience performing internal audits of BSA/AML programs and related controls, providing strong knowledge and competency of BSA/AML program and pillar requirements, and first-hand experience as BSA/AML regulatory compliance professionals within financial institutions.

The audit execution team is also supported by a PNFP senior internal auditor and a PNFP internal audit staff associate. All PNFP audit resources possess a knowledge of BSA/AML

compliance as well as a strong understanding of the PNFP audit process and PNFP operations.

#### Conflicts of Interest

The team confirmed that there are no known conflicts (confirmed or potential) of interest that would impact independence and objectivity in performing this audit.

#### Budget

	PNFP	Co-source	Total	% PNFP Manager Hours	Co-source Support Model
Original Budget Hours	400	600	1000	20%	High
Revised Budget Hours (only if applicable)	N/A	N/A	N/A	N/A	No Change

#### Execution Schedule and Audit Duration

The audit is expected to be executed over ~8 weeks. The kick-off meeting was held on January 17, 2023 and the target report issuance date is 3/14/2023.